EXTENSION OF THE INTEREST EQUALIZATION TAX

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-THIRD CONGRESS

FIRST SESSION

ON

H.R. 3577

AN ACT TO PROVIDE AN EXTENSION OF THE INTEREST EQUALIZATION TAX, AND FOR OTHER PURPOSES

MARCH 7, 1973

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EXTEND THE INTEREST EQUALIZATION TAX

WEDNESDAY, MARCH 7, 1973

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2221, Dirksen Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Ribicoff, Byrd (of Virginia), Gravel, Bentsen, Curtis, and Hansen.

The CHAIRMAN. The committee will come to order.

This morning the committee is conducting hearings on H.R. 3577, a bill to extend the interest equalization tax for a period of 15 months through January 30, 1974.

The interest equalization tax is now 10 years old. It was designed to lessen the flow of U.S. capital into foreign investments. Though the tax has reduced somewhat, the purchases of foreign securities by Americans, the deficit in our balance of payments for the 2-year period 1971 and 1972 reached a staggering $35 billion on a liquidity basis. The interest equalization tax does not apply to new issues from Canada, even though that country has large balance of trade and payments surpluses with the United States. Nor does the tax apply to direct foreign investment by U.S. corporations.

The present interest equalization tax is equivalent to a rate of three-quarters of 1 percent per year in interest costs for foreign persons who obtain capital from U.S. sources. The law allows the President to vary the tax rate by an amount equivalent to an interest rate of from zero to 1½ percent. However, the President has not changed the rate during the past 4 years.

Our Subcommittee on International Trade, under the able leadership of Senator Ribicoff, has just completed a series of hearings on the impact of multinational corporations on the world economy. During the course of those hearings, we became involved in issues related to the international monetary system, the nature of U.S. investments abroad, the balance of trade and the balance of payments.

It seems to me most fitting that the committee has those hearings fresh in its mind as we deal with extension of the interest equalization tax.

I am pleased that our first witness will be the Honorable Paul A. Volcker, Under Secretary of the Treasury for Monetary Affairs, who will present the administration case and will, no doubt, be able to answer our questions dealing with the international monetary situation.

We will include at this point, in the printed hearing, a copy of H.R. 3577 and our press release announcing this hearing.

(The material referred to follows:)

PRESS RELEASE

FOR IMMEDIATE RELEASE
FEBRUARY 28, 1973

COMMITTEE ON FINANCE
UNITED STATES SENATE
2227 Dirksen Office Building

HEARINGS ANNOUNCED ON INTEREST EQUALIZATION TAX

The Honorable Russell B. Long (D., La.), Chairman of the Committee on Finance, announced today that the Committee would hold a one day hearing Wednesday, March 7, 1973 on H. R. 3577, a bill to extend the interest equalization tax for 15 months (until June 30, 1974). The hearing will be held in room 2221 Dirksen Senate Office Building, and will begin at 10:00 A.M.

The interest equalization tax is an important part of the Administration's balance of payments program. The tax, in effect, provides the equivalent of a three quarters percentage point per annum rise in interest costs for foreigners obtaining capital from U.S. sources whether in the form of debt obligations or equity capital.

The Honorable Paul A. Volcker, Under Secretary of the Treasury for Monetary Affairs, will be lead-off witness and will present the Administration's case for this legislation.

Requests to be Heard. -- Senator Long stated that those individuals who desire to testify on March 7 should make their request to Tom Vail, Chief Counsel, Senate Committee on Finance, 2227 Dirksen Senate Office Building, no later than noon Monday, March 5. Persons scheduled to appear must submit 25 copies of their statement to the Committee not later than noon on Tuesday, March 6. Statements should be on double-spaced, letter-size pages (not legal size), and each statement must be preceded by a summary of the principal points presented by the witness. The Chairman emphasized that pursuant to the requirements of the Legislative Reorganization Act of 1946, witnesses will be expected to limit their oral presentation to brief summaries of their statement. He urged those with similar views to coordinate their oral statements in order to prevent duplicative and repetitive testimony.

Senator Long said that the Committee would welcome written comments on H.R. 3577; five copies of these comments should be sent to Mr. Vail by the close of business on Friday, March 9. He indicated that these written comments would be given the same close consideration as though the writer had testified orally.

P.R. #4

93D CONGRESS
1ST SESSION

H. R. 3577

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28, 1973

Read twice and referred to the Committee on Finance

AN ACT

To provide an extension of the interest equalization tax, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE, ETC.**
4 (a) SHORT TITLE.—This Act may be cited as the
5 "Interest Equalization Tax Extension Act of 1973".
6 (b) AMENDMENT OF 1954 CODE.—Whenever in this
7 Act an amendment is expressed in terms of an amendment
8 to a section or other provision, the reference is to a section
9 or other provision of the Internal Revenue Code of 1954.

II

1 **SEC. 2. EXTENSION OF INTEREST EQUALIZATION TAX.**

2 Section 4911 (d) is amended by striking out "March 31,
3 1973" and inserting in lieu thereof "June 30, 1974".

4 **SEC. 3. OTHER AMENDMENTS.**

5 (a) ESTATE TAXATION OF CERTAIN DEBT WHERE
6 INTEREST EQUALIZATION TAX APPLIES.—

7 (1) ESTATE TAX NOT TO APPLY.—The last sen-
8 tence of section 2104 (c) (relating to treatment of
9 certain debt obligations for estate tax purposes) is
10 amended by inserting "or section 861 (a) (1) (G)"
11 after "by reason of section 861 (a) (1) (B)".

12 (2) EFFECTIVE DATE.—The amendment made by
13 paragraph (1) shall apply with respect to estates of
14 decedents dying on or after January 1, 1973.

15 (b) REPEAL OF EXEMPTION FOR SHIPPING COMPA-
16 NIES IN LESS DEVELOPED COUNTRIES.—

17 (1) IN GENERAL.—Section 4916 (relating to in-
18 vestments in less developed countries) is amended by
19 adding at the end thereof the following new subsection:

20 "(e) ISSUES AFTER JANUARY 29, 1973, IN CASE OF
21 SHIPPING COMPANIES IN LESS DEVELOPED COUNTRIES.—

22 "(1) REPEAL OF EXCLUSION.—Except as pro-
23 vided by paragraphs (2), (3), and (4), subsection (a)
24 (2) shall not apply to acquisitions of stock or debt obli-
25 gations of a corporation described in subsection (c) (1)

1 (B) (relating to certain less developed country ship-
2 ping companies) which were issued on or after Janu-
3 ary 30, 1973.
4 "(2) EXCEPTION FOR PREEXISTING COMMIT-
5 MENTS.—Paragraph (1) of this subsection shall not
6 apply to an acquisition—
7 "(A) made pursuant to an obligation to ac-
8 quire which, on January 29, 1973—
9 "(i) was unconditional, or
10 "(ii) was subject only to conditions con-
11 tained in a formal contract under which partial
12 performance had occurred; or
13 "(B) as to which on or before January 29,
14 1973, the acquiring United States person (or, in
15 a case where 2 or more United States persons are
16 making acquisitions as part of a single transaction,
17 a majority in interest of such persons) had taken
18 every action to signify approval of the acquisition
19 under the procedures ordinarily employed by such
20 person (or persons) in similar transactions, sub-
21 ject only to the execution of formal documents evi-
22 dencing the acquisition and to customary closing
23 conditions, and the acquiring United States person
24 (or persons)—
25 "(i) had sent or deposited for delivery

1 to the foreign issuer or obligor from whom the
2 acquisition was made written evidence of such
3 approval in the form of a commitment letter,
4 memorandum of terms, draft purchase contract,
5 or other document setting forth, or referring to
6 a document sent by the foreign issuer or obligor
7 from whom the acquisition was made which set
8 forth, the principal terms of such acquisition, or
9 "(ii) had received from the foreign issuer
10 or obligor from whom the acquisition was made
11 a memorandum of terms, draft purchase con-
12 tract, or other document setting forth, or-refer-
13 ring to a document sent by the acquiring United
14 States person (or persons) which set forth, the
15 principal terms of such acquisition.
16 "(3) EXCEPTION FOR PUBLIC OFFERING.—Para-
17 graph (1) of this subsection shall not apply to an ac-
18 quisition if—
19 "(A) a registration statement (within the
20 meaning of the Securities Act of 1933) was in effect
21 with respect to the stock or debt obligation acquired
22 at the time of its acquisition;
23 "(B) the registration statement was first filed
24 with the Securities and Exchange Commission on

1 January 29, 1973, or within 90 days before that
2 date; and
3 "(C) no amendment was filed with the Securi-
4 ties and Exchange Commission after January 29,
5 1973, and before the acquisition which had the
6 effect of increasing the number of shares of stock or
7 the aggregate face amount of the debt obligations
8 covered by the registration statement.
9 "(4) EXCEPTION FOR OPTIONS, FORECLOSURES,
10 AND CONVERSIONS.—Paragraph (1) of this subsection
11 shall not apply to an acquisition—
12 "(A) of stock pursuant to the exercise of an
13 option or similar right (or a right to convert a debt
14 obligation into stock), if such option or right was
15 held on January 29, 1973, by the person making
16 the acquisition or by a decedent from whom such
17 person acquired the right to exercise such option or
18 right by bequest or inheritance or by reason of such
19 decedent's death, or
20 "(B) of stock or debt obligations as a result
21 of a foreclosure by a creditor pursuant to the terms
22 of an instrument held by such creditor on Janu-
23 ary 29, 1973."
24 (2) CONFORMING AMENDMENT.—Section 4916(a)

1 (2) is amended by inserting "(except as provided in
2 subsection (e))" after "less developed country
3 corporation".

4 (c) EXCLUSION FOR SECURITIES ISSUED TO FINANCE
5 NEW OR ADDITIONAL DIRECT INVESTMENT IN THE UNITED
6 STATES.—

7 (1) EXCLUSION FROM TAX.—Subchapter A of
8 chapter 41 (relating to acquisition of foreign stock and
9 debt obligations) is amended by adding at the end
10 thereof the following new section:

11 **"SEC. 4922. EXCLUSION FOR CERTAIN ISSUES TO FINANCE**
12 **NEW OR ADDITIONAL DIRECT INVESTMENT**
13 **IN THE UNITED STATES.**

14 "(a) GENERAL RULE.—The tax imposed by section
15 4911 shall not apply to the acquisition by a United States
16 person of stock or a debt obligation constituting all or part
17 of an original or new issue (as defined in section 4917(c))
18 which was issued for the purpose of financing new or addi-
19 tional direct investment (as defined by the Secretary or his
20 delegate) in the United States by the foreign issuer or
21 obligor and which qualifies under subsection (b).

22 "(b) QUALIFICATION FOR EXCLUSION.—In order for
23 any issue of stock or debt obligations to qualify for an exclu-
24 sion under subsection (a), the foreign issuer or obligor
25 (prior to the issuance of such stock or debt obligations) shall

1 have established to the satisfaction of the Secretary or his
2 delegate, pursuant to rules or regulations prescribed by the
3 Secretary or his delegate, that—
4 "(1) at least 50 percent of the total funds required
5 for the direct investment involved will come from sources
6 outside the United States;
7 "(2) such investment will be made for a period of
8 at least 10 years;
9 "(3) during such 10-year period the aggregate
10 amount of all investments in the United States by the
11 foreign issuer or obligor will at no time be reduced below
12 the aggregate amount of such investments as determined
13 immediately after the investment to which the exclusion
14 applies;
15 "(4) during such 10-year period the foreign issuer
16 or obligor will comply with such other conditions and
17 requirements as the Secretary or his delegate may pre-
18 scribe and make applicable to such issuer or obligor; and
19 "(5) during such 10-year period the foreign issuer
20 or obligor will submit such reports and information, in
21 such form and manner, as may be required by the Sec-
22 retary or his delegate to substantiate compliance by the
23 foreign issuer or obligor with the requirements of the
24 preceding paragraphs.

1 "(c) LOSS OF ENTITLEMENT TO EXCLUSION IN CASE
2 OF SUBSEQUENT NONCOMPLIANCE.—
3 "(1) IN GENERAL.—Where an exclusion under sub-
4 section (a) has applied with respect to the acquisition
5 of any stock or debt obligation, but the foreign issuer
6 or obligor subsequently fails (before the termination
7 date specified in section 4911 (d)) to comply with any
8 of the requirements enumerated in subsection (b) or
9 made applicable to such issuer or obligor under para-
10 graph (4) thereof, then liability for the tax imposed
11 by section 4911 (in an amount determined under para-
12 graph (2) of this subsection) shall be incurred by such
13 foreign issuer or obligor (with respect to such stock or
14 debt obligations) at the time such failure to comply
15 occurs as determined by the Secretary or his delegate.
16 "(2) AMOUNT OF TAX.—In any case where an
17 exclusion under subsection (a) has applied with respect
18 to an original or new issue of stock or debt obligations,
19 but a subsequent failure to comply with the require-
20 ments enumerated in or made applicable to the foreign
21 issuer or obligor under subsection (b) occurs and liabil-
22 ity for the tax imposed by section 4911 is incurred by
23 the issuer or obligor as a result thereof, the amount of
24 such tax shall be equal to the amount of tax for which
25 all persons acquiring such stock or debt obligations (as

1 part of the original or new issue) would have been
2 liable under such section upon their acquisition thereof
3 if such exclusion had not applied to such acquisition."
4 (2) PENALTY.—Subchapter B of chapter 68 (re-
5 lating to assessable penalties) is amended by adding at
6 the end thereof the following new section:
7 "SEC. 6689. FAILURE BY CERTAIN FOREIGN ISSUERS AND
8 OBLIGORS TO COMPLY WITH UNITED STATES
9 INVESTMENT EQUALIZATION TAX REQUIRE-
10 MENTS.
11 "In addition to any other penalties imposed by law, any
12 foreign issuer or obligor with respect to an original or new
13 issue of whose stock or debt obligations an exclusion from
14 tax under section 4922 applied, but who fails to comply with
15 any of the applicable requirements enumerated in or made
16 applicable to such issuer or obligor under subsection (b) of
17 such section and (under section 4922 (c)) incurs liability for
18 the tax imposed by section 4911 as a result thereof, shall,
19 unless it is shown that such failure to comply is due to rea-
20 sonable cause and not due to willful neglect, be liable (in
21 addition to the liability for tax so incurred) for a penalty
22 equal to 25 percent of the total amount of such tax."
23 (3) CONFORMING AMENDMENTS.—
24 (A) The table of sections for subchapter A of

1 chapter 41 is amended by adding at the end thereof
2 the following new item:

"Sec. 4922. Exclusion for certain issues to finance new or additional direct investment in the United States.".

3 (B) The table of sections for subchapter B of
4 chapter 68 is amended by adding at the end thereof
5 the following new item:

"Sec. 6689. Failure by certain foreign issuers and obligors to comply with United States investment equalization tax requirements.".

Passed the House of Representatives February 27, 1973.

Attest: W. PAT JENNINGS,

Clerk.

The CHAIRMAN. Mr. Volcker, we are very pleased to have you.

STATEMENT OF HON. PAUL A. VOLCKER, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. VOLCKER. Thank you very much.

I have a short statement which with your permission I will read

The CHAIRMAN. Yes.

Mr. VOLCKER. I am pleased to appear on behalf of the administration to support the extension of the interest equalization tax. Under present legislation, the IET would expire at the end of this month.

This tax was enacted in 1964 as a temporary measure, designed to help curtail our balance-of-payments deficit. Our continuing deficit has made it necessary to extend the bill on four previous occasions. We believe that recent exchange rate actions—accompanied by and combined with effective policies in other directions—can, and will, and must bring that deficit to an end. But those actions cannot bring a cure to the deficit instantaneously. The hard fact is that no matter how forceful our policies—and I believe they are forceful—it will take time for the more fundamental cures to work, and for our trade balance to recover. For the transitional period ahead, therefore, our payments position still needs the protection provided by the IET.

The IET sharply restrains the purchases by U.S. residents of securities issued by other developed countries of the world (with the exception of Canada) by imposing a graduated tax, currently equivalent to ¾ percent per annum. By effectively raising the cost of U.S. capital to borrowers in the developed countries to a level more comparable with borrowing costs in their own countries, the outflow of portfolio capital from the United States is contained. Our experience with the IET indicates that it has been effective in those areas to which it applies. Moreover, the tax complements and supports the Commerce Department's program to restrain outflows of direct investment capital (FDIP) and the Federal Reserve's voluntary program to limit the export of funds by financial institutions (VFCR). These three programs are interrelated and mutually reinforcing.

As I suggested, we are pursuing policies, both at home and internationally, to bring an end to a payments deficit that has persisted for too long. So far as exchange rates are concerned, two exchange rate realinements—one at the Smithsonian and again in February—have, I am convinced, produced a fair and realistic base for repairing our trade and payments position.

We do not, and cannot, look to exchange rate changes to do the whole job. Competitive pricing, to be effective, requires that foreign markets be open to us. We must attend to the efficiency, productivity, and price stability of the U.S. economy to maintain our competitive edge. The administration has, as you know, been moving vigorously in these directions.

91-578 O - 73 - 2

Our confidence that the steps we have taken and are taking will restore our basic balance of payments position is an important factor in our thinking that this is the last time we should ask for an extension of this legislation, provided the expiration date is set at the end of 1974.

The speculative atmosphere in international currency markets in the past few weeks does not disturb our basic conviction in that respect.

I would point out the currency movements which have occurred are not of the type that the IET is designed to impede or, indeed, is capable of impeding. However, it also seems obvious that this is not the time to permit this measure to expire. We continue to need the IET and the other programs of capital restraint in this period of transition and uncertainty in international monetary affairs.

We are now engaged in an effort to build a new international economic system. One of our objectives in that effort is to establish a cooperative monetary order in which the United States and other nations do not have to rely on controls to maintain balance. Our conviction on that score also underlies our expressed intent to phase out the IET by the end of 1974, along with the foreign direct investment program. However, the objectives of reform would not be served by a precipitous dismantling of these restraint measures today. Instead, we must move by stages, consistent with anticipated improvement in our basic payments position. As we do so, we hope and expect that more foreign capital will be attracted to our markets, reflecting the positive attributes not only of satisfactory return, but of high liquidity and freedom from threat of official controls.

The IET extension bill, as it was approved by the House, incorporates certain technical amendments which we are prepared to support. However, extension of the IET authority until December 31, 1974 rather than the date of June 30, 1974 provided in the bill as passed by the House—seems to us appropriate. This would bring the expiration date into line with the final "phasing out" date stated by Secretary Shultz for the existing restraint programs announced on February 12 in his statement on foreign economic policy. This date should provide us with an ample margin of time to accomplish the objective, without forcing action out of keeping with the development of our external position.

At the same time, we have signaled our determination to achieve a payments position and a monetary system that can stand without this artificial crutch.

Thank you, Mr. Chairman.

The CHAIRMAN. Why has the administration decided to unilaterally abandon the interest equalization tax if this has been as effective as it is claimed in dampening the outflow of U.S. capital, in view of the fact that the balance-of-payments problem exists and continues to exist in this country?

Mr. VOLCKER. That is why we are not abandoning it today. We have not taken any action today but we want to look forward to the day, and we do look forward to the day, when this kind of special

control isn't necessary and we have taken some very vigorous actions, as you are aware, Mr. Chairman, to deal with the balance-of-payments problem in a way that we think will produce results in this time period.

The CHAIRMAN. Mr. Volcker, if you will look at this table prepared here in our committee, you will see that it shows the Canadians have run a balance-of-trade surplus with the United States of over $7 billion and a balance-of-payments surplus of almost $6 billion in the last 5 years.

(The table referred to follows:)

UNITED STATES BALANCES OF TRADE AND PAYMENTS WITH CANADA
1968–72
[In millions of dollars]

	Merchandise trade	Balance of payments (basic balance) [1]	New Canadian security issues in the United States capital outflow
1968	−435	−511	−957
1969	−799	−1,367	−1,270
1970	−1,676	−1,649	−776
1971	−1,690	−913	−790
1972	−2,494	[2] −1,552	[2] −617
Cumulative, 1968–72	−7,094	−5,992	−4,410

[1] Current account and long-term capital; excludes short-term private capital.
[2] January-September 1972, at annual rate.
Source: U.S. Department of Treasury.

The CHAIRMAN. Yet Canada is the only developed country which has an exemption from the interest equalization tax for new security issues under this legislation.

Can you see any reason at all for continuing the Canadian exemption in light of our persistent trade and balance-of-payments deficits with that country? How can you justify the exemption, under the guise of international monetary stability, for a country which is running such large surpluses with the United States? If anything, it would appear to me to be that the exemption contributes to international monetary instability.

Mr. VOLCKER. Well, I can understand those questions because the Canadian position has changed a great deal in recent years, and their position has become substantially stronger and particularly stronger vis-a-vis the United States.

However, we are in a period where we would like to look forward to eliminating this tax rather than extending it, and we have, I think, a new variable in this situation inasmuch as the Canadian exchange rate is floating, and that should bring over a period of time some kind of equilibrium in these flows through movements in the Canadian exchange rate, perhaps, with the exemption continuing.

Now, practice does not always follow theory but that is the way it's supposed to work.

The CHAIRMAN. Let me ask you something about our trade problem, and I know that you are working on it and are concerned about it: If we are able to balance off our trade, which is a herculean task, considering how far we are behind now, it looks like the trend will be for us to export agricultural commodities and import manufactured goods. Doesn't that seem to be the trend?

Mr. VOLCKER. I think I want to subdivide that with one further classification, perhaps, Mr. Chairman. I think we have a strong competitive advantage in agriculture, and we should be net exporters of agricultural commodities, and we are, and I would like that to increase.

In the manufactured goods area, it depends upon whether you are talking about highly advanced goods, goods that incorporate highly advanced technology. We tend to be in a relatively strong position there, and in a net importing position with more basic manufactures, and I don't know whether more basic is the right term but more traditional type of manufactured goods.

The CHAIRMAN. There is a chart on page 23 of the little pamphlet the staff has prepared which shows what our balance of trade in manufactures is compared with Germany and with Japan. It is on a CIF basis. The chart points out that we have moved from a surplus to a deficit in trading in manufactures. I will ask that the chart that appears on page 23, and the data that appears on page 24 to back that up, appear in the record at this point.

(The items referred to follow:)

Balance of Trade in Manufactures

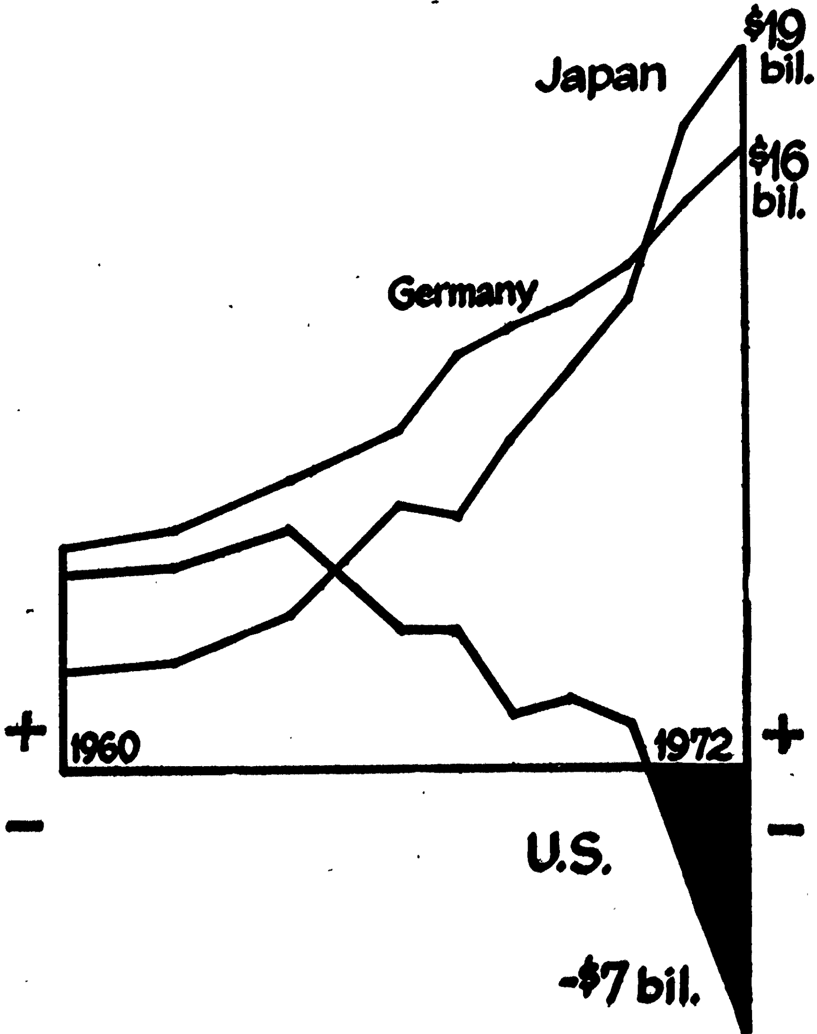


TABLE 6.—TRADE IN MANUFACTURES 1960-72

[In billions of dollars]

	United States	EEC Total	EEC Excluding Intra-EEC	Germany	United Kingdom	Japan
Exports, f.o.b:						
1960	12.7	23.1	16.1	10.1	8.4	3.6
1966	19.5	42.0	24.6	18.0	12.3	9.1
1967	21.2	44.9	26.6	19.5	12.1	9.8
1968	24.1	51.6	29.9	22.3	13.0	12.2
1969	27.1	61.2	33.6	26.2	15.0	15.0
1970	29.7	71.6	38.6	30.7	16.3	18.1
1971	30.8	79.5	43.4	35.0	19.0	22.6
1972 [1]	33.4	87.5	46.8	39.6	20.0	25.7
Imports, c.i.f.:						
1960	7.5	13.6	6.6	4.2	4.0	1.0
1966	15.8	28.8	11.6	9.0	6.9	2.1
1967	17.4	29.6	11.7	8.5	7.8	3.1
1968	22.7	34.9	13.6	10.6	9.1	3.5
1969	25.3	44.6	17.2	13.9	9.9	4.4
1970	28.5	53.4	20.7	17.4	11.0	5.6
1971	33.8	57.4	21.8	20.0	12.7	5.5
1972 [1]	40.5	63.1	23.3	23.2	14.8	6.7
Trade balance:						
1960	5.2	9.5	9.5	5.9	4.4	2.6
1966	3.7	13.2	13.0	9.0	5.4	7.0
1967	3.7	15.3	14.9	11.0	4.3	6.7
1968	1.4	16.7	16.3	11.7	3.9	8.7
1969	1.8	16.6	16.4	12.3	5.1	10.6
1970	1.2	18.2	17.9	13.3	5.3	12.5
1971	−3.0	22.1	21.6	15.0	6.3	17.1
1972 [1]	−7.1	24.4	23.5	16.4	5.2	19.0

[1] January-September at annual rate.

Source: U.S. Department of Commerce, "International Economic Indicators," December 1972, p. 14.

The CHAIRMAN. Now, what that chart shows is that in trade of manufactured commodities Japan has a surplus of $19 billion.

Mr. VOLCKER. I don't understand that figure, Mr. Chairman.

The CHAIRMAN. In trade in manufactures.

Mr. VOLCKER. A surplus of $19 billion.

The CHAIRMAN. Yes, sir. They have a surplus of $19 billion; Germany has a surplus of $16 billion in trade of manufactured commodities; while we have a deficit of $7 billion.

Senator HANSEN. Would the chairman yield for a question at this point.

The CHAIRMAN. Yes.

Senator HANSEN. Mr. Chairman, do I understand that we are talking only about manufactured articles expressed in terms of Japan's export of manufactured articles as contrasted with its imports of manufactured articles. This does not take into account agricultural imports to Japan.

Mr. VOLCKER. Or raw material imports.

The CHAIRMAN. This does not take into account their oil imports, which constitute a very big item. The chart just looks at manufactured commodities, and there is Japan, according to our staff study, with a $19 billion surplus, Germany with a $16 billion surplus, in that aspect of their trade; and the United States with a $7 billion deficit. Now I would assume that would continue to be the trend, that our deficits will get bigger——

Mr. VOLCKER. If I may just interject there, Mr. Chairman.

The CHAIRMAN (continuing). On that item. Please understand——

Mr. VOLCKER. I want to enter a reservation on that item.

The CHAIRMAN. Yes.

Mr. VOLCKER. Because we made some very important changes here, including the changes in exchange rates and, for instance, the exchange rate between the United States and Japan has changed in the space of the past 18 months by something like 35 to 40 percent. Well, that is going to make a change in these trends, I am confident, and a change with respect to the industrialized countries of Europe basically 20 to 35 percent, and I am confident that will make a change in these trends, so I don't think you can just project these trends ahead without allowance for that.

The CHAIRMAN. Well, now, Mr. Secretary, that is all great, but let's just take the facts of life. As far as this Senator is concerned, I can just be as cheerful as anybody in this room about the import of Japanese automobiles. We don't manufacture any automobiles in Louisiana. The Toyota has gone up in price 4 percent since the devaluation, and it still has the same quality of workmanship, so the Japanese one way or the other have been able to cushion this change in monetary relationship so as to still be in position to put a great deal of additional manufactures into our market in spite of the devaluation. This leads me to believe that the trend shown in the chart is going to continue.

They will continue to expand their export of manufactured commodities into our market, and if we are going to reach some balance we are going to have to ship agricultural commodities in their direction. Now is that correct or is that wrong?

Mr. VOLCKER. Well, I think we have got a large potential for agricultural commodities and I don't want to in any way contradict that

point you are making. I just think this trend in manufactured goods can be shifted, too, so it is less adverse.

The CHAIRMAN. Now that gets me down to the problem I am concerned about. I don't know why I should get upset about the fact that we export more agricultural commodities and more raw products and they ship us more manufactured goods. We in Louisiana are an agricultural State on balance, I suppose, but speaking in terms of the overall national problem, it seems to me that if we are trading them jobs making automobiles and jobs making electronic goods for jobs in agriculture, which tend to be low wage jobs, then we are trading them a biscuit for a barrel of flour—and the way it is now, they won't even let us have the biscuit. What I want to know is why we can't reach some kind of an understanding here that in trading, we will pursue an effective policy where if we are supposed to get the biscuit for the barrel of flour we will at least get the biscuit. Instead of trading them low wage jobs for high wage jobs we don't even get the low wage jobs out of it, and that is of great concern to people who are thinking about jobs for American workingmen.

Why can't we put this thing on a basis that we are just not going to continue to run these enormous deficits? Nobody else on earth would try to do it, would they?

Mr. VOLCKER. Well, I think that is precisely what we are doing. We have come to the end of being able to run these enormous deficits and we have had to make changes and we have had to make monetary changes and changes in trade arrangements so that these enormous deficits stop, and I think we can let the market determine pretty much the allocation of the change, but the deficit overall has to stop, and I think we have got to improve in agriculture and we have got to improve in manufactured goods too compared to where we have been. I don't disagree with that at all, and we are moving with all the vigor at our command in that direction.

The CHAIRMAN. Well, having started out for myself, I can see ways that this thing can be corrected, and I don't see how we can continue to run these enormous deficits.

Now this interest equalization tax, I think, is one of the few things that has been done that does tend to do some good. I can't see where an eye dropper's worth of good is done by saying that a tourist can only bring back $25 instead of bringing back $100, or by enacting the DISC proposal whch looks to me as though it is not doing much good.

It seems to me as though we are going to have to move in some of these areas of telling people "Well, look, you are going to have to buy in our store if we are going to buy in your store, if we are going to do business."

Mr. VOLCKER. That is right, and that is what we have been saying and that is what we are aiming to do, and these deficits have to stop, and the other side of that is their surpluses have to stop and it is as simple as that, and that seems to me what we are doing.

The CHAIRMAN. Frankly, I am getting pretty dismayed waiting for you fellows to find out a way to bring this thing about—and I am not just pointing the finger of scorn at this administration for this trend has been going on for quite some time.

Mr. VOLCKER. Exactly, and that is why it is so hard to turn it around and it has been so hard and that is why we have had to take

such radical action in some directions. But I am convinced it is going to turn around.

The CHAIRMAN. I thought that perhaps the best Cabinet officer that Dwight Eisenhower had was Robert Anderson, the Secretary of Treasury. That man came to us in the Finance Committee room and told us in confidence back when he was Eisenhower's Secretary of Treasury that he was very upset about the fact that we had had these aid and trade policies which were initiated more to benefit the other guy than to benefit this country, and that it was fantastic how hard it was to turn that thing around and head it in the other direction when that policy was no longer justified. Now he couldn't turn it around, his successor couldn't turn it around, the successor of that man tried mightily and he couldn't turn it around, even though he thinks he did manage to have about one good year, and we are still struggling with that thing and it seems to me——

Mr. VOLCKER. That is right, it has taken a long time to turn it around and I am convinced it is being turned around. It is a struggle.

The CHAIRMAN. Well, the figures don't prove it. That is all I can say.

Mr. VOLCKER. That is right, but there is all that momentum in those figures and it is a real job turning those around.

The CHAIRMAN. After John Connally made a foray against those people with all the trade and fortitude a man could muster, I tried to find every way I could to back him. Yet we come back and look at it a year or two later and the deficit is twice as big as it was at the time he made the fight. When are we going to start getting results?

I have protested enough, but I want the message to go out down there.

Mr. VOLCKER. I understand the message.

The CHAIRMAN. Senator Hansen.

Senator HANSEN. Thank you, Mr. Chairman.

I am reminded of an intercollegiate fight I saw one time—a boxing match. In the sixth round, the second for the fighter who had obviously been taking quite a beating told the fighter encouragingly, "Get in there and hit him. He hasn't laid a hand on you yet." And the poor fighter replied, "Well then, watch that referee—somebody is beating the hell out of me." [Laughter.]

I hope the Secretary is right, a man for whom I have great admiration and respect. But I must say on the basis of the evidence that we see so far, there is little evidence to reflect your enthusiasm that we have turned it around.

Mr. VOLCKER. I can understand that because the figures, this momentum of which the chairman was speaking persisted right pretty much through 1972, and, you know, I can tell you that the trade balance was a little bit less in the second half of 1972 than it was in the first half but it is not enough to show very much. The significant thing is that that happened, I think, for the first time in many years when the domestic economy was moving ahead very rapidly, when the trade balance normally gets a lot worse, and I can attach some significance to that, and I think it is indicative that a turn around is beginning.

But you look at this broad picture and I can understand you can't really see it very clearly yet and I agree with that and that is why we took the further action that we took in February to further exchange rate change because we thought that was necessary to provide the impetus and thrust to turning this around, and we have made a very substantial change in that connection, and just taking that as one measure, and I think that is as far as we need to go, as far as we can go in that area, but I think it is going to have an impact, and I am sure this takes still some time and that is unfortunate and I am impatient, but I can't do anything to speed it up any further in that area.

Senator HANSEN. I do have a couple of questions, Mr. Chairman, that deal with the specifics of the testimony given by the Secretary. Before I proceed to those, I would just like to ask your opinion on this point. It seems to be the view of some, at least, who write that while these devaluations of our dollar may be helpful in their immediate impact, it certainly does make it more difficult for exporting nations to get their products into the United States and conversely, theoretically easier for us to sell our products abroad.

On the other hand, where we have troops stationed in Europe, as is now the situation, I think just the reverse is true. While it is easier for us to trade in foreign countries on a favorable basis insofar as U.S. manufacturers and agriculture is concerned, it is conversely more difficult for us to buy the kinds of services and to make the purchases that we have to make abroad. Is this not true?

Mr. VOLCKER. Yes, it makes it 10 percent more expensive to buy the marks that are necessary to maintain those troops in Germany.

Senator HANSEN. One of the——

Mr. VOLCKER. That is an offset.

Senator HANSEN. One of the concerns of another committee that I serve on, the Interior Committee, is that we are going to be importing more and more energy, specifically in the form of oil, with the result that Arab oil producing countries will be earning fantastic sums of foreign exchange.

The Chase Manhattan Bank, incidentally, estimates that Arab dollar holdings could exceed $200 billion by 1985. Isn't it a fact that the ability of central banks and governments to maintain fixed exchange rates and to fight speculation appears almost impossible against such massive currency holdings by other countries.

Mr. VOLCKER. Well, I think that phenomenon to which you refer, and there are all sorts of projections, you see, they are all large but they vary in degree of largeness, creates an important potential problem in two respects, the direct balance of payments impact of importing all this oil, and the problem of adding further to the amount of volatile capital that is ready to move around the world, and we have a lot of that already, and to the extent that adds to it, and it will add to it, potentially very importantly, it does create more difficulties in terms of this speculative potential.

Now, one approach toward dealing with this is more flexibility in exchange rates, there may be other approaches as well but certainly there is a problem upon which people have to focus attention because

it is an increasing problem, and probably a factor in this last speculative episode and, as you say, it is going to get much larger than much smaller.

Senator HANSEN. Well, if it took only the movement of around $6 billion to force an effective dollar devaluation against the mark and other currencies, it would seem to me that as we anticipate what very likely will occur with respect to several Arab countries insofar as the numbers of dollars they have in their hands, we will be going from one monetary crisis to another. Do you share this view?

Mr. VOLCKER. I think any systematic monetary reform effort such as we are engaged upon, that does not take account of this kind of problem, this kind of potential, isn't going to be very realistic for the very reason you suggest and this has to figure in these discussions and outlook very consciously and directly.

Senator HANSEN. Mr. Volcker, would you care to comment upon or to speculate as to where these dollars that are so obvious and so painfully present are coming from? There have been reports that the Arab countries are selling them, and there have been reports that multinational corporations have been selling them. Would there be any merit in your judgment, in including in this bill a provision that American citizens would be required, including corporations and banks located abroad, to provide the Treasury Department with a monthly listing of their short term foreign assets in each currency?

Mr. VOLCKER. We do collect some statistics of that kind now and we have the authority, I think we have all the necessary authority we need, but that, you know, the honest answer I have to give you to your first question is I don't know because the statistical reporting net in this country or other countries simply isn't good enough to pick up at least a great portion of these kinds of flows. That is partly because some of the flows may not involve Americans directly at all. It would involve shifts of money, of dollars held abroad, in the first place, into another form, and it does not come within any reporting system directly that we have and a great deal of it undoubtedly is a churning of money abroad not directly involving U.S. citizens or U.S. residents.

Now some of it does, I am sure, too, but it goes through many channels. Some of this we will identify, the part that went through the banking system is more identifiable, directly or indirectly, than some other parts, but a lot of it, for instance, this is the most difficult area of all, perhaps, can take the form of trade related transactions where one speeds up payments or delays payments, and the reporting network isn't sophisticated enough or accurate enough to pick up the difference in timing of payments so that we can identify just where all this money comes from. But we want to be examining this and getting all we can out of the statistics available or what other statistics might be generated.

You have to have some little passage of time to permit the statistics to become available that we do have and not enough time has passed. But I don't believe we need any more authority in collecting statistics.

Senator HANSEN. It is adequate.

One final question; I know I have taken more time than I should have, Mr. Chairman. It is my understanding that the Treasury De-

partment is prepared to accept the amendment proposed by several companies which would allow for the issuance of additional shares of domestically treated stock in two instances: One, upon the exercise of employee stock options and, two, in the case of foreign acquisitions.

I would invite your comment upon this proposed technical amendment, if you would care to do that.

Mr. VOLCKER. I think our people would have to look at the precise text carefully. We would not, if the committee wants to move in these areas, I think something could be worked out if the limitations are appropriate. We don't particularly sponsor the amendments but we wouldn't oppose them if they are appropriately limited so that they don't become a general loophole in the legislation.

Senator HANSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, as you can appreciate this is a rather difficult subject for a country boy like myself and if I ask some elementary questions I hope you will abide with me.

Mr. VOLCKER. You are a country boy like the chairman. [Laughter.]

Senator BYRD. You say the deficits must stop. If you will, let's get some figures. Give me the balance of payments deficits for 1972.

Mr. VOLCKER. You run into a little definitional problem.

Senator BYRD. That is what I am trying to get straightened out.

Mr. VOLCKER. Senator Byrd, the so-called official deficit settlement in 1972 as I recall it was in the area of $10 or $11 billion. I can give you that figure, I think, more precisely—$10.9 billion.

Senator BYRD. That is the balance-of-payments deficit?

Mr. VOLCKER. 1972, on an official, so-called official reserve-transactions balance, that is the overall deficit, it is the net outflow of dollars in all forms.

Senator BYRD. What other type of balance do you have?

Mr. VOLCKER. Well, sometimes we compute something called, we always compute something called the basic balance which is felt to be somewhat more stable and indicative of trends, which includes the current account, the trade, interest, other current items and long-term capital, and that figure in 1972 we don't have in final form yet, but it is in the neighborhood of $10 billion, very close to the other figure I gave you.

Senator BYRD. Not much different.

Mr. VOLCKER. Not much different than last year. Some years it is a lot of difference but this last year they were not.

Senator BYRD. What did you call that?

Mr. VOLCKER. Official reserve transactions balance is the official name, I guess.

Senator BYRD. Official reserve transactions balance?

Mr. VOLCKER. Right.

Senator BYRD. What was the same figure for 1971?

Mr. VOLCKER. $30 billion, $30.5 billion, actually.

Senator BYRD. What was it for 1969?

Mr. VOLCKER. 1969 there was a surplus, $2.7 billion.

Senator BYRD. And 1968?

Mr. VOLCKER. Also a surplus of $1.6 billion.

Senator BYRD. And 1967?

Mr. VOLCKER. Deficit of $3.4 billion.

Senator BYRD. And 1966?

Mr. VOLCKER. A small surplus of $200 million.

Now that figure is very much affected, as you can see, by these violent fluctuations by short-term capital movements, and when money was tight in the United States in 1968 and 1969, we drew in a lot of short-term capital, and that is why we had a surplus for those 2 years.

Senator BYRD. That is the balance of payments.

Now let's get to the balance of trade for 1972 FOB and CIF. FOB is $6.9 billion, as I recall.

Mr. VOLCKER. Yes, and the balance of payments is $6.8 billion.

Senator BYRD. On FOB basis for balance of trade?

Mr. VOLCKER. That is FOB—I don't have the——

Senator BYRD. What about a CIF?

Mr. VOLCKER. CIF, it runs a couple of billion higher than that, maybe, it is several billion higher than that. I don't have the figure with me.

Senator BYRD. The figure that the Finance Committee report shows is $14.5 billion.

Mr. VOLCKER. $14.5 billion. That seems high to me on any basis.

Senator BYRD. CIF, excluding foreign aid.

Mr. VOLCKER. Well, excluding foreign aid is another addition. I don't have those figures with me.

Senator BYRD. Well, would you—you have no reason then to dispute the figure of $14.5?

Mr. VOLCKER. It sounds high to me but I can't dispute it in the absence of other figures.

AID would add a couple of billion to this figure and CIF, I would have thought, wouldn't have added more than $4 billion or so at the outside, but it is a little short of the figure you have.

Senator BYRD. Now you said in your dialog with Senator Hansen, that you found it necessary to take radical action. Would you indicate the radical action to which you referred?

Mr. VOLCKER. Well, we devalued the dollar twice and had a major exchange rate realignment in the last 14 months twice, I consider that radical action.

Senator BYRD. That is what I was interested in knowing.

Mr. VOLCKER. That is the most striking action we have taken.

Senator BYRD. Because some have indicated it was not a radical action. Devaluation in itself solves very little, does it?

Mr. VOLCKER. Well, it provides a base for restoring this position but it is not an answer by itself, I agree with that.

There are two other major areas that I don't think we can lose sight of and that is what we are doing at home in terms of inflation and price stability and that is important, and it is critically important, and then I think we have the whole area of trading arrangements, and fair treatment by American producers abroad particularly, and markets have to be opened to us.

Being competitive in price is one thing and devaluation can help there, and it does help there, but we have to have the market open to us.

Senator BYRD. So devaluation does not solve some of our most basic problems?

Mr. VOLCKER. It is not a complete solution.

I think insofar as exchange rates are relevant here we have done that part of the job, and it's been difficult and it's been disturbing, it's been unsettling. I think it's done; we have gone through that.

Senator BYRD. And it is in your judgment, radical action to devalue the dollar twice in 14 months?

Mr. VOLCKER. It is indeed and this is nothing I look forward to repeating at all. It is radical action.

Senator BYRD. I note from the New York Times today with a Paris dateline which says the nine Common Market countries are expected to make a joint demand that the United States support the dollar in the international financial markets at next Friday's emergency meeting of the major industrial countries' Finance Ministers in Paris.

I understand that you and Secretary Shultz and Dr. Burns will be there.

Assuming such a demand is made, and assuming that you want to respond affirmatively to such a demand, what steps could be taken or do you envision could be taken?

Mr. VOLCKER. I don't think I can comment very intelligently on these newspaper reports and what they hypothetically might ask or have in their minds.

I think it is important to find out what they do have in their minds precisely.

Senator BYRD. Let's put it this way: Let us forget the newspaper report; just for my edification, how do you support the dollar in the event you want to support the dollar?

Mr. VOLCKER. Well, what could be done is one can borrow foreign currencies and sell foreign currencies for dollars.

Now, in effect, they lend us dollars and when they acquire the dollars in the market, we don't—it is not voluntary on our part, they do it in order to maintain their exchange rates by buying the dollars in the market.

It can be done technically in more than one way. We can borrow currencies from them and support the dollar in much the way that they do but we are doing it instead of their doing it.

Senator BYRD. But there isn't, do I take it from your reply that there isn't much that we can do to support the dollar, other than what's already been done?

Mr. VOLCKER. Well, there is very little we can do other than borrowing from them, which we already do in a different form.

Senator BYRD. So what is happening, is it not, is a lack of confidence in the dollar?

Mr. VOLCKER. I think having gone through these two devaluations there has been a certain amount of unsettlement of psychology.

Now, I am convinced that these exchange rates are now fair and realistic and they provide a basis for a strengthening position and I think the dollar is going to do well over a period of time, I have no doubt about that in my mind but certainly there has been some psychological unsettlement in the market. I look at the market and that is what they tell you, that this kind of change has led to some unsettle-

ment, and I think things are going to settle down over a period of time and the realization that the United States is still the strongest economy in the world, relatively certain we are doing very well in our price front, that we are now in a competitive position, in my judgment, so far as exchange rates are concerned, are going to repenetrate the market consciousness, and the dollar is going to be doing very well.

Senator BYRD. How much importance do you attach insofar as the lack of confidence in the dollar is concerned; how much importance do you attach to the unbelievable deficits that the Federal Government has been running in recent years?

Mr. VOLCKER. I think how we conduct our fiscal policies is certainly a factor in how people look upon the dollar, and that is why it's been important that we follow the kind of budgetary restraint that the President has so firmly established, and I think it's very important that those targets and budgetary projections be adhered to.

Even with those projections, as you suggest, the deficits are still sizable, but they are getting smaller.

Senator BYRD. I really don't see any decrease in spending. I have a table here which I will put in the record in a minute, but I don't see any decrease in spending.

Mr. VOLCKER. I agree with that. The spending is still a sizable increase, and the point I would——

Senator BYRD. I am taking the administration's budget, the budget that the President submitted.

Mr. VOLCKER. Right.

Senator BYRD. It provides for an increase.

Mr. VOLCKER. That's right.

Senator BYRD. Now, in reading the newspapers and listening to television one gets the impression that Treasury has recommended that expenditures be reduced. That is not the case.

Mr. VOLCKER. It is only reduced from what they would otherwise be and I agree with your point. (Laughter) There is a substantial increase here, and we must not exceed these figures. There is already a sufficient increase and we can live with a quarter of a trillion dollars and we can live with $268 billion next year and that is an increase——

Senator BYRD. If you can do that, then you are saying, that you can live with these tremendous deficits, and I am convinced, and maybe you will straighten me out on my thinking, I am convinced that these smashing deficits are leading to the decline of the dollar, to the decline in the value of the dollar perhaps much more than any other single factor.

Mr. VOLCKER. Well, I think what is important in the end in this respect is that we do make progress on this inflation front, as we mean to do. I think we can do it consistent with the kind of budget that the President has proposed, not the Treasury but the President.

But certainly we ought to be making every effort to diminish those deficits and certainly not increase them, and if we could make them smaller, I would like to see that and I am all in favor of that.

Senator BYRD. In this current fiscal year according to the Treasury's own figures, they show the highest Federal fund deficit in the history of

the Nation with the exception of World War II, when we were fighting a war on two fronts with 12 million men under arms.

How that is making progress, I don't quit easy.

Mr. VOLCKER. Well, these deficits are being brought down. I am looking at the overall unified budget deficit, of course.

We have a substantial surplus in the trust funds. The deficit is very high and I would like to see it less, but I think these deficits can be financed responsibly, without adding to inflationary pressures but the danger is on making them bigger and we ought to be bending every effort to making them smaller and I agree with that.

Senator BYRD. You will have a $130 billion deficit, Federal funds deficit, in the 5-year period ending June 30, 1974. That is 25 percent or maybe more of your total national debt that will have accumulated over the entire history of this Nation. Yes, 25 percent of that will have occurred during the 5-year period ending June 30, 1974. I don't think that is—I think there is logic, there is going to be deterioration in the value of the dollar. I don't oppose devaluation of the dollar for the simple reason, for one who is not an expert in finance, that all that is being done is formally recognizing what is taking place, namely, a deterioration in the value of the dollar.

At this point, I ask unanimous consent to insert in the record, Mr. Chairman, a table that I have had prepared giving the income and expenditures of the Government for fiscal years 1968 through 1974.

The CHAIRMAN. Without objection agreed to.

(The table referred to follows:)

91-578—73——3

Income and expenditures of the Government for fiscal years 1968-74

	Fiscal year—						
	1968	1969	1970	1971	1972	1973 [1]	1974 [1]
Receipts in billions:							
Individual income taxes	$69.0	$87.0	$90.0	$86.0	$95.0	$99.0	$112.0
Corporate income taxes	29.0	37.0	33.0	27.0	32.0	34.0	37.0
Total	98.0	124.0	123.0	113.0	126.0	133.0	149.0
Excise taxes (excluding highway)	10.0	11.0	10.3	10.5	9.1	9.4	9.6
Estate and gift	3.0	3.5	3.6	3.7	5.2	4.6	5.0
Customs	2.0	2.3	2.4	2.6	3.2	3.0	3.3
Miscellaneous	2.5	3.0	3.4	3.9	3.5	4.0	4.1
Total Federal fund receipts	116.0	143.0	143.0	134.0	149.0	154.0	171.0
Trust Funds (Social Security retirement, highway)	38.0	44.0	51.0	54.0	60.0	71.0	85.0
Total	154.0	188.0	194.0	188.0	209.0	225.0	256.0
Expenditures in billions:							
Federal funds	143.0	149.0	156.0	164.0	178.0	188.0	199.0
Trust funds	36.0	36.0	40.0	48.0	54.0	62.0	70.0
Total	179.0	185.0	196.0	212.0	232.0	250.0	269.0
Unified budget surplus (+) or deficit (−)	−25.0	+3.1	−2.0	−24.0	−23.0	−25.0	−13.0
Federal funds deficit	−27.0	−6.0	−13.0	−30.0	−29.0	−34.0	−28.0

[1] Estimated figures.

Senator BYRD. Also, Mr. Chairman, I ask unanimous consent that a table that I prepared showing deficits and Federal funds and interest on the national debt for the 20-year period 1955–74, inclusive.

Incidentally, it shows that the interest on the debt, just the interest charges, have doubled in the last 8 years. We now have $26 billion in interest that we are paying on the debt.

Then I have another table that I ask unanimous consent to insert in the record: Total U.S. gold liquid assets and liabilities to foreigners.

The CHAIRMAN. Without objection, agreed to.

(The tables referred to follow:)

Deficits in Federal funds and interest on the national debt, 1955–74 inclusive.

[In billions of dollars]

	Receipts	Outlays	Surplus (+) or deficit (−)	Debt interest
1955	$58.1	$62.3	−$4.2	$6.4
1956	65.4	63.8	+1.6	6.8
1957	68.8	67.1	+1.7	7.3
1958	66.6	69.7	−3.1	7.8
1959	65.8	77.0	−11.2	7.8
1960	75.7	74.9	+.8	9.5
1961	75.2	79.3	−4.1	9.3
1962	79.7	86.6	−6.9	9.5
1963	83.6	90.1	−6.5	10.3
1964	87.2	95.8	−8.6	10.7
1965	90.9	94.8	−3.9	10.3
1966	101.4	106.5	−5.1	12.0
1967	111.8	126.8	−15.0	13.4
1968	114.7	143.1	−28.4	14.6
1969	143.3	148.8	−5.5	16.6
1970	143.2	156.3	−13.1	19.3
1971	133.7	163.7	−30.0	21.0
1972	148.8	178.0	−29.2	21.8
1973 [1]	154.3	188.4	−34.1	24.2
1974 [1]	171.3	199.1	−27.8	26.1
20-year total	2,039.5	2,272.1	232.6	264.7

[1] Estimated figures.

Source: Office of Management and Budget and Treasury Department. Feb. 1, 1973.

U.S. gold holdings, total reserve assets and liquid liabilities to foreigners

[Selected periods in billions of dollars. Prepared for Senator Harry F. Byrd, Jr., of Virginia]

	Gold holdings	Total assets	Liquid liabilities
End of World War II	20.1	20.1	6.9
Dec. 31, 1957	22.8	24.8	15.8
Dec. 31, 1970	10.7	14.5	43.3
Dec. 31, 1971	10.2	12.2	64.2
Dec. 31, 1972	10.5	13.2	79.0

Source: U.S. Treasury Department, March 1973.

Senator BYRD. Total U.S. gold liquid assets and liabilities to foreigners.

Fifteen years ago our Government had $25 billion in reserve assets, with liquid liabilities to foreigners of $16 billion.

As of December 31—and if you have updated figures I would be glad if you would let me have them—we have total reserve assets of $13 billion but liquid liabilities to foreigners of $79 billion and that has increased in 1 year from $64 billion to $79 billion. The year before that it was $43 billion.

So in a 2-year period, it's increased from $43 billion to $79 billion. It seems to me there is your answer.

Mr. VOLCKER. That reflects those deficit figures we were talking about earlier.

Senator BYRD. There is your answer to the deterioration of the dollar.

Mr. VOLCKER. I agreed with that and this trend has to be changed and reversed.

(The table referred to follows:)

Transfers of U.S. resources to foreign nations, fiscal years 1971–73

[In thousands of dollars]

	Security assistance [1]			Development and humanitarian assistance			Total all assistance		
	1971	1972	1973	1971	1972	1973	1971	1972	1973
Asia	5, 106, 092	5, 175, 784	5, 023, 610	1, 355, 101	1, 273, 353	1, 409, 483	6, 461, 193	6, 449, 137	6, 433, 093
Afghanistan	204	250	215	13, 721	58, 043	32, 319	13, 925	58, 293	02, 534
Burma	438	32		1, 052	621	621	1, 490	653	621
Cambodia	267, 619	246, 510	326, 525	8, 510	14, 618	30, 018	276, 129	261, 128	356, 543
Ceylon	3, 000		15	17, 725	20, 130	14, 157	20, 725	20, 130	14, 172
China (Taiwan)	89, 760	105, 346	113, 374	20, 690			110, 450	105, 346	113, 374
Cyprus				1, 259	3, 960	3, 960	1, 259	3, 960	3, 960
Greece	63, 312	83, 383	97, 974				63, 312	83, 383	97, 974
Hong Kong/Macao				305	126	126	305	126	126
India	491	629	591	442, 630	196, 920	275, 131	443, 121	197, 549	275, 722
Indonesia	23, 936	24, 515	34, 754	176, 197	217, 300	211, 120	200, 133	241, 815	245, 874
Iran	129, 603	152, 337	207, 232	1, 209	2, 157	2, 344	130, 812	154, 494	209, 576
Iraq				2, 533			2, 533		
Israel		50, 000	50, 000	58, 750	55, 342	45, 342	58, 750	105, 342	95, 342
Japan	326	30, 328	352				326	30, 328	352
Jordan	5, 000	45, 000	40, 000	9, 947	18, 592	4, 242	14, 947	63, 592	44, 242
Korea	676, 804	473, 181	428, 606	177, 693	198, 271	173, 294	854, 497	671, 452	601, 900
Kuwait		41, 000	45, 000					41, 000	45, 000
Laos	212, 940	300, 464	423, 300	8, 033	5, 196	4, 999	220, 974	305, 660	428, 299
Lebanon				431	14, 505	5, 305	431	14, 505	5, 305
Malaysia	2, 428	767	181	3, 525	3, 447	3, 866	5, 953	4, 214	4, 047
Nepal	12	26	29	4, 406	4, 182	3, 704	4, 418	4, 208	3, 733
Pakistan	561	515	695	110, 854	160, 530	185, 158	111, 415	161, 045	185, 853
Philippines	18, 801	20, 131	28, 864	30, 073	64, 787	56, 336	48, 874	84, 918	85, 200
Singapore		625		172	45	45	172	670	45
Southern Yemen				99	90	90	99	90	90
Syria				172	216	216	172	216	216
Thailand	152, 996	110, 518	99, 686	7, 376	19, 999	20, 370	160, 372	130, 517	120, 056
Turkey	145, 383	132, 337	153, 303	89, 715	71, 635	71, 014	235, 098	203, 972	224, 317

Western Samoa				420	449	525	420	449	525
Vietnam	2, 685, 246	2, 963, 730	2, 529, 900	140, 551	121, 245	131, 266	2, 825, 797	3, 084, 975	2, 661, 166
Yemen				2, 400	1, 026	1, 026	2, 400	1, 026	1, 026
East Asia regional	308	8, 379	21, 275	16, 086	13, 232	16, 317	16, 394	21, 611	37, 592
Near East regional/ CENTO	19	19	3, 099	8, 567	6, 689	6, 572	8, 586	6, 708	9, 671
Other (see classified DOD supplement)	626, 905	385, 762	418, 640				626, 905	385, 762	418, 640
Unallocated						110, 000			110, 000
Europe	32, 836	62, 728	74, 005	8, 359	40, 509	860	41, 195	103, 237	74, 865
Austria		63	74					63	74
Belgium	543	352	321				543	352	321
Denmark	599	358	363				599	358	363
France	362	302	342				362	302	342
Germany	1, 553	1, 273	1, 344				1, 553	1, 273	1, 344
Iceland				1, 296	800	650	728	10, 600	13, 184
Italy	728	10, 600	13, 184				1, 296	800	650
Malta	167			232	9, 709	210	399	9, 709	210
Netherlands	528	284	267				528	284	267
Norway	560	302	286				560	302	286
Portugal	1, 500	5, 640	3, 345		30, 000		1, 500	35, 640	3, 345
Romania				6, 831			6, 831		
Spain	26, 197	33, 380	34, 870				26, 197	33, 380	34, 870
United Kingdom		10, 003	10, 000					10, 003	10, 000
Regional	83	159	9, 585				83	159	9, 585
Other (see classified DOD supplement)	16	12	24				16	12	24
Africa	72, 709	43, 071	45, 556	315, 094	314, 131	328, 618	387, 803	357, 202	374, 174
Botswana				2, 828	10, 042	10, 142	2, 828	10, 042	10, 142
Burundi				488	920	920	488	920	920
Cameroon				1, 125	979	1, 080	1, 125	979	1, 080

See footnotes at end of table.

Transfers of U.S. resources to foreign nations, fiscal years 1971–73—Continued

[In thousands of dollars]

	Security assistance [1]			Development and humanitarian assistance			Total all assistance		
	1971	1972	1973	1971	1972	1973	1971	1972	1973
Central African Republic	---	---	---	261	210	210	261	210	210
Chad	---	---	---	651	522	591	651	522	591
Congo (Brazzaville)	---	---	---	2, 677	1, 800	1, 800	2, 677	1, 800	1, 800
Dahomey	---	---	---	545	775	839	545	775	839
Ethiopia	15, 087	12, 559	15, 750	23, 362	22, 099	18, 988	38, 449	34, 658	34, 738
Gabon	---	---	---	50	---	---	50	---	---
Gambia	---	---	---	1, 241	1, 307	1, 363	1, 241	1, 307	1, 363
Ghana	53	48	55	22, 040	30, 848	47, 975	22, 093	30, 896	48, 030
Guinea	---	---	---	7, 802	4, 984	4, 970	7, 802	4, 984	4, 970
Ivory Coast	---	---	---	2, 193	2, 057	2, 176	2, 193	2, 057	2, 176
Kenya	---	---	---	5, 269	5, 343	5, 996	5, 269	5, 343	5, 996
Lesotho	---	---	---	2, 203	1, 606	2, 072	2, 203	1, 606	2, 072
Libya	202	190	181	---	---	---	202	190	181
Liberia	1, 187	1, 474	1, 777	7, 896	9, 592	8, 543	9, 083	11, 066	10, 320
Malagasy Republic	---	---	---	538	510	510	538	510	510
Malawi	---	---	---	525	656	655	525	656	655
Mali	1	52	50	3, 646	2, 366	1, 820	3, 647	2, 418	1, 870
Mauritani	---	---	---	1, 746	1, 170	1, 170	1, 746	1, 170	1, 170
Mauritius	10	---	---	1, 969	1, 602	1, 460	1, 979	1, 602	1, 460
Morocco [2]	---	---	---	66, 098	49, 299	60, 111	66, 098	49, 299	60, 111
Niger	---	---	---	1, 365	2, 119	2, 204	1, 365	2, 119	2, 204
Nigeria	18, 419	3, 558	64	18, 691	22, 290	24, 500	37, 110	25, 848	24, 564
Rwanda	---	---	---	613	360	360	613	360	360
Senegal	---	25	25	1, 987	2, 885	2, 404	1, 987	2, 910	2, 429
Seychelles	---	---	---	76	60	60	76	60	60
Sierra Leone	---	---	---	2, 749	3, 281	3, 423	2, 749	3, 281	3, 423
Somalia	---	---	---	284	450	450	284	450	450
Sudan	---	---	---	93	45	180	93	45	180
Swaziland	---	---	---	3, 774	410	479	3, 774	410	479

Tanzania				5,591	3,270	7,770	5,591	3,270	7,770
Togo				1,633	1,153	1,254	1,633	1,153	1,254
Tunisia [2]				47,669	46,969	36,013	47,669	46,969	36,013
Uganda				3,446	5,913	3,151	3,446	5,913	3,151
Upper Volta				4,739	3,635	3,708	4,739	3,635	3,708
Zaire	14,821	3,704	5,240	15,352	5,446	11,162	30,173	9,150	16,402
Zambia				58	320	320	58	320	320
CWA regional				14,734	29,900	24,085	14,734	29,900	24,085
East Africa				9,043	5,805	1,600	9,043	5,805	1,600
Southern Africa				10,921	14,135	8,200	10,921	14,135	8,200
Africa regional	268	400	93	17,123	16,998	23,904	17,391	17,398	23,997
Self-helf [3]				(1,732)	(1,700)	(2,050)	(1,732)	(1,700)	(2,050)
Other (see classified DOD supplement)	22,661	41,061	22,321				22,661	21,061	22,321
Latin America	83,339	91,008	107,137	439,137	446,002	514,888	522,476	537,010	622,025
Argentina	17,368	16,840	16,355	509			17,877	16,840	16,355
Barbados				632			632		
Bolivia	2,828	4,911	10,342	11,836	45,899	27,914	14,664	50,810	38,256
Brazil	12,559	22,334	17,337	98,984	17,178	32,795	111,543	39,412	50,132
Chile	6,353	6,767	7,661	8,433	7,059	6,128	14,786	13,826	13,789
Colombia	7,142	7,631	11,510	102,776	115,055	102,228	109,918	122,686	113,738
Costa Rica	90	87	88	7,850	3,336	2,851	7,940	3,423	2,939
Dominican Republic	2,040	1,778	2,163	28,367	25,938	29,805	30,407	27,716	31,968
Ecuador	493	527	1,300	22,966	10,837	20,567	23,459	11,364	21,867
El Salvador	734	562	1,150	4,485	10,550	15,533	5,219	11,112	16,683
Guatemala	7,380	2,134	4,324	16,587	16,858	27,752	23,967	18,992	32,076
Guyana				2,099	14,072	11,880	2,099	14,072	11,880
Haiti	3,049			1,450	4,211	7,251	4,499	4,211	7,251
Honduras	958	828	1,099	7,064	7,122	20,178	8,022	7,950	21,277
Inter-American organizations				12,594	14,861	16,880	12,594	14,861	16,880
Jamaica				23,187	6,202	12,137	23,187	6,202	12,137
Mexico	1,561	750	2,087				1,561	750	2,087
Nicaragua	1,349	1,189	1,445	13,230	13,178	8,344	14,579	14,367	9,789

See footnotes at end of table.

Transfers of U.S. resources to foreign nations, fiscal years 1971–73—Continued

[In thousands of dollars]

	Security assistance [1]			Development and humanitarian assistance			Total all assistance		
	1971	1972	1973	1971	1972	1973	1971	1972	197
Panama	690	879	945	12, 202	16, 919	23, 375	12, 892	17, 798	24, 320
Paraguay	2, 210	1, 609	1, 474	12, 843	10, 511	10, 224	15, 053	12, 120	11, 698
Peru	752	1, 048	5, 993	15, 426	37, 436	23, 973	16, 178	38, 484	29, 966
ROCAP				3, 863	13, 417	28, 056	3, 863	13, 417	28, 056
Trinidad and Tobago				141	90	90	141	90	90
Uruguay	6, 238	3, 943	4, 442	5, 444	1, 920	28, 132	11, 682	5, 863	32, 574
Venezuela	9, 238	12, 048	16, 735	2, 450	7, 009	2, 080	11, 688	19, 057	18, 815
Eastern Caribbean regional				1, 420	11, 342	21, 788	1, 420	11, 342	21, 788
Regional programs	307	5, 243	687	22, 299	35, 002	34, 927	22, 606	40, 245	35, 614
Oceania	133, 933	99, 000	95, 000				133, 933	99, 000	95, 000
Australia	123, 000	89, 000	90, 000				123, 000	89, 000	90, 000
New Zealand	10, 933	10, 000	5, 000				10, 933	10, 000	5, 000
Regional									
Other development and humanitarian assistance:									
Nonregional				364, 492	668, 936	529, 381	364, 492	668, 936	529, 381
Undistributed				26, 031	36, 172	54, 885	26, 031	36, 172	54, 885
Adjustment to net assistance, Public Law 480				−760	1, 800	3, 600	−760	1, 800	3, 600
U.S. contributions to international financial institutions				255, 000	407, 305	920, 000	255, 000	407, 305	920, 000

Other security assistance:									
General military assistance costs	5,254	5,363	68,988				5,254	5,363	68,988
Interregional	41,443	15,000	28,200				41,443	15,000	28,200
Undistributed	8,665						8,665		
Other (see classified DOD supplement)	217,009	739,900	485,680				217,009	739,900	485,680
Grand total	5,701,280	6,231,854	5,928,176	2,762,454	3,188,208	3,761,715	8,463,734	9,420,062	9,689,891
State Department migration and refugee programs				5,700	8,690	8,200	5,700	[4] 8,690	8,200
State Department administrative expenses	4,100	4,200	4,800				4,100	4,200	4,800
Overseas Private Investment Corporation				15,800	12,500	85,000	18,800	12,500	85,000
Export-Import Bank (other than military loans included in security assistance)							2,880,800	7,331,800	7,331,800
Overall grand total							11,373,134	16,777,252	17,119,691

[1] The Departments of State and Defense consider the totals derived for some country lines to represent a false summation of costs to the United States since they are sums of both appropriated fund programs and other transfers at no cost to the U.S. Government.

[2] See DOD supplement.

[3] Nonadd figures included in country lines.

[4] Excludes $6,850,000 transferred from AID.

Senator BYRD. My point is we are not changing it; we are not reversing.

We have another chart here, transfer of U.S. resources to foreign nations. It is a rather comprehensive table broken down by countries, and it shows that our foreign-aid program, that is transfer to U.S. resources to foreign nations, is at around $9.5 billion, and if you include the Export-Import Bank, it goes up to $17 billion.

The administration consistently has insisted on an increase in foreign aid. How can you justify an increase in foreign aid under the conditions that you have just been enumerating to the committee?

Mr. VOLCKER. Well, I don't recognize figures of the magnitude you cite for foreign aid. The total flow in recent years has been running, has been declining a trifle rather than increasing, has been running under $4 billion of all types of Government capital running out, including the Export-Import Bank.

The aid program bilaterally has been cut.

The CHAIRMAN. Well, to put it all together, here are some figures acquired by our staff and when you put all this together, it comes up to a total of—if you put the security assistance, the development and humanitarian assistance and other, all these various things together, it adds up to a figure of $9,698 million, roughly $10 billion and not including the loans.

Senator BYRD. Not including export import?

The CHAIRMAN. Where the loans are being put on such long terms in those cases where it would make better sense to make it a purchase instead of a loan, put $7 billion into that and that runs into $17 billion.

But you have got $10 billion clearly aid.

Mr. VOLCKER. I will have to examine these figures and see how they reconcile with the figures that I have.

I am sure looking at the Export-Import Bank the $7 billion figure must be something like their gross commitments, and not offset against the repayments that they are continually getting, because the net——

Senator BYRD. If you will check into it, you will find that the administration consistently has asked for an increase in foreign aid, and I refer you also to page 36 of the committee print of February 26, in which it gives the total foreign assistance at $10.1 billion, and if you include the Export-Import Bank, it runs up to $17.5 billion, and I ask unanimous consent also to insert in the record at this point, Mr. Chairman, this table of "Transfer of U.S. Resources to Foreign Nations."

The CHAIRMAN. Without objection.

Senator BYRD. I thought the entire table should go into the record and it just seems to me we are not going to get our deficit problems under control and we are not going to solve these problems when we continually ask for an increase in foreign aid, and when we are making no effort to reduce the foreign aid, that I can see.

Certainly, those who appear before the committee seeking foreign aid appropriations do not submit figures of reducing them.

As a matter of fact, the figures, as I say are increasing.

Mr. VOLCKER. I think you will find our economic assistance has in fact been declining in the bilateral programs, Senator.

Senator BYRD. You have to take the total programs. I think you will agree, don't you, Mr. Secretary, we have to take the total program, not just one.

Mr. VOLCKER. I agree not just the economic assistance but the military and multinational institutions, I agree they are all part of a total picture, but all these programs have sharply differing impacts on the balance of payments. For instance, in the military assistance programs where we simply give away military goods really don't have any impact on the net balance of payments.

Senator BYRD. It has an impact on the taxpayers of the country when we are giving away resources.

Mr. VOLCKER. That has an impact on the taxpayer when we are giving away resources, I agree with you, but it doesn't have a balance-of-payments impact in any direct sense for that type of program.

Senator BYRD. Certainly you have a very difficult problem, no doubt about that, and I just can't see how you are going to solve the problems of the world currency and solve our own currency problems worldwide until we solve our problem of continued deficit financing right here in the United States by our own Government. We can't solve that by going into new programs—we went into a $30 billion new program last year, revenue sharing, $30 billion new program piled on top all the others, at the time when we are running these smashing deficits, at a time when we are going to devalue the dollar.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, I am going to call on the committee members based on the time when they entered the room because simple social justice, I think, demands that one who has been sitting for a long time should be recognized.

I call on the Senator from Texas.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Mr. Secretary, I wish I could share your optimism that this will stem the tide internationally but, frankly, I don't think so. I think we are treating symptoms which have to be treated but I think we have to go far beyond that.

Fourteen months ago the administration was saying that we had then arrived at an 8-percent devaluation, and that was a fair rate of exchange. You have reiterated it again this morning that we are approaching 18 percent in the 14 months, so I think we have to take some strong unilateral action on the part of this Nation against those countries that had a continuing surplus of trade with us and will not give some concessions particularly on nontariff barriers.

I was late to this committee this morning because I was talking to an American businessman who had just returned last night from the Middle East. He still is in shock over having talked to a number of Middle East rulers of very small kingdoms but who had a substantial impact on what has happened to the devaluation of our currency.

He told me he was speaking to one ruler of a tiny kingdom who told him with a great deal of pleasure that he had put $800 million into this volatile market. He said, "I want to thank you Americans for the $80 million I made off of you in the last couple of weeks, and I want to thank you again for the 11.2-percent increase in the price I will receive for my oil."

We heard Senator Hansen talking about some of the figures that the Chase Bank has worked up on what is going to happen to the Middle East, and the incredible amount of currency that they are going to

accumulate, and I read one report from Chase that Saudi Arabia between now and the mideighties will have $150 billion worth of oil income.

Now, that is not $150 million, but $150 billion. By the eighties the Middle East nations will be receiving from $30 to $40 billion a year from oil exports.

Now, whether it is 30 to 40 or 20 to 30 we have never seen that kind of a situation before, and it can lead to some extremely serious monetary problems.

I am wondering if there is—that perhaps we should be thinking of a cartel of consumer nations. They have a cartel of producing nations with the OPEC nations where they bargain collectively against the consumer nations. Perhaps we should have a cartel of the European Common Market, the United States, Japan, major consuming nations of oil. Perhaps that would give us some additional muscle in trying to keep realistic prices on the oil that we are going to have to import.

It seems to me we ought to give some consideration to that.

Then, how can we sop up some of this money that is floating around being used for speculation? I read with a great deal of interest yesterday that one German economist was suggesting to his Government that perhaps they should be buying some very long-term bonds at modest interest rates from the United States

Is there feasibility in perhaps working out something along those lines with some of these countries to take some of these dollars off the market with long-term bonds?

I know we don't find a lot of compassion in the world but we went through this type of thing with the Marshall plan in assisting those countries and perhaps it is time for some reciprocity. Not that we are asking for a gift but for the stability of the monetary system of the world, for the self-interest of those countries, too, that they accept long-term obligations of this country for those floating dollars to take them out of the market.

Is there some feasibility to that, Mr. Secretary?

Mr. VOLCKER. Well, I think this is an important problem and it is also, like everything else, a very difficult problem.

One of the difficulties is there is not much point in selling, let's say, long-term bonds to somebody who is holding dollars anyway, and somebody who may be ready to trade or speculate in those dollars isn't going to be so easily enticed into a long-term, low-interest loan because they are looking for speculative profit. How do you attract them into Amercian securities?

I don't think any of these problems are really acceptable, Senator. They will still be in American securities and they will be delighted to buy American securities when they think American currency is stable and the American economy is strong.

That gets back partly to our balance-of-payments problem. As that improves, as we show the stability of our domestic economy, a lot of this money is going to run back into dollars because fundamentally we do have the largest and strongest economy and we are not going to be very successful, I think, with other devices without this natural force supporting that tendency anyway.

Now, there are other—I don't exclude that there can be funding, consolidation, efforts of one sort or another, and some of those have

been under discussion in the context of the monetary reform effort, and and perhaps some of that could be speeded and brought forward, but it is a complicated problem.

Senator BENTSEN. Perhaps we could put a maintenance-of-value clause in the contract on bonds which might make them more attractive?

Mr. VOLCKER. That is one——

Senator BENTSEN. If you had a devaluation there would be compensation.

Mr. VOLCKER. It is one kind of device that may have, in connection with some of these schemes, some role to play.

Senator BENTSEN. I would like to ask you one or more questions on a technical basis. We have had an exception on your interest equalization tax concerning underdeveloped countries.

I understand the House has now moved to close a loophole in the shipping industry, and I think justifiably, in that a number of ships under foreign flags have been in underdeveloped countries and, in turn, have issued the obligations but, in effect, the ships were not built there but built in Japan.

Mr. VOLCKER. Right.

Senator BENTSEN. But that, as often happens when you try to correct that kind of a problem, you run into other situations where inequities are created, and there are some of these ships under foreign registry where the ships are actually being built in this country, and so as the change was made in the bill, as I understand it, on the House side, it meant that these companies in turn were affected by it, and it seems to me as long as the ships are built in this country that the interest equalization exception should be allowed.

Mr. VOLCKER. I think that is correct, and if the House language does not deal with that situation we would want to look at it again.

I agree there is a major difference whether the ship is built here or abroad, and I thought, my thought was, that came under essentially the export exemption, if that for some reason does not, then I think we had better look again.

Senator BENTSEN. I am told that it does not, but I would appreciate your exploring that.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. Mr. Chairman, the thought occurs to me as I listened to Mr. Volcker, and I have the highest respect for him, that in my 10 years on this committee I am always rather surprised how little information we ever get from the Treasury Department. This applies not only to this administration, but to all administrations. And it also strikes me, as I think about the actions that are asked for, if the Treasury has ever toted up how many times they have been wrong as against how many times they have been right in the last 10 years in asking this committee for various actions. I think it would be very intriguing for us to know.

We are being asked to act on very important matters and find very little information that we get from the Treasury Department that is really very helpful.

What is intriguing to me, Mr. Volcker, is that it seems that it doesn't take a very large shift of funds to create a world monetary crisis. There

are some $268 billion of short-term funds available, with American multinationals and banks having holdings of more than $100 billion. A shift of only $6 billion into Deutsch Mark a few weeks ago caused the latest monetary crisis. How strong then is the dollar if it just takes that much of a shift when you consider the total amount involved?

Mr. VOLCKER. Well, let me say, Senator, it was not that shift or this so-called crisis that I think caused the devaluation of the dollar. What caused the devaluation of the dollar—that was on the surface—what caused it was this underlying deficit, this underlying trade position that we were speaking about. There would have been no excuse, no reason for us to take this action to change the exchange rates unless there had been this underlying deficit in our position, that is what we were concerned about more than the shift of $6 million in a particular week.

Now, having said that, and that is the reason for our exchange rate action, I think you correctly point out a major problem of the international monetary system, that the volume of funds ready to move around on short notice is very large, and we have to have arrangements where various funds can be either absorbed or diffused in a way that does not create tensions within the system, and that is a central issue of reforming our monetary arrangements so that these kinds of shifts of funds do not create unnecesary disturbances. It is a small fraction of the total volume of funds potentially available.

In a sense we have grown up now to a world in which both the volume of funds and the freedom to move these funds around has been very much enhanced, and the institutional arrangements we had have been outgrown, so we have got to build some new arrangements to deal with that problem.

Senator RIBICOFF. Now, when this monetary case struck a few weeks ago the financial columnists all seemed to indicate that the President's phase III program shocked the Europeans and Japanese because it indicated to them that it was a go-ahead signal for further inflation in this country.

Would you want to comment on that?

Mr. VOLCKER. Well, again, I would comment by saying if you look at this in terms of the exchange rate realinement and the devaluation of the dollar, it had nothing to do with phase III. We didn't devalue the dollar because the President one day announced phase III.

Senator RIBICOFF. When you devalued the dollar was that the interpretation of the holders of these huge sums of dollars, along with their attitude about the American economy? The signal may have been unjustified——

Mr. VOLCKER. That is right.

Senator RIBICOFF (continuing). But that is how they read it.

Mr. VOLCKER. There was some interpretation of that kind in the press. I think, at home and abroad, and I think, this among other factors, probably contributed to some psychological unsettlement.

I think it was a false reading and I don't think that was a major factor myself, but it was one factor, and people since have talked about it in retrospect and I think blown up its relative importance more than is justified.

But to the extent that people interpreted the announcement of phase III as meaning more inflation that is a wrong interpretation;

but to the extent they interpreted it that way this was a factor in psychological unsettlement.

Senator RIBICOFF. Can you tell us who profited from this devaluation. Which groups, which companies, which individuals or which countries made profits?

Mr. VOLCKER. Well, I can't answer a question like that unfortunately very fully because in the most immediate sense of exchange profits and losses, you know, the basic answer is I don't know.

But when you look broadly and say who profited and who lost from this kind of exchange, and look at it even from the standpoint of a company, an individual company, he may either gain or lose on his particular exchange position at the time.

But then you also have got to look at much more fundamentally, I think, look at how this affects his competitive position and his profitability over a period of time, and in that latter sense I say American producers and American workers gained. They are in a better competitive position.

Senator RIBICOFF. This is repeated time and time again but somehow it does not really work out. You keep on saying that this devaluation means we will be more competitive. But, if you analyze this, it just isn't as simple as that. Sure, the cost of American goods will be less in relation to the Japanese yen, for example, but then the yen buys that much more of American raw materials that go into the finished products so it is a standoff to their net cost.

Mr. VOLCKER. It is not a standoff, there are some offsets.

Senator RIBICOFF. I know there are some offsets, you also have their productivity, their industries' relationships with their governments, and a subsidies of one type or another. Aren't you faced with a whole range of policy reviews, as indicated by my colleague, Senator Byrd, and Senator Long, and Senator Bentsen?

We have a situation, as Senator Byrd pointed out, of some $10 billion of economic and military aid, plus $7 billion of long-term loans from the Export-Import Bank. Here we are making these loans when we really don't have the assets to do it. Every time we make one of those loans or give some of this foreign aid, our position worsens in the world money markets. So we really are in a situation now that we are not a rich uncle any more. West Germany and Japan have accumulated all the reserves. Isn't it time for us to say to them "You must help us with these burdens."

You still have 300,000 American troops in West Germany which produces another $1 billion deficit for us. Aren't we in a position to say, "Well, if our troops have to be there, West Germany and the other countries that hold so many of our dollars are going to have to pick up more of the total tab."

In other words, don't we now have to review all of our foreign economic policies because the shattering of the dollars' power is a blow to the United States that in many ways is equivalent to a military defeat.

When you suffer a military defeat it involves geopolitical problems. But it seems to me in the future the world is not going to have military confrontations on a large scale. The world and the United States is now entering a period where there are greater economic confronta-

tions, where ecopolitics is taking the place of geopolitics in arranging the affairs of nations.

It becomes very obvious that the United States is coming out second best in the economic struggle with other nations of the world. Last year Japan had a $19 billion trade surplus in manufactured goods, Germany had a $16 billion surplus, and the United States had a $7 billion deficit. To continue on, also what Senator Bentsen raised when he left, with a $150 billion in reserves projected for Saudi Arabia for the next 10 years and $200 billion for the Persian Gulf oil-producing countries, aren't we really heading into something entirely new?

Someone told me that you recently made the statement, "Let these countries come and invest in the United States." Think of what $350 billion could buy of America. Who is going to end up owning America? America will no longer be the master of its own house. We won't own America any more. Americans won't own America. I really don't see any long-range thinking or planning anywhere to deal with this new situation.

The CHAIRMAN. While you are making your statement would you mind just elaborating on that question of who will be owning America at that point?

Senator RIBICOFF. Well, it becomes very obvious, the Japanese, the West Germans and the Arab oil sheikdoms will own much of America at that point. They will be able to control whole industries. I wouldn't be a bit surprised if they have begun buying in on American companies at a very rapid rate now. Their holdings are probably in street names, Mr. Chairman, and that is how they are going to use their dollars.

Our dollars were used after the war to buy up much of Europe's businesses. Now you are going to find it turned around.

You have a whole range of policy objectives that have to be achieved—some along the lines suggested by the Senator from Virginia, some along the lines suggested by you and Senator Bentsen.

I don't know what you ought to be telling our major trading partners, Mr. Volcker. I don't think that I should tell you what to tell them, but they have a hundred billion dollars that they are holding, and I don't think we should bail them out to the extent that the dollar is being devalued. They are suffering a loss, too. I think that the European countries and Japan and the Arab oil countries have a vested interest in keeping the dollar strong. I don't think I would go over to Paris or Geneva and make a deal where the dollar gets pushed down any further.

If there was ever a time that we should let others assume more of the world's economic burdens, now is the time to do it. Otherwise you will have economic chaos. Certainly with the dollar still being the medium of international exchange, I don't think that these large creditors, for their own self-interest, can afford to attack the dollar.

The value of the dollar is being driven down. You can argue back home that it doesn't mean much to the average American citizen, but it does. If you start shaking the confidence in the dollar around the world, the repercussions are going to be catastrophic to every nation. I don't see how any nation can maintain a sense of economic well-being with a shattered U.S. economy.

I have just been thinking out loud here with you, Mr. Volcker, and I would be interested in your general comments.

Mr. VOLCKER. Well, I think I would just respond with two comments really, Senator. I agree very much with the theme you were expounding at the start about exchange rates not being the whole thing, and this goes through the gamut of all our foreign economic policies, as well as our domestic policies. I just have to agree with that, you have to look at all these things and review all these things and adopt new policies, and I think we are doing that to a very considerable extent.

In that process, of course, in particular areas you run into conflicting objectives, but in the basic thrust of what you are saying I agree with.

I think I disagree with the rather more pessimistic cast that you put over in the end. I think the United States is still quite clearly the strongest force in the world's economy.

Senator RIBICOFF. But how do you turn around these figures? Here we have a $7 billion trade deficit. You have the dollar being attacked. You have predictions of a great energy crisis and the U.S. needs for oil supplies leading to a $15 billion deficit by 1980.

Yesterday we heard testimony from the AFL-CIO that our manufacturers of high technology goods were having units of high technology, which in the past had been earners of large sums in our balance of trade, being manufactured abroad. Where do you see us turning around both our growing trade deficit and the balance-of-payments deficit?

Mr. VOLCKER. Well, in terms of the trade deficit, assuming now we do a reasonably good job at home in containing inflation, I just have to come back in part to the extent of the change in the exchange rates which I think does transform the competitive situation that has laid behind this steady deterioration we have had, and we have made a very big change in competitive pricing, and that is going to help right across the board, and particularly in the area of manufactured goods where we are going to have to make some gains.

Senator RIBICOFF. Yes, but that didn't help in the Smithsonian——

Mr. VOLCKER. No; I disagree with that.

Senator RIBICOFF. Did it?

Mr. VOLCKER. I think these changes, and this is one of the realities we have to struggle with, only take place over a period of time.

Now, you take the present situation: This has gone on so long that in some areas where imports have made very large inroads, American productive capacity really isn't available. Even if the price relationships are transformed overnight, it takes time for the American manufacturer to say, "Well, this line is again profitable for me, I can open up a new assembly line, I can build a new factory, I can get back into this line that I dropped 5 years ago."

It takes time to make those kinds of decisions, make that kind of investment and, therefore, to have it fully effective.

This has come at a time when our industrial capacity is pretty well utilized anyway, so it takes even more time under those circumstances. I think this process can begin fairly quickly in some areas. But for that to fully work out takes literally years, and I think that is inevitable because in the end you have got to get right back to the in-

vestment process and less incentive to invest abroad and more incentive to invest in the United States, and that is part of this.

Senator RIBICOFF. Right. And 14 months ago when there was a devaluation, we heard—I forgot whether it was from Mr. Connally or from you—that the initial effect of devaluation would be for the trade deficit to grow worse.

Mr. VOLCKER. Right.

Senator RIBICOFF. This is because we get less for our exports and pay more for our imports until there is a time for exports to grow and for imports to contract, which you are now saying. Does this suggest that our balance of trade after this recent devaluation also will grow worse for a period of time?

Mr. VOLCKER. Well, I am not sure because, if you look at the figures, the impact of the exchange rate change, I think, initially is adverse for some months, a half year or whatever. I think this time we took the action at a time when we expected our trade balance to be getting somewhat better, not good enough, not healthy, but better than the very unhealthy figures of last year, so we are working against what we judge to be a stream moving in our direction but a trend that was not nearly vigorous enough, and I would expect still that the trade deficit this year could be less than last year, and by the end of the year I would think it would be moving rather strongly.

Now, one of the interesting things here is that our trade balance, bad as it is, did not get worse over the past 6 or 8 months, despite the fact that we were having a domestic boom. Now, that is typically the period when a trade balance gets decidedly worse. This time it didn't. God knows it was bad enough to start with, but at least it didn't get worse during this period. Now, I think that is perhaps one evidence that the Smithsonian was beginning to work.

Senator RIBICOFF. This is what our distinguished chairman meant about the "good news" reports. We always get those good news reports on a month-to-month basis until finally the roof falls in with the final figures, Mr. Chairman.

Mr. VOLCKER. Well, precisely, our judgment was the situation was not good enough, it was poor; that is why we went ahead and devalued. So I don't cite these figures in saying everything was glorious. It obviously wasn't. All I say is that, I think, the trend was beginning to turn.

Senator RIBICOFF. Just one final question. How do you expect to control inflation with a rapid and galloping increase in the price of food? Do you think the labor unions are going to stand still for a wage increase formula which will not allow them to pay the higher food prices they have to pay?

Mr. VOLCKER. Food is a very real problem here, and this is much more important, in my judgment, than the phase III announcement and interpretations.

We have a very serious problem in the food area and it is not unique to the United States. This is a worldwide problem. There is a relative shortage of food or an increase in demand. There were crop failures and this permeates the world.

In response to that very real and serious problem, I think some very vigorous actions have been taken that are going to have an effect

in the course of this year; 40 million acres that have been taken out of production for years and years have been released for production. We are selling from stockpiles accumulated over a period of years, the setaside acreage can be used for grazing. These are all major problems of politics and economics that have bedeviled us for years, and very vigorous measures have been taken and I think this has to be an answer to food shortage worldwide and what can be done to maximizing our productive capacity and that is exactly what we are doing.

Senator RIBICOFF. Was it 40 million acres being put back into production or 9?

Mr. VOLCKER. Well, 40—in more than one announcement 40 million acres were released.

Senator RIBICOFF. There are agricultural experts here but I was under the impression it was 9 million acres.

Senator HANSEN. I was under the impression it was 40 million.

Mr. VOLCKER. 40 million acres. I think there was an announcement, one of the bites of this, as I recall it offhand, was for 9 million acres, but the cumulative total here has been 40 million.

Senator RIBICOFF. Why not put the whole 60 million back?

Senator CURTIS. Mr. Chairman, I believe the figure is 40. We discussed it in the Committee on Agriculture. I do not want to inject their problems here, but there is concern about that much production as to what that will do to prices domestically, and on a 1-year gain in foreign exports. We hope they stay up and will support the efforts to keep them up, but the agriculturists have some very serious questions about this without some safeguards.

Senator RIBICOFF. Thank you.

Senator CURTIS. That is not a matter before this committee.

The CHAIRMAN. Senator Gravel has been waiting for some time. I believe we will call on the Senator from Alaska.

Senator GRAVEL. Thank you, Mr. Chairman, and Mr. Secretary. Senator Bentsen spoke of the relationship of the energy crisis to the financial crisis. I would like to take the question of energy imports one step further, as the administration has been quiet concerning the long-run impact of this problem.

What we are talking about here is a mandate we would anticipate as a result of the dollar hemorrhaging that will take place in the next decade. I, of course, as my colleagues are, am waiting to see what the President's energy message will be, as this problem is an adjunct to that one. But there will be two separate problems. One is the domestic energy crisis itself. The other is balance-of-payments problems caused by the dollar hemorrhaging that will take place as more and more aid must be imported to meet our energy needs.

In the short run, we can deal with the balance-of-payments problem by hiding behind a cacoon of devaluation and protectionism and allowing commercial enterprise system to depend on our large domestic market. We are not really an exporting enterprise Nation like Japan and West Germany and other countries in Europe.

However, in the long run, as our energy demands increase and we are forced to import large quantities of resources such as oil, we must become an exporting Nation or suffer further deficits in our balance of payments which would further weaken our economic secu-

rity. I just came back from the Middle East and was astounded by the criticism of so many people in the area that our businessmen are not out hustling products like the businessmen of other nations. What incentives are going to be proposed to try to make us move into outreach, into the world commercial community?

Mr. VOLCKER. I think that is correct. I think it is a disturbing phenomenon. I think you are right. I think we have not been export-oriented, and part of that, I think, derives from the very basic fact that over the years our businessmen have felt two things: That in many cases the prices were not terribly competitive and, therefore, it was not worth the effort and, of course, they had a big domestic market, and in many cases they felt they were shut out of foreign markets by nontariff barriers, administrative regulations, national attitudes, and all the rest, and we have got to attack both of those fronts, and I think we are attacking both of those fronts and we are attacking them with some success.

We have—the exchange rate changes the competitive position. We have got, through trade legislation, through pressures, through discussions with our trading partners, we have got to get relaxation of trade barriers, and we have had some success in that area, not enough.

We need a lot more, but we are pressing just as hard as we can in those areas.

We have attempted to spur our businesmen here through, I think, the finest export credit program in the world.

We and this committee took action with legislation the chairman mentioned earlier to DISC, in an effort to call their attention to the advantage of, to the opportunities that exist in export markets and to remove any tax disadvantages they had in that area, so we have moved into the—in both the tax and credit directions.

In the end, we have to get a state of mind among the American business men and, sure, that looks toward foreign markets not just as a place to invest but as a place to export, and that is terribly important, and we have to get that into the minds of American businessmen by whatever device we have.

If we take a devaluation, or all these other actions, as just another opportunity to be fairly soft in a domestic market, then it is not going to work. We have got to get them out aggressively, moving abroad, and aggressively just as important competing with exports, other people's exports here. That they just don't sit behind a better exchange rate relationship and refuse to compete with all those imports coming in.

They have got the opportunity to compete and they must do it.

Senator GRAVEL. And you feel then that there is a sufficient incentive, say, a year from now, that American industry will not have turned inward but will have turned outward.

Mr. VOLCKER. That is the whole thrust of our effort and I think with fair competitive conditions, which I think we have achieved in our exchange rate area and with progress on the balance-of-payments front, we can.

Senator GRAVEL. With progress on the trade fronts as a result of devaluation?

Mr. VOLCKER. Yes, I think there has been, particularly with respect to Japan. If you ask me whether there has been moving progress it is

another question. But the question of whether there has been progress, I think, can be answered straightforwardly, yes, there has been some.

Senator GRAVEL. Would you make us privy to anything that is going on for a possible proposal to handle the problem that has just been discussed, that is, the hemorrhaging of the dollar that exists between now and 1985 as a result of our energy requirements?

Mr. VOLCKER. When you look out to 1985, I think these estimates become very uncertain. There is obviously a problem here. This is what all these estimates tell us, there is going to be a problem, but I hate to attempt to assess the magnitude of that very precisely. When you look at that in a shorter run perspective, but still fairly long run, 5 or 6 years, that kind of thing, I don't think there is any question at all the projections show increasing oil imports.

In terms of the total impact on our balance of payments, assuming that other areas of the balance of payments are coming along as they should, I don't think this is overwhelming. It is an adverse factor, but so many of these projections simply look at the additional petroleum imports which are very sizable and, to some extent, the additional exports of the oil countries in the form of oil will be offset by increasing imports of those countries.

It is important that we get our share of those imports. If we do get our share, you come toward a balance.

Senator GRAVEL. Excuse me, Mr. Secretary, these countries will be importing a sizable amount as an offset?

Mr. VOLCKER. They fall into several categories. The countries with sizable populations.

Senator GRAVEL. They won't be the ones who are getting control of our dollar. The country that will be getting control of our dollar will be Saudi Arabia.

Mr. VOLCKER. And now I am not talking about Saudi Arabia and Kuwait. Saudi Arabia and Kuwait cannot simply spend this money and they are going to be accumulating it, but not all of our troubles come from Arab sheikdoms that can't spend the money. Iran spends the money, Venezuela spends the money.

Senator GRAVEL. But that is not where we are getting most of our oil from.

Mr. VOLCKER. Well, Nigeria.

Senator GRAVEL. No.

Mr. VOLCKER. Well, some of it, they fall into two categories I am stating. You talk about Saudi Arabia, that is another story. They are going to be accumulating very large amounts of dollars.

Senator GRAVEL. I don't see a serious problem in Iran. I don't see a serious problem in Kuwait. I see a serious problem in Saudi Arabia and Bahrein.

Mr. VOLCKER. Those countries are accumulating huge amounts of dollars and they are going to have to invest some of that abroad. We are going to get some of that investment. We discussed earlier an important aspect of this problem is not simply whether we get some of this investment back or whether we get our fair share back, but the fact it can be volatile, and so the fact we can get it back at some point, the shifting of that money around the world on short notice just aggravates this whole speculative problem, the whole problem of liquid capital.

That is an important element of the problem in the international monetary system to which we are devoting attention or will be devoting attention. It is not just a problem for the United States, and I think it has to be taken care of, as I said earlier, in any realistic monetary reform, and we have set our minds to that problem.

Senator GRAVEL. But there is no immediate plan that addresses itself to the magnitude of the problem?

Mr. VOLCKER. I cannot give you an immediate answer. We have made some proposals, as a matter of fact, in connection with our monetary reform proposals. We specifically addressed ourselves to this problem but I can't say that we fully answered the problem. We made one kind of suggestion that would be helpful which, I think, illustrates the fact that we have given this some thinking.

Senator GRAVEL. Well, I think we are all thinking of it but I think we need to be thinking more of the magnitude of the problem.

Thank you, very much.

The CHAIRMAN. Generally speaking, doesn't it make sense, that a nation which has these recurring deficits in its international payments really has no business exporting capital?

Mr. VOLCKER. Well, we would like to arrive at a situation where, in effect, the market can decide the extent to which we export capital, the extent to which we import capital, within the framework. What is important, is that we don't have this overall deficit. We wouldn't like to get into the business of permanently exerting control. That shows that something is out of whack, and we want to achieve an equilbrium so that it is not necessary.

Now consistent—I think you have a vision of the world, at least I do, where if you have a general equilibrium I doubt that the United States will be a large net capital exporter to Europe or Japan, which is a big area for where we have been exporting capital. But in recent years on a net basis we have not been exporting capital to Europe. That is often forgotten. We have as much capital come back from Europe to the United States as we have been exporting to Europe.

The CHAIRMAN. I am not talking about Europe right now, but generally speaking isn't it desirable that the countries that have the big surpluses ought to be exporting capital and the countries that have the big deficits ought to be importing capital?

Mr. VOLCKER. Yes, that is true but you take a big country like ours, we are the richest country in the world, and I think the natural flow of money would be from rich countries to poor countries, and so I would answer your question by saying the natural outcome would be that we would be investing in some amount in developing countries, in particular, they run a trade deficit, and they are willing to run a trade deficit if they have investments, and you have a balance between a trade and a current accounts surplus which permits you some margin to export capital.

I think that is the natural structure of our balance of payments for the period immediately ahead any way if we were in balance.

Now, what we are doing is exporting the capital and we haven't got the trade surplus.

The CHAIRMAN. One of the things we are talking about here is that America has traditionally, and I think it is a matter of social and economic justice, tried to hold interest rates low. We do not want to

subject people who have to rent housing or people who have to buy housing or people who have to borrow money to buy an automobile or do business to the kind of high interest rates that exist in certain other countries, where they have traditionally been willing to tolerate a much higher level of interest rates.

Mr. VOLCKER. Right.

The CHAIRMAN. So that while we are asking labor to agree to a limitation on what they can get for wage increases, they have a right to ask that we have some control over the interest rates they have to pay or the rent they have to pay or what they have to pay to finance the purchase of an automobile, and so the interest equalization tax, is important in this picture.

But now, here we have this exemption for Canada on the theory that that promotes stability, and yet Canada from the figures I put in the record and the charts I gave you, it looks as if we are going to have a deficit of $2½ billion, which is part of a 5-year deficit of $7 billion, in trading with Canada. Yet here we are shipping capital up there with an exemption from the interest equalization tax.

We have a big deficit trading with them. We have passed laws that helped bring that about, though they are not doing what we had a right to expect of them under that auto parts agreement, for example, and at the same time we are still shipping them capital where they have higher interest rates than we do. How do you justify that?

It would seem to me that the Canadian exemption, far from creating stability, is contributing instability. Our balance-of-payments deficit with Canada is one of our big problems.

Mr. VOLCKER. Well, I think you raise a reasonable question. They have been borrowing less here than they did earlier despite the exemption, they have been making some efforts to borrow more in Canada. I think that really two questions arise here, as I indicated earlier: Do we want to at this point apply this to Canada when really in the not so much longer run context we would like to get rid of the whole thing and, secondly, in terms of our trade position and our trade problems are we assisting the game or not.

I would not like to see the Canadian exchange rate depreciate as a result of this kind of action because it would aggravate our trade problems.

We have some legitimate complaints with Canada, as you suggested. I would like to see some progress made in that area which perhaps would be a more positive approach toward this kind of problem than using restrictions that we would like to phase out. But one can't, in saying that, not recognizing the legitimacy of your question. It is a matter of judgment which way you come out.

The CHAIRMAN. The Canadians are not doing what they are supposed to do under the automobile agreement. They have been in default for a long time, and we have been trying to get them to come to terms with us and do what they were supposed to do and what we had a right to expect of them.

Wouldn't it stand to reason if we took away this exemption from Canada it might help to bring them to some arrangement with us where they might consider doing what they were supposed to be doing under that agreement?

Mr. VOLCKER. I just don't know.

The CHAIRMAN. I am told by negotiators that as it stands now, there is no way that we are going to make any headway with Canada on that matter. Here is an agreement we made with them where it would be a good deal for both countries if both sides did what was expected. It turned out to be a lousy deal for the United States because Canada has not fulfilled its end of the bargain.

Here is something we don't have to do for them. We could treat them just like we treat anybody else. They are in default on doing what they in good faith were supposed to do in doing business with us and it is costing us jobs and it is hurting us in our balance of trade and balance of payments.

Now here is something that you are giving Canada that you don't have to give them. You could just treat them like you treat everybody else, including those who are not in default in trading with us. Why don't we just end that Canadian exemption up until we get some of these matters worked out?

Mr. VOLCKER. I recognize, I think, the legitimacy of that question. There are other considerations that enter into here and it is simply a matter of judgment as to whether that is an appropriate course of action at this time.

The CHAIRMAN. Does your announcement that you intend to terminate capital control by the end of 1974 suggest that you believe that we will have a large surplus in our balance of trade at that time and therefore can resume investing abroad at the same rate as we did in the past?

Mr. VOLCKER. It assumes certainly that our position will be swinging strongly in a favorable direction at that time, and in those circumstances it could even be that removal of this kind of control only encourages confidence in the dollar and investment in the United States, and it is not clear that it would be a net loss to us under those circumstances to remove this kind of control.

We want an environment in the United States in which the foreigner who wants to invest in the United States feels he can freely invest without any threat of controls, and one way you make that point is by removing the controls that you have.

I think it does imply a background of strongly improving balance-of-payments position.

The CHAIRMAN. I am sure you know Mr. Arthur B. Lafler, who wrote an article in the Wall Street Journal discussing some of these problems.

Mr. Lafler, as you know, was with Mr. Shultz as one of his advisers, and he is now at the University of Chicago. He wrote an article that appeared just recently in the Wall Street Journal pointing out that a devaluation doesn't really help as much as one might think; in fact, it doesn't help much at all. He says that:

> While no one can say for sure that exchange rates do not matter, it appears fair to say that their effects on trade balances and thereby domestic employment have been greatly exaggerated in policy discussions.

I would suggest that this article appear at this point in the record.

(The article referred to follows:)

[From the Wall Street Journal]

Do Devaluations Really Help Trade?

(By Arthur B. Laffer)

In policy as well as academic circles, it is widely believed that changes in exchange rates cause changes in trade balance. Devaluations are believed to lead to improved trade balances, while revaluations are supposed to lead to worsened trade balances. Yet, more than a year after the Smithsonian accord, the U.S. trade balance has shown no sign of improving. According to many people, we need just a little more time for the devaluation to have its effects.

While obviously not definitive, the evidence presented here places doubt on the notion that devaluations bring about improvements in trade balances; the trade balance being one of the major components of the balance of-payments, that component thought to be most responsive to exchange rate changes. In addition, the evidence points very strongly to a close and lasting relationship between changes in trade balances and changes in relative rates of growth. The theory of this latter relationship being firmly placed on the well-accepted notion that a country's net demand for foreign goods depends upon its level of income.

The popular theory behind the relationship between exchange rates and trade balances is straightforward. A representative statement of that theory as it pertains to the U.S. might proceed as follows: By raising the dollar price of foreign exchange (devaluation of the dollar), the dollar cost of foreign goods will naturally rise. In a like manner—because the foreign exchange price of the dollar has fallen as a consequence of U.S. devaluation—the foreign currency price of American export goods will now be lower. Americans will buy less of the now higher-priced foreign goods, while at the same time, American export goods should sell better abroad because of the decline in the price foreigners have to pay for them. The end result of a dollar devaluation should be an improvement in the overall U.S. trade balance (U.S. exports minus U.S. imports), though perhaps only after a lag of as much as two years.

Nothing appears to be more at odds with this theory than the current trade balance picture of the U.S. In May-June of 1970, the foreign currency value of the U.S. dollar depreciated by about 6%, vis-a-vis the currency of our major trading partner, Canada. A year later, the dollar depreciated again relative to the Swiss franc, the German mark, the Austrian schilling and the Dutch gilder. Between August of 1971 and the beginning of 1972, the dollar was further devalued versus virtually every major currency.

In sum, during 1970, the dollar depreciated (on a trade weight basis) by nearly 3% relative to our principal industrial trading partners. In 1971, there was a further depreciation of about 6% and during the first three quarters of 1972, the foreign currency value of the dollar depreciated an additional 2%.

Demolishing a Theory

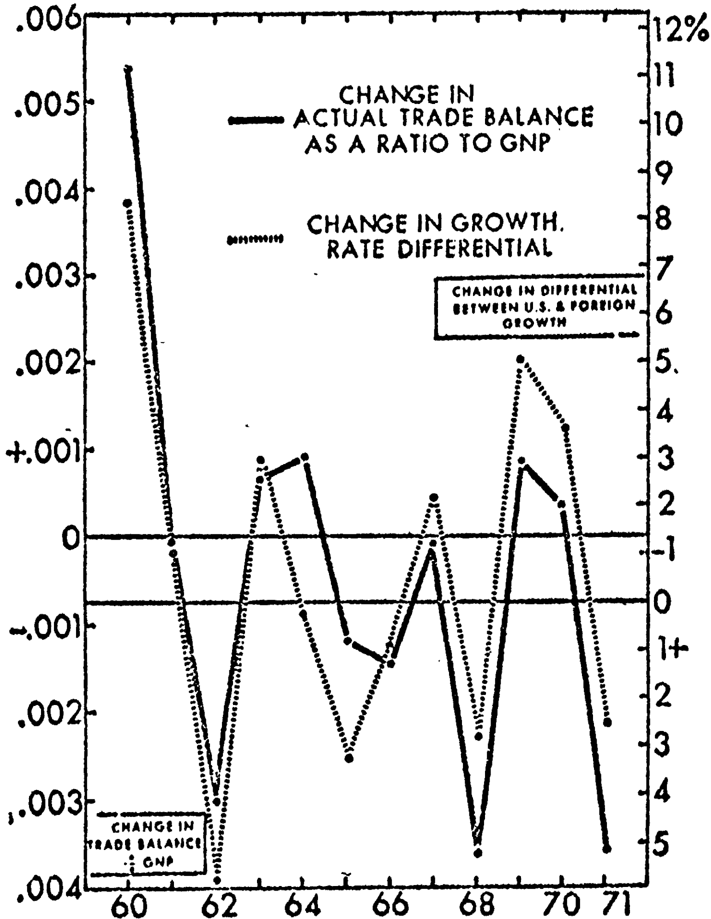
Although some argue that the failure of the U.S. to improve its trade balance is due to offsetting special circumstances, it should not come as a total surprise to those who have observed other countries' experiences with devaluations or revaluations. Of the major devaluations since 1950, few have been followed by significant improvements in the particular country's trade balance.

For the devaluation experience of Britain, Spain, Denmark and Austria, the trade balance was as bad, if not worse, three years after devaluation as it was the year prior to devaluation. Of some 14 convertible currency devaluation experiences that I have examined, a full 10 had larger deficits in trade three years after devaluation than they had in the year immediately preceding the year of devaluation.

The revaluation picture is not very different, but there are very few examples, and German mark revaluations account for nearly all of them. The effective number of revaluations that Germany has carried out depends upon how one treats changes in border tax adjustments. But, irrespective of precisely how many times the German mark has been revalued, it would be no mean task to discern a substantial deterioration in the German trade balance. Thus, given at least a casual look at the historical experience of foreign countries, it should not come as a complete surprise that the U.S. trade balance has not turned around since the foreign currency value of the dollar started to decline.

While trade balances may not respond predictably to exchange rate changes, they do appear to be quite closely related to differential growth rates. When a country increases its economic growth rate relative to its trading partners, we often find a deterioration in that country's trade balance. Perhaps the closest of these relationships is to be found between the U.S. and other industrial countries.

For illustration, the graph below shows how annual changes in the U.S. trade balance as a share of GNP are correlated with changes in the foreign economic growth advantage over the U.S. This graph covers the period 1960 through 1971.



While not exact, the relationship is immeasurably better than anything we could devise for exchange rate changes even if long lags were assumed. During the 1960–71 period, a number of exchange rate changes and other trade measures were initiated in addition to the large body of trade barriers that were already in place. From the graph, it is plain that we would have difficulty attributing much of a trade balance effect to any of these measures—except, of course, to the extent that they affected relative rates of growth.

The corresponding relationships for Japan, the European Economic Communities and United Kingdom are also very close. Other factors, including some associated with the special characteristics of individual countries, explain persistent deficits or surpluses in individual nations. But in each case, an increase

in the differential between domestic and foreign growth is usually associated with a deterioration in the trade balance.

In the most recent of times perhaps more policy measures than ever have been pushed through in the hope of improving the U.S. trade position. The dollar has been devalued, capital controls and trade restrictions have continued to sprout everywhere, Export-Import bank outlays have grown, voluntary quotas have been placed on a number of commodities, anti-dumping and countervailing duty measures have been threatened, and so on.

In face of it all, the trade balance has proceeded much as usual.

When we consider how rapidly the U.S. has grown recently, it seems reasonable that the growth rate will taper off in the future. The rest of the world, on the other hand, has recently been growing slowly relative to historical norms and should show some resurgence. If foreign growth does rise and U.S. growth slackens, we should expect a noticeable improvement in the U.S. trade balance. This improvement should, in my opinion, be attributed to U.S. growth relative to foreign growth, and not (as it probably will) to the delayed effects of devaluation.

INCOME AND IMPORTS

From a theoretical standpoint, the relationship between a country's trade balance and its relative rate of growth is based entirely upon the unarcane, well-accepted notion that the higher a country's income is, the more that country will import. Thus, as it well documented in virtually all elementary textbooks, net imports depend upon income. Changes in net imports depend, therefore, on changes in income. And, as displayed in the graph, changes in net imports, as a share of GNP, depend upon a country's growth rate.

Any one country's imports are necessarily the exports of the rest of the world, and its exports are the rest of the world's imports. Therefore, a country's trade balance surplus is the rest of the world's deficit. Because one country's trade balance surplus is all other countries' deficit, that country's trade balance must likewise depend upon the growth of the rest of the world, as well as its own growth rate. Therefore, based solely on the notion that the level of a country's imports depends on its income, we find that changes in its trade balance (or current account) should depend upon changes in its growth rate relative to the rest of the world.

From a policy standpoint, there are several observations that can be made concerning the balance of trade. (The reader must again be careful to distinguish between the balance of trade and the overall balance of payments.)

First, while no one can say for sure that exchange rate changes do not matter, it appears fair to say that their effects on the trade balance and thereby domestic employment have been greatly exaggerated in policy discussions.

Second, I think the use of the trade balance as a policy indicator distinct from domestic growth has probably been overdone and should be played down. Thus, much of the blame placed on the current administration for poor trade performance should properly be praise for bringing about rapid economic growth.

Third, both official and private pessimism as to the future American trade position also appear to me to have been substantially overstated. While we may not soon again see the surpluses of the late forties, the very recent trade deficits also appear to be somewhat abnormal.

Finally, although no one can ever deny with certainty that trade measures other than exchange rate changes help the trade balance, there is a widely held presumption in policy discussions that these trade measures do matter and matter a lot. This point of view has clearly been given too much weight in trade policy. The trade balance, like many other economic indicators, responds both predictably and in a logical way to the overall economic environment. Using gimmicks to alter the trade balance is to a large extent futile, and perhaps even mischievous.

The CHAIRMAN. Have you read that article and are you familiar with that logic?

Mr. VOLCKER. Yes, and I might say in the process of making one point that is very valid, I think he drew another conclusion which is not true. He makes the point—that article makes the point—that trade balance is not responsive to business conditions, which I agree with.

I made that point earlier. That is, the significance of the leveling out of our deficit last year was not that it leveled out just by itself. It was not, by itself, to be all that significant, but it took place at a time when, if you just look at the factors that Mr. Lafler was looking at, would suggest a business deterioration because we were growing very fast. That is what he was pointing out—that the grade balance is very sensitive, and when you look at it in the short run—in the course of a year or two—the thing it is most sensitive to is certainly the pace of business activity, both here and abroad. You have to look at those together.

But I don't think that answers the question over a period of time as to what the effect of an exchange rate change is. We know it bounces up and down in response to business conditions, but what happens when all those bounces up and down leave you in a quite different position after several years?

Then you have to look at different factors, and that is where the exchange rate change comes into effect on basic competitive conditions, so that those ups and downs take place in a different trend.

The CHAIRMAN. Well, thank you very much for your testimony here today.

Are there any further questions, gentlemen?

Senator BYRD. Just two brief questions, Mr. Chairman.

Mr. Secretary, the liquid liability at the end of 1970 was $40 billion; at the end of 1972, it was an increase of $36 million, or almost double. Could you cite the reasons—one, two, three—as to why there should be that tremendous increase?

Mr. VOLCKER. There is just one reason, Senator. That reflects precisely those deficit figures which we were talking about earlier, that $30 billion deficit in 1971, and $10 billion deficit in 1972. Those deficits are computed essentially from those changes in liabilities. It is because we have the balance-of-payments deficit that those liabilities go up.

Senator BYRD. Those figures, then, are tied in closely, or almost entirely, with the balance of payments?

Mr. VOLCKER. Yes, sir; they are the net reflection of the whole balance of payments.

Senator BYRD. And to get back to the devaluation a moment, you regard that, as I recall you stated, as a radical action that was taken twice in 14 months.

Mr. VOLCKER. Yes, sir.

Senator BYRD. Now just one last question: For some time I have been watching the Treasury market financing from mid-October to mid-February. I started this some years ago, and I noticed it has been heavy financing during that period.

Mr. VOLCKER. Typically, yes.

Senator BYRD. And most of it—the larger amount of it—has been in exchange, and the smaller amount has been in cash.

Mr. VOLCKER. Well, we have, typically, four large exchange operations a year. One of those periods is February, and another of those periods is November, so the period that you refer to covers two large exchange operations. But we, because of seasonal reasons, tend to have to do a fair amount of new cash financing during those months as well.

Senator BYRD. Now what I was trying to understand is that, in the past, going back to 1968, it has been mostly exchange with very little cash or with much less cash involved. But that same period for this past year, namely October of last year through February 15 of this year, the reverse occurred.

Most of it was for cash, $13, $14 billion—no, $17 billion for cash, and $4 billion for exchange. I am just wondering why that would be, and is that good or is that bad, vis-a-vis the other years.

Mr. VOLCKER. I would have to refresh my memory more precisely about the operations in these years. But in recent years, we have, in effect, handled more of our refunding. Instead of by making an exchange over to the holdings of the existing securities, we offer the market generally a new cash issue, and we take the cash and pay off the maturing issue, and part of the shift that you have noted may be because, instead of refunding maturing issues in November as fully by an exchange offering, as we have sometimes done in the past, we refunded it by offering a new cash issue, which would affect the figures that you have. But I would have to refresh my memory precisely by looking at these years.

It is also true that we had quite a large cash deficit due to the budget deficit during this period, so we did more cash financing than we usually do.

Senator BYRD. That is what I was trying to get at.

Mr. VOLCKER. Given the figures you cited, I think it is a combination of both of those figures.

Senator BYRD. Well, the figures I put in the Congressional Record yesterday—they are on page S4100—were $17 billion in financing for cash, and $4 billion for exchange.

Mr. VOLCKER. I think part of that $17 billion are cash issues that we sold to refund maturing issues, and part of it is net new cash.

Senator BYRD. Wouldn't that come in the other column, though? Wouldn't that be exchange?

Mr. VOLCKER. If your exchange figure is only $4 billion, it does not, because we had maturing issues during that period more in the order of $8 billion, if I remember.

Senator BYRD. These are figures from the office of Treasury.

Mr. VOLCKER. I assume the figures are accurate, but in the last—in the February financing, for instance—which refunded about half the issue by an exchange offering, it was only about $2.5 billion, by an exchange offering. Although the maturing issue was $4.8 billion—as I recall it—the rest we raised the cash separately, so the remaining $2.3 billion, whatever it was precisely, we paid off by selling another cash issue, and that probably fell in your cash total rather than in the exchange total.

Senator BYRD. Well, would you have someone in your office examine the figures that I put in the record yesterday, and let me know whether they are comparable one year to the other?

Mr. VOLCKER. Yes, I would be glad to do that, and I would guess that, of the $17 billion of cash financing, probably $3 or $4 billion of it was to refund outstanding issues, but I will confirm that with you.

Senator BYRD. Thank you, sir, because the more financing the Federal Government has to do, the greater effect I would assume it would have on interest rates.

Mr. VOLCKER. Depending on whether it is refunding issues, so this question is relevant.

Senator BYRD. Yes, it seems to me——

Mr. VOLCKER. The more net financing we do.

Senator BYRD. It seemed to me quite significant because it is a reversal of what has occurred in the 4 previous years.

Mr. VOLCKER. Well, part of that, I suspect. I don't recall the earlier years—I recall part of this year—and we will go back and give you those figures adjusted for which portion of the cash sales were really designed to refund an outstanding issue.

Senator BYRD. Until you change your bookkeeping, the figure should say exactly what they said here.

Mr. VOLCKER. We don't change the method of bookkeeping, but it is just a different technique of refunding issues, and sometimes we use one technique and sometimes another.

Senator BYRD. Thank you.

Senator HANSEN. Mr. Chairman, I would like to direct a couple more questions to the Secretary, if I may. I think, in response to a question or an observation by Senator Ribicoff, you indicated that our industrial capacity in this country was presently being pretty well utilized. Am I correct about that?

Mr. VOLCKER. Yes, of course. This varies from line to line.

Senator HANSEN. Yes.

What, then, is the justification for the present budget imbalance? I was under the impression that this full employment budget was a projection of our financial and economic well-being budgetwise in this country, assuming we were utilizing our industrial plant and capacity.

Mr. VOLCKER. Well, the full employment calculation, of course, rests technically on the labor force utilization.

Senator HANSEN. Yes.

Into what other sources, aside from industrial, do you look for an expansion of employment? Do you think primarily of service industries?

Mr. VOLCKER. I think the industrial plant is being fairly well utilized. obviously it is not; there is obviously some room for expansion, but from contrast with a year or two, it is being more fully utilized and there is not as efficient excess capacity around as there was. These concepts of industrial capacity are pretty hazy anyway, but it is more fully utilized today, and it could be still more fully utilized. It would have to be before we would get back to the full employment notion which this budgetary calculation rests upon, this arbitrary 4 percent unemployment figure.

Senator BYRD. During the last couple of years, we have had a number of witnesses before this committee, many representing larger corporations, multinational corporations, that have set up plants abroad to produce those products which historically have been the hallmark of American industrial might and technology. I think of several. Let me ask you—the Burlington Industries, Zenith—I don't recall all of them, but it is a long list—I gain the impression, in listening to these witnesses in the past few years that they felt that, given the ready exchange of technology around the world, as seems to characterize our actions—and I think that was underscored by Mr. Biemiller's testi-

mony yesterday—do you believe that American industry can compete with foreign based industry under the same general management as I think is implicit in multinational corporation activity, and pay several times the wages per hour that are being paid by foreign workers?

Mr. VOLCKER. I think we can, yes.

Now, of course, this is part of the process of currency adjustment, and not just the currency adjustment, but basic wage rates and basic wage trends. In many cases, our wage rates are now much closer to the wage rates in other developed countries than was the case 5 years ago, both because we have had changes in the currency values, and their wages have been increasing at a very rapid rate of speed.

Overall, the American worker and the American industry is still more efficient and more productive than our foreign competitors, and that is why we can compete.

But I am afraid the hard fact is we found we couldn't compete effectively enough without a change in the relative currency values and that is why it had to be done. This is, as I say, 35 to 40 percent vis-a-vis Japan in the space of 2 years, and 20 to 25 percent against our other leading industrial competitors in the sapce of 2 years. That is a pretty big adjustment, and I think now that enables us to compete on a fair basis where we couldn't do it without those adjustments.

Senator BYRD. Well, you are saying, that as these wage scales approach equality—ours with foreign countries— that our ability to compete would thereby become enhanced.

Mr. VOLCKER. Yes; I don't say——

Senator BYRD. I agree with that.

Mr. VOLCKER. But they don't have to reach equality, because wages are one part of the dimension, and the other is how productive the worker is. Fortunately, our workers are still, by and large, more productive. We found that that is not as strikingly true now as it was 20 years ago, and some foreign industries have become very productive, very efficient. They are as efficient as our industries. That is the problem. But that is not true across the board. It is true in some industries.

Senator BYRD. Well, I certainly would be interested to have submitted for the record any documentation on that precise point that you think would be relevant, Mr. Secretary. I must say that I believe it was Mr. Woodcock who testified here within the last couple of weeks, and maybe less time than that, and among other things mentioned some experiences he had had in Japan, and the attitude that was exhibited by Japanese workers, which he felt was rather in sharp contrast——

Mr. VOLCKER. I agree with that. Some of these Japanese industries, they are obviously producing a first-class product and producing it very efficiently; and it reflects the attitude of labor, management, and the country as a whole; and they have become extremely effective competitors.

Senator BYRD. Well, he went on to point out that when he was queried about—or rather, when he queried the Japanese about—absenteeism, their response was well, yes, they had people who were ill and were not able to be on hand to work on a particular day, and he said, "No, I don't mean that."

He said, "What about those workers who for personal reasons chose not to come to work on a given day," and I gathered from his observa-

tion that this situation is almost totally nonexistent in Japan. He spoke about the esprit de corps, if that term would be applicable.

Mr. VOLCKER. Right.

Senator BYRD. How they sang a company song and how there seemed to be a strong sense of competitiveness among the workers on the various shifts to see who could be the most productive.

Now, having in mind those observations made by him, I repeat again, do you think that we are more efficient, more productive, on a worker basis than are the Japanese?

Mr. VOLCKER. Yes, sir. But——

Senator BYRD. I sure hope you are right.

Mr. VOLCKER. I think that is true overall. I think you will find industries in Japan where they are extremely well organized and have the best productive equipment and a great spirit, and we are going to have to learn to compete in this kind of a world. I think there are—I am not saying in every industry—there are modern industries in Japan in some cases as efficient as ours and maybe more efficient, and that is why we have to make these adjustments.

Senator BYRD. Well now, I gather that, in three broad general areas, it has been the belief of a number of people in this country that we are competitive.

One is agriculture, the second is aircraft airframes, and the third is computers. According to Mr. Biemiller, we are exporting a rather significant proportion of our aircraft technology and know-how.

Would you say that if that trend were to continue, that we might expect to become more a land of farmers and let these other countries be the manufacturers and the skilled producers of manufactured products?

Mr. VOLCKER. We have been in the process of letting these other countries become the producers of a large range of manufactured goods, not, by and large, the most technologically advanced, but the whole middle range of manufactures, and that is what has happened, and we have let that process go too far.

Senator BYRD. Then referring to some of the observations made by the chairman and the feelings that were expressed by Senator Ribicoff with respect to food prices, if this might be the direction that we are taking, would you agree it would make good sense to let the price of food rise more rapidly than it is in order that agriculture could pay wages that would satisfy the average American worker? I don't see much indication that people want to leave a job with GM or with any of the other automobile manufacturers, to take a job working on a farm.

Mr. VOLCKER. Well, I won't pretend to any agricultural expertise, which I do not have, but it is not my impression that the limitation on our agricultural production, our basic agricultural production, is a shortage of labor, and this is, of course, one of the areas where I spoke of the American economy and American workman being more efficient overall.

The place where we really stand out is in agriculture, with production per man-hour or however you want to measure, being immensely higher in the United States than it is in all other countries.

Senator BYRD. Of course, that is very true. But as one who has had a little exposure to agriculture, let me observe if you will look at the investment per employer in agriculture, you will find that the machines that are bought to replace workers have been fantastic.

Mr. VOLCKER. Right, I agree with that.

Senator BYRD. And I can't view this sort of expansion as one that bodes more jobs, more high-paying jobs, for American workers. I mean, if we are going to go that way, we may have a high-average man/average-high employee production ratio for agriculture, but there won't be very many agricultural jobs.

Mr. VOLCKER. I think we can create the jobs in this country, as we are now. The important thing is to have the domestic economy prosperous consistent with a balanced position externally, and I think we can do that, but it will take some adjustment, and this adjustment is difficult.

Senator BYRD. Well, doesn't it get down primarily when we speak about the kind of domestic economy that we want, aren't we saying, what we are really talking about, is having most of our people gainfully employed at very satisfactory wages, are we not?

Mr. VOLCKER. Sure, sure.

Senator BYRD. And I must say that I don't take much encouragement from the trends in the last few years, that we are moving that way.

Mr. VOLCKER. Well, in the end, to all these problems you come down to the productivity and efficiency of the American economy; and if the basic trend there is not satisfactory, our wage scales, real wages in absolute terms, as relative to those abroad are not going to be satisfactory; in every area, whether it is agriculture or manufacturing, you come back to productivity and efficiency.

Senator BYRD. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Secretary, I was just looking at the chart on page 24 of the staff bluebook. I will ask that it appear in the record at this point. On this chart we see that if you look at U.S. exports in manufactures even on an f.o.b. basis, they moved from $12 billion in 1960 to $33 billion in 1972; and then you look at imports on a c.i.f. basis, and they moved from $7 billion up to $40.5 billion, so that caused our trade balance to move from a $5 billion plus to a $7 billion minus.

Now then, you look at what happened to the other countries; for example, look at the EEC, they moved from $23 billion exports in 1960 up to $87.5 billion, a fourfold increase by 1972, and the imports moved from $13 billion up to $63 billion; that gave them an increase in trade surplus from $9 up to $24 billion.

Japan moved their exports from $3.6 billion up to $25.7 billion, and their imports from $1 billion up to $6.7 billion, so they moved from $2.6 billion surplus to a $19 billion surplus.

(The table referred to follows:)

91-578--73----5

TABLE 6.—TRADE IN MANUFACTURES 1960–72

[In billions of dollars]

	United States	EEC Total	EEC Excluding Intra-EEC	Germany	United Kingdom	Japan
Exports, f.o.b:						
1960	12.7	23.1	16.1	10.1	8.4	3.6
1966	19.5	42.0	24.6	18.0	12.3	9.1
1967	21.2	44.9	26.6	19.5	12.1	9.8
1968	24.1	51.6	29.9	22.3	13.0	12.2
1969	27.1	61.2	33.6	26.2	15.0	15.0
1970	29.7	71.6	38.6	30.7	16.3	18.1
1971	30.8	79.5	43.4	35.0	19.0	22.6
1972 [1]	33.4	87.5	46.8	39.6	20.0	25.7
Imports, c.i.f.:						
1960	7.5	13.6	6.6	4.2	4.0	1.0
1966	15.8	28.8	11.6	9.0	6.9	2.1
1967	17.4	29.6	11.7	8.5	7.8	3.1
1968	22.7	34.9	13.6	10.6	9.1	3.5
1969	25.3	44.6	17.2	13.9	9.9	4.4
1970	28.5	53.4	20.7	17.4	11.0	5.6
1971	33.8	57.4	21.8	20.0	12.7	5.5
1972 [1]	40.5	63.1	23.3	23.2	14.8	6.7
Trade balance:						
1960	5.2	9.5	9.5	5.9	4.4	2.6
1966	3.7	13.2	13.0	9.0	5.4	7.0
1967	3.7	15.3	14.9	11.0	4.3	6.7
1968	1.4	16.7	16.3	11.7	3.9	8.7
1969	1.8	16.6	16.4	12.3	5.1	10.6
1970	1.2	18.2	17.9	13.3	5.3	12.5
1971	–3.0	22.1	21.6	15.0	6.3	17.1
1972 [1]	–7.1	24.4	23.5	16.4	5.2	19.0

[1] January-September at annual rate.

Source: U.S. Department of Commerce, "International Economic Indicators," December 1972, p. 14.

The CHAIRMAN. It seems that the trend is for this Nation to be increasingly an importer of manufactures, while the European Common Market, United Kingdom, Japan, and Germany seem to be the big expanders in the export of manufactured commodities. That seems to be the trend, and I would ask you if it is likely that this trend will continue.

Mr. VOLCKER. That is what the trends that we have to change is, and that is what we are trying to change. This trend has gone too far, it has been too deeply ingrained in our behavior and their behavior, and it has got to be changed and that is what we are attempting to change.

The CHAIRMAN. Thank you very much, Mr. Secretary. You have been very responsive to our questions here today, and we appreciate the information you have given us.

Mr. VOLCKER. Thank you.

The CHAIRMAN. Next we will call Mr. John E. Leslie, chairman of the board of Bache & Co., and chairman of the New York Stock Exchange Advisory Committee on International Capital Markets; accompanied by Dr. William Freund. We are pleased to have you here.

JOHN E. LESLIE, CHAIRMAN OF THE NEW YORK STOCK EXCHANGE ADVISORY COMMITTEE ON INTERNATIONAL CAPITAL MARKETS, ACCOMPANIED BY DR. WILLIAM C. FREUND, VICE PRESIDENT, NEW YORK STOCK EXCHANGE

Mr. LESLIE. Good morning, Mr. Chairman. My name is John Leslie and I am chairman of the board of Bache & Co., and chairman of the New York Stock Exchange Advisory Committee on International Capital Markets. With me is the committee's executive secretary, Dr. William C. Freund, who is an exchange vice president and its chief economist.

In recognition of the growing importance of international trade and finance and the critical stake of the United States in this development, the New York Stock Exchange last December established the Advisory Committee on International Capital Markets. The committee members include some of the most distinguished and knowledgeable individuals in the area of capital markets and international finance, as well as prominent men who have served the public at the highest level of Government. In its area of concern, the committee represents probably the best collection of talent available. A list of the members appears in exhibit 1. The work of the committee and the objectives in the field of international finance set forth by the New York Stock Exchange for the committee will require organizing a new International Finance Division at the New York Stock Exchange, which step our committee has recommended.

So far, the committee has devoted its meetings to discussions of the top priority items to be studied. Among them is the interest equalization tax. I am not here to express the views of the committee either collectively or individually. But, all the committee members have independently expressed themselves in favor of phasing out the IET as soon as the international balance of payments and other conditions permit.

Therefore, we were all very heartened by the administration's recent commitment to phase out the IET and other capital controls at the latest by December 1974. This reflects the administration's awareness of the benefits to be realized by loosening governmental controls on international capital flows. But, I do urge this committee to include in the legislation the utmost flexibility to enable the executive branch of the Federal Government to adjust to changing circumstances during this phaseout period. To my mind, the important question regarding the IET is the extent to which it will be responsive to the changing world economic picture, the extent to which the act is flexible enough to allow for various contingencies and to keep pace with fast moving international developments. For this purpose, I have prepared a proposed amendment to H.R. 3577 (exhibit 2), that would give the administration this much needed flexibility in applying the IET.

This proposal does not change the rate of tax, nor does it alter in any way the freedom of the President to determine the tax rate within the bounds delegated to him by Congress. All it does is give the President greater freedom to determine that the tax rate could be different for various countries and for different types of securities subject to the provisions of the tax. Right now, significant and sensitive international negotiations are going on in the Group of Twenty to restructure the world monetary system. If for no other reason, utmost flexibility should be provided in the extension of the IET to permit desirable changes during its remaining life, and also to give U.S. representatives in these negotiations the opportunity to use the IET in their bargaining with other nations to achieve a freer flow of capital worldwide.

The kind of legislative flexibility we propose would allow the IET to be varied by countries, by types of investment and by types of securities. Such flexibility would convert the IET from a relatively blunt tool into a more sensitive instrument, better able to respond to changing international economic conditions.

The need for the most flexible kind of approach has been vividly demonstrated by the currency turmoil of recent weeks. We have seen revaluations of varying degrees among various currencies of the world relative to the U.S. dollar. The ultimate effects of these differential currency realinements cannot be predicted with precision. We do not even know at this point whether the U.S. dollar is intrinsically overvalued today and, if so, by how much, in relation to specific currencies of other countries. Consequently, it makes sense to preserve a high degree of flexibility, especially in this phasing-out period of the IET, and in this period of uncertainty as the world monetary order gropes toward a new period of equilibrium. It is not coincidental that we are recommending a new phase of flexibility in administering the IET at the very time when currency relationships are also displaying a new flexibility in adjusting to balances in international payments.

In considering the phaseout of the tax, consideration will have to be given to the announcement effect of the termination of the tax at the end of 1974. It is reported that Europeans are concerned that there will be an immediate halt of American purchases of foreign securities.

The IET would have to be paid now in full on any purchases of foreign securities, without any prospect of recovery, since American investors will, after the tax expires, be allowed free access to foreign markets. Thus, utmost flexibility in the final administration of the IET appears highly desirable.

As I mentioned earlier, our Advisory Committee on International Capital Markets will be in a position to recommend to the U.S. Government specific steps which might be taken to modify the interest equalization tax within the flexible limits proposed. I can assure you that any such recommendations will be based solely on the best interests of the United States, and will be the result of careful and exhaustive study by some of the best minds in international finance. But the committee can be effective only if sufficient flexibility exists to implement these recommendations.

The need for flexibility is also pointed up by the fact that since the IET is to be phased out, it will probably be necessary to do it in steps, and to monitor their results. As your committee well knows, when the tax was first imposed 10 years ago, it was envisioned as a temporary measure designed to cope with a hopefully temporary problem. The original expectation was that the tax would be permitted to lapse at the original expiration date at the end of 1965. The IET has since been extended four times and its coverage broadened.

Over the long run, U.S. investments in foreign securities are deemed to be beneficial and, indeed, essential to the balance of international payments. Income receipts from past investments not only add to dollar inflows, but they are relatively stable from year to year, in contrast to the sharp fluctuations in trade accounts; U.S. receipts from past indirect investments, I might note, have far outweighed the annual U.S. capital outflows on foreign securities. In 1971, income receipts were $2.5 billion, approximately three times as much as the $900 million net outflow of U.S. capital for foreign securities investment.[1]

There are indications that a decade of the IET may already have contributed to slowing American income from past indirect (portfolio) investments. The rate of growth of income received from indirect investments dropped from 15.3 percent in the 1961–66 period to 9.6 percent during the years 1966–71.

Moreover, I should like to note that the IET has been a major factor, a real major factor, in weakening the U.S. capital markets as the center of international finance, and in the creation of the Eurobond market. Since the introduction of the IET, the growth of the Eurobond market has been spectacular. In 1963, Eurobond flotations totaled $164 million. Eight years later, they had grown to over $3.6 billion. U.S. companies themselves accounted for $1.1 billion of Eurobond issues, compared with zero such flotations in 1963. I think we can agree that the U.S. capital markets are a prime national and also international asset which must be nurtured and encouraged to retain

[1] Some observers have even questioned the short-run benefits of the tax, noting that the IET may have changed only the geographical distribution of foreign bond borrowings in the United States, rather than the total amount. There is some evidence pointing to greater borrowing by Canadian, Japanese, Israeli, and other IET-exempt borrowers since 1968. (See exhibits 3 and 4.)

their worldwide preeminence. Once our position as the premier world capital market has been eroded, it will be difficult to restore its vitality and stature. The result of erosion would be to damage a vital link in the efficient worldwide allocation of resources and in stimulating economic growth. Moreover, it would redound to the detriment of the U.S. long-term balance-of-payments position itself, since capital outflows ultimately come back in the form of repayments, investment, and income.

My purpose here today is to urge that, as this country faces the possibility of significant changes on the international economic scene, and as the administration enters into very delicate and far-reaching international negotiations on a new monetary system, Congress permit utmost flexibility in dealing with changes as promptly as they occur. There should be ample discretion under the act, during the IET phaseout period, to vary the tax by countries to reffect internal interest rate situations and other specific conditions. Its impending repeal notwithstanding, the tax should be flexible enough to accommodate differential treatment by types of investment and by types of securities issued and outstanding. I look forward with satisfaction to the prospect of the IET being phased out, thereby contributing to the strengthening of the U.S. capital markets as the center of world finance.

Thank you.

(The exhibits referred to follow:)

EXHIBIT I. ADVISORY COMMITTEE ON INTERNATIONAL CAPITAL MARKETS

John E. Leslie (Committee Chairman), Chairman of the Board, Bache & Company, 100 Gold Street, New York, N.Y. 10038.

Harry B. Anderson, Senior Vice President-Director, Merrill Lynch, Pierce, Fenner & Smith Inc. Ltd., One Liberty Plaza, 165 Broadway, New York, N.Y. 10006.

George W. Ball, Senior Managing Director, Lehman Brothers, Inc., One William Street, New York, N.Y. 10004.

I. W. Burnham, II, Chairman of the Board, Burnham & Co., Inc., 60 Broad Street, New York, New York 10004.

Henry W. Fowler, Partner, Goldman, Sachs & Co., 55 Broad Street, New York, N.Y. 10004.

Andre Meyer, Partner, Lazard Freres & Co., One Rockefeller Plaza, New York, N.Y. 10019.

Leo Model, Chairman of the Board, Model, Roland & Co., Inc., 120 Broadway, New York, N.Y. 10005.

Frank A. Petito, Chairman, Morgan Stanley & Co., Inc., 140 Broadway, New York, N.Y. 10005.

Robert V. Roosa, Partner, Brothers Harriman & Co., 59 Wall Street, New York. N.Y. 10005.

Nathaniel Samuels, Partner, Kuhn, Loeb & Co., 40 Wall Street, New York, N.Y. 10005.

James J. Needham. NYSE, *ex officio*.

William C. Freund, NYSE, Executive Secretary.

EXHIBIT 2. PROPOSED AMENDMENT TO H.R. 3577, A BILL TO EXTEND AND AMEND THE INTEREST EQUALIZATION TAX

Section 3 of H.R. 3577 is amended by redesignating it as Section 4, and by substituting the following section as Section 3:

"SEC. 3 Modification of Tax. (a) Section 4911(b)(2) is amended to read as follows:

"'(2) MODIFICATION OF TAX BY EXECUTIVE ORDER.—

"'(A) IN GENERAL.—If the President of the United States determines that the rates of tax imposing under this section are lower or higher than is necessary to achieve the balance of payments objectives or international economic policies and objectives of the United States, he may by Executive order (effective as provided in subparagraph (D) (ii) increase or decrease the rates of tax on the acquisition of stock or debt obligations specified in such order or exempt such acquisitions from tax. In his discretion the President may increase or decrease rates with respect to any classification of stock or debt ogl'gations set forth in subparagraph (B). By subsequent Executive order the President may terminate or modify any Executive order previously issued under this paragraph.

"'(B) CLASSIFICATIONS.—For purposes of subparagraph (A)—

"'(i) Stock may be classed according to type of stock, category of issuer, category of stockholder, country of issuer, whether or not an original or new issue, purpose of the offering, aggregate amounts exempt from tax, or any other criteria similar to any of the foregoing.

"'(ii) Debt obligations may be classed according to type of debt obligation, category of obligor, category of obligee, country of obligor, period running to maturity, purpose of the offering, aggregate amounts subject to tax or not subject to tax, or any other criteria similar to any of the foregoing.'

"(b) Section 4911 (b)(2)(B) and (b)(2)(C) are redesignated as (b)(2)C) and (b)(2)(D), respectively.

"(c) Section 4911(b)(2)(D)(i) is amended to read:

"'(i) Except as to those particular classes of stock or debt obligations exempted from tax or made subject to tax at a lower rate by an Executive order issued pursuant to subparagraph (A), each increase and each decrease in the rates of tax of general application which is prescribed in an Executive order issued under subparagraph (A) shall provide for the same proportionate increase or decrease in each rate of tax, except that any such rate may be rounded to the nearest 0.01 percent.'"

EXHIBIT 3

BALANCE OF PAYMENTS IN STOCK AND BOND TRANSACTIONS

[Millions of dollars]

Year	Net dollar flows attributable to transactions in—						
	U.S. stock by foreigners	Foreign stock in the United States	U.S. corporate bonds by foreigners	Foreign bonds in United States	Net stock balance	Net bond balance	Overall net balance
1958	-$56	-$336	$17	-$1,026	-$392	-$1,009	-$1,401
1959	363	-238	73	-512	125	-439	-314
1960	202	-83	50	-562	119	-512	-393
1961	323	-370	-99	-460	-47	-559	-606
1962	111	-104	-51	-944	7	-995	-988
1963	198	51	9	-1,095	249	-1,086	-837
1964	-349	200	176	-928	-149	-752	-901
1965	-413	290	38	-1,242	-123	-1,204	-1,327
1966	-333	229	1,011	-914	-104	97	-7
1967	757	-157	313	-1,163	600	-850	-250
1968	2,270	-314	1,964	-1,380	1,956	584	2,540
1969	1,487	-517	1,202	-1,029	970	173	1,143
1970	626	35	956	-951	661	5	666
1971	731	-49	684	-888	682	-204	478
1972 (January–November)	1,927	362	1,510	-796	2,289	714	3,003

[1] Negative sign indicates net purchases by Americans.

Source: U.S. Treasury Bulletin, January 1973.

GROSS SALES OF FOREIGN BONDS IN THE UNITED STATES

[In millions of dollars]

	1963	1965	1968	1969	1970	1971
Switzerland	$74	$91	$269	$229	$186	$115
United Kingdom	87	130	224	194	155	245
Other Europe	329	331	313	269	255	242
Total Europe	490	552	806	692	596	602
Canada	968	1,103	1,284	1,283	1,130	1,040
Latin America	101	138	433	145	136	162
Israel	70	93	179	176	192	239
Japan	143	65	6	17	6	25
Other Asia	13	66	84	65	18	43
Total Asia	226	224	269	258	216	307
Total Africa	37	7	77	9	4	9
Total other		88	14	10	0	4
Total foreign countries	1,821	2,111	2,883	2,398	2,081	2,123
Canadian share	53	52	45	54	54	49

Source: U.S. Treasury bulletin, December 1972.

Senator GRAVEL (presiding). Thank you very much, Mr. Leslie. Do you have any questions, Senator Hansen?

Senator HANSEN. Mr. Leslie, do you think some of the countries which have previously been exempt from this tax should now be included? For example, your table No. 3, shows that 49 percent of the foreign bonds sold in the United States are Canadian bonds and you comment that perhaps this tax rather than preventing the outflow of U.S. money through the purchase of foreign obligations has simply prompted the redistribution of those purchases toward countries not covered by the IET.

Are you perhaps also suggesting that foreign governments might be using the Canadian market in an effort to circumvent this tax?

Mr. LESLIE. Senator, I have noticed this statement, and it is quite obvious that the share and the portion of Canadian figures in the total is very large. I do feel—and I do not know whether I am right or wrong—that this probably entails some broad political issues which are probably beyond my area of expertise.

Senator HANSEN. How competitive are European bond and dollar markets? It is my understanding that the interest equalization tax was first adopted so that European markets could develop and become competitive with U.S. markets. Yet, is it not true that the average long-term yields on U.S. debt issues are still significantly lower than the yields on foreign issues? Have the foreign markets become competitive? Why or why not?

I realize I have asked you a series of questions and comment in a general way if you would like.

Mr. LESLIE. This is a very pertinent question—no doubt about it. We have here, in the background material which we accumulated and prepared for this presentation, of domestic corporate bond yield differentials between the United States and selected IET countries

Now, Dr. Freund, who is the economist, will want to take over and give you his figures. We have them right here.

Dr. FREUND. Senator Hansen, the reason why we recommend that there be increased flexibility is that there is not a worldwide pattern. It varies. The rate differential between yields in the United States and bond yields vary by countries and, as you quite correctly pointed out, the IET was first imposed to eliminate these yield differentials. But we find, for example, in November of 1972, that in the United Kingdom, rates were lower than in the United States by a very substantial margin. I would be glad to submit this table for the record.

Senator HANSEN. That would be fine.

(The table referred to follows:)

DOMESTIC CORPORATE BOND YIELD DIFFERENTIALS BETWEEN THE UNITED STATES AND SELECTED IET COUNTRIES [1]

[In percent]

Year	Japan	United Kingdom	France	Germany	Italy	Netherlands	Switzerland	United States actual
1967	+1.83	+1.23	+0.78	+0.21	+0.41	-0.03	-1.63	6.75
1968	+1.62	+2.12	+.72	-.61	+.08	-.06	-1.91	7.04
1969	+.12	+1.75	-.24	-1.35	-.44	-.41	-3.37	8.95
1970	+1.30	+2.94	+.93	-.13	+1.84	-.02	-1.81	7.90
1971	+.08	+1.89	+1.39	+.29	+1.16	+.61	-1.88	7.30
1972 (November)	-.70	+2.97	+.77	+1.44	+1.29	+.20	-1.84	7.33

[1] Yields at or near the end of December.

Source: Morgan Guaranty Trust, "World Financial Markets," December 1972.

Dr. FREUND. We find that is true in France, Germany, Italy, and the Netherlands. We find quite a different pattern with respect to Japan and Switzerland. So that one reason for recommending flexibility in the legislation is that the President can indeed focus on specific countries and achieve the purpose of the act, which is to eliminate interest differentials.

Senator HANSEN. The short-term purpose of the IET is to keep U.S. money from going abroad but, in the long run, the amount the investor was paid out was interest returns to the United States. Are we not then stifling investments for the present balance-of-payments problem without giving due consideration to the longrun ramifications of this tax?

Mr. LESLIE. Senator Hansen, I listened to the prior presentation here this morning. And I recall a discussion I had in New York with some people in the world of finance. There is no question that obviously one day we are going to have a large deficit, resulting from the oil, and so forth. It is on everyone's mind, and the opinion has been voiced that one way—not entirely, but one way—to cope with the situation is if we export capital. And if we do, it is a fact that the amounts will be much larger than the original investment abroad. So, therefore, this would be one way—of course, many ways will have to be found—but this is one way how the gap may be narrowed down. That is one consideration.

I pointed out, as Dr. Freund says, there are already indications that the decade of the tax has contributed to slowing American income from past indirect investments. I repeat what I said in my statement a few minutes ago, that the rate of growth of income received from such investments has declined from 15.3 to 9.6 percent. This is an important consideration, no question about it.

Senator HANSEN. When I recall the experience some of our companies have had in investments, and I realize we are not speaking of quite the same thing, but some of our companies that have invested in operations around the world, Chile and Peru, to mention two, are there not some risks involved attendant in our investment, and I am thinking of——

Mr. LESLIE. Unquestionably.

Senator HANSEN (continuing). Expropriation of American property, and so forth?

Mr. LESLIE. Yes, there is no question. On the one hand, we all have witnessed that international investments bear certain risks, which are quite obvious. On the other hand, foreign countries increasingly invest in the United States. And that is a two-way proposition.

Senator HANSEN. Thank you, Mr. Chairman.

Senator GRAVEL. Thank you, Senator Hansen.

Mr. Leslie, your points are very well taken, and they will be considered in executive session of the committee with respect to the item of flexibility. Thank you very much for your presentation.

Mr. LESLIE. Thank you very much.

Dr. FREUND. Thank you.

Senator GRAVEL. Our next witness is the vice president of Syntex Corp., Mr. Kenneth Davis.

Mr. Davis, the floor is yours. Would you please introduce your colleague and then proceed?

STATEMENT OF KENNETH N. DAVIS, JR., VICE PRESIDENT, FINANCE, SYNTEX CORP., ACCOMPANIED BY WILLIAM H. BRAYER, JR., ATTORNEY

Mr. DAVIS. Thank you.

I have with me Mr. William Brayer, our general counsel, of the firm of Holtzmann, Wise & Shepard, and I will be very brief as I know you are, of course, at the end of your session this morning. I have here a request for technical amendment to interest equalization tax extension bill to continue exemption for employee stock option plans of foreign corporations such as Syntex, which are not treated as foreign issuers under existing legislation.

Syntex had its origin in Mexico as one of the early discoverers of steroid hormone pharmaceuticals. Syntex Corp., the parent corporation of the Syntex group, was incorporated in Panama in 1957. As such, we are an international company incorporated outside the United States but whose capital stock is held in the large majority by U.S. residents and has its principal market on a U.S. national stock exchange registered with the SEC. Syntex's capital stock is traded on the American Stock Exchange and well over 90 percent of the shares outstanding are owned by U.S. persons. Under the existing Interest Equalization Tax Act, dating back to 1965, provisions have been included to give the same tax treatment to stock options granted to employees of such corporations as is given to U.S. corporations.

The report of the Committee on Ways and Means accompanying the Interest Equalization Tax Extension Act of 1965 specified that shares isued by such corporations pursuant to exercise of qualified

stock options which were granted under a qualified stock option plan in existence before November 10, 1964, were exempt from the tax.

However, under basic U.S. stock option tax law—completely apart from any interest equalization tax considerations—qualified stock option plans can only run for a 10-year period before being resubmitted for stockholders' approval. Thus, the combination of the interest equalization tax, November 1964 base date, and the 10-year maximum life for qualified stock option plans means that companies such as Syntex would be unable to grant stock options free of interest equalization tax consequences after 1974—in Syntex's case, April 16, 1974, 10 years from the date its current plan was adopted, unless a specific amendment is included in this year's extension.

From Syntex's standpoint, it has been extremely valuable in building a successful business to be able to offer the same employee incentives as are offered by its competitors. In order to attract and retain highly skilled technical and management personnel required in research, production, and sales programs, Syntex has found it necessary and desirable to offer its employees the benefits of a stock option plan.

From the standpoint of the U.S. public and the country as a whole, we believe the results have been beneficial as well. Syntex is best known for its work in the field of steroid hormones. The steroid hormone field has become one of the most rapidly growing areas for new drug development, and such products have been developed by Syntex for treatment of arthritis, rheumatism, skin disease, bronchial asthma and for birth control. In addition to the medical advances made possible by the successful growth of our business, we have also contributed in a modest way to the American economy. Syntex's operations in the United States began in the late 1950's. These operations have grown from virtually nothing in 1956 to a very sizable U.S. business today. Syntex now employs 2,300 people in the United States and has an investment in plant and equipment exceeding $60 million in this country.

It is clear that Syntex's business has benefitted by being able to compete on even terms with other high technology companies in offering incentive programs to key personnel. We respectively urge the Senate Finance Committee to provide for continuation of the existing interest equalization tax treatment for employee stock option plans as one of the most important of these incentive programs.

A more detailed technical discussion of the proposed legislation is attached for the record.

We thank you for this opportunity in presenting our statement to the committee and we will be glad to respond to any questions you may like to ask.

(The attachments referred to follow:)

MEMORANDUM SUBMITTED ON BEHALF OF SYNTEX CORP., BY HOLTZMANN, WISE & SHEPARD

I. INTRODUCTION

This memorandum is submitted on behalf of Syntex Corporation, a Panamanian corporation, engaged in the manufacture and sale throughout the world of pharmaceutical products, animal health products and medical instruments. The purpose of the memorandum is to request an amendment to the Interest Equalization Tax Act to provide relief from certain serious problems which would arise upon exercise of qualified stock options granted by Syntex after April 15, 1974.

II. BACKGROUND

Section 4920(b)(2) Interest Equalization Tax Act provides, in part, that a foreign corporation shall not be considered a foreign issuer subject to the Interest Equalization Tax with respect to a class of its stock ("exempt class") if the exempt class had its principal market during 1962 on a national securities exchange registered with the SEC, and, as of its latest record date before July 19, 1963, more than 50% of such exempt class was held of record by U.S. persons. The exempt class is defined as all shares issued and outstanding as of the corporation's latest record date before July 19, 1963, which were identical with respect to rights and interest in control, profits and assets of the corporation, and further included:

(1) all shares of exempt class issued on or before November 10, 1964;

(2) all shares of the exempt class issued after November 10, 1964, pursuant to a written commitment made by the issuing corporation prior to such date;

(3) all shares of the exempt class issued in certain reorganizations and recapitalizations.

The report of the Committee on Ways and Means to accompany H.R. 4750, Interest Equalization Tax Extension Act of 1965 (Report No. 602) clearly indicates that shares issued pursuant to exercise of qualified stock options which were granted under a qualified stock option plan in existence before November 10, 1964 were part of the exempt class under the preexisting written commitment rule:

"Shares issued after November 10, 1964 to employees of a foreign corporation pursuant to stock option plans in existence on or before that date would be treated as part of an exempt class of stock under this provision if such shares are identical with shares of an exempt class of stock, whether or not such employees were employed by the issuing corporation until after November 10, 1964, and whether or not the corporation was required to authorize the issuance of additional shares after that date in order to meet its obligations under the plan."

Thus, Syntex employees have been able to exercise all qualified stock options granted under its qualified stock option plan adopted April 16, 1964, without payment of the Interest Equalization Tax.

III. PROBLEM

Section 422 (b)(2) provides that a qualified stock option must be granted within 10 years from the date when the plan is adopted, or approved by shareholders, whichever is earlier. Since the Syntex Corporation Qualified Stock Option Plan was adopted on April 16, 1964, no options can be granted under such plan after April 15, 1974. In order to continue to utilize the qualified stock option as a vehicle for employee compensation, after April 15, 1974, Syntex Corporation must adopt a new Qualified Stock Option Plan. Shares issued pursuant to the exercise of options granted under such new plan apparently would not be part of the exempt class, since they would not be issued pursuant to a pre-existing written commitment of the issuing corporation, i.e., a qualified stock option plan in effect prior to November 10, 1964.

In the case of stock received upon exercise of qualified options granted after April 15, 1974, or issued and delivered pursuant to non-qualified plans, not only would Interest Equalization Tax be payable, but the resulting stock would not be part of the exempt class, a fact which gives rise to even more serious problems.

The Internal Revenue Service has taken the position that stock of a corporation claiming exemption under Section 4920(b), and not exempt pursuant to any exceptions to the November 10, 1964 cut-off date, must be readily distinguishable from stock which has the benefit of the exemption. The American Stock Exchange has advised that such non-exempt stock cannot be traded on the Exchange in the same market as the exempt stock. Since the number of shares of such non-exempt stock would be relatively small, a separate market could not be created on the Exchange and such share would have to be traded over the counter.

IV. RELIEF REQUESTED

We recommend that Section 4920(b), IETA, be amended to include within the exempt class all shares issued pursuant to exercise of qualified stock op-

tions, or pursuant to other arrangements to issue such stock as compensation to employees. Such amendment might be achieved by inserting after "4917" in Section 4920(b)(2)(D)(iv), the following:

"* * * or are shares issued upon exercise of an option described in Section 4914(a)(8) (determined without regard to whether or not the optionee is a United States person) granted to an employee who immediately after such option is granted is an individual described in Section 422(b)(7), provided that the aggregate number of shares of such class subject to all options described in Section 4914(a)(8) (determined without regard to whether or not the optionee is a United States person) granted during any one calendar year does not exceed one percent of the total number of outstanding shares of such class on the first day of such calendar year, such numbers to be adjusted to reflect recapitalization and stock dividends during such year."

We have been advised that the text of this amendment has been discussed with the staff of the Joint Committee on Internal Revenue Taxation. A representative of Syntex Corporation will be available at the hearing of the Senate Finance Committee to answer questions on this matter.

Senator GRAVEL. Thank you very much, sir. Your problem seems to have great merit, and I am sure the committee in executive session will take it up and will likely see if an exception does really exist. I understand you were in Zurich at the time of the panic, if we might call it that.

Mr. DAVIS. Yes; I was a treasurer of an international company and international vice president, and it does require being out in the money markets at times, and I was there 2 days after the Swiss floated the Swiss franc.

Senator GRAVEL. Would you give us your perceptions as briefly as as possible?

Mr. DAVIS. Well, it was interesting in that it supports a lot of what we heard earlier this morning about how much surprise there has been about this recent crisis because at that time, the top Swiss bankers told me that this would be a temporary flurry and within 3 to 4 days we would see restoration of the former Swiss arrangements as far as exchange, free exchange, rather than floating. They thought this was a temporary thing, and here they were at the very seat of knowledge at the international monetary market, and they could not see coming what happened in the next 2 weeks, this whole massive flood of dollars that went from Switzerland then into the mark, and everything since then. So what it said to me was that the seriousness of the situation of this massive overseas fund of dollars that can attack a currency, has now reached a point where even the most expert international bangers do not know when it is going to come.

Senator GRAVEL. Thank you, Senator Hansen, do you have anything you would like to address to Mr. Davis?

Senator HANSEN. How would the adoption of your amendment benefit U.S. stockholders and help the U.S. economy in general?

Mr. DAVIS. I think we can only say indirectly to the extent that being able to offer incentive programs of this kind has become a key part of building a business. It is very hard for me to say we could not have built our company if we could not have been able to do this, but what we do know is we compete with some other very capable high technology companies who are attempting to attract the same people we are able to. We have been able to get them, get our share, by having this kind of a plan; and as we look at this extension of the legislation that was coming up and realized that now in combination with the 10-year maximum plan limit allowed under the stock option law, that we

were no longer going to be able to have the incentives we have had in the past, and we became very much concerned, and in our management discussions about how serious it was, and whether we should bring the problem to Washington, and so on, we felt it was serious enough to ask for your help.

Senator HANSEN. Would you explain what effect your amendment would have on U.S. revenues? For example, would there be any loss to the Treasury in tax revenues as a result of the adoption of your proposed amendment?

Mr. DAVIS Well, first of all, as a continuation of what has been going on already, there would be no change in that sense. If you looked at this as a possible source of additional tax revenue by eliminating what has been available in the past, it would only bear on foreign employees who were given these stock options, who ultimately sold the stock and had, therefore, a small drain resulting from it. In our case, it is maybe a third of the people who have options are foreign residents, it may be 60 or 70 people, something like that, so it would be very minimal and very long term if there were anything at all.

Senator HANSEN. No further questions.

Senator GRAVEL. How many companies would have the same situation?

Mr. DAVIS. There are not very many, Mr. Chairman, companies that are in this peculiar situation of being foreign based but largely owned in the United States. I really do not know what the number is. I do know that only three or four companies have expressed an interest to the committee on this problem, so there cannot be too many.

Senator GRAVEL. Do you have the names of those companies, or could you secure them for the record?

Mr. DAVIS. I know of two that we know of.

Senator GRAVEL. We have them.

Mr. DAVIS. OK.

Senator GRAVEL. Thank you very much.

Mr. DAVIS. Thank you very much for your time.

Senator GRAVEL. I understand there is a Mr. Paul Butler, Jr., from the law firm of Shearman & Sterling, and that he is representing Schlumberger Ltd., and would like to give us some testimony. We would be happy to hear him.

STATEMENT OF PAUL M. BUTLER, JR., ATTORNEY FOR SCHLUMBERGER LTD.*

Mr. BUTLER. Mr. Gravel and Mr. Hansen. I am here today representing Schlumberger Ltd. On behalf of Schlumberger, we have submitted a statement requesting amendments that would permit Schlumberger to issue new shares upon exercise of employee stock options and in connection with foreign acquisitions. In our statement we have explained the problem and the solutions which we have proposed. I would like to point out why this is important not only to Schlumberger and its shareholders, but also to the United States.

We have heard much testimony this morning relating to jobs in the United States and the exporting of jobs. We have also heard a great deal about the energy crisis.

*The witness is registered with the Department of Justice under the Foreign Agents Registration Act of 1938. Copies of the registration statement are available for public inspection in the Department of Justice files.

With respect to jobs, Schlumberger certainly has bucked the trend. It is a foreign corporation which over the past 20 years has moved its principal office to the United States. It is engaged in trade or business in the United States, and it pays taxes here. It has gone from no employees in the United States to a point where today it employs over 8,500 Americans. The restrictions in the Interest Equalization Tax Act which have not permitted Schlumberger to issue new shares for stock options or for foreign acquisitions have required the company to go out in the open market with funds generated in its business and buy shares to cover its option program and for foreign acquisitions. This has kept the company from using these funds for research and development and expansion which would have provided additional jobs in the United States and thereby benefited the U.S. labor market.

We have heard about the energy crisis this morning. Schlumberger provides services to the drillers of oil and gas wells. As we all know, today you cannot walk out in Texas, or in Alaska, or in Wyoming, or anywhere else in the United States and drive a sharp stick in the ground and strike oil. The easy oil has been found. It is now very difficult to find and produce the oil that remains here.

Schlumberger has developed high-technology devices which enable producers of oil and gas to determine where to drill their wells, and once they have drilled where the commercially productive zones are and where they should drill their next wells. To the extent that Schlumberger is successful in producing better equipment and developing better technology, the cost of producing this oil and gas will be cheaper. We are all interested in this saving and in it being passed on to the consumer. We are also interested in the United States being able to produce its oil and gas in the United States.

That is the extent of my remarks as to why this is so important to Schlumberger, to its shareholders, and to the United States.

(The full statement of Mr. Butler follows:)

STATEMENT ON BEHALF OF SCHLUMBERGER LIMITED

On behalf of Schlumberger Limited ("Schlumberger"), we respectfully request consideration by your committee of certain proposed amendments to the Interest Equalization Tax Act. In that connection, we are filing this statement for inclusion in the record of your committee's hearings on H.R. 3577, the Interest Equalization Tax Extension Act of 1973.

DEAR MR. CHAIRMAN: On behalf of Schlumberger Limited ("Schlumberger"), we respectfully request consideration by your committee of certain proposed amendments to the Interest Equalization Tax Act. In that connection, we are filing this statement for inclusion in the record of your committee's hearings on H.R. 3577, the Interest Equalization Tax Extension Act of 1973.

Under present provisions of the Interest Equalization Tax Act, a foreign corporation is treated as a domestic corporation with respect to a class of its stock which was predominantly owned by United States persons just prior to the 1963 effective date for such Act. However, this treatment only applies to shares issued and outstanding on November 10, 1964, and to shares issued after such date under extremely limited conditions. Additional shares issued upon exercise of employee stock options are not included as "domestic" shares. Similarly, additional shares issued in connection with the acquisition of a foreign business are not included as domestic shares, although additional shares issued in connection with the acquisition of a domestic business would be included.

As is also true of most corporations, Schlumberger is required to provide stock options in order to attract and retain top-flight executive personnel and to be able to use its stock in making acquisitions, both domestic and foreign. However, as a foreign corporation which is treated as a domestic corporation with respect

to its class of common stock, Schlumberger is not permitted to issue new shares upon exercise of employee stock options or in connection with foreign acquisitions. Schlumberger believes that the ability to issue additional shares for these purposes is important for the continued growth of its business and therefore would be of direct benefit to its shareholders who are predominantly United States persons.

It is proposed that a foreign corporation which is treated as a domestic corporation with respect to a class of its stock be permitted to issue additional shares of such class upon exercise of stock options subject to the following limitations: (a) the options must be non-transferable options granted to an employee in connection with his employment, the options may not be transferable otherwise than by will or the laws of descent and distribution, and the options may be exercisable during the lifetime of the employee only by him; (b) the employee may not own 5% or more of the total combined voting power of all classes of stock of the issuer; and (c) the number of shares subject to all such options granted during any one calendar year may not exceed 1% of the total number of outstanding shares on the first day of such year.

With respect to shares issued in connection with foreign acquisitions, it is proposed that the foreign corporation be permitted to issue additional shares subject to the following limitations: (a) the additional shares must be issued in connection with the acquisition of stock or assets of a foreign corporation; (b) the issuer must meet the present requirements for the issuance of additional shares; (c) the issuer must be a large, publicly-traded corporation and must have certain contacts with the United States; and (d) the aggregate number of additional shares issued may not exceed a cumulative 1% per year.

Attached hereto are proposed amendments which will permit the issuance of additional shares in these instances. We have discussed these amendments with the staff of your committee and with the staff of the Joint Committee on Internal Revenue Taxation. The undersigned will be available at the hearings to answer any questions which the committee may have with respect to these amendments.

Very truly yours,

PAUL M. BUTLER, Jr.

PROPOSED AMENDMENTS TO THE INTEREST EQUALIZATION TAX ACT TO PERMIT A CORPORATION DESCRIBED IN SECTION 4920(b) TO ISSUE ADDITIONAL SHARES UPON EXERCISE OF EMPLOYEE STOCK OPTIONS AND IN CONNECTION WITH FOREIGN ACQUISITIONS

With respect to the issuance of additional shares upon exercise of employee stock options, it is proposed that section 4920(b)(2)(D)(iv) be amended by inserting after "4917," the following:

"* * * or are shares issued upon exercise of an option described in section 4914(a)(8) (determined without regard to whether or not the optionee is a United States person) granted to an employee who immediately after such option is granted is an individual described in section 422(b)(7), provided that the aggregate number of shares of such class subject to all options described in section 4914(a)(8) (determined without regard to whether or not the optionee is a United States person) that are granted during any one calendar year does not exceed one percent of the total number of outstanding shares of such class on the first day of such calendar year, such number to be adjusted to reflect recapitalizations and stock dividends during such year,"

Options described in section 4914(a)(8) are non-transferable options granted to employees in connection with their employment. For purposes of the proposed amendment, the reference to options described in section 4914(a)(8) may be construed to mean only options granted to United States persons. Since a foreign corporation will normally have some employees who are not United States persons as well as employees who are United States persons, a parenthetical has been added to provide that the options referred to include options granted to non-United States persons as well as to United States persons. The requirement that the employees must be individuals described in section 422(b)(7) (i.e., individuals who own less than 5% of the stock of the corporation) is to prevent the benefits of the amendment from applying to options granted to an owner-employee whose options may not have been granted in connection with bona fide employment but rather in connection with his position as an owner. Lastly, the 1% per year limitation on the options which may be granted will prevent a foreign corporation from abusing the benefits of this amendment.

With respect to the issuance of additional shares in connection with foreign acquisitions, it is proposed that the following new section 4920(b)(2)(E) be added:

"(E) issued after [the date of enactment] as consideration for, or upon conversion (or in connection with the prior conversion) of debt obligations which were the consideration for, the acquisition of stock of a foreign corporation, if immediately after such acquisition such corporation owns (directly or indirectly) more than 50 percent of the total combined voting power of all classes of stock of such foreign corporation, or the acquisition of more than 50 percent (in value) of the assets of a foreign corporation, provided that the foreign corporation was engaged in the active conduct of a trade or business (other than as a dealer in securities) immediately before the date of such acquisition, if—

"(i) such corporation satisfied the requirements of sections 4920(b)(2)-(D)(i), (ii) and (iii);

"(ii) shares of such class were held of record by more than 5,000 persons on such corporation's latest record date before January 1, 1973;

"(iii) on January 1, 1973, shares of such class were listed for trading on one or more national securities exchanges registered with the Securities and Exchange Commission;

"(iv) such corporation had its principal office in the United States on January 1, 1973, and maintains its principal office in the United States at the time of issuance of the additional shares;

"(v) such corporation was engaged in trade or business in the United States on January 1, 1973, and is engaged in trade or business in the United States at the time of issuance of the additional shares; and

"(vi) the aggregate number of additional shares (other than additional shares issued under (B), (C) or (D) of this subsection) issued during any five-year period (beginning on January 1, 1973) does not exceed five percent of the total number of outstanding shares of such class on the first day of such five-year period, such number to be adjusted to reflect recapitalizations and stock dividends during such period."

This amendment will permit the issuance of shares as consideration for the acquisition of stock of a foreign corporation if immediately after such acquisition the issuer owns more than 50% of the total combined voting power of all classes of stock of the acquired corporation. Shares may also be issued as consideration for the acquisition of more than 50% of the assets of a foreign corporation. Since it has become quite common for acquisitions to be effected by using convertible debt obligations as consideration, it is further provided that shares may be issued upon conversion of debt obligations, or in connection with the prior conversion of debt obligations (such as to repay a loan of exempt shares used to convert such debt obligations), which were the consideration for the acquisition of stock or assets. In any case, the acquired corporation must have been engaged in the active conduct of a trade or business (other than as a dealer in securities) immediately before the date of the acquisition. This latter restriction will prevent the acquisition of a foreign corporation which has made portfolio investments. It will also be necessary for the issuer to meet the existing requirements for the issuance of additional shares, e.g., such corporation must have been actively engaged in a trade or business on July 19, 1963, shares of the class of stock must have been held of record by more than 250 shareholders prior to July 19, 1963, and prior to the issuance of additional shares the percentage of shares of such class held of record by United States persons must not be less than the minimum requirements for qualification under section 4920(b). The additional requirements are included to prevent an issuer without sufficient contacts with the United States from qualifying for the benefits of the amendment. Lastly, restricting the number of additional shares to a cumulative 1% per year will prevent an issuer from abusing the privilege of issuing additional shares in connection with foreign acquisitions.

Senator GRAVEL. I think your comments are a very good addition to Mr. Davis'.

Senator Hansen, did you have any questions?

Senator HANSEN. I might ask him similar questions as were asked of Mr. Davis. What effect would this amendment have on U.S. revenues?

Mr. BUTLER. As is the case with Syntex, Schlumberger is not issuing new shares to employees who exercised stock options. Therefore, no tax is being paid. Schlumberger is buying outstanding shares in the open market and using those shares when options are exercised.

The proposed amendment would have the same effect; no tax would be paid on the issuance of additional shares. However, I would note

that the Interest Equalization Tax Act is not a revenue act. It is a control measure regulating the exporting of capital. I think that it should be pointed out, in this connection, that over the past 5 years, Schlumberger has made a net contribution of more than $250 million to the balance of payments of the United States. This is not a deficit. This is a plus. Schlumberger's U.S. subsidiaries export high-technology devices used in providing well services to oil and gas producers. Schlumberger's foreign subsidiaries buy equipment in the United States for use around the world. Schlumberger pays dividends to its U.S. shareholders. The net effect is a positive contribution of more than $250 million over just the last 5 years, and it will grow in the next several years, certainly during 1973 and 1974 while the interest equalization tax remains in effect. However, as in the case with Syntex, there could be some slight outflow. If a U.S. employee purchases shares under the option program, the money goes to Schlumberger. It would be available for use outside the United States, but as is evident from the figures for Schlumberger's postiive contribution to the U.S. balance of payments, it can be attributed to U.S. investment. We are talking about a small stock option program as total program for Schlumberger of less than $10 million a year, compared to an average of over $50 million a year positive effect on the U.S. balance of payments.

Senator HANSEN. Thinking about our energy production in North America, and in the free world, would it be your contension that schlumberger's activities help in this total search for energy and, as a consequence, its success redounds to the benefit, not only of Japan and the Western European countries, but to the United States as well in that, as those of sources of supply are augmented in other parts of the world, the competition is not as severe as would otherwise be the case between other countries and the United States?

Mr. BUTLER. Mr. Hansen, I think that there is no question that the success of Schlumberger will benefit all of the oil-consuming and energy-consuming countries of the world. Schlumberger is the largest supplier of these well services. Schlumberger provides these well services everywhere that oil and gas wells are drilled throughout the free world. They hope some day to be able to provide these well services in Russia and China.

Senator HANSEN. Thank you, Mr. Chairman.

Senator GRAVEL. Let me just ask one question here. Does Schlumberger meet today's test for the percent of stock held domestically needed in order for its stock to be exempted from IET?

Mr. BUTLER. Yes; more than 70 percent of the stock of Schlumberger is owned by U.S. persons, so they do continue to meet the test.

Mr. Hansen asked the Secretary this morning as to Treasury's feelings with respect to these amendments, and Treasury indicated that they would not be opposed, provided restrictions are placed upon the issuance of additional shares. We have developed restrictions which include this test—that before the issuance of any more shares, the company would have to continue to meet the 65 or 50 percent ownership requirement so that it would still be a predominantly U.S.-owned company.

Senator GRAVEL. Thank you very much.

Mr. BUTLER. Thank you.

Senator GRAVEL. The hearings will be adjourned.

(Whereupon, at 1:00 o'clock p.m., the hearings were adjourned.)

APPENDIX

Communications Received by the Committee Expressing an Interest in the Subject of the Interest Equalization Tax

Statement of Hon. John V. Tunney, a U.S. Senator from the State of California

I am submitting this statement to the Senate Finance Committee in view of my interest in the film industry of the United States. In 1971, Congress made clear that for the future at least motion picture films are to be considered as tangible personal property which, therefore, may qualify for the investment tax credit. However, the investment credit is generally not available for property which is used predominately outside of the United States and motion picture films are often circulated both in the United States and in foreign countries at the same time. In these cases, in some years more revenues are obtained from the foreign showing than in the United States. This and other problems with the application of the investment credit in the case of motion picture films have created difficulties in determining in what cases the investment credit should be available for motion picture productions.

One basic purpose of the investment credit is to create jobs in the United States. In the case of motion pictures, if the majority of the production expenses are paid for direct labor costs incurred in the United States, it would be desirable, in my judgment, to allow the credit even if the film is later exhibited primarily outside of the United States. On the other hand, if the major portion of the direct labor costs are incurred for services which are not performed in the United States, the credit should not be allowed because the film is not creating United States jobs to any substantial extent. Thus, under these circumstances, there should be no credit, even if the film is exhibited primarily in the United States.

I believe a motion picture film or tape should be eligible for the investment credit only in those cases where 60 percent or more of the total amount paid for direct labor costs incurred in the production of the particular picture are paid to American nationals who perform services within the United States. The investment credit claimed for a motion picture film or tape to which this proposal would apply would not be altered in any manner in a subsequent taxable year by reason of the showing of the film outside of the United States. Similar exceptions have been created by Congress in the past for property such as airplanes or railroad rolling stock which is used both within and outside the United States.

There has also been difficulty in determining the useful life of motion picture films since this involves a forecast of the success of a motion picture. Because of the difficulty and uncertainty in determining the years of useful life of a motion picture. I suggest that an election be made available under which motion picture productions which qualify for the credit would receive two-thirds of the investment credit (which assumes a useful life of 5 years) without regard to the useful life of the film. However, depreciation as described in the Committee Report accompanying the 1971 Revenue Act, on the film would also have to be taken over the same period for the credit to be available.

For purposes of this amendment, amounts paid for services performed in the production of a motion picture film or tape should include amounts paid for services to writers for their services in connection with the development of the story property, screen play or television play and also amounts paid for travel, lodging and other comparable expenses regardless of to whom paid (even though paid to a foreign carrier) so long as the travel, lodging or other comparable expense is for services performed within the United States.

Statement of James W. Riddell on Behalf of Beneficial Corp.

Mr. Chairman, the Beneficial Corporation is a publicly-owned corporation which invests in and makes loans to its subsidiary corporations. Beneficial International Corporation ("International") is a wholly-owned subsidiary of Beneficial Corporation. International, which is a United States corporation, borrows funds abroad (Eurodollars or foreign currency) with the guaranty of its parent, Beneficial Corporation, and in turn lends them to certain affiliates engaged in the finance business in Great Britain and Australia.

Because of certain requirements of the Federal Reserve Bank, all of the capital and earnings and profits of International must be retained in and invested in the United States, and because of certain Internal Revenue Service requirements, International must maintain a five-to-one debt-to-equity ratio. Both International

and Beneficial are prohibited by the Guidelines of the Federal Reserve Bank from investing additional United States source funds in Beneficial's Australian subsidiary and would like to borrow funds abroad to make such an investment. However, since International must maintain approximately 16½% in capital and/or in taxable earnings and profits invested in the United States in order to maintain the five-to-one debt-to-equity ratio required by the Internal Revenue Service, the word "primarily" as used in Section 4920(a) (3A) (C) would result in the imposition of the Interest Equalization Tax should any additional investment be made in the stock of the Australian subsidiary even though only foreign funds are used.

This problem has been discussed with the staff of the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation.

An additional problem arises because of language in Section 4920(a)(3A)(A) which defines "lending or finance business" as encompassing obligations with a term of not more than 48 months.

At the time that this limitation was adopted, trade practice was such that the maturity of lending and finance obligations was not more than 48 months. However, trade practices have changed and today such obligations are regularly issued for a period of 60 months. Therefore, in order to bring the provisions of Section 4920(a)(3A)(A) in line with lending practices, we urge that the limitation of maturities to 48 months be removed and extended to 60 months. This problem has also been discussed with the staffs of the Treasury Department and the Committee on Internal Revenue Taxation.

Neither of these proposals for amendment affect the United States balance of payments or the export of any United States jobs. The funds which will be utilized are foreign funds.

STATEMENT OF JAMES W. RIDDELL ON BEHALF OF C.I.T. FINANCIAL CORP.

Mr. Chairman, C.I.T. Financial Corporation is a publicly-owned United States corporation which is engaged in the lending and finance business. It is currently negotiating for an opportunity to enter the lending and finance business in Japan. Because of restrictions arising under Japanese law, it is possible for C.I.T. to accomplish its purpose only by entering into a venture with Japanese citizens or corporations. To this end C.I.T. Finance Corporation is being offered an opportunity to acquire no more than 15% of the stock of a Japanese corporation which will conduct the lending and finance business in Japan.

Section 4920 of the Internal Revenue Code permits the formation of qualified lending and finance corporations (QLFC's). Investments in QLFC's may be made without the imposition of the Interest Equalization Tax, however, investments in such corporations are exempt only if the United States finance company making the investment in the QLFC owns 50% or more of the voting power of the QLFC. Because of restrictions imposed by the Japanese, it is impossible for C.I.T. to own more than 50% of the undertaking and, indeed, as I have stated, C.I.T. will not be permitted to own more than 15%. Since C.I.T. intends to make its investment in the QLFC only with foreign funds, it is urged that the provisions of Section 4920(d)(2) be amended to permit ownership of 10% or more of the voting power of a QLFC without the imposition of the Interest Equalization Tax.

An additional problem arises because QLFC's are prohibited from acquiring the stock of foreign issuers. Under the law of Japan, finance companies are permitted to acquire stock in connection with the making of a loan or even as an investment, and, indeed, it is the practice within the United States for banks and finance companies to acquire stock or warrants in connection with a lending transaction.

We urge that section 4920(d)(3) be amended to permit a QLFC to acquire stock of foreign issuers incidental to and in connection with a bona fide lending or finance transaction.

The staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation have been informed of this problem.

DUNNINGTON, BARTHOLOW & MILLER,
New York, N.Y., March 5, 1973.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I am writing on behalf of J. R. Timmins and Co., a stock brokerage firm in New York City, to bring before the Committee a problem in the administration of the exemption for prior American ownership and compliance.

Generally, if a U.S. person acquires foreign securities and pays the interest equalization tax, subsequent purchasers of the same securities are exempt. The exemption is normally established through stock brokerage firms which have agreed to participate in administering the exemption and are known as "participating firms." If specified statutory conditions are met, a participating firm that sells securities may issue a confirmation of the sale indicating that the tax does not apply. This establishes the purchaser's exemption.

The various conditions under which a participating firm may issue a confirmation establishing the purchaser's exemption are listed in section 4918(e) of the Internal Revenue Code. Thus, a participating firm may issue a confirmation if it receives from its customer a validation certificate issued by the Treasury Department evidencing that its customer is a U.S. person and has paid, or is not liable for, the tax.

If the customer does not furnish a validation certificate, the firm may still issue a valid confirmation if it withholds from the proceeds of the sale the amount of tax that would otherwise be payable. Under Treasury regulations, the amount withheld must be segregated in a separate bank account within 30 to 45 days. If the customer furnishes a validation certificate after the sale, the participating firm may pay him the amount withheld. Otherwise it must be paid over to the Treasury not later than the normal quarterly filing date.

Section 4918(e) lists a number of other circumstances under which a participating firm may issue a valid confirmation. However, section 4918(e) does not specifically provide for the issuance of a confirmation where a participating firm, instead of selling securities for a customer who pays the tax, sells securities it purchased for its own account and pays the tax itself. The Internal Revenue Service has announced that the Treasury regulations to be issued under section 4918 will contain a provision authorizing the issuance of valid confirmations in this situation. However, these regulations have not yet been issued.

Because there has been no provision in the statute or in regulations describing the conditions under which a firm selling for its own account may issue a valid confirmation, there has been uncertainty within the industry as to precisely what conditions must be met when a participating firm sells securities for its own account. The Internal Revenue Service has published an announcement describing what the regulations are expected to contain on various aspects of this problem. The announcement said that the regulations will provide that a confirmation will be considered to be valid where a participating firm is selling for its own account only if the firm pays the tax on or before the date it disposes of the securities. However, announcements of this kind, known as Technical Information Releases, are merely preliminary expressions of the Treasury's intention. They do not have the force of law, and are not considered by the Revenue Service to have the force even of an interpretive ruling. Moreover, they are not given the wide distribution that a statute, regulation, or ruling would receive.

The validity of the confirmation is important mainly because section 6681 of the Code provides for a penalty, where a participating firm issues a false confirmation, of 125 percent of the tax that would otherwise be payable. This penalty, the heaviest civil penalty in the Internal Revenue Code, was designed for cases of outright fraud by a participating firm, such as participating in the use of forged certificates of prior American ownership, as described to the Finance Committee in its 1967 hearings. There is nothing in the legislative history of these provisions to indicate that the 125 percent false confirmation penalty was intended to be imposed for mere late payment, in addition to the normal late filing and late payment penalties (unless, of course, payment is late enough to raise the suspicion of tax avoidance).

It should be kept in mind that the heavy false confirmation penalty would be applied under these circumstances only where a firm is selling for its own account. If it is selling for a customer, it has 30 to 45 days to put the funds it withholds in a separate account, and 1 to 4 months to pay them over to the Treasury. More-

over, even if the firm does not segregate or pay over the amounts withheld on time, the validity of the confirmation is not affected, and the 125 percent penalty does not apply.

If it is considered necessary to apply the heavy false confirmation penalty merely for late payment by a firm selling for its own account, we believe the requirements for issuing confirmation in such circumstances should be described in the statute. Because of the uncertainty arising from the absence of any provision in the statute or regulations describing the conditions under which a firm selling for its own account may issue a valid confirmation, we ask that some leeway be allowed for past transactions. This could be done by providing that a confirmation would be treated as valid if the firm paid the tax not later than the date it would have had to deposit the funds in a separate account if it had been acting for a customer instead of for itself.

Such a provision would not condone late filing. The normal late filing and late payment penalties that apply to all Federal tax returns clearly apply to these transactions under present law and would continue to apply. Furthermore, the 125 percent penalty would apply in all tax avoidance cases, including cases where a firm's delay in paying the tax raises an inference of tax avoidance.

I have discussed this problem with the staff of the Joint Committee on Internal Revenue Taxation, and I will be available at the Committee's hearing on March 7, 1973 to answer any questions the Committee members may desire to ask.

Sincerely yours,

JOHN BROADBENT.

MELROD, REDMAN & GARTLAN,
Washington, D.C., March 6, 1973.

TOM VAIL, Esq.,
Chief Counsel, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Reference is made to H.R. 3577, the proposed extension of the Interest Equalization Tax, and in particular to the proposed elimination of the Less-Developed Country Exemption insofar as applicable to shipping corporations (see proposed Section 4916(e) of the Internal Revenue Code, as contained in the Bill as passed by the House).

In behalf of Greyhound Leasing & Financial Corporation, we hope that clarification can be provided in the printed record on this legislation, to eliminate possible ambiguities in the protection proposed to be given to "preexisting commitments." In particular, we desire clarification of the phrase "customary closing conditions," in proposed Section 4916(e)(2)(B) of the Code and the requirement that the commitment letter set forth the "principal terms" of the commitment contained in proposed Section 4916(e)(2)(B)(i). Because of a preexisting commitment of Greyhound, we believe that this clarification can be helpful in avoiding possible problems with Internal Revenue Service examiners.

First, as to the phrase "customary closing conditions," Greyhound has committed to enter a financial lease of a motor vessel with a less-developed country corporation. That lease is treated as an indebtedness for Interest Equalization Tax purposes, but the shipping corporation exemption avoided any liability for interest equalization tax when the commitment was issued.

The lease is subject to Maritime Administration approval, required pursuant to Section 37 of the Shipping Act of 1916, as amended (46 U.S.C. 835). The regulations of the Department of Commerce make it clear that such approval is granted subject to fairly routine requirements, *e.g.*, that the vessel not be made available to certain proscribed countries and that it not engage in trade prohibited to United States flag vessels. On January 29, 1973, consummation of that lease was subject only to formal documentation and Maritime Administration approval. Since this approval is customarily granted, from a business standpoint the parties clearly believe there is a preexisting commitment.

However, this proposed addition to the Code (proposed Section 4916(e)(2)) makes that exemption available only if obtaining Maritime Administrtaion approval is a "customary closing condition". We are concerned that a revenue agent on audit may take a restrictive view of this provision. To avoid difficulty, we hope that the printed record accompanying H.R. 3577 will clarify the phrase "customary closing conditions" to state that routine agency approvals, for example, of the Maritime Administration under Section 37 of the Shipping Act, are generally considered "customary closing conditions".

Our second problem also involves the requirements of the proposed legislation before protection is afforded to a "preexisting commitment." Proposed Section 4916(e)(2)(B) requires that a commitment letter have been issued which sets forth the "principal terms" of the obligation in the commitment letter. While Greyhound's commitment letter summarizes the contemplated transaction in great detail, including lease term; rental; options for early termination; provision for payment of closing costs, legal fees, etc.; arrangements for insurance, maintenance and taxes; registration of the vessel; requirements for Maritime Administration approval; guarantees, etc., another question arose during the course of formal documentation.

The commitment letter provided a purchase option to repurchase the vessel at the termination of the primary lease term, for a specific dollar amount. During the course of documentation, the parties for the first time recognized that under the Shipping Act, Maritime Administration approval will be required, should the lessee's option to purchase be exercised at the end of the lease term, many years in the future. Obviously, therefore the possibility arises that the Maritime Administration may for unforeseen reasons refuse, many years from now, to approve a sale of the vessel, pursuant to exercise of the purchase option. Accordingly, after January 29, 1973, the parties negotiated what we believe is a routine arrangement, an option in the lessee to extend the primary lease term at a new rental, exercisable only in the event that the lessee exercises its purchase option but the Maritime Administration refuses to accede to the sale of the vessel pursuant to that option exercise.

Proposed Section 4916(e)(2)(B (i), as contained in H.R. 3577, requires that the commitment letter set forth the "principal terms" of this financial lease in order for the purchaser of the indebtedness, *i.e.* the lessor under the financial lease, to be entitled to this exemption from Interest Equalization Tax as a "preexisting commitment". We believe you will agree that the fact that parties have now recognized the possibility that the Maritime Administration may refuse to approve a sale, should the lessee ultimately exercise this purchase option many years in the future, is not a change in the "principal terms" of the commitment. That the parties have defined what will occur in such an event does not change the fact of this preexisting commitment, which general business practices require be honored. However, because of the difficulty in predicting how a Revenue Agent may define "principal terms", the parties are naturally concerned as to the protection from tax given this commitment.

Here also, we hope that the printed record on H.R. 3577 will clarify the pertinent language. Clarification or explanation of the phrase, "principal terms", as contained in proposed Section 4916(e)(2)(B), should reduce the area of doubt in a determination of the exemption available for preexisting commitments. Taxpayers are obviously handicapped if they are exposed to tax by good faith efforts to resolve omissions, such as the instant one, that come to light during the course of documentation.

We have discussed both of these matters with the staff of the Treasury Department and the Joint Committee on Internal Revenue Taxation, and we believe they are familiar with these matters.

If we can provide any further information, or if you would like to hear from us further on these items, please let us hear from you.

Sincerely,

JERRY M. HAMOVIT.

DEBEVOISE, PLIMPTON, LYONS & GATES,
New York, N.Y., March 5, 1973.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
Washington, D.C.

DEAR SENATOR LONG: Pursuant to the invitation in your recent press release, I respectfully request consideration by the Committee on Finance of a clarification of the grandfather clause in section 4916(e)(2) of the Internal Revenue Code as proposed in H.R. 3577 (the "Interest Equalization Tax Extension Act of 1973"). The clarification is necessary so that the parties to a transaction which was negotiated and signed up last December will not be exposed to the danger of losing the benefits of their contract as the result of later changes in the interest equalization tax which were not proposed until more than a month after they made their firm commitments.

Background. The transaction in question was arranged by ITEL Leasing Corporation. It involves a 264,000 deadweight ton tanker which is being constructed by a Japanese shipyard and is scheduled for delivery on or about July 31, 1973. An affiliate of a domestic oil company contracted for the tanker on September 11, 1970, and the keel was laid by the shipyard on December 11, 1972.

The principal documents for the transaction are a Participation Agreement, a Trust Agreement, an Indenture of Trust, a Charter, a Subcharter, and a Guarantee. All of these documents were fully negotiated, printed in final form and executed last December, resulting in firm commitments by all of the parties to go through with the transaction subject to normal closing conditions.

The transaction involves the establishment of a trust as a vehicle for acquiring and holding title to the tanker. On the tanker delivery date the owners will make equity contributions to the trust and the trust will borrow the balance of the purchase price from a group of lenders. At the time of delivery by the shipyard, a Liberian affiliate of the domestic oil company will acquire the tanker and sell it to the trust, which in turn will charter it to a Delaware affiliate of the oil company which will subcharter it back to the Liberian affiliate. The lenders will be secured by an assignment of the charter and a first preferred ship mortgage. The performance of the oil company's affiliates will be guaranteed by the oil company.

The Delaware affiliate was interposed between the trust and the ultimate Liberian subcharterer so that there will be a full charge against the oil company's OFDI allowables. This aspect of the structure of the transaction was discussed orally in a joint meeting with representatives of the Office of Foreign Direct Investments of the Department of Commerce and the Board of Governors of the Federal Reserve System. Based on the results of that discussion it is anticipated that the transaction will be the subject of written clearances from both the Office of Foreign Direct Investments and the Federal Reserve System.

For interest equalization tax purposes the charter obligation of the Liberian affiliate will constitute a "debt obligation" of a foreign obligor. The transaction was negotiated and committed for on the assumption there would be no tax liability because the Liberian corporation would qualify as a "less developed country corporation" under section 4916 (c)(1)(B). It is a condition to closing that there be satisfactory opinions of counsel as to the absence of tax liability.

The transaction presents a question of interpretation under the grandfather clause of section 4916(e)(2) as proposed in H.R. 3577 because the owner position was taken at the last moment, after other prospects had dropped out, by ITEL Corporation, the parent of ITEL Leasing Corporation. ITEL Corporation made its commitment in the expectation that it would be able to assign the owner position to one or more third parties prior to the vessel delivery date. It is not clear that an assignee of ITEL would be entitled to the benefits of proposed section 4916(e)(2) because (*a*) subparagraph (B) of that section does not expressly refer to assignees of the United States person covered thereunder, and (*b*) although subparagraph (A) seems to permit assignment, clause (i) of subparagraph (A) does not allow normal closing conditions and clause (ii) requires partial performance.

Since the transaction was firmly negotiated and signed up more than a month prior to January 29, 1973, it obviously presents a more sympathetic case for grandfather clause relief than the type of transaction already covered by subparagraph (B) of proposed section 4916(e)(2). If relief is not extended, there is a danger that the parties will lose the benefits of their contract because ITEL Corporation's planned assignment of the owner position will give rise to a threat of interest equalization tax which may seriously disrupt the transaction if not cause its abandonment.

Suggestions for Clarification. There are several ways in which the language of section 4916(e)(2) might be modified to provide relief. The broadest is based on our understanding, derived from conversations with officials in the Treasury Department, that repeal of the exemption for shipping companies has been proposed to plug a loophole in the rules of the Federal Reserve Board and the Department of Commerce which have made it possible to transfer funds to shipping companies without acceptance of full chargeability for OFDI or VFCR purposes. If this is the reason for proposing repeal, it is suggested that the following additional clause be added to section 4916(e)(2):

"(C) made to finance in whole or in part a vessel or aircraft the construction of which was performed pursuant to a binding contract entered into on or before January 29, 1973, *provided* that, so long as both the Foreign Direct

Investment Regulations of the Department of Commerce and the Voluntary Foreign Credit Restraint Guidelines of the Board of Governors of the Federal Reserve System shall be in effect, such financing involves positive transfers of capital by direct investors under such Regulations and/or charges to the guideline ceilings of banks or non-bank financial institutions under such Guidelines which transfers and/or charges in the aggregate equal the amount of the funds used to finance the vessel or aircraft which are obtained within the United States."

This clause would permit financing of vessels or aircraft which were ordered on or prior to January 29 so long as there is acceptance of full chargeability for OFDI or VFCR purposes. It would thus achieve the goal of full chargeability without any increase in financing costs. Companies which ordered ships in the expectation of being able to finance them under then prevailing conditoins would not have this expectation defeated. (Ships ordered after January 29 will not, we understand, present a problem if the interest equalization tax is phased out on or before December 31, 1974 in accordance with the President's announcement. Under normal conditions, ships ordered now would not be delivered until some time in 1975.)

Another alternative is to modify the language of subparagraph (B) of proposed section 4916(e)(2) to make it clear that assignees of persons who made commitments on or prior to January 29 are entitled to the benefits of that subparagraph. A possible revision is as follows:

"(B) as to which on or before January 29, 1973, the acquiring United States person *or a predecessor in interest to such person* (or, in a case where 2 or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons *and/or their predecessors in interest*) had taken every action to signify approval of the acquisition under the procedures ordinarily employed by such person *or predecessor* (or persons *and/or predecessors*) in similar transactions, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions, and the acquiring United States person *or predecessor* (or persons *and/or predecessors*)—

"(i) had sent or deposited for delivery to the foreign issuer or obligor from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign issuer or obligor from whom the acquisition was made which set forth, the principal terms of such acquisition, or

"(ii) had received from the foreign issuer or obligor from whom the acquisition was made a memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the acquiring United States person *or predecessor* (or persons *and/or predecessors*) which set forth, the principal terms of such acquisition." (Italic indicates additions.)

A third alternative would be to expand clause (i) of subparagraph (A) of proposed section 4916(e)(2) to allow normal closing conditions. This would only be effective if there were assurance (perhaps by way of a statement of intent in the Committee report) that subparagraph (A) will be read to permit assignment.

I appreciate the Committee's consideration of this matter.

Very truly yours,

PHILIP S. WINTERER.

DAVIS POLK & WARDWELL,
New York, N.Y., March 5, 1973.

Re HR 3577: Proposed amendment to section 4920(e) of Internal Revenue Code submitted on behalf of the Japan Fund, Inc.

Hon. RUSSELL B. LONG, *Chairman, Committee on Finance, U.S. Senate, Dirksen Office Building, Washington, D.C.*

DEAR SENATOR LONG: We respectfully submit a proposed amendment to HR 3577, a Bill to provide an extension of the Interest Equalization Tax, and for other purposes, which proposed amendment would in turn amend Section 4920(e) of the Internal Revenue Code of 1954. Section 4920(e) relates to certain mutual funds which have elected to be treated as a "foreign issuer or obligor" for purposes of the Interest Equalization Tax. The proposed amendment would clarify Section 4920(e) in a manner that we understand is consistent with the underlying intent of that provision. As amended, Section 4920(e) would read as follows, with the new matter in italic:

PROPOSED AMENDMENT

"(e) Certain Mutual Funds.—Notwithstanding subsection (a)(3)(B), a domestic corporation described in such subsection shall not be treated as a 'foreign issuer', 'foreign obligor,' or 'foreign issuer of obligor' with respect to any acquisition of stock or a debt obligation which is attributable to funds obtained by borrowing or through issuance of its stock after March 24, 1971 *other than through the issuance of its stock as part of a capital gain dividend (as defined in section 852(b)(3)(C)).*" (New matter in italic).

REASONS FOR AMENDMENT

This submission is made on behalf of the Japan Fund, Inc. (the "Fund").

The Fund is a Maryland corporation which is a closed-end diversified management company registered under the Investment Company Act of 1940. Since November 1963, the Fund has elected to be treated as a foreign issuer or obligor for Interest Equalization Tax purposes pursuant to Code Section 4920(a)(3)(B). The purpose of the Fund is to invest in Japanese securities, and almost all of its assets fall in that category.

As a regulated investment company, the Fund since its incorporation has distributed its long-term capital gains in the form of capital gains dividends as defined in Code Section 852(b)(3)(C). Commencing in 1967, the Fund's stockholders have been given an option to receive such capital gains dividend either in cash or in shares of the Fund. At that time the Fund received a ruling from the Internal Revenue Service that the receipt of shares of the Fund would be exempt from Interest Equalization Tax under Section 4914(a)(4) as a distribution by a corporation of its stock with respect to its stock regardless of the fact that such distribution would be taxable to the stockholders for income tax purposes.

In the past, approximately 80–85% of the shareholders of the Fund have elected to receive shares of the Fund in lieu of cash as a capital gains dividend. In each such year, the capital gains underlying the capital gains dividend had been realized by the Fund during the immediately preceding calendar year. Under Japanese Exchange Control rules, the Fund might not be able to reinvest the proceeds of the sale of Japanese securities in other Japanese securities unless it did so reinvest within 24 hours of the sale. Accordingly, virtually all of the proceeds of all sales of Japanese securities, including the capital gain portion of the proceeds derived from the sale of Japanese securities, are reinvested in other Japanese securities within 24 hours and prior to the subsequent declaration of the capital gain dividend. Accordingly, the sole effect of the shareholders electing to receive shares rather than cash on the declaration of the capital gain dividend is to reduce the dollar amount of securities which must be liquidated by the Fund to pay the cash portion of the capital gain dividend.

In 1971, Section 4920(e) was enacted, under which a domestic corporation which is treated as a foreign issuer or obligor under Section 4920(a)(3)(B) will not be treated as such "with respect to any acquisition of stock or a debt obligation which is attributable to funds obtained by borrowing or through issuance of its stock after March 24, 1971". The report of the Senate Finance Committee makes it clear that this provision was intended to apply to investments made by such corporations with "new capital". Nevertheless, the Internal Revenue Service now construes Section 4920(e) as applying to investments or acquisitions made by an investment company such as the Fund on the theory that by retaining the gains represented by a distribution of stock in lieu of cash, acquisitions have or will have been made that are attributable to funds obtained through issuance of stock. Of course, if the Fund were to issue new shares for new cash, such cash could be segregated and the investments and reinvestments attributable to such new funds would be readily identifiable and made subject to the Interest Equalization Tax.

The position of the Internal Revenue Service creates major uncertainties with respect to the identification of the foreign securities deemed attributable to funds supposedly obtained through the issuance of the stock dividend, since the sole effect of shareholders' elections to take stock rather than cash is to cause the Fund to liquidate a smaller number of foreign investments that have previously been made from funds generated internally. If sustained by the courts, the Internal Revenue Service position would either result in a substantial and recurring Interest Equalization Tax liability that must be calculated on some arbitrary and yet unspecified manner, or it will be necessary for the Fund to substantially deplete its assets by paying capital gains dividends in the form of cash only.

Presumably no Interest Equalization Tax would be incurred even though the same sales proceeds are reinvested were the Fund to retain capital gains and pay the capital gains tax at the Fund level, but this would require accruing a capital gains tax liability, for accounting purposes, for the entire unrealized appreciation of the Fund's investments, to the detriment of the Fund's shareholders.

It is submitted that an election of the shareholders to take stock in lieu of a cash dividend does not result in new capital going into the Fund and does not represent an outflow of funds from the United States for balance of payments purposes. Accordingly, the proposed amendment would be consistent with the underlying intent of Section 4920(e).

The proposed amendment has been submitted to and discussed with representatives of the Treasury and Joint Committee staffs. The undersigned will be available for questioning at the convenience of the Committee.

Respectfully yours,

DAVID A. LINDSAY.

STATEMENT ON BEHALF OF TAXPAYERS WHO ARE SHAREHOLDERS OF AMERICAN INTERNATIONAL REINSURANCE COMPANY, INC., A FOREIGN COMPANY

Section 4920(b)(2) IRC has resulted in certain inequities from the impact of its present wording on employee stock options granted by the very limited number of foreign corporations which, because of their predominantly U.S. stock ownership when the Interest Equilization Tax Act was enacted in 1963, were considered to be domestic issuers. In particular, the present language discriminates between optionees of the same issuer by exempting some option stock from the tax while imposing it on others, solely on the basis of whether or not such stock was outstanding on July 19, 1963. This in turn has resulted in marketing confusion as between exempt and nonexempt shares.

Attached are the texts of three amendments to Section 4920(b)(2) which complement each other and which together would go a long way toward curing the present inequities. They would have no appreciable adverse effect upon the U.S. balance of payments position.

These amendments have been discussed with the Treasury and with the Joint Committee Staff. A representative of the interested taxpayers will be present at the hearing conducted by the Senate Finance Committee on March 7, 1973.

PROPOSED AMENDMENTS TO SECTION 4920(B)(2) IRC

1. Amend subparagraph (ii) of Paragraph (D) to read as follows:

"Shares of such class *are held* of record by more than 250 shareholders on the corporation's latest record date before *its issuance of such additional shares;*"

2. Amend subparagraph (iv) of Paragraph (D) by adding after the figures "4917" the following:

"* * * *or are shares issued upon exercise of an option described in section 4914(a)(8) (determined without regard to whether or not the optionee is a United States person) granted to an employee who immediately after such option is granted is an individual described in section 422(b)(7), provided that the aggregate number of shares of such class subject to all options described in section 4914(a)(8) (determined without regard to whether or not the optionee is a United States person) that are granted during any one calendar year does not exceed one percent of the total number of outstanding shares of such class on the first day of such calendar year, such number to be adjusted to reflect recapitalizations and stock dividends during such year (in accordance with Regulations prescribed by the Secretary or his delegate);*"

3. Amend Section 4920(b)(2) by renumbering the present Paragraph "(D)" as "(E)" and by adding a new Paragraph "(D)" to read as follows:

"*issued after November 10, 1964, and if the tax imposed by Section 4911 has been paid by a United States person on the acquisition of such additional shares; or*"

WILLIAMS & JENSEN,
Washington, D.C., March 6, 1973.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As you know, the Interest Equalization Tax Extension Act of 1973 (H.R. 3577), as recently passed by the House of Representatives, would repeal the long standing exemption from IET for acquisitions of stock and debt obligations issued by less developed country shipping companies. In this

connection, we have noted that the provision repealing this exemption (§ 3(b) of the bill) contains an exception for preexisting commitments, and that this exception is designed to cover all acquisitions constituting part of a single transaction which was substantially completed by January 29, 1973, the day before Under Secretary of the Treasury Volcker first proposed repeal of the shipping company exemption in his testimony before Ways and Means on January 30, 1973.

We agree, of course, that it is appropriate for the repealer to include such transition rules for preexisting commitments, since there may be several ship financing transactions which were substantially completed at the time of the repealer announcement, and which would become subject to IET if the transition rules were not available. However, we are concerned that the transition rules in H.R. 3577 in some situations (1) may be too rigid, (2) may fail to give adequate recognition to custom in investment banking activities relating to the financing of ships, and (3) may be overly concerned with the form as opposed to the substance of a transaction ongoing as of January 30, 1973.

It is our opinion that the transition rules in their present form may be construed to mean that each acquiring U.S. person, in order to qualify thereunder, must have on or before January 29, 1973 either submitted 'written evidence" of his commitment to acquire securities of the foreign issuer 'or obligor, or received a written document setting forth the principal terms of the acquisition. We are of the view that such a requirement for written documentation, at least insofar as it contemplates an exchange of written documents, fails to take into account the usual form of oral commitments customary in the investment banking business and ordinarily employed in transactions of this type. Such a commitment often involves only an oral commitment by an institution to one of an investment banker's salesmen that the institution will purchase a security subject to approval of the institution's investment committee and to approval by the institution of the documentation for the transaction. We understand that this procedure of making investment commitments is known in the investment banking business as "circling" (a term derived from the salesman's circling of an amount beside the customer's name when receiving the oral commitment). It is common in the investment banking business for commitments to be reduced to writing only shortly before the closing of the transaction.

We, therefore, respectfully suggest, Mr. Chairman, that the transition rules in § 3(b) of the bill be amplified to eliminate any possible doubt that they would apply to a ship financing transaction involving oral approvals or commitments (where such a procedure is customary) by the acquiring persons on or before January 29, 1973.

We suggest that the Committee may also wish to consider including in the transition rules an exception for ship financing transactions where a request for a ruling under § 4916(c)(1)(B) of the Internal Revenue Code was filed on or before the January 29, 1973 cutoff date with the Internal Revenue Service in connection with the transaction. A precedent for such a ruling request transition rule may be found in the addition of § 311(d) to the Internal Revenue Code in the Tax Reform Act of 1969 (P.L. 91-172, § 905(c)). *See* H.R. Rep. No. 91-782, 91st Cong., 1st Sess. 333 (1969) (Conference Report to accompany H.R. 13270).

Finally, we would suggest that the Committee may wish to include in the shipping company transition rules an exception for ship financing transactions in which the vessel is delivered on or before an early date in 1973, such as May 1, 1973. As you can appreciate, the design, construction, and sea trials of a vessel involve a substantial long-term undertaking. If a vessel is delivered on or before May 1, 1973, this condition would appear to serve as a justifiable basis for the addition of another transition rule to § 3(b) of H.R. 3577. We believe that precedent for such a transition rule may be found in the pre-termination property rules in § 49(b) of the Code developed with respect to the temporary repeal of the investment tax credit in the Tax Reform Act of 1969. *See, e.g.*, I.R.C. §§ 49(b)(2) and (3), 49(d). *See also* S. Rep. No. 91-552, 91st Cong., 1st Sess. 228, 232-236 (1969).

Since the three changes we have proposed in H.R. 3577 are of a technical nature, and since you announced that written comments would be given the same close consideration as though the writer had testified orally, we have not filed a request to be heard in person, but we will have a representative present at the hearings on March 7, 1973, and would be glad to provide further amplification of our views if the Committee so desires. We should add that we have already had the privilege of discussing the above points with the staffs of the Committee on Finance and the Joint Committee on Internal Revenue Taxation.

One further request, Mr. Chairman, is that this correspondence be made a part of the record of the Committee's consideration of H.R. 3577.

Respectfully submitted.

J. D. WILLIAMS.

MILLER & CHEVALIER,
Washington, D.C., March 6, 1973.

HON. RUSSELL B. LONG
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The following comments are submitted on behalf of Pacific Lighting Corporation for consideration by the Committee in connection with H.R. 3577, the Interest Equalization Tax Extension Act.

It is respectfully suggested that the interest equalization tax be made inapplicable to loans by U.S. persons which are necessary to enable the U.S. lender to secure a long-term supply of foreign produced natural gas.

At the present time, domestic demand for natural gas exceeds domestic production by 3 trillion cubic feet a year. It is projected that domestic production will become increasingly inadequate to satisfy domestic demand in future years. For example, it is projected that domestic demand will exceed domestic production by 5.1 trillion cubic feet by 1975 and by 14.1 trillion cubic feet by 1980. (See attached table from Federal Power Commission Staff Report No. 2.)

It is extremely important to develop additional supplies of natural gas, which now provides about one-third of the energy consumed in the United States, to deal with the present and projected energy shortage and also because natural gas is an environmentally superior fuel due to its cleanness.

U.S. gas users and distributors must turn to foreign produced natural gas for these additional supplies if they are to even begin to fill the gap between domestic demand and domestic production. For a U.S. user or distributor to secure the necessary long-term commitment with respect to foreign produced gas which is necessary for continued service, however, it often must agree to provide financing to the foreign lease or concession holder to assist in the exploration for and development of natural gas deposits on the lease or concession. Obviously, a loan of this type is not a portfolio investment or motivated by a desire to obtain an intest rate differential. Rather, it is absolutely necessary from a business standpoint if the U.S. user or distributor is to obtain a long-term right to purchase the foreign produced gas. Nevertheless, the interest equalization tax at present would be imposed on such a loan and thus would operate to inhibit or discourage the securing of needed additional supplies of natural gas for United States consumers.

The interest equalization tax in this sutuation, thus, works against the alleviation of the shortage of domestically produced natural gas. The need to alleviate this shortage and the important role which this clean fuel plays in our total energy picture far outweigh the balance-of-payments impact of allowing U.S. persons to provide the exploration and development financing required for the obtaining of long-term commitments of foreign natural gas. Accordingly, the interest equalization tax should be made inapplicable to loans by U.S. persons which are necessary to enable the lender to secure a long-term supply of foreign produced natural gas. Specifically, an exception to the tax should be provided for a loan to a foreign person to be used in the exploration for, or development of, natural gas deposits if the U.S. lender, or a related corporation, has the right to purchase a substantial portion of the natural gas produced from the deposits developed in this manner. A suggested draft of such an amendment is attached.

Sincerely yours,

BARRON K. GRIER.

AMENDMENT TO H.R. 3577

After section 3(c) of the bill, insert the following subsection:

"(d) EXCLUSION FOR LOANS TO ASSURE SUPPLY OF NATURAL GAS.—

"(1) EXCLUSION FROM TAX.—Section 4914 (relating to exclusion for certain acquisitions) is amended by adding at the end thereof the following new subsection:

" '(1) LOANS TO ASSURE SUPPLY OF NATURAL GAS.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor by a United States person of a debt obligation of such obligor if—

" '(1) such debt obligation arises out of a loan (made by such United States person to such obligor) the proceeds of which will be used by such obligor pursuant to a contract with such United States person for the exploration for or development of a deposit or deposits of natural gas, and

" '(2) such United States person, or one or more includable corporations in an affiliated group (as defined in section 48(c)(3)(C)) of which such United States person is a member, has the right under such contract to purchase a

substantial portion of the natural gas produced from any deposit or deposits developed by such foreign obligor with the proceeds of loans described in paragraph (1).'

"(2) CONFORMING AMENDMENT.—Section 4914(b) (relating to excluded acquisitions) is amended by adding at the end thereof the following new paragraph:

" '(17) ACQUISITIONS TO ASSURE SUPPLY OF NATURAL GAS.—Of debt obligations of a foreign obligor arising in connection with loans to assure a supply of natural gas, to the extent provided in subsection (1).'

"(3) EFFECTIVE DATE.—The amendments made by paragraphs (1) and (2) shall apply with respect to acquisitions of debt obligations made on or after the date of enactment of this Act."

TABLE 1.—U.S. GAS SUPPLY-DEMAND BALANCE, ACTUAL 1966-70; PROJECTED 1971-90

[All volumes in trillions of cubic feet at 14.73 P.s.i.a. and 60° Fahrenheit]

Year	Annual demand [1]	Net pipeline imports	LNG imports	Gas from coal	Gas from Alaska	Gas from liquid hydrocarbons	Domestic production	Annual consumption	Unsatisfied demand	Reserve additions	Year-end reserves	R/P ratio
1966	17.9	0.4					17.5	17.9	0	19.2	286.4	16.4
1967	18.8	.5					18.4	18.8	0	21.1	289.3	15.8
1968	19.9	.6	(2)				19.3	19.9	0	12.0	282.1	14.6
1969	21.3	.7	(2)				20.6	21.3	0	8.3	269.9	13.1
1970	22.6	.8	(2)				21.8	22.6	0	11.1	259.6	11.9
1971	24.6	.9	(2)				22.8	23.7	.9	12.0	248.8	10.9
1972	26.1	1.0	(2)			(3)	23.8	24.8	1.3	13.0	238.0	10.0
1973	27.7	1.1	(2)			(3)	24.7	25.8	1.9	14.0	227.3	9.2
1974	28.8	1.1	(2)			(3)	24.8	25.9	2.9	15.0	217.4	8.8
1975	29.8	1.2	0.3			(3)	24.7	26.2	3.6	16.0	208.7	8.4
1980	34.5	1.6	2.0	0.3	0.7	(3)	20.4	25.0	9.5	17.0	186.1	9.1
1985	39.8	1.9	3.0	1.4	1.3	(3)	18.5	26.1	13.7	17.0	175.4	9.5
1990	46.4	1.9	4.0	3.3	2.3	(3)	17.8	29.3	17.1	17.0	170.4	9.6
971-90 total	707.6	31.1	38.0	17.3	20.6	(3)	414.2	521.2	186.4	325.0		

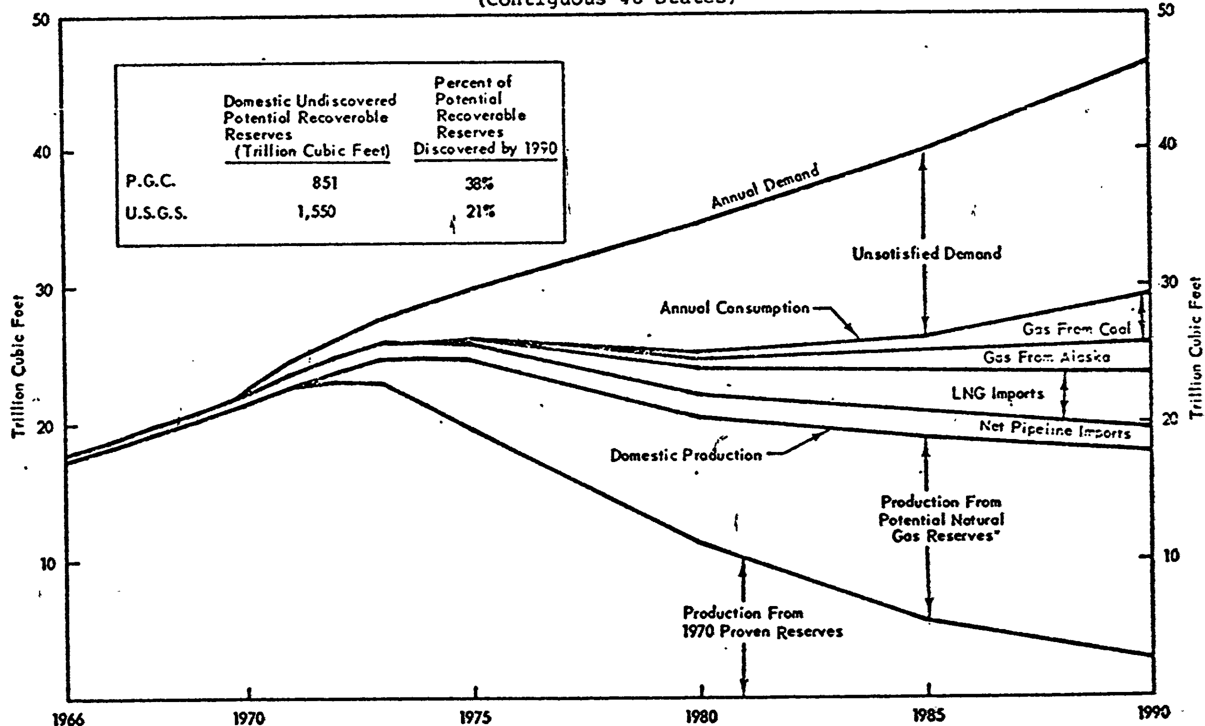
[1] Contiguous 48 States.

[2] Very small volumes.

[3] Insufficient data for quantitative projection: unsatisfied demand will be reduced by the amount of SNG actually produced.

Figure 1

UNITED STATES GAS SUPPLY-DEMAND BALANCE
(Contiguous 48 States)



*U.S. Natural Gas Reserve Additions (1971-1990) Total 325 Trillion Cubic Feet.

NEW YORK STATE BAR ASSOCIATION TAX SECTION, COMMITTEE ON TAXATION OF INTERNATIONAL TRADE & INVESTMENT

REPORT ON H.R. 3577, THE BILL TO EXTEND AND AMEND THE INTEREST EQUALIZATION TAX ACT

This bill would (i) extend the expiration date of the interest equalization tax to June 30, 1974; (ii) exclude from the gross estates of non-resident aliens debt obligations the interest on which qualifies as income from sources without the United States under Section 861(a)(1)(G) of the Code relating to debt obligations of a domestic corporation or partnership, acquisition of which is subject to interest equalization tax pursuant to Section 4912(c) of the Code and which meet certain requirements specified in Section 861(a)(1)(G); (iii) eliminate applicability of the less developed country corporation exclusion to stock or debt obligations of so-called "less developed country shipping corporations" and (iv) provide a new exclusion for original or new issues to finance direct investment in the United States.

Amendment of the estate tax provisions to exclude debt obligations interest on which is deemed derived from sources without the United States under Section 861(a)(1)(G) is believed a desirable logical extension of the action already taken in enacting Section 4912(c) and Section 861(a)(1)(G). However it is believed that consideration should be given to establishing an effective date of April 1, 1971 for the new exclusion, since that was the effective date of the Interest Equalization Tax Extension Act of 1971 which added Sections 4912(c) and 861(a)(1)(G) to the law.

Extension of the termination date of the tax and elimination of the exclusion for less developed country shipping corporations are believed to involve purely questions of policy as to which no opinion is expressed. It is believed, however, that the policy issues involved in terminating an exclusion are of such importance that further hearings should be held with respect thereto.

Assuming that the less developed country exclusion is to be made inapplicable to "less developed country shipping corporations" it is believed that the transitional provisions should be broadened to preserve the exclusion in cases where appropriate action had been timely taken by a parent or affiliate of the foreign issuer or foreign obliger or by the United States person. The Committee understands that in the shipping industry the foreign entity involved is often not formed until immediately prior to the execution of contracts and that all prior activities in respect of the contemplated transaction are carried on by the parent or affiliates of the foreign entity.

The advance Treasury clearance requirement prescribed in connection with the new exclusion for direct investment in the United States is believed to be undesirable in principle as imposing a new administrative burden on the Treasury, comparable to the advance ruling requirement of Section 367. Experience with the delays and problems under Section 367 leads the Committee to recommend removal of the requirement for advance approval.

It is also believed that the 50% participation requirement should be made more specific as to whether or not the foreign participation must be *pari passu* in each class or type of security issuance of which produces funds for direct investment in the United States.

Finally, it is suggested that the legislative history should make it clear that the 50/50 test proposed for Section 4922 is not intended to affect the present Internal Revenue Service ruling policy with respect to debt to equity ratios of International Finance Subsidiaries.

SHEARMAN & STERLING,
New York, N.Y., March 6, 1973.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of Citicorp Leasing International, Inc. ("CLI"), a wholly-owned subsidiary of First National City Corporation and an affiliate of First National City Bank, we respectfully request consideration by your committee of certain proposed amendments to the Interest Equalization Tax Act. In that connection, we are submitting this statement for inclusion in the record of your committee's hearings on H.R. 3577, the Interest Equalization Tax Extension Act of 1973.

For purposes of the interest equalization tax, a lease which is entered into principally as a financing transaction is treated as a debt obligation. If the lessor is a domestic corporation and the lessee is a foreign corporation, the lessor is subject to interest equalization tax with respect to such lease. However, if the property subject to the lease is manufactured in the United States (i.e., "export property"), the transaction is not subject to interest equalization tax because of an exemption for the leasing of export property. If the lessor borrows funds from a United States person to purchase the export property, the United States person may be deemed to have acquired from the foreign lessee a debt obligation of such foreign lessee which would be subject to interest equalization tax. It is submitted that in order to promote exports, a lessor of export property should be permitted to obtain from United States sources funds to finance the purchase of export property. Accordingly, an amendment is proposed which would exempt a loan to a United States person where the proceeds are used to finance the acquisition of export property for leasing to non-United States persons.

Under the present provisions of the Interest Equalization Tax Act, a domestic or foreign corporation may elect to be a "qualified lending or financing corporation" ("QLFC") and to engage in lending and financing activities outside the United States. In general, provided the funds used in such business are obtained from sources outside the United States, the QLFC is not subject to interest equalization tax on its acquisition of debt obligations of foreign obligors. However, in the two years since the Interest Equalization Tax Extension Act of 1971 which provided for the organization and operation of a QLFC, it has been discovered that 4 problems have arisen in the normal operation of a QLFC.

First, an important part of the activities of a QLFC consists of leasing export property. In order to facilitate the financing of export property and thereby increase United States exports, it is proposed that a QLFC be permitted to obtain funds from domestic sources to provide the financing for the acquisition of export property for leasing outside the United States. This would be in accord with the exemption for export property directly financed.

Second, under present law a QLFC is not permitted to own stock of any other corporation, except under limited conditions. Often it is advisable for a QLFC to own the stock of another QLFC in order to avail itself of favorable foreign tax provisions (e.g., consolidated tax returns for QLFCs incorporated in the same country and favorable foreign tax treaties) and to integrate related activities into one corporate structure for management and other business purposes. It is also deemed essential that a QLFC be permitted to obtain ownership of stock through foreclosure where such stock was held as a pledge or as security for a loan or lease. Lastly, it is sometimes necessary for a QLFC to be able to purchase and resell stock held in connection with a loan or lease in order to receive a "balloon" payment at the end of the loan term or to realize on the residual value of property leased to the issuer of such stock. Amendments are proposed which would allow a QLFC to own stock under these circumstances.

Third, when the provisions relating to QLFCs contained in the Interest Equalization Tax Extension Act of 1971 were first drafted, the procedure whereby a domestic corporation may designate a particular issue of its debt obligations as being subject to interest equalization tax so that they may be sold outside the United States was not part of the law. In order to update the provisions relating to permissible sources of funds for a QLFC to reflect the addition of this designation procedure, an amendment is proposed which would provide that a QLFC may obtain funds from the sale of debt obligations by a related domestic corporation which has designated such debt obligations as subject to interest equalization tax.

Fourth, under present law if a QLFC borrows from a foreign branch of a related domestic commercial bank, such foreign branch is not required to give advance notice to the Secretary or his delegate or to trace funds loaned to the QLFC to any sale of its own debt obligations. However, if a QLFC borrows from a related foreign corporation which is a commercial bank, such related foreign corporation is required to give such notice and to trace such funds; in this instance, prior notice and tracing has proved virtually impossible because funds are received daily and for varying maturities. Furthermore, a QLFC is not permitted to borrow from another related QLFC, even though such borrowing would permit a group of related QLFCs to take advantage of favorable interest rates, foreign tax law provisions, tax treaties and exchange control laws. In order to facilitate the gathering of funds under such circumstances, an amendment is proposed which would permit a QLFC to borrow from a related foreign corporation which is a

commercial bank without the requirement for prior notice or tracing and to permit one QLFC to borrow funds from another related QLFC.

Attached hereto are the proposed amendments outlined above. We have discussed these amendments with the staff of the Joint Committee on Internal Revenue Taxation. The undersigned will be available at the hearings to answer any questions which the committee may have with respect to these amendments.

Very truly yours,

PAUL M. BUTLER, Jr.

PROPOSED AMENDMENTS TO THE INTEREST EQUALIZATION TAX ACT RELATING TO EXPORT LEASE FINANCING AND TO QUALIFIED LENDING AND FINANCING CORPORATIONS

I

Under section 4020(a)(1)(A) of the Internal Revenue Code of 1954, a lease will be treated as a debt obligation for purposes of the interest equalization tax if it is entered into principally as a financing transaction. Under section 4012(b)(3), a domestic corporation engaged in this type of leasing to foreign lessees may be treated as having been formed or availed of for the principal purpose of obtaining funds (directly or indirectly) for a foreign obligor. As a result, if the lessor borrows funds from a United States person to purchase the property subject to the lease, the lender is deemed to have acquired from the foreign lessee a debt obligation of such foreign lessee. Under present law, the lessor is not subject to interest equalization tax if the property subject to the lease is produced in the United States. However, there is no exemption for the United States person lending funds to the lessor to purchase the export property. In order to provide an exemption for such loans, it is proposed that section 4914(c) be amended as follows:

(1) Subsection 4914(c) is amended—

(A) by redesignating paragraphs (7) and (8) as (8) and (9); and

(B) and by inserting after paragraph (6) the following new paragraph:

"(7) Loans to Lessors of Export Property—The tax imposed by section 4911 shall not apply to the acquisition of stock or a debt obligation of a domestic corporation described in section 4912(b)(3) (and such acquisition shall not be deemed an acquisition of stock or a debt obligation of a foreign issuer or obligor under such section) or to the acquisition of a debt obligation of a domestic corporation described in section 4920(a)(3B)(A) or a foreign corporation described in 4915(c)(2)(C) if—

(A) not less than 85 percent of the actual value of such stock or the face amount of such debt obligation is attributable to the acquisition for leasing of property manufactured, produced, grown, extracted, created, or developed in the United States, or to the performance of services by United States persons, or to both, and

"(B) the acquisition of the stock or the extension of credit and the acquisition of the debt obligation related thereto are reasonably necessary to finance or refinance the acquisition of such property or the services of United States persons."

It is requested that this proposed amendment be made effective for acquisitions of stock or debt obligations on or after February 1, 1973.

II

The present provisions of section 4920(d)(2) (relating to a qualified lending or financing corporation ("QLFC")) do not require a QLFC to use foreign source funds to acquire for leasing property manufactured or produced in the United States. However, neither this section nor the parallel provisions of section 4915 provide an exclusion for acquisitions by the QLFC of debt obligations arising out of exports or export property with domestic source funds. In order to permit a QLFC to use domestic source funds for these purposes, it is proposed that sections 4915(c)(1)(A)(i) and 4920(d)(2) be amended as follows:

(2) Subsection 4915(c)(1)(A)(i) is amended to read as follows:

"(A)(i) the amounts received by the corporation as a result of the acquisition will not be used to acquire stock of foreign issuers or debt obligations of foreign obligors, *the direct acquisition of which by the United States person would be subject to the tax imposed by section 4911*, or utilized in any way outside of the United States *other than the acquisition for leasing of tangible*

personal property manufactured or produced in the United States, or (ii) the funds used for such acquisition were obtained from sources outside the United States;".

(3) Subsection 4920(d)(2) is amended to read as follows:

"(2) all debt obligations of foreign obligors (*the acquisition of which by such corporation were it a United States person would be subject to the tax imposed by section 4911*) acquired by such corporation, and all tangible personal property not manufactured or produced in the United States acquired by such corporation for leasing, are acquired and carried solely out of—",

III

The present provisions of section 4920(d) do not permit a QLFC to own shares of any other corporation, except under limited conditions. Often it is necessary in order to isolate liability risks of ownership of leased property to establish more than one QLFC in a foreign country. In order to obtain the benefit of consolidated tax reporting in such country, it would be necessary for one QLFC to own one or more QLFCs organized in the same country. In other cases, in order to secure performance of a loan or lease, it is necessary to obtain a pledge of or security interest in stock of a foreign borrower or lessee or stock of a foreign corporation of the foreign borrower's or lessee's group. In order for such pledge or security interest to be meaningful, it is necessary for the QLFC to have the right to obtain ownership of the stock through foreclosure in the event of a default by the foreign borrower or lessee. In still other cases, the terms of a loan or lease give the QLFC a call on stock of the foreign borrower or lessee or stock of a foreign corporation of the foreign borrower's or lessee's group. The call is intended as a means of providing the QLFC with a method for receiving a "balloon" payment at the end of the loan term or to realize on the residual value of the property subject to the lease. Therefore, it is necessary for the QLFC to have the right to obtain ownership of the stock so that it may be resold at a profit, thereby giving the QLFC the additional payment under the loan or lease. In order to provide for the ownership of stock by a QLFC under these circumstances, it is proposed that sections 4020(d)(1) and 4020(d)(3) be amended as follows:

(4) Subsection 4920(d)(1) is amended—

(A) by redesignating subparagraphs (E) and (F) as (F) and (G),

(B) by inserting after subparagraph (D) the following new subparagraph (E):

"*(E) owning stock of a qualified lending or financing corporation,*" and

(C) by amending redesignated subparagraph (F) to read as follows:

"*(F)* carrying on incidental activities in connection with its business described in subparagraphs (A), (B), (C), (D), or *(E)*, or,".

(5) Subsection 4920(d)(3) is amended to read as follows:

"(3) such corporation does not acquire any stock of foreign issuers or of domestic corporations or domestic partnerships other than—

(A) stock of one or more members of a controlled group (as defined in section 48(c)(3)(C) of which such corporation is a member (or of a corporation which would be a member if it were a domestic corporation) acquired as payment for stock, or as a contribution to capital, of such corporation,

(B) *stock of a qualified lending or financing corporation,*

(C) *stock acquired through foreclosure where such stock was held as security for a loan or a lease, or*

(D) *stock acquired under the terms of a loan or a lease where such stock was held in connection with the residual value of the property to which the loan or lease relates; and*".

IV

The present provisions of section 4920(d)(2)(A) permit a QLFC to derive qualified foreign source funds through a sale of its own debt obligations or the debt obligations of a related domestic corporation described in section 4912(b)(3). In order to give effect to the mechanism provided by section 4912(c) whereby a domestic corporation may elect to have a specific issue of its debt obligations treated as debt obligations of a foreign obligor (the acquisition of which by a United States person would be subject to interest equalization tax), a QLFC should be permitted to derive qualified foreign source funds from a related domestic corporation which has made an election with respect to an issue of its debt obliga-

tions. In order to provide for this treatment, it is proposed that section 4920(d)(2)(A) be amended as follows:

(6) Subsection 4920(d)(2)(A) is amended to read as follows:

"(A) the proceeds of the sale of its debt obligations (including a sale in a transaction described in section 4919(a)(1)) by such corporation (or *of its debt obligations* by a domestic corporation which *has made an election under section 4912(c) with respect to such debt obligations, or a* domestic corporation described in section 4912(b)(3), which is a member of a controlled group, as defined in section 48(c)(3)(C), of which such corporation is a member) to persons other than—".

V

The present provisions of section 4920(d)(2)(A)(iii) require a related foreign corporation which intends to lend funds to a QLFC to give prior notice of a sale of its debt obligations and to be able to trace funds loaned to a QLFC to a sale of such debt obligations. Where a QLFC is an affiliate of a domestic commercial bank, no prior notice or tracing is required if the QLFC were to borrow from a foreign branch of such domestic commercial bank. However, such prior notice and tracing are required if the QLFC borrows from a related foreign corporation which is a commercial bank. It has been discovered that the requirement for prior notice and tracing is virtually impossible for a foreign commercial bank because it receives deposits daily with varying maturities. It is deemed appropriate to eliminate the requirements for prior notice and tracing when the related foreign corporation is a commercial bank, thereby according such entity treatment similar to that accorded a foreign branch of a domestic commercial bank. In other cases, it would be advantageous to use one QLFC as a borrowing vehicle for affiliated QLFCs in order to obtain the benefits of lower interest rates and favorable foreign tax laws, tax treaties and exchange control laws. In order to permit a QLFC to borrow from a related foreign commercial bank and form a related QLFC, it is proposed that section 4920(d)(2)(A)(iii) be amended as follows:

(7) Subsection 4920(d)(2)(A)(iii) is amended to read as follows:

"(iii) a foreign corporation (*not including a qualified lending or financing corporation or a foreign corporation engaged in the commercial banking business which acquires such debt obligations in the ordinary course of such commercial banking business*), if such corporation (or one of more includible corporations in an affiliated group, as defined in section 1504, of which such corporation is a member) owns directly or indirectly (within the meaning of section 4915(a)(1)) 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation, except to the extent such foreign corporation has, after having given advance notice to the Secretary or his delegate, sold its debt obligations to persons other than persons described in clauses (i) and (ii) and this clause and is using the proceeds of the sales of such debt obligations to acquire the debt obligations of such corporation (or such other domestic corporation),".

SHEARMAN & STERLING,
New York, N.Y., March 6, 1973.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of White, Weld & Co. Incorporated ("White Weld"), we respectfully request consideration by your committee of an amendment to the Interest Equalization Tax Act which would provide interest on a refund of an overpayment of interest equalization tax under the circumstances described below. In that connection, we are submitting this statement for inclusion in the record of your committee's hearings on H.R. 3577, the Interest Equalization Tax Extension Act of 1973.

White, Weld, a Delaware corporation, is a member of the New York Stock Exchange and other securities exchanges and is engaged in the securities business both as broker and as principal for its own account. In the course of its business, White Weld acquiries stock of foreign issuers and debt obligations of foreign obligors with respect to which it is subject to interest equalization tax imposed by section 4911 of the Internal Revenue Code of 1954. However, under the provisions of section 4919, White Weld is allowed a credit or refund of the tax to the extent such stock and debt obligations are resold to non-United States persons.

Under section 6011(d)(1)(A), White Weld is required to file an interest equalization tax return for each calendar quarter during which it incurs liability for tax. This return is due not later than the last day of the first month following such quarter. Frequently, White Weld does not resell the foreign stock or debt obligations with respect to which liability is incurred until after the due date for the quarterly return. Accordingly, White Weld is required to pay the tax shown on such return. Subsequently, White Weld resells the foreign stock or debt obligations to non-United States persons, thereby becoming entitled to a refund of the tax paid. White Weld has filed claims for refund with respect to such overpayments of tax and has experienced delays of up to 2 years in the processing of such refunds.

Under the present provisions of section 4919(a), White Weld is not entitled to interest on a refund, regardless of the length of time the Internal Revenue Service takes to process the claim for such refund. In order to provide equitable treatment for White Weld and other similarly situated taxpayers, it is proposed that the Interest Equalization Tax Act be amended to provide for interest on a refund which is not paid within 45 days after the date on which the claim for refund is filed.

Attached hereto are proposed amendments which will provide for interest on a refund under these circumstances. We have discussed these amendments with the staff of the Joint Committee on Internal Revenue Taxation. The undersigned will be available at the hearings to answer any questions which the committee may have.

Very truly yours,

PAUL M. BUTLER, Jr.

PROPOSED AMENDMENTS TO THE INTEREST EQUALIZATION TAX ACT TO PROVIDE INTEREST ON A REFUND OF TAX UNDER SECTION 4919

In order to provide for the payment of interest on an overpayment of interest equalization tax not timely refunded under section 4919(a) of the Internal Revenue Code of 1954, it is proposed that the second sentence of section 4919(a) be amended to read as follows:

"Under regulations prescribed by the Secretary or his delegate, credit (without interest) or refund shall be allowed or made with respect to such overpayment."

In order to provide a reasonable time for the processing of a claim for refund of an overpayment arising under section 4919(a), it is proposed that section 6611 be amended by redesignating subsection (h) as subsection (i) and adding the following new subsection (h):

"(h) Interest Equalization Tax Refund Within 45 Days After Claim for Refund is Filed.—If any overpayment of tax arising under section 4919(a) is refunded within 45 days after the date on which the claim for refund with respect to such overpayment is filed, no interest shall be allowed under subsection (a) on such overpayment."

STATEMENT OF C. M. HAFERKAMP, TREASURER, WEST INDIA SHIPPING CO., INC.

Mr. Chairman and members of the Committee, my name is C. M. Haferkamp. I am Treasurer of West India Shipping Co., Inc., a U.S. corporation which acts as a general shipping agent. The proposed extension and amendment of the interest equalization tax, in the form passed by the House, would have an unforeseen impact on: (1) current refinancing of existing debts incurred to acquire and construct ships built in U.S. shipyards, and (2) planned borrowings to build new ships in U.S. shipyards.

The company is general agent for a company which now owns 13 small specialized ships, all built in U.S. shipyards in Texas and Florida, at an original cost of over $16,000,000. The ships are open-deck landing craft, designed to carry heavy equipment fully assembled, unloading onto beaches if necessary, where no port facilities exist. The principal products carried are United States exports of oil drilling and refining equipment, construction equipment, generating plants, chemical and manufacturing plants and the like. We serve American oil companies, contractors and heavy manufacturers. While these ships are under Liberian flag, all our ship construction, reconstruction, maintenance and repairs are done in U.S. shipyards. We know of no U.S.-flag ships in existence similar to ours.

At the present time, the company has an outstanding loan from a U.S. bank of $11,875,000, secured by a mortgage on all our ships. We must now refinance this loan, and also arrange for an additional loan to cover building of another planned ship in a U.S. shipyard.

The proposed amendments to the interest equalization tax, as they now stand, would impose a heavy penalty on us, despite the fact that we buy our ships in the United States, and despite the fact that we assist many U.S. companies in their exports. The Liberian corporation for which we are agent would lose its "less developed country" exemption and be subject to a major tax penalty.

We seek a minor amendment to the House bill which would (1) permit us to refinance our present loan without interest equalization tax penalty and (2) permit us to make additional loans for construction or reconstruction of ships in U.S. shipyards, without penalty. The amendment would hurt no U.S.-flag shipping company, would create business for U.S. shipyards, and would assist American companies to earn foreign exchange by shipping their equipment abroad on our ships.

The Ways and Means Committee stated the reason for repeal in the following language:

"* * * Furthermore, it appears that this exclusion has also had the effect of encouraging the use of U.S. funds for the construction of ships in other developed countries (not the United States) * * *"

The amendment we propose would allow U.S. funds to cover the cost of construction of ships in U.S. yards. Furthermore, the amendment is consistent with the encouragement of increased foreign investment in the United States.

Proposed Amendment to H.R. 3577

Section 3(b) of H.R. 3577 is amended by adding a new paragraph (5) to subsection (e)

"(e) Issues After January 29, 1973, In Case of Shipping Companies in Less Developed Countries—

"(1) Repeal of Exclusion.—Except as provided by paragraphs (2), (3), (4) and (5), subsection (a)(2) shall not apply to acquisitions of stock or debt obligations of a corporation described in subsection (c)(1)(B) (relating to less developed country shipping companies) which were issued on or after January 30, 1973.

* * * * * * *

"(5) Exception for Certain Refinancings and Construction.—Paragraph (1) of this subsection shall not apply to an acquisition if the purpose of that acquisition is—

"(A) the refinancing of a debt outstanding on January 29, 1973 secured by vessels constructed or reconstructed in the United States and registered under the flag of a less developed country, or

"(B) the financing of future construction or reconstruction in the United States of vessels to be registered under the flag of a less developed country."

Statement on Behalf of Bralorne Can-Fer Resources, Ltd.

Summary of Statement

(1) The interest equalization tax presently exempts from tax the stock of foreign companies which on July 19, 1963, the effective date of the original interest equalization tax, was more than 65% United States owned by classifying the issuing companies as domestic corporations.

(2) Companies which have achieved more than 65% United States ownership since July 19, 1963 are subject to the interest equalization tax as they continue to be treated as foreign despite their substantial United States ownership.

(3) The purpose of the tax is to equalize the cost of capital between foreign and United States capital markets, and limit the access of foreign owned companies to the United States capital market.

(4) To treat foreign corporations which are more than 65% United States owned as if they were domestic corporations for interest equalization tax purposes is reasonable for such companies are substantially American and should have free access to our capital markets.

(5) However, limiting this classification to those foreign corporations qualifying on July 19, 1963 is discriminatory, and there is no rational basis for the discrimination.

(6) This inequitable discrimination should be ended by amending H.R. 3573 to broaden the law and to free from interest equalization tax companies which currently have more than 65% United States ownership.

STATEMENT

Introduction

The pending Interest Equalization Extension Act should be revised to amend Section 4920(b) of the Internal Revenue Code to eliminate unwarranted discrimination against certain foreign corporations. That revision would provide that a foreign corporation shall not be considered a foreign issuer with respect to any class of its stock if, as of the corporation's latest record date before July 19, 1963 or before January 1, 1973, more than 65% of such class of stock was held of record by United States persons. However, no shares qualifying under the amendment would be treated as domestic prior to the date of enactment so that no one would receive a refund of tax as a result of this change. A proposed draft of the suggested change to Section 4920(b) is attached as Appendix A to this statement.

The purpose of such an amendment would be to enable corporations which are now essentially United States owned to have access to the United States capital markets without regard to the barrier of the interest equalization tax.

In General

The Internal Revenue Code provides for the imposition of an interest equalization tax on the stock and debt obligations of foreign issuers when acquired by United States persons. The tax is designed to equalize for foreign persons the cost of acquiring capital in the United States as against acquiring capital in other markets and to prevent foreign issuers from excessively depleting United States capital resources. The equalization tax is necessary as the cost of capital in the United States has been less than overseas. This differential would result in a substantial outflow of dollars in the absence of the tax. The original interest equalization tax was adopted in 1963 and has been extended several times. The current tax expires on March 31, 1973 and H.R. 3577 proposes to extend the tax until June 30, 1974.

Section 4920(b) presently provides that a foreign corporation (other than an investment company) shall not be considered a foreign issuer with respect to any class of its stock if (a) as of the corporation's latest record date before July 19, 1963, more than 65% of such class of stock was held of record by United States persons, or (b) the class of stock had its principal market during the calendar year 1962 on one or more of the national securities exchanges registered with the S.E.C. and as of the corporation's latest record date before July 19, 1963 more than 50% of such class of stock was held of record by United States persons.

As can be appreciated, Section 4920(b) has the effect of freeing from interest equalization tax the stocks of companies which meet the foregoing definition. It would seem that the underlying rationale of this provision of the statute is that where corporations are substantially United States owned they are in essence United States corporations, even though they may happen to be incorporated abroad, and as such should have free access to United States capital markets. Thus, it would seem that all corporations which could demonstrate they were substantially United States owned, whether in 1963 or subsequent to that time, should be entitled to similar treatment.

The foregoing result would be achieved by the proposed legislative change which would expand Section 4920(b) by classifying as domestic after the date of the amendment the stock of any foreign corporation which on its latest record date before January 1, 1973 had more than 65% of such class of stock held of record by United States persons.

The Bralorne Can-Fer Co.

This amendment is sought on behalf of Bralorne Can-Fer Resources Limited, a Canadian natural resources company, although it is assumed that there are a number of other corporations which are similarly situated. The original Bralorne company (Bralorne Pioneer Mines Limited) was incorporated under the laws of the Province of British Columbia, Canada, in 1931 and was largely Canadian owned. In January 1968, Can-Fer Mines Limited, a Canadian corporation then engaged in mineral exploration in Canada, and owned primarily in the United States, acquired a small interest in Bralorne, then mainly engaged in operating a gold mine. Late in 1969, the companies combined, Bralorne, the smaller company, issuing stock for the assets of Can-Fer, and changing its name to Bralorne Can-Fer

Resources Limited. Thus, the present company is a composition of both companies, although the former Can-Fer shareholders have the major interest in the combined companies. The company presently is engaged in a variety of mining and related activities in the natural resources area. Its stock is listed on the Montreal, the Toronto and the Vancouver stock exchanges, and both now and in 1963 was traded "over-the-counter" in the United States. It has one operating subsidiary in the oil and gas business.

While Bralorne's operations are centered in Canada, approximately 75% of its shares are now owned by United States persons. In fact, it maintains a co-transfer agent in the United States for the convenience of United States shareholders. As of April 27, 1972, Bralorne had 4,851,645 shares outstanding, 3,616,771 of which were held by United States persons. Of its 7,209 shareholders, 4,457 were United States persons. Thus, approximately 75% of its shares are owned by United States persons and approximately 62% of its shareholders are United States persons.

Bralorne is presently treated as a foreign issuer under the interest equalization tax law and it cannot presently qualify under Section 4920(b). On its predecessor company Can-Fer's last record date before July 19, 1963, approximately 56% of Can-Fer's then outstanding shares were owned by United States persons and it was not listed on a U.S. national security exchange. Its predecessor company Bralorne Pioneer had no significant U.S. ownership on July 19, 1963.

Reasons for the Proposed Change

The original Interest Equalization Tax Act as it passed the House of Representatives had a provision, Section 4920(b)(1)(B), treating as a domestic corporation a foreign corporation (other than an investment company) whose stock was traded on a national securities exchange, provided more than 50% of the stock was held by U.S. persons and had its principal market in the United States. The Senate Finance Committee added a provision, Section 4920(b)(1)(A), to qualify a foreign corporation for this treatment if 65% of its stock was owned by Americans on the latest record date before July 18, 1963. There is no specific discussion in the committee reports concerning the precise purpose of the original proposal or the Senate Finance Committee modification. One can deduce, however, from these provisions that Congress was concerned that corporations which had a substantial U.S. share interest would be handicapped by the interest equalization tax and chose not to impose that burden upon them.

In other words, this provision recognizes that while the incorporation of a company as United States or foreign may often be an appropriate dividing line between imposing the interest equalization tax or not, testing the imposition of the tax on this basis does not always produce the correct result. What Congress has also said in our interest equalization tax is that Americans are entitled to have access to the capital markets of the United States as in the past; foreign corporations are also welcome to use our capital markets, provided that they pay a modest additional price. However, in setting out this conclusion Congress recognized that no tax should apply where the foreign corporation is substantially U.S. owned.

It follows, then, that any company which can demonstrate that it is essentially American owned under the basic tests already established by Congress should be entitled to free access to the U.S. capital markets. Bralorne is presently in this position, and accordingly asks that Section 4920(b) be amended to recognize that it is essentially now an American company.

The following additional arguments support the wisdom of this suggested change:

1. Under Section 4920(b) as it stands at present a company which was 65% owned in the United States in 1963 continues to be free of interest equalization tax even though its U.S. shareholders have largely sold their interest and it can no longer be fairly considered a United States company. In view of this very liberal rule for continued qualification for exempt status, despite a decline in United States ownership, it seems proper that companies which since 1963 have become more than 65% United States owned should be permitted to qualify for exempt status. To suggest that a company's domestic status in 1963, if favorable then, should always continue, but if unfavorable then, can never change, ignores the basic purpose of the tax and the logic of Section 4920(b): American companies, wherever incorporated, should have free access to the U.S. capital market.

2. The present rule discourages Canadian investors from acquiring the shares of American investors, thus preventing American investors from bringing home their Canadian investments. This result seems inconsistent with the purposes of the interest equalization tax. The result follows from the fact that the stock is cheaper

in Canada than in the United States because of the tax, so that Canadian investors will always buy Canadian shares. To the extent their purchases push up the price of the stock in Canada, the United States market follows, so the barrier continues. The ending of the tax on the shares would permit the United States-Canada market to develop naturally.

3. New issues of securities by corporations organized in Canada and Japan are free of interest equilization tax in any event under special rules authorizing exemptions for new issues where required for international monetary stability. This exemption not only dies not alleviate the basic problem here—discrimination against those currently holding shares of American owned foreign companies—but, if used, introduces additional discrimination against current shareholders.

4. The expressed intention of the President to phase-out interest equalization tax justifies prompt action to liberalize the present law. Bralorne and companies similarly situated should not be forced to wait until the tax expires to be treated equitably.

5. The proposed change presents no difficult problems of administration. Companies qualifying as domestic under the proposed change can present the pertinent facts to the Internal Revenue Service which can publish a list of qualifying companies as was done previously for companies qualifying on July 19, 1963. A Treasury Department assertion of administrative complexity would be unwarranted.

Conclusion

It would be equitable and desirable to amend Section 4920(b) to permit companies organized since 1963 and those which have become American owned since 1963 to qualify as domestic issuers so they are free of the interest equalization tax. Such an amendment would do justice to American companies which happen to be incorporated abroad and would be consistent with the original intention of Congress. No refunds of tax previously paid would be involved, and such an amendment would not set any undesirable precedent. Furthermore, no group of shareholders would profit from such a change, since it could be expected that on the adoption of such an amendment the presently higher United States price because of the tax would drop to the foreign price which represents the true underlying value of the security.

PROPOSED AMENDMENT TO SECTION 4920(b)

(b) FOREIGN STOCK ISSUES TREATED AS DOMESTIC.—

(1) IN GENERAL—For purposes of this chapter, a foreign corporation (other than a company registered under the Investment Company Act of 1940) shall not be considered a foreign issuer with respect to any class of its stock if—

(A) as of the corporation's latest record date before July 19, 1963, more than 65 percent of such class of stock was held of record by United States persons, or

(B) the class of stock had its principal market during the calendar year 1962 on one or more national securities exchanges registered with the Securities and Exchange Commission, and, as of the corporation's latest record date before July 19, 1963, more than 50 percent of such class of stock was held of record by United States persons, or

(C) *with respect to any period beginning after the date of enactment of this subparagraph, as of the corporation's latest record date before January 1, 1973, more than 65 percent of such class of stock was held of record by United States persons.*

AMERICAN COMMITTEE FOR FLAGS OF NECESSITY,
New York, N.Y., March 8, 1973.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
Dirksen Office Building, Washington, D.C.

DEAR SENATOR LONG: In response to your Committee's press release of February 28, 1973 I would like to comment on H.R. 3577, but only with respect to the provisions which would result in an across-the-board removal of the interest equalization tax ("IET") exemption currently applicable to ships under certain foreign registries controlled by American citizens or by citizens of less developed countries. For the reasons stated herein, I would also like to propose for your

Committee's consideration a modification of the provisions in H.R. 3577 relating to such vessels.

I am submitting these comments and proposed modification on behalf of the American Committee for Flags of Necessity, a maritime trade association of American companies controlling 10.4 million deadweight tons of Liberian and Panamanian flag vessels. These ships make up a very substantial part of the U.S. effective control fleet. Unlike other foreign flag vessels, they are unique in that they are available to the United States in the same manner as U.S. flag vessels in the event of war or national emergency.

I have been advised that the purpose underlying the Department of the Treasury's proposal to eliminate the IET foreign shipping exemption was to curtail efforts by some companies to avoid chargeability under the Foreign Direct Investment controls ("OFDI") and/or the Voluntary Foreign Credit Restraint Guidelines of the Board of Governors of the Federal Reserve System ("VFCR"). However laudable this purpose may be, I do not believe that the specific problem of nonchargeability can justify the across-the-board approach taken in H.R. 3577.

The blanket repeal of the IET exemption would penalize those American companies which, to the extent that domestic source funds are being used for ship construction abroad, are charging such funds pursuant to OFDI or VFCR. This approach is so sweeping that it would make those companies, which have complied with the spirit and intent of the various restraints on capital outflows, pay an additional price, simply because others may have succeeded in avoiding OFDI or VFCR chargeability.

It would seem to me that any such non-chargeable situations could best be handled through a simple modification of OFDI and/or VFCR. However, if your Committee concludes that the non-chargeability problem can best be met by restructuring IET coverage, then I would recommend that *the IET exemption be eliminated only in those cases where there is no chargeability under OFDI and/or VFCR*. This modification would accomplish the objective of inhibiting otherwise unrestricted capital outflows yet would not unnecessarily and unjustly affect those transactions already subject to OFDI or VFCR restraints.

Because of prevailing financing patterns the shipping provisions now appearing in H.R. 3577 would have a minimal balance of payments impact. In my judgment the only predictable effect of the bill as it now stands is that American shipowners would be burdened with additional ship construction costs. This is so because both near and long term opportunities to obtain foreign source funds with the terms needed to build modern vessels are, at best, unsure. In all likelihood shipowners would have to rely primarily on domestic source funds and thus incur IET liabilities—a result which would accomplish nothing in terms of our balance of payments yet would needlessly increase costs.

I am also concerned by the fact that the foreign shipping provisions currently appearing in H.R. 3577 could directly inhibit the growth of U.S. effective control shipping at a time when, particularly because of mounting energy needs, such shipping is assuming even greater importance. It is these U.S. effective control ships which together with U.S. flag bottoms must be relied upon to handle both military and civilian sealift requirements in the event of an emergency. It should be noted that any restraint on the expansion of the U.S. effective control fleet would not help its counterpart, the U.S. flag fleet, in any way nor could it help the U.S. shipbuilding industry in any way; it could only succeed in encouraging the growth of foreign owned shipping, to the detriment of important national interests.

The recent announcement by Secretary of the Treasury of the impending demise of IET underscores the need to avoid any needlessly restrictive action with respect to shipping. Due to a current ship construction lead time of about three years, the impact of any restrictions on financing of vessels brought about by H.R. 3577 would not be substantially felt until 1976 or 1977—at a time when, we are told, there may be no IET restrictions whatsoever. Taken in this perspective, the predictable result of the current language in H.R. 3577 would be to complicate and obstruct near term planning for financing of vessels to be delivered during the latter half of the 1970's.

I hope you will agree that this postponed effect of H.R. 3577, coupled with the announced phasing out of capital outflow restrictions, argues strongly that the shipping provisions in the bill should be modified by your Committee, either by keeping intact the IET foreign shipping exemption under current law (perhaps in favor of an appropriate amendment to OFDI or VFCR regulations which

would extend coverage to otherwise non-chargeable transactions) or by repealing the IET exemption only in those transactions where OFDI or VFCR chargeability has not been effected.

This latter approach could be achieved by adding a further subparagraph to Section 8(b) of H.R. 3577 to the following effect:

"EXCEPTION FOR CERTAIN OBLIGATIONS.— * * *

"*Provided, however*, That subsection (e)(1) shall not apply to an acquisition of an obligation the issuance of which involved a corresponding transfer of capital by a Direct Investor under the Foreign Direct Investment Program authorized by the President of the United States under Executive Order Numbered 11387, dated January 1, 1968 and/or a corresponding charge within the guideline ceilings of banks or non-bank financial institutions under Voluntary Foreign Credit Restraint Guidelines of the Board of Governors of the Federal Reserve System."

I apprecite being afforded the opportunity to state our position and would be pleased to meet with you or your staff to discuss in further detail any aspect of this matter.

Sincerely,

PHILIP J. LOREE.

HOUSEHOLD FINANCE CORP.,
Washington, D.C., March 8, 1973.

Mr. TOM VAIL,
Chief Counsel, Senate Committee on Finance,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Pursuant to the February 28, 1973 "Press Release" of the Committee on Finance, United States Senate, we appreciate the opportunity to submit the attached letter and suggested amendment o H.R. 3577.

The amendment pertains to Section 4920(d)(2)(B) of the Internal Revenue Code and would relieve a situation created when amendments were adopted to the Act in 1971.

In preparing to organize a subsidiary to engage in consumer financing in the United Kingdom, an apparent inequity in the present Interest Equalization Tax laws was brought to our attention. A change in the law as suggested in the attached letter from our accounting and tax advisors, Haskins and Sells, would simply enable two or more U.S. Corporations to join together in organizing a foreign lending company to do what one U.S. Corporation is now permitted.

We respectfully request that the Senate Committee on Finance give this matter close consideration.

Sincerely,

J. THOMAS NELSON.

HASKINS & SELLS,
Washington, D.C., March 7, 1973.

HOUSEHOLD FINANCE CORP.,
Prudential Plaza,
Chicago, Ill.
(Attention Mr. D. C. Clark, treasurer.)

DEAR SIRS: The purpose of this letter is to explain certain technical provisions of the interest equalization tax statutes as they relate to your proposed operations in the United Kingdom. As the letter will point out, these provisions present a serious roadblock to the United Kingdom venture. We are, therefore, including in the letter suggestions for a remedial amendment to the Internal Revenue Code which you may wish to present to appropriate Congressional committees. The discussion is based on our understanding of the pertinent facts as set forth below.

Household Finance Corporation (HFC) proposes to organize a subsidiary to engage in consumer financing in the United Kingdom. The laws of that country require that a United Kingdom subsidiary be utilized in this business in order to borrow funds in the sterling market. Because of the intricacies of the U.K. laws dealing with lending, it is necessary to have the technical knowledge of banking specialists in this venture. Therefore, HFC proposes to have 24.9% of the stock of the subsidiary owned by a major United States one bank holding company (Bank). Because of strictures in the United States Federal Reserve Act where there is a one bank holding company involved, its ownership interest must be less than 25% in order for the holding company's bank to extend credit to the proposed U.K. lending subsidiary.

The specific interest equalization tax provisions with which we are here concerned are Section 4915(e) and 4920(d) of the Internal Revenue Code which were amended by the Revenue Act of 1971. The purpose of the amendments was to enable United States lending companies to operate abroad without suffering interest equalization tax (IET) on obligations acquired abroad through foreign subsidiaries.

In order to facilitate understanding of the exemption provision, it may be helpful to review at the outset the basic principles of the interest equalization tax. The principles are as follows: The interest equalization tax applies generally to the acquisition by a United States person of stock of a foreign issuer or obligations of a foreign obligor. Currently the rate is 11.25% on foreign stock and is graduated from 0 to 11.25% on foreign indebtedness, depending upon maturities. An exemption applies where the person acquiring the stock or obligations owns at least 10% of the combined voting power of the corporate issuer or obligor. This exemption does not apply, however, if the foreign corporation is "formed or availed of for the principal purpose" of acquiring securities, the direct acquisition of which by the 10% or more shareholder would be subject to IET.

Thus, in the absence of the 1971 amendments a United States finance company could be subject to interest equalization tax on its stock investment in a foreign lending subsidiary because the obligations acquired by the subsidiary would be subject to IET had they been acquired directly by the parent. The 1971 Act made an exception to the exception, that is, it provided that a foreign lending company as defined in the amended provisions would not be considered a formed or availed of company. One of the requirements which must be met before this exemption applies is that any capital contributed to the foreign lending subsidiary be borrowed abroad or that it be retained in the United States. Moreover, capital contributed by a shareholder owning 50% or less cannot be transferred abroad even though it may have been derived from foreign-source borrowings. Capital contributed by such a shareholder would have to be retained as a United States bank account or invested in other United States assets owned by the foreign lending subsidiary.

It can be seen that the above provisions preclude United States companies from joining together to form a foreign lending company without retaining at least part of the capital contribution in the United States. If both United States shareholders own 50% of the subsidiary, then neither could transfer its capital contribution abroad. Even where the percentages are not equal, one of the two corporate shareholders would have to retain its capital investment in the foreign subsidiary in the United States. In your proposed U.K. operation this restriction would apply to the Bank, thus limiting the amount that can be used in the foreign lending business. If the Bank violates this restriction, IET would apply to the entire stock in the U.K. subsidiary, both that held by HFC and that held by the Bank.

It would seem that the restriction on transfers of funds abroad by a shareholder owning 50% or less of the subsidiary's stock is unnecessary and was probably unintended. Elimination of this restriction would have no affect on the balance of payments because of the requirement that the capital contribution be obtained from foreign borrowings. A change in the law would simply enable two or more United States corporations to join together in organizing a foreign lending company to do what one United States corporation can now do.

The foregoing inequity in the law could be eliminated by modifying the definition of a qualified lending and finance corporation in Section 4920(d)(2)(B). The modification could remove the restriction on transfers of capital abroad by shareholders owning 50% or less of the shares of the foreign lending subsidiary. The restriction could be limited to a shareholder owning less than 10% of the shares, a change which would be compatible with the 10% direct investment exclusion in Section 4915(a)(1).

It is, of course, true that some relief would be provided by any reduction of the 50%-or-less rule described above even a change to a less-than-50% rule. Such a change would at least permit two equal United States shareholders to transfer their capital contributions abroad to the qualified foreign lending subsidiary. A change to less than 10% is suggested, because it is believed that administering the law, with respect to 10% shareholders would not impose any administrative burden on the Treasury, a burden that might arise if the Treasury had to determine that a number of shareholders with small interests did

in fact borrow abroad to make their capital contribution. As noted above this would be compatible with the 10% direct investment exclusion in Section 4915 (a)(1). In this respect it is important to point out that if the breaking point were as much as 25%, a shareholder bank (as in your proposed venture) would be unable to avail itself of the intended relief without restricting its ability to extend a foreign line of credit to the foreign finance company. This is because of the Federal Reserve Act limitation dealing with banks owning 25% or more of the stock of another corporation as explained above.

An amendment to the Internal Revenue Code to provide relief could be effected by deleting from Section 4920(d)(2)(B) of the Internal Revenue Code the phrase reading "by one or more members of a controlled group (as defined in Section 48(c)(3)(C)) of which such corporation is a member (or by a corporation which would be such a member if it were a domestic corporation)," and substituting therefor the following: "by a person owning 10 per cent or more of the total combined voting power of all classes of stock of such corporation."

Yours very truly,

HASKINS & SELLS.

O'MELVENY & MYERS,
March 7, 1973.

Re Interest Equalization Tax Extension Act of 1973.
Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Dirksen Office Building, Washington, D.C.

It is respectfully requested that your Committee consider in extension of the Interest Equalization Tax Act the following clarifying amendment to the present Act:

"SEC. 3. OTHER AMENDMENTS.—* * *

"(d) Formed or Availed of Domestic Corporations or Partnerships.

"(1) Section 4912(b)(3) is amended by adding at the end thereof, the following sentence:

" 'This paragraph shall not apply to the acquisition of stock or a debt obligation of a domestic corporation all of whose acquisitions of stock or debt obligations of foreign issuers or obligors are taxable under section 4911 or are exempt from tax under sections 4916, 4917, 4918, and 4920(b).' "

EXPLANATION

Section 4912(b)(3) of the present Interest Equalization Tax has proved impossible to administer for both the Internal Revenue Service and for companies subject to the tax. In its present form, 4912(b)(3) imposes a tax at the shareholder or partner level where a corporation or partnership is formed or availed of for the principal purpose of investing abroad. Under 4918(c) the corporation or partnership is then to be given a credit for tax paid at the shareholder or partner level.

We believe that section 4912(b)(3) was aimed at a situation where the sole purpose for making foreign investments through a domestic corporation or a partnership was to obtain the benefit of certain exclusions from Interest Equalization Tax available solely because of the corporate or partnership status. For example, ten partners of a U.S. partnership might invest 20% in a German corporation on a pro rata basis. If something like 4012(b)(3) did not exist, the partnership could claim the 10% or more investment exclusion of 4915(a) and the partners could claim their investment was only in a U.S. partnership. This is clearly a situation which should be covered by an avoidance preventive like 41912(b)(3).

On the other hand, we believe it is clear that Congress did not intend to impose a tax greater than that which would have been imposed if the shareholders or partners in the example above had purchased the foreign securities directly. This is evidenced by the credit section which presently exists in 4918(c).

The most difficult area where the present inadequacies of section 4912(b)(3) appear is that of registered investment companies investing in foreign securities. If the conduit principles outlined in the Committee Reports to the Interest Equalization Tax are followed with respect to an investment company which is availed of for the principal purpose of investing abroad, the Internal Revenue Service would have to examine the day-by-day status of foreign investments to deter-

mine what portion of a new shareholder's investment should be subject to tax. Because of the administrative impossibility of doing this, the Internal Revenue Service has taken the position that, where more than a de minimis amount of foreign investment is planned or carried on by an investment company, the whole issue of shares by the investment company may be subject to Interest Equalization Tax at the full rate. This is clearly not what Congress intended.

The difficulty with present 4912(b)(3) is caused by the tax at the shareholder or partner level. The amendment proposed above would leave to the Treasury or to appropriate Committee Reports the interpretation of the key term "the principal purpose" and of situations where new 4912(b)(3) is to be applied. However, the proposed addition to 4912(b)(3) would impose tax at the corporate level where all foreign investments of the domestic corporation were taxable or protected by sections 4916, 4917, 4918 or 4920(b). The exception of 4915 could not apply to a corporation excluded from operation of present 4912(b)(3) and other exceptions contained in the Interest Equalization Tax Act would not be available to such corporation.

This proopsed amendment has been discussed with Robert Cole of Treasury and Dr. Lawrence N. Woodsworth, Chief of staff of the Joint Committee on Internal Revenue Taxation and copies of this communication are being forwarded directly to them.

Respectfully submitted.

DONALD R. SPUEHLER.

EDWARDS & ANGELL,
Providence, R.I., March 6, 1973.

THOMAS VAIL, Esq.,
Chief Counsel, Senate Finance Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. VAIL: The undersigned, on behalf of the Industrial National Bank of Rhode Island, respectfully requests that the following underlined language be added to Section 3(b) of H.R. 3577:

"(2) Exception for preexisting commitments. Paragraph (1) of this subsection shall not apply to an acquisition—

"(A) * * *; or

"(B) as to which on or before January 20, 1973 the acquiring United States person (or, in a case where two or more United States persons are making acquisition as part of a single transaction, a majority of interest of such persons) had taken every action to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions, subject only to execution of formal documents evidencing the acquisition and to customary closing conditions, and the acquiring United States person (or persons)—

"(i) had sent or deposited for delivery to the foreign issuer or obligor from whom the acquisition was made, *or to the person which as of the date of such acquisition owned, as determined under Section 958(a), at least 80% of each class of stock of the foreign issuer or obligor, or to the agent or representative of such controlling person*, written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign issuer or obligor from whom the acquisition was made, *or by the person which as of the date of such acquisition owned, as determined under Section 958(a), at least 80% of each class of stock of the foreign issuer or obligor, or by the agent or representative of such controlling person*, which set forth the principal terms of such acquisition, or

"(ii) had received from the foreign issuer or obligor from whom the acquisition was made, *or from the person which as of the date of such acquisition owned, as determined under Section 958(a) at least 80% of each class of stock of the foreign issuer or obligor, or from the agent or representative of such controlling person*, a memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the acquiring United States person (or persons) which set forth the principal terms of such acquisition.

In October of 1972 Industrial National Bank of Rhode Island (the "Bank") received a proposal from an investment banker, who was acting as the agent

and representative of a United States ship operator, concerning the acquisition by Industrial National Bank of two petroleum carriers, which were scheduled for completion in 1974 and 1975, and the charter of such vessels to a wholly owned foreign affiliate of the United States ship operator. It is anticipated that the total cost of the vessels will be approximately $32,000,0000. In November, 1972 the Credit Policy Committee of the Bank approved the proposed acquisition which contemplated that the Bank, along with other equity investors who might agree to join with the Bank, would invest an amount equal to approximately 20% of the cost of each vessel, i.e. $6,000,000. The balance of the cost of each vessel, i.e. $26,000,000, was to be raised from lenders located by the investment banker. Prior to the end of 1972, a leasing company that is affiliated with the Bank by reason of common ownership had located other equity investors who had notified the leasing company of their intention to join with the Bank in the investment to the extent of approximately $8,000,000. Also prior to the end of 1972 the investment banker had obtained commitments from investment officers of certain institutional investors to provide the required debt investment. On January 4, 1973, first drafts of the Participation Agreement, which sets forth the terms and conditions of the transaction, and the form of Bareboat Charter Party under which the vessels are to be leased were circulated to counsel for the Bank, the investment banker, the Lenders and the U.S. ship operator.

The addition of the above suggested language to Section 3(b)(B)(ii) of H.R. 3577 will make it clear that the proposed amendment will not apply to preexisting commitments of the type described above. Although the above described commitments would not be covered by Section 3(b)(B)(i) of H.R. 3577 as the investment banker and U.S. ship operator were notified by telephone rather than by letter of the commitments of the equity and debt investors, I have suggested similar language in that provision in the interests of conformity.

Very truly yours,

BRENDAN P. SMITH.

SECURITIES INDUSTRY ASSOCIATION,
New York, N.Y., March 7, 1973.

Re Interest Equalization Tax Act of 1973, H.R. 3577.

Mr. THOMAS VAIL,
Chief Counsel, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. VAIL: The International Finance Committee of the Securities Industry Association supports the principal provisions of H.R. 3577.

While the Committee and its predecessors have long urged that the interest equalization tax, first enacted as a temporary measure in 1963, be terminated at the earliest possible opportunity because of the restrictions it imposes on the free flow of capital, it recognizes that it is not practical under current conditions to permit the tax to expire on March 31, 1973 as it would under the law currently in effect. The Committee supports the continuation of the tax to June 30, 1974 as provided in H.R. 3577, but it urges that the President exercise his authority under Section 4911(b)(2) of the Internal Revenue Code of 1954, as amended, to decrease the tax rates at the earliest time permitted by the United States balance-of-payments objectives. The Committee would be opposed to continuation of the tax beyond June 30, 1974.

The Committee has long supported an exclusion from the tax for direct investment in the United States, and approves in principal the exclusion provided in Sections 3 (c) of H.R. 3577. Technical comments on certain aspects of the exclusion have been discussed by the Committee's counsel with the staff of the Joint Committee on Internal Revenue Taxation, and it is hoped that these comments will be considered by the Senate Finance Committee.

The Committee has also long recommended that the exemption from estate tax in the present law for debt obligations of certain domestic corporations be extended to debt obligations of domestic corporations that are subject to the interest equalization tax by virtue of the election provided by Section 4912(c) of the Internal Revenue Code of 1954, as amended. The Committee therefore approves Section 3 (a) of H.R. 3577 which would accomplish this.

Very truly yours,

STEPHEN M. KELLEN, *Chairman, International Finance Committee.*

SINGER, LEVINE, SINGER & TODRES,
New York, N.Y., March 7, 1973.

Re H.R. 3577, Interest Equalization Tax Extension Act of 1973.

Hon. TOM VAIL,
Committee on Finance, U.S. Senate,
Dirksen Senate Office Building,
Washington, D.C.

DEAR MR. VAIL: It is respectfully requested that your Committee consider eliminating Section 3(b) of H.R. 3577 relating to repeal of exemption for shipping companies in less developed countries for the reason that press of time has prevented sufficient study and comments. As a result, this hasty legislation will adversely affect United States persons with respect to their holdings of shipping companies.

Specifically, proposed subsection (e)(4) of Section 4916 is patently unfair to a large class of United States persons who, subsequent to January 29, 1973, became or will become holders of options to purchase stock (or indebtedness convertible into stock) or less developed country shipping companies. These securities have been traded in the public securities markets and American investors who exercise or convert, up until now, were protected from the burden of the Interest Equalization Tax by the shipping company exemption. Trading since January 29, 1973 undoubtedly has not diminished, and American holders, upon enactment of H.R. 3577 in its proposed form, will have a rude awakening to the fact that exercise and conversion will subject these American holders to an interest equalization tax. Even the January 29, 1973 holder is not protected economically by Section (e)(4) because the selling price of the options or convertible debt will reflect a downward adjustment for the Interest Equalization Tax which his purchaser will ultimately have to pay.

It is an ironic anomaly that a holder who can avail himself of a proposed subsection (e)(3) of Section 4916 is in a much better position than the holder under Section (e)(4). Subsection (e)(3) exempts stock and debt obligations in a registration statement filed with the Securities and Exchange Commission within 90 days before January 29, 1973. Since the term "stock" and "debt obligation" include options to purchase stock and debts convertible into stock (Section 4920 (a)(1)(A) and (a)(2)(E)), the options and convertible debentures in subsection (e)(3) registration statements may very well escape the Interest Equalization Tax even if exercised or converted many years in the future.

In light of the anomalies of subsection (e)(3) and (e)(4) and the attendant harm to United States holders as well as the announced policy of the Administration not to seek a further extension of the Act, it is respectfully submitted that hasty action in eliminating exemptions which have been relied on in the past will result in unintended inequalities to United States persons. Accordingly, the proposed repeal of the exemption for shipping companies in less developed countries should be deleted.

Respectfully submitted,

MORTON LEVINE.

STATEMENT ON BEHALF OF THE KINGDOM OF THE NETHERLANDS, NETHERLANDS ANTILLES*

This statement is submitted on behalf of the Kingdom of the Netherlands—Netherlands Antilles in support of a proposal which would modify the effective date provisions of section 3 of H.R. 3577. Under the proposal, which is annexed as Exhibit A, section 3(a)(2) of H.R. 3577 would be modified to make such provision apply, with respect to debt obligations issued prior to January 1, 1973, only if the Interest Equalization Tax imposed by section 4911 has first expired.

The purpose of the proposal is to establish that debt obligations of financing corporations incorporated in foreign jurisdictions, including the Netherlands

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*The Law Firm of Silverstein and Mullens is registered with the Department of Justice under the Foreign Agents Registration Act of 1938 as amended as an agent of the Government of the Netherlands Antilles. Copies of the firm's registration statement are available for public inspection in the Department of Justice files.

This material is prepared and circulated by Silverstein and Mullens, 1776 K Street, N.W., Washington, DD.C. 20006, which is registered under the Foreign Agents Registration Act as an agent of the Netherlands Antilles Government, Willemstad, CuraCao, Netherlands Antilles. This material is filed with the Department of Justice, where the required registration statement is available for public inspection. Registration does not indicate approval of the contents of this material by the United States Government.

Antilles, would not be affected by the proposed amendment and that, in consequence, such corporations would not seek to reincorporate as domestic corporations in order to avoid existing local income taxes such as that imposed by the Netherlands Antilles on their net earnings.

On the other hand, new issues of debt obligations (not including those issued in substitution for existing obligations) would have available the provisions of section 3. Accordingly, holders of debt obligations of a domestic financing corporation which has made a proper election pursuant to section 4912(c) would enjoy the full benefits of section 3 of H.R. 3577.

REASONS FOR THE PROPOSED MODIFICATION

1. Economic Circumstances of the Netherlands Antilles Government

Since 1954, the Netherlands Antilles has been an economically autonomous partner in the tripartite Kingdom of the Netherlands (consisting of the Netherlands, the Netherlands Antilles and Surinam). Economic activity in the Netherlands Antilles has been traditionally heavily influenced by the operations of two oil companies, which process (on the islands of Curacao and Aruba) crude oil, mainly imported from Venezuela, for export to North America and Europe. Although in the early 1950s the oil operations resulted in the employment of more than 20,000 persons and contributed 40 percent of the Netherlands Antilles gross national product, this shrank sharply in employment and contribution to gross national product terms in the period approximately 1955–1965. From 1965 through 1968, some improvement in the economy occurred, resulting from modernization of the oil company investments, an expansion of tourism and the establishment of some new industries. Such changes in the trend of the economy did not, however, eradicate economic difficulties since such new jobs as were created by new industries produced wages at a lower rate scale than those payable in oil operations. In May, 1969, strikes and disorders occurred. These were settled by arrangements in which wage scales were significantly raised. Additionally, the Netherlands Antilles Government enacted intensified tax measures aimed at stabilizing the economy through additional employment opportunities and resulting improved consumer conditions. In consequence of these steps, the Netherlands Antilles domestic economic situation was strengthened. At the present time, however, unemployment is very high. Moreover, the Netherlands Antilles is not in a position to finance either social security or unemployment benefits. There has, in addition, been a major population explosion, contributing further to the potential of additional unemployment.

In consequence, all sources of revenues now available to the Netherlands Antilles are desperately needed to maintain the economy at its present level of stability. Any erosion of this income in the immediate future (particularly without opportunity to seek substitute sources) could seriously contribute to a rapid deterioration of the island's economy and social structure.

2. Netherlands Antilles Revenue Production

Although the Netherlands Antilles Government has traditionally maintained a moderate taxing structure needed to attract foreign private capital and know-how and to discourage emigration of skilled labor, income taxes and other indirect taxes have been increased in order to raise needed additional revenues. Under the emergency tax program adopted in 1970 and enacted in 1971, maximum marginal rates on personal income taxes reach 41.24 percent for married taxpayers and 44.12 percent for single persons. Corporate taxes are levied at a maximum rate of 34 percent on all taxable profits over NA f. 1 million. A summary of the types of taxes and actual and estimated collections is annexed as Exhibit B.

Notwithstanding the wide variety of direct and indirect taxes, the rate base to which the tax is applied is narrow. It is not believed, therefore, that such rates can be raised in the immediate future in form which would generate additional local revenues.

Because of its favorable tax climate, including its treaty relations with the United States, its geographical location and general congeniality to the United States, the Netherlands Antilles has been chosen as the place of incorporation for a substantial number of foreign financing subsidiaries.[1] In acting as a place

[1] A foreign finance subsidiary has been utilized in situations in which the subsidiary desired to make investments in its United States parent or a domestically incorporated affiliate of its parent or in a less developed country corporation.

of incorporation, the Netherlands Antilles, in turn, facilitated the United States in implementing its problems respecting foreign investments and has assisted thereby with the United States balance of payments problems.

Although precise figures identifying the portion of revenues attributable to foreign financing intermediaries is not available for earlier years, it is estimated that at the present time the tax attributable to these companies approximates $10 million, or 15 percent of the total revenue collections of the Netherlands Antilles Government.

3. Circumstances Which May Result from Enactment of Section 3 of H.R. 3577 Without Amendment

Section 3 of H.R. 3577 in its present form provides that holders of finance corporation debt obligations dying after January 1, 1973, can avoid United States estate tax if the issuing company reincorporates itself domestically and, as part of such reincorporation, effects a proper election under section 4912(c). While it is not possible to ascertain the number of corporations which would reincorporate, the likelihood exists that this will occur—either immediately or within the near-term future. Two circumstances result: (1) to the extent that reincorporation takes place, direct loss of revenue will result to the Netherlands Antilles; (2) since the opportunity for reincorporation will exist, the uncertainty as to the continued availability of the revenue collections will overhang near-term planning without opportunity for the Netherlands Antilles Government to reassess circumstances and develop, over a reasonable period of time, a program of substitution for such lost taxes.

On the other hand, the proposed modification to section 3 would—at least for the period in which the Interest Equalization Tax remains effective—assure the Netherlands Antilles of the revenue production attributable to the financing corporations.

While it is not possible to attribute portions of revenues to specific sectors of the Netherlands Antilles economy, it is to be noted that approximately 35–40 percent of the current budget is devoted towards education. Both the population explosion and the general rate of literacy have made this aspect of the island's social structure a crucial factor, and major efforts have been made to continue education at as high a level as possible. Any reduction in current revenues and any forecast of such loss of revenues will result in a comparable reduction in the portion of the budget attributable to education.

No alternate source of revenues is available. The lack of feasibility of raising existing tax rates has heretofore been noted. It is further to be observed that no opportunity exists in terms of the Netherlands Antilles' relationship with the Kingdom of the Netherlands to obtain direct grants to substitute for loss of current revenues.

In the absence of the income forecast from the operations of foreign financing companies, the possibility of further social disorders in both the near and long-term is high.

4. Effect of the Proposed Modification Upon United States Parent Corporations Owning Shares in Foreign Financing Subsidiaries

The acceptance of the proposed amendment would in no way prevent United States corporations from raising fresh capital abroad through all available means, including a United States financing subsidiary which makes an election under section 4912(c) and respecting which holders of its debt obligations would be assured exoneration from United States estate tax by reason of enactment of the new provision.

The only consequence of the proposed revision to prospective operation would be to assure that existing finance subsidiaries remain in the Netherlands Antilles. The initial and continuing costs of operation in the Netherlands Antilles were initially taken into account when the obligations were first issued. While the benefits (in terms of savings of Netherlands Antilles taxes) resulting from a domestic subsidiary, the benefit to its parent or the holders cannot be accurately determined. It would, in any event, constitute an unintended benefit which was neither anticipated at the time of initial offering and, so far as can be ascertained, has not been sought since initial offering. Such reincorporation, moreover, would not in any way improve the marketability of the obligations which, because of the favorable climate afforded by the Netherlands Antilles, have been freely negotiable since issuance.

The detriments which would directly result to the residents and to the general economy of the Netherlands Antilles can be immediate and severe.

In light of the proximity of the United States to the Netherlands Antilles and our interest in maintaining a benign and stable economy, capable of continuing oil production for domestic cosumption, in the islands, we submit that difficulties which can arise from an adverse change in the economic climate of the Netherlands Antilles far outweigh the casual benefits (to holders of pre-1973 debt obligations and possibly the issuing companies) which can accrue with respect to changes in the terms of existing debt obligations.

We, accordingly, urge that the proposed modification to section 3 be adopted by the Committee.

Respectfully submitted.

SILVERSTEIN & MULLENS,
LEONARD L. SILVERSTEIN.

ANNEX A. PROPOSED AMENDMENT

Amend Section 3(a)(2) of H.R. 3577 by inserting on page 2, line 14, after the words "decedents dying on or after January 1," the following:

"1973, except that in the case of obligations issued before January 1, 1973 (or obligations issued after such date in substitution of such obligations) only if the tax imposed by section 4911 has first expired."

TABLE III-3.—TAX COLLECTIONS BY CENTRAL GOVERNMENT AND ISLAND GOVERNMENTS COMBINED

[In millions of Netherlands Antilles guilders]

	1967	1968	1969	1970	[1] 1971	[2] 1972
Taxes on income and property:						
Income tax	23.1	26.5	25.1	35.1	41.0	45.0
Profit tax	32.1	35.0	38.8	46.0	59.0	60.0
Real estate and occupancy tax	3.7	5.5	5.0	4.7	4.7	6.0
Estate duties	.5	.4	.4	.4	.4	.5
Subtotal	59.4	67.4	69.3	86.2	105.1	111.5
Taxes on consumption:						
Import duties (except gasoline)	16.0	18.2	20.0	26.0	30.0	33.5
Duty on gasoline	7.5	9.4	10.0	11.0	12.0	13.5
Excise on liquor	4.0	4.2	4.4	5.3	5.7	6.0
Excise on beer	2.3	3.2	3.6	3.7	6.0	6.5
Excise on tobacco	.7	1.9	2.0	2.1	3.5	4.0
Motor vehicle fees	1.8	2.0	2.0	2.9	3.8	4.7
Stamp duties	3.6	3.8	3.8	4.3	4.8	5.0
Foreign exchange commission	2.2	2.8	3.1	3.2	5.0	6.0
Gambling licenses	1.1	1.2	1.6	1.6	1.6	1.8
Tax on licensing, transfers, and other	1.0	1.1	1.2	1.3	1.4	1.5
Subtotal	40.2	47.8	51.7	61.4	73.8	82.5
Total	99.6	115.2	121.0	147.6	178.9	194.0

[1] Revised forecast.
[2] Staff estimate.

Source: Netherlands Antilles Bureau of Statistics, Statistical Bulletin; and information provided by the Netherlands Antilles authorities.

DAVIS POLK & WARDWELL,
New York, N.Y., March 5, 1973.

Re H.R. 3577—Proposed Amendment to Section 4916(e)(3) of Internal Revenue Code submitted on behalf of Smith, Barney & Co. Inc.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Dirksen Office Building, Washington, D.C.

DEAR SENATOR LONG: We respectfully propose a technical amendment to H.R. 3577 designed to clarify the meaning of the "public offering exception" to the repeal of the exemption from Interest Equalization Tax for shipping companies in less developed countries. This submission is made on behalf of Smith, Barney & Co. Incorporated, the representative of a group of underwriters in connection with a current public offering of 600,000 shares of Common Stock of Angelicous-

sis Shipholding Group Limited. The registration statement with respect to these shares was filed with the Securities and Exchange Commission on December 18, 1972.

Based on prior experience, the meaning of subsection (A) of the proposed new Section 4916(e)(3) would be clarified if it were amended as follows (new matter underscored, deleted language in brackets):

> "(A) *with respect to the stock or debt obligation acquired,* a registration statement (within the meaning of the Securities Act of 1933) [was] *had been* in effect [with respect to the stock or debt obligation acquired] at the time [of its acquisition] *such stock or debt obligation was issued;*"

The language proposed to be revised is ambiguous in application, depending on conflicting views as to the period a registration statement remains "in effect". One view is that once a regisrtation becomes effective it continues to be "in effect" indefinitely, unless it is subsequently withdrawn by the registrant or its effectiveness is suspended by a "stop order" issued by the Securities and Exchange Commission. The other view is that the function of the registration statement is to register the securities for sale in the manner described therein, and that any resales by initial purchasers are evaluated independtly to determine whether an additional registration statement is required under the Securities Act for such subsequent transactions. Accordingly, there is some question whether all future sales of stock of an "LDC" shipping company initially covered by a registration statement, otherwise satisfying Section 4916(e)(3)(B) and (C), would continue to be exempt, as intended by the exception, without regard to whether a prior American Ownership exemption was available in respect of any share. We understand that the original intent of the exception subsumes the first view; this would be more clearly reflected, and more workable in the context of an excise tax that requires certainty of application, by adoption of the proposed amendment.

The proposed amendment has been submitted to and discussed with representatives of the Treasury and Joint Committee staffs. The undersigned will be available for questioning at the convenience of the Committee.

Respectfully submitted,

LYDIA E. KESS.

BANGOR PUNTA CORP.,
Greenwich, Conn., March 2, 1973.

Hon. RUSSELL B. LONG,
Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: In connection with your consideration of H.R. 3577, the Interest Equalization Tax Extension Act of 1973, I should like to bring to your attention a proposed amendment which would rectify what appears to be a legislative oversight in sections 861(a)(1)(G) and 4912(c) of the Internal Revenue Code as a result of their amendment by P.L. 92-9, 92d Congress, H.R. 5432, April 1, 1971, the Interest Equalization Tax Extension Act of 1971.

As you are aware, and as is explained in the Ways and Means Committee Report on H.R. 3577 at paragraph 2 of the General Explanation of the Bill, as well as in Senate Report 92-47 on H.R. 5432, March 26, 1971, the amendments made to section 861(a)(1)(G) and 4912(c) were designed to obviate the further necessity of employing foreign incorporated subsidiaries to obtain foreign funds, by allowing U.S. obligors to issue obligations directly, or through a U.S. incorporated subsidiary. By electing to have these obligations subject to the Interest Equalization Tax under the provisions of 4912(c), exemption from the withholding provisions of sections 1441 and 1442 would be provided under section 861(a)(1)(G) instead of the exemption provided under section 861(a)(1)(B) where the "80-20" test must be met.

Such exemption under section 861(a)(1)(G) is available in the following instances:

(1) Where the domestic obligor elects the provisions of section 4912(c) to debt obligations which are part of a new or original issue which when issued had a maturity not exceeding 15 years,

(2) Where the election is made in respect of an issue outstanding on April 1, 1971 which was treated as the debt obligation of a foreign obligor under section 4912(b)(3), and, which, when issued had a maturity not exceeding 15 years, and

(3) Where the election is made as a result of the assumption of the obligation

of an affiliated corporation. In this instance the date of the assumption is treated as the date of issue for purposes of measuring the 15 year maturity requirement of section 861(a)(1)(G).

Under present law the exemption of section 861(a)(1)(G) does not appear to be available to a domestic subsidiary which makes the election in its own behalf where the obligations were originally issued for (e.g.) 20 years, but as of the date of the anticipated election have less than 15 years remaining to maturity.

The anomaly in the present law is thus apparent—a parent corporation may, by its section 4912(c) election gain the benefit of section 861(a)(1)(G) by assuming the 20 year obligations of its domestic subsidiary when those obligations have 15 years or less to run to maturity—the domestic subsidiary itself may not gain the benefit of section 861(a)(1)(G) by electing under section 4912(c) when its 20 year obligations have 15 years or less to run to maturity.

In view of this anomaly, the patent discrimination against a class of obligations covered by indentures drafted without allowance for assumption, and the evident intent of the current legislation to facilitate the employment in the United States of foreign funds, the following amendment to H.R. 8577 is respectfully submitted for your consideration:

"SEC. 3. OTHER AMENDMENTS.

*   *   *   *   *   *   *

"(d) Technical Amendments.—

"(1) Section 861(a)(1)(G) (relating to interest not constituting gross income from sources within the United States) is amended by inserting "section 4912(c)(2) or (3)" in lieu of "section 4912(c)(2)."

"(2) Section 4912(c) (relating to election to subject certain debt obligations to tax) is amended by re-numbering paragraphs (3) and (4) as paragraphs (4) and (5) respectively, and adding after paragraph (2) the following new paragraph:

"(3) Election for outstanding obligations. In the case of debt obligations which are part of an issue outstanding within the meaning of paragraph (1)(B) an election under paragraph (1) shall be treated as the issuance of a new or original issue of debt obligations."

Your consideration of this proposed amendment to H.R. 8577 would be greatly appreciated. I would appreciate the opportunity of testifying in support of this amendment should you feel such testimony would be of benefit to the Committee.

Respectively yours,

DAVID L. OTTENSTEIN,
Assistant Vice President and Director of Taxes.

PAUL, WEISS, RIFKIND, WHARTON & GARRISON,
New York, N.Y.

DONALD C. EVANS, Jr., Esq.,
Joint Committee on Internal Revenue Taxation, Longworth House Office Building, Washington, D.C.

DEAR MR. EVANS: This letter will confirm our telephone discussion relating to the suggested technical amendment to section 4920(d)(3) of the Internal Revenue Code, which would permit a "qualified lending and financing corporation" (QLFC) to foreclose on stock which it holds as security for loans or lease obligations.

As you will recall, we originally proposed that QLFCs should be given the same right to foreclose on stock as commercial banks have under section 4914(b)(2)(B) of the Code. That section permits a bank to foreclose on stock held as security "for loans which were made in the ordinary course of its commercial banking business." Our proposal did not contemplate that a QLFC which found it necessary to foreclose on stock would be required to dispose of the stock within any specific time period. However, during the course of our discussions with you, as well as members of the staff of the Senate Finance Committee and the Office of the International Tax Legislative Counsel of the Treasury Department, we were advised that you would consider an amendment which would permit QLFCs to foreclose on pledges of stock if the QLFC sells or otherwise disposes of such stock within a relatively short period of time following the foreclosure.

As we have indicated to you, we believe that such a time limitation would be unnecessarily restrictive and might force a QLFC to sell stock acquired on foreclosure under distressed market conditions at a considerable loss. For example, in the common situation involving ship mortgage transactions, a QLFC will often require that the borrower-owner of the ship secure its borrowings by a pledge of its stock. Typically, the owner-borrower will be a "single purpose corporation" whose only asset is the ship which is being financed. In the event of a foreclosure the QLFC would by virtue of its ownership of the stock in substance become the owner of the ship and would have to find a buyer for the ship. Since a default is most likely to occur when the shipping market is in decline, it might be difficult to obtain a buyer on satisfactory terms within an artificially imposed time period. Even if it is possible to obtain a buyer relatively quickly, often the legal details involved in consummating the transaction may well require several months time to complete. Accordingly, we suggest that if a specific time period is imposed that the period should be at least 1 year. Even if such a longer period is permitted, unforeseen circumstances may arise which could make it difficult for the QLFC to satisfy such time requirement. Accordingly, we suggest that any legislation should include a provision which would allow the Secretary of the Treasury or his delegate to extend the period on application by the QLFC. Such a provision would be similar to that contained in section 1033(a)(3)(B) of te Code, relating to the period for replacing property which it involuntarily converted.

We are submitting as Appendix A all of the amendments to section 4920(d)(3) of the Code which were suggested in our March 8, 1978 letter to Chairman Long, revised to reflect the additional changes discussed above.

If you have any question about the foregoing, or if we can provide you with any additional information, please do not hesitate to let us know.

Very truly yours,

ALFRED D. YOUNGWOOD.

APPENDIX A

Section 4920(d)(3) of the Internal Revenue Code of 1954 is amended to read as follows:[1]

*　*　*　*　*　*　*

(3) such corporation does not acquire any stock of foreign issuers or of domestic corporations or domestic partnerships other than—

(i) stock of one or more members of a controlled group (as defined in section 48(c)(3)(C)) of which such corporation is a member (or of a corporation which would be a member if it were a domestic corporation) acquired as payment for stock, or as a contribution to capital, of such corporation; [and]

(ii) stock acquired by such corporation through foreclosure, where such stock was held by such corporation as security for loans (including obligations arising under leases which were entered into principally as financing transactions) or leases of tangible personal property made in the ordinary course of its business described in subsection (d);

(iii) stock of foreign corporations or domestic corporations which for the taxable year of such corporation in which the acquisition occurs are qualified lending or financing corporations, if immediately following such acquisition such corporation owns (directly or indirectly) 10 percent or more of the total combined voting power of all classes of stock of such acquired corporation; or

(iv) stock of partnerships, if immediately following the acquisition such corporation owns (directly or indirectly) 10 percent or more of the profits interest in such partnerships.

In any case in which subparagraph (iii) applied to the acquisition of stock and the corporation whose stock is acquired ceases at any time before the termination date specified in section 4911(d) to be a qualified lending or financing corporation, then as of such time the acquiring corporation shall be treated as

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[1] New matter is italicized; matter to be deleted is bracketed.

having utilized its funds in violation of regulations prescribed under section 4915(e)(1) for purposes of section 4915(e)(3). In any case in which a qualified lending or financing corporation acquires stock described in subparagraph (iii) or (iv) such stock shall be acquired and carried solely out of the sources described in subsection (d)(2).

In any case in which such corporation acquires stock in the circumstances described in subparagraph (ii) the acquiring corporation shall sell or otherwise dispose of all stock or the acquired corporation shall be liquidated—

(i) no later than 1 year after the date on which the acquiring corporation first acquired ownership of such stock, or

(ii) subject to such terms and conditions as may be spesified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

*   *   *   *   *   *   *

Department of Defense report on transfers of U.S. resources, fiscal years 1971–73

[In thousands of dollars]

Recipient country	Col. 1 Totals[1] 1971	Col. 1 Totals[1] 1972	Col. 1 Totals[1] 1973	Undelivered balance as of Dec. 31, 1971	Col. 2 Military assistance program[3] 1971	Col. 2 1972	Col. 2 1973	Col. 3 Military assistance service-funded 1971	Col. 3 1972	Col. 3 1973
Grand total[2]	5,701,280	6,211,854	5,928,176	925,183	752,485	528,756	503,412	2,325,950	2,339,400	2,055,000
(Total excluding U.S.)	(5,481,271)	(5,591,954)	(5,412,496)							
East Asia and Pacific										
Burma	438	32		53	59					
Cambodia	237,619	215,210	328,523	223,018	182,967	179,719	209,511			
China, Republic of	86,709	105,316	113,371	25,105	20,012	10,931	7,612			
Indonesia	23,936	21,515	34,751	21,155	16,822	18,009	28,715			
Japan	325	50,328	352							
Korea	476,864	473,181	425,606	278,163	285,233	150,000	215,710	205,250	188,900	133,500
Laos	212,910	500,464	421,300					155,800	210,200	360,000
Malaysia	2,128	767	181		228	134	181			
Philippines	18,801	20,131	28,864	50,570	17,000	14,043	20,780			
Singapore		625								
Thailand	152,996	110,518	99,686				59,951	113,000	66,101	
Vietnam, South	2,685,256	2,954,739	2,529,961					1,848,900	1,844,101	1,561,500
Regional	508	8,379	21,275		92	79	375			
Total	4,131,632	4,284,526	4,066,817	581,774	525,404	372,995	542,928	2,325,900	2,339,400	2,055,000
Near East & South Asia										
Afghanistan	201	250	215	9	261	250	215			
Ceylon	3,009		15	2,689	3,000		15			
Greece	63,312	84,353	97,974	21,881	19,999	9,883	9,551			
India	491	629	591	2,680	167	300	231			
Iran	121,605	152,532	207,232	9,056	2,310	935	492			
Kuwait		11,000	45,000							
Nepal	12	26	29	2	12	26	29			
Pakistan	361	545	695	4	174	85	213			
Turkey	145,354	132,317	153,520	115,605	93,646	60,000	85,611			
Classified (see supplement)	631,505	480,762	475,640	42,473	35,507	38,710	43,160			
Regional	19	19	3,099			19	93			
Total	971,190	891,258	1,016,793	230,502	161,408	110,228	142,952			
Europe										
Austria		61	74			13	21			
Belgium	344	352	321							
Denmark	599	358	361							
France	362	302	312							
Germany	1,553	1,273	1,344							
Italy	725	10,600	13,181							
Malta	167									
Netherlands	528	284	267							
Norway	560	302	286	193						
Portugal	1,500	5,610	3,345	2,674	1,035	1,010	905			
Spain	26,197	31,380	31,870	42,097	25,001	11,190	9,261			
United Kingdom		10,003	10,009							
Classified (see supplement)	16	12	21		16	12	24			
Regional	83	159	9,555	314	83	159	85			
Total	32,836	62,728	74,005	45,278	26,135	12,384	10,299			
Africa										
Ethiopia	15,087	12,559	15,750	9,611	12,031	9,000	12,139			
Ghana	53	48	55		53	48	55			
Libya	202	190	181							
Liberia	1,157	1,474	1,777	242	513	316	499			
Mali	1	52	50		1	52	59			
Mauritius	10									
Nigeria	18,449	3,553	64		213	107				
Senegal		25	25			25	25			
Zaire (Congo)	14,821	3,701	5,219	9	429	457	455			
Classified (see supplement)	22,661	21,061	22,321	6,693	5,255	2,702	4,659			
Regional	268	400	93		48	100	93			
Total	72,709	43,071	45,556	16,585	18,573	12,597	17,975			
Latin America										
Argentina	17,368	16,840	16,355	316	532	798	559			
Bolivia	2,823	4,911	10,312	3,516	1,774	3,352	4,873			
Brazil	12,559	22,234	17,337	2,050	929	895	988			
Chile	6,353	6,767	7,661	1,977	731	856	1,114			
Colombia	7,142	7,631	11,510	620	924	738	778			
Costa Rica	90	87	88							
Dominican Republic	2,010	1,778	2,163	1,378	1,258	828	1,435			
Ecuador	493	527	1,309	553	441	527	1,009			
El Salvador	734	562	1,150	264	413	502	805			
Guatemala	7,350	2,131	4,324	2,591	2,613	1,449	1,736			
Haiti	3,049									
Honduras	958	828	1,099	312	579	550	734			
Mexico	1,561	750	2,087		90	117	57			
Nicaragua	1,349	1,189	1,415	615	887	761	1,045			
Panama	690	879	915	879	511	462	527			
Paraguay	2,210	1,669	1,474	1,076	951	831	731			
Peru	752	1,048	5,993	652	558	879	820			
Uruguay	6,238	3,943	4,412	1,064	1,186	767	1,160			
Venezuela	9,238	12,018	16,735	19	986	722	870			
Regional	267	5,213	657	41	295	231	657			
Total	84,339	91,008	107,137	17,936	15,711	15,068	20,300			
DOD undistributed	8,665									
Oceania										
Australia	123,900	89,000	90,000							
New Zealand	10,933	10,000	5,000							
Regional										
Total	132,933	99,000	95,000							
Interregional, Cyprus, UNRWA	41,443	15,000	28,200							
General costs	5,254	5,363	68,988	33,058	5,254	5,363	68,988			
Administration	(13)	(13)	(13)		(13)	(13)	(13)			
Inspector general	(175)	(175)	(175)		(175)	(175)	(175)			
Supply operations	(2,357)	(1,607)	(65,634)	(33,058)	(2,357)	(1,607)	(65,634)			
Training, miscellaneous	(2,722)	(3,581)	(3,179)		(2,722)	(3,581)	(3,179)			

Recipient country	Col. 4 MAAG administration and training[3] costs 1971	Col. 4 1972	Col. 4 1973	Col. 5 Transfer of defense stocks (excluding excess defense articles)[4] 1971	Col. 5 1972	Col. 5 1973	Col. 6 Excess defense articles (legal value)[5] 1971	Col. 6 1972	Col. 6 1973	Cumulative loans to fiscal year 1971	Col. 7 Ships transfers (loans, leases)[6] 1971	Col. 7 1972	Col. 7 1973
Grand total	116,568	116,733	114,231	278,428	462,086	105,500	118,399	185,000	215,000	201,365	16,150	47,539	32,000
East Asia and Pacific													
Burma	383	32											
Cambodia	777	2,791	2,481				7,075	15,000	15,500				
China, Republic of	5,702	4,534	4,232				21,454	41,500	46,500	20,466	1,392	331	
Indonesia	631	1,848	1,599				957	3,500	4,500	7,460	5,493	1,167	
Japan	325	324	352					30,000		51,811			
Korea	11,965	11,597	14,896	111,028	101,456	200	16,375		35,000			3,163	5,700
Laos	3,609	3,251	2,500	12,690	7,410	9,000	N/A	2,500	2,000				
Malaysia	1,197	1,259	1,284				391	3,000	3,000	1,761		631	
Philippines	8,900	10,268	9,632	14,100	14,610			4,500	4,500	1,200		1,792	3,899
Singapore												625	
Thailand	41,500	41,583	11,500	137,610	338,580	96,600		N/A	33,400		2,880	2,607	
Vietnam, South													
Regional													
Total	77,102	80,614	76,359	278,428	462,086	105,500	46,253	103,000	103,000	82,691	9,765	9,820	9,500
Near East & South Asia													
Ceylon	2,050	2,013	2,020				20,557	25,500	25,500	17,556	2,676	597	5,900
Greece	321	323	357									4,283	
India	7,293	7,169	6,740										
Nepal	557	150	452							2,617			
Pakistan	4,754	4,532	4,592				38,514	40,000	40,000	11,710	2,500	12,605	5,100
Turkey	2,491	2,532	2,650				307	2,500	2,500				
Total	17,328	17,025	16,811				59,378	68,000	68,000	32,083	5,176	18,005	11,000
Europe													
Austria		50	53										
Belgium	344	352	351							467			
Denmark	599	358	363										
France	362	302	312							12,500			2,600
Germany	1,553	1,273	1,344							7,249	167		
Italy	725	600	584										
Netherlands	528	284	267										
Norway	560	302	256					2,000	2,000			2,167	
Portugal	465	463	410				125	6,000	6,000	21,370		15,184	15,600
Spain	1,071	1,006	1,009									3	
Total	6,409	4,550	5,006				125	8,000	8,000	41,586	167	17,354	18,200
Africa													
Ethiopia	2,701	2,559	2,611				355	1,000	1,000				
Libya	202	190	181										
Liberia	634	655	778				40	500	500				
Mali											10		
Nigeria	43	51	64										
Senegal	1,184	1,247	1,255				8						
Zaire (Congo)	1,324	1,359	662				1,052	2,000	2,000				
Total	6,088	6,064	5,551				1,455	3,500	3,500		10		
Latin America													
Argentina	826	793	805				196	800	500	7,500		219	
Bolivia	858	759	969						200	17,569	625		
Brazil	1,605	1,339	1,319							7,633		469	900
Chile	559	412	417				256		100	2,500		738	
Colombia	962	625	632								17		
Costa Rica	73	87	88				31	100	100		49	219	
Dominican Republic	699	601	628				52		300	2,133			
Ecuador	289	243	245				52		100			17	
El Salvador	499	385	353				212	300	200				
Guatemala	267	261	265				112		100		267		
Haiti												17	
Honduras	308	297	300				151	100	100		1,471	633	
Mexico	149	217	318					200	100			31	
Nicaragua	354	475	483				905	300	200				
Panama	194	169	174							7,167			
Paraguay	534	476	482				518	700	500				
Peru	852	859	865							533		467	
Uruguay	12	12											
Total	9,681	8,010	8,437				2,491	2,500	2,500	45,035	2,429	2,409	900
DOD undistributed							8,665						
Oceania													
Regional											933		
Total											933		

Recipient country	Col. 8 Real property transfers[7] 1971	Col. 8 1972	Col. 8 1973	Col. 9 Security supporting assistance[8] 1971	Col. 9 1972	Col. 9 1973	Col. 10 FMS credit sales 1971	Col. 10 1972	Col. 10 1973	Col. 11 Export-Import Bank military loans[9] 1971	Col. 11 1972	Col. 11 1973	Col. 12 Public Law 480 (sec. 104(c))[10] 1971	Col. 12 1972	Col. 12 1973	Col. 13 Purchase of local currency[11] 1971	Col. 13 1972	Col. 13 1973
Grand total	217,600	739,500	485,630	572,971	598,100	574,500	743,400	550,000	629,000	453,000	300,000	360,000	130,500	100,900	124,000	181,200	260,400	91,900
East Asia and Pacific																		
Cambodia				10,600	37,100	75,600							6,800	11,900	21,000			
China, Republic of							11,000	45,000	35,000									
Indonesia				11,150	47,600	49,800	15,000	15,000	25,000				20,000					
Korea							2,200											
Laos				16,905	15,000	25,000												
Thailand				375,686	385,000	585,000												
Vietnam, South				216	500	8,400		8,000	12,500				95,700	92,000	100,000	181,200	260,400	91,900
Total				505,315	484,400	743,500	35,200	68,000	92,500				130,500	100,900	121,000	181,200	260,400	91,900
Near East & South Asia																		
Greece							15,000	45,000	55,000									
Iran										120,000	140,000	200,000						
India											41,000	45,000						
Nepal								15,000	15,000									
Pakistan				5,000	95,000	90,000	355,200	312,000	370,000									
Turkey									3,000									
Total				5,000	95,000	90,000	606,200	402,000	443,000	123,000	181,000	245,000						
Europe																		
France										10,000	10,000							
Portugal				3,000						10,000	10,000							
Regional				9,500														
Total				12,500						20,000	20,000							
Africa																		
Mali				18,163	3,400													
Nigeria							13,200	2,000	3,500									
Senegal							15,000	15,000	15,000									
Zaire (Congo)				220	300													
Total				18,383	3,700		28,200	17,000	18,500									
Latin America																		
Argentina							16,000	15,000	15,000									
Bolivia									4,000									
Brazil							9,400	20,000	15,000									
Chile							5,000	5,000	5,000									
Colombia							5,000	6,000	10,000									
Ecuador				45			4,000		2,000									
El Salvador				2,782														
Honduras									2,000									
Nicaragua									5,000									
Paraguay							4,000	2,000	2,000									
Peru							7,400	10,000	15,000									
Uruguay								5,000										
Total				2,827			50,800	63,000	75,000									
Oceania																		
Australia										123,000	89,000	90,000						
New Zealand										10,000	10,000	5,000						
Total										133,000	99,000	95,000						
Interregional, Cyprus, UNRWA				41,443	15,000	28,200												

[1] The Departments of State and Defense consider the totals derived for some country lines to represent a false summation of costs to the United States since they are sums of both appropriated fund programs and other transfers at no cost to the U.S. Government.

[2] All fiscal year 1971 data are actual; fiscal year 1972 data are estimated; fiscal year 1973 data are projected.

[3] Includes MAP-funded and service-funded costs.

[4] Includes Korea forces in SEA and Korea transfer under Public Law 91-652. All data at acquisition value.

[5] Legal values, i.e., 1/3 of acquisition value.

[6] Ships transfers include loans and leases at 1/4 of average class acquisition value. (Sales are normally FMS cash purchases; if purchased on credit, transactions are included as FMS credit sales.) Fiscal years 1950–70 cumulative data represent vessels still operational.

[7] All data on real property transfers listed on classified supplement but not included in country or regional totals.

[8] Levels for fiscal year 1972–73 security supporting assistance for Cambodia are higher than in the fiscal year 1973 security assistance program congressional presentation because of agreements subsequent to the CPD printing.

[9] Export-Import Bank credit to Iran is partially direct credit and partially the Bank's guarantee of private credit for fiscal year 1972–73.

[10] Public Law 480 transactions include only those affected under sec. 104(c).

[11] Purchases of Vietnamese piasters by DOD were made from official Vietnam sources at official rates of exchange in effect when the transactions were consummated, based on Treasury Department policies and procedures recognizing sovereign rights of the Government of Vietnam to prescribe official rates and procurement of local currency only from official and authorized sources.

[12] Includes real property transfers. See footnote to col. 8.

[13] These MAP costs are included in col. 4 on a country line basis, including prorated MAP departmental and OSD costs, and are not additive in this column.

Development and Humanitarian Assistance, fiscal years 1971-73

[In thousands of dollars]

	Unexpended balance Dec. 31, 1971†	Agency for International Development — Development and humanitarian assistance 1971	1972	1973	International narcotics control and contingency fund 1971	1972	1973	Other programs — Peace Corps 1971	1972	1973	Public Law 480 1971	1972	1973	International financial institutions 1971	1972	1973	Total all programs 1971	1972	1973
Total	2,849,253	1,257,345	1,420,419	1,595,976	26,242	50,291	72,800	85,021	61,900	72,200	1,138,843	1,249,966	1,099,780	255,000	407,305	920,000	2,762,454	3,159,908	3,763,765
Latin America	967,265	328,325	321,526	359,416		2,000		15,958	16,247	18,913	91,856	103,929	106,359				439,137	446,002	511,888
Argentina	11,606	509															509		
Barbados											632						612		
Bolivia	28,231	3,675	33,573	18,214		[3] 2,000		1,113	34		7,048	10,293	9,700				11,536	45,899	27,914
Brazil	286,435	79,379	9,320	8,300				3,115	2,218	2,625	16,490	5,589	21,870				98,951	17,175	32,795
Chile	19,354	1,310	1,022	820				863	858	418	6,120	5,679	4,890				8,133	7,039	6,128
Colombia	114,557	83,990	91,850	78,600				1,373	1,625	1,898	17,241	21,990	21,730				102,776	115,055	102,228
Costa Rica	28,768	6,432	1,655	1,060				723	655	765	695	1,026	1,026				7,850	3,336	2,851
Dominican Republic	27,247	11,472	6,815	11,600				728	428	500	11,367	18,695	17,705				28,567	25,938	29,805
Ecuador	49,811	15,316	4,596	14,543				845	972	1,135	6,785	5,269	4,880				22,996	10,837	20,567
El Salvador	17,211	2,132	8,958	14,150				403	413	154	1,570	1,179	900				4,183	10,550	15,204
Guatemala	32,418	11,137	13,400	24,350				465	655	765	1,989	2,803	2,637				16,587	16,858	27,752
Guyana	23,233	1,270	12,500	10,160				139	7		719	1,565	1,789				2,009	14,072	11,880
Haiti			2,900	6,000							1,470	1,251	1,251				1,459	4,311	7,251
Honduras	16,272	5,159	5,325	18,212				752	825	664	1,102	972	972				7,051	7,122	25,178
Inter-American organizations	7,275	12,591	14,861	16,890													12,591	14,861	16,880
Jamaica	21,652	20,937	1,218	19,849				1,475	718	838	1,175	4,256	470				23,187	6,202	12,137
Nicaragua	20,973	12,478	11,600	7,599				439	412	516	316	1,076	378				13,259	13,178	8,344
Panama	46,686	11,120	15,825	22,205				537	14		515	1,089	1,080				12,292	16,919	23,575
Paraguay	20,651	6,941	6,681	7,994				409	358	418	5,493	3,472	2,712				12,843	10,511	10,224
Peru	32,839	6,888	21,662	13,747				1,459	1,512	1,766	7,099	11,862	8,459				15,426	37,136	23,973
ROCAP	88,035	3,531	13,099	27,709				150	174	203	139	153	151				3,563	13,417	28,036
Trinidad and Tobago											141	90	90				141	90	93
Uruguay	13,525	4,994	1,455	21,500				123	79	92	586	458	3,310				5,411	1,920	25,132
Venezuela	726	975	850	500				1,473	1,351	1,550		4,800					2,470	7,009	2,050
Eastern Caribbean regional	10,042	8	10,050	20,350				1,028	866	1,012	384	426	426				1,420	11,312	21,788
Regional programs	21,654	20,590	32,490	31,992				1,703	2,512	2,945							22,299	35,002	31,927
Social progress trust fund	17,900																		
Asia	653,996	458,279	338,340	356,061	1,500	33,500	17,200	19,401	16,929	19,752	875,921	854,281	836,470				1,355,101	1,273,313	1,409,483
Afghanistan	22,741	3,766	26,500	6,720				1,131	1,253	1,499	8,824	30,200	24,100				13,721	58,011	32,319
Burma	118										1,032	621	621				1,032	621	621
Cambodia											8,510	14,018	30,018				8,510	14,618	30,018
Ceylon	1,116							57			17,668	20,130	14,157				17,725	20,130	14,157
China (Taiwan)	217										20,690						20,690		
Cyprus											1,259	3,960	3,960				1,251	3,960	3,960
Hong Kong/Macao											305	126	126				305	126	126
India	268,735	205,918	9,575	99,590				3,808	2,770	3,211	232,901	184,575	172,330				442,630	196,920	275,131
Indonesia	128,157	78,507	121,140	123,200							97,690	96,160	87,920				176,197	217,300	211,120
Iran	2,465							1,209	1,113	1,300		1,044	1,044				1,209	2,157	2,344
Iraq											2,533						2,533		
Israel											58,750	55,312	45,312				58,750	55,312	45,312
Jordan	7,547	1,000	550	1,200		[3] 15,000					8,917	3,012	3,012				9,917	18,592	4,242
Korea	74,885	60,617	25,325	28,600				1,870	1,879	2,191	115,200	171,057	142,500				177,693	198,271	173,291
Laos	3,465	7,485	500	870		[3] 1,100	[3] 700				518	3,596	3,429				8,033	5,198	4,999
Lebanon											431	14,503	5,303				431	14,503	5,303
Malaysia								2,592	2,459	2,993	933	958	958				3,525	3,417	3,866
Nepal	1,975	2,357	2,532	1,883				1,247	1,020	1,191	572	630	630				4,406	4,182	3,701
Pakistan	59,891	7,095	62,455	79,800							103,759	98,015	105,358				110,851	160,530	185,158
Philippines	15,692	9,559	29,109	20,565	[3] 1,500			2,034	1,657	1,971	16,950	33,700	33,899				30,073	61,757	56,336
Singapore											172	45	45				172	45	45
Southern Yemen											93	90	90				93	90	90
Syria											172	216	216				172	216	216
Thailand	7,289	5,545	1,500	2,115		[3] 1,300	[3] 1,000	1,525	1,312	1,568	306	15,657	15,657				7,376	19,999	20,370
Turkey	131,080	53,602	43,215	43,000		[3] 15,700	[3] 15,000	86			36,027	12,660	13,014				89,715	71,635	71,014
Western Samoa								420	449	525							420	449	525
Vietnam	195	[4] 238	325	316		[3] 500	[3] 500				110,313	120,420	130,420				110,551	121,245	131,266
Yemen											2,400	1,026	1,026				2,400	1,026	1,026
East Asia regional	14,031	13,010	10,505	13,141				3,078	2,727	3,156							16,089	13,232	16,317
Near East regional/CENTO	3,731	4,320	4,698	5,011				340	170	199	3,907	1,821	1,362				8,567	6,689	6,572
Unallocated				110,000															110,000
Europe	623					9,500		11	9	10	8,348	31,000	850				8,359	40,509	860
Iceland											1,296	800	650				1,296	800	650
Malta						[3] 9,500		11	9	10	221	200	200				232	9,709	210
Portugal												30,000						30,000	
Romania											6,531						6,831		
Yugoslavia	580																		
Europe regional	43																		
Africa	262,354	157,758	159,374	173,209				20,625	19,832	23,149	136,711	136,625	134,310				315,094	315,831	330,668
Botswana		63	(*)	(*)				425	592	692	2,340	9,450	9,450				2,828	*10,012	*10,112
Burundi		159	(*)	(*)							299	920	920				458	*920	*920
Cameroon	541	80	(*)	(*)				510	599	700	505	380	380				1,125	*979	*1,080
Central African Republic		100	(*)	(*)							161	210	210				261	*210	*210
Chad		130	(*)	(*)				417	412	481	104	110	110				651	*522	*591
Congo (Brazzaville)	2										2,677	1,800	1,800				2,677	1,800	1,800
Dahomey	319	127	(*)	(*)				369	385	449	49	390	390				545	*775	*839
Ethiopia	33,684	20,380	19,125	16,550				2,093	1,117	1,304	889	1,557	1,134				23,362	22,099	18,988
Gabon		50	(*)	(*)													50	(*)	(*)
Gambia		23	(*)	(*)				260	327	382	958	980	980				1,241	*1,307	*1,363
Ghana	29,260	18,550	17,410	32,370				1,814	2,008	2,315	1,646	11,400	13,260				22,010	30,848	47,975
Guinea		63		(*)				672	11		7,067	4,970	4,970				7,802	4,984	*4,970
Ivory Coast		25	(*)	(*)				773	707	826	1,395	1,350	1,350				2,193	*2,057	*2,176
Kenya	1,459	2,138	2,150	2,535				1,743	2,013	2,351	1,388	1,180	810				5,269	5,343	5,996
Lesotho		37	(*)	(*)				161	256	299	2,005	1,350	1,773				2,203	*1,606	*2,072
Liberia	8,867	5,470	4,710	3,709				2,000	2,092	2,444	426	2,790	2,360				7,896	9,592	8,513
Malagasy Republic	1,056	90		(*)							448	510	510				538	510	*510
Malawi	2,462	100	(*)	(*)				363	406	475	62	250	180				525	*656	*655
Mali	1,839	62	(*)	(*)				226	206	240	3,358	2,160	1,580				3,646	*2,366	*1,820
Mauritania		15	(*)	(*)							1,731	1,170	1,170				1,746	*1,170	*1,170
Mauritius		52	(*)	(*)				143	132	155	1,774	1,470	1,305				1,969	*1,602	*1,460
Morocco	20,708	12,289	1,695	17,055				921	904	1,056	52,888	46,790	42,000				66,098	49,299	60,111
Niger	768	100	(*)	(*)				693	539	629	572	1,580	1,575				1,365	*2,119	*2,204
Nigeria	24,606	14,448	21,430	23,870				143			4,100	860	630				18,691	22,290	24,500
Rwanda		25	(*)	(*)							588	360	360				613	*360	*360
Senegal	5	50	(*)	(*)				620	617	721	1,317	2,268	1,683				1,987	*2,885	*2,404
Seychelles			(*)	(*)							76	60	60				76	*60	*60
Sierra Leone		93	(*)	(*)				1,348	1,441	1,683	1,308	1,840	1,740				2,749	*3,281	*3,423
Somalia	7,850	283						1				450	450				284	450	450
Sudan											93	45	180				93	45	180
Swaziland		50	(*)	(*)				408	410	479	3,316						3,774	*410	*479
Tanzania	5,710	3,051	1,900	6,400							2,330	1,370	1,370				5,591	3,270	7,770
Togo		100	(*)	(*)				729	603	704	804	550	550				1,633	*1,153	*1,254
Tunisia	17,917	12,951	17,200	3,150				721	619	723	33,994	29,150	32,140				47,669	46,969	36,013
Uganda	7,345	2,861	5,335	2,530				447	378	441	138	180	150				3,446	5,913	3,151
Upper Volta		98	(*)	(*)				411	435	508	4,230	3,200	3,200				4,739	*3,635	*3,708
Zaire	21,362	13,380	1,380	6,950				559	566	1,012	1,413	3,200	3,200				15,352	5,146	11,162
Zambia	83	10	(*)	(*)							48	320	320				58	*320	*320
CWA regional	10,812	14,731	29,900	24,085													14,734	29,900	24,085
East Africa	2,689	9,043	5,805	1,600													9,043	5,805	1,600
Southern Africa	2,267	10,921	14,135	8,200													10,921	14,135	8,200
Africa regional	58,345	15,514	15,239	21,855				1,595	1,754	2,049	11	5					17,123	16,998	23,904
Self-help	2,338	(1,732)	1,700	2,050													(1,732)	1,700	2,050
Nonregional	402,170	312,983	571,617	476,081	24,742	4,991	35,300				26,767	92,328	18,000				361,192	668,936	529,381
American schools and hospitals abroad	23,650	13,407	20,016	15,575													13,407	20,016	15,575
International organizations and programs	134,536	[5] 131,261	[6] 170,897	[7] 176,835	[2] 1,000	[2] 2,000	[2] 5,000				26,767	27,798	18,000				162,031	200,693	199,835
Industrial basin development	(1,443)	(11,905)	(30,262)	(43,000)													(11,905)	(30,262)	(43,000)
South Asian relief	100,050		[8] 200,000	100,000								64,530						264,530	100,000
Administrative expenses, AID	7,060	63,722	61,000	58,800													63,722	61,000	58,800
Contingency fund, undistributed						[2] 2,966	30,300											2,966	30,300
Program support and interregional activities [10]	136,924	101,590	119,701	124,871	[9] 23,742	[9] 25											125,332	119,729	124,871
Undistributed	[11] 532,905		[12] 27,289	[12] 24,209			[3] 20,300	26,031	8,883	10,376							26,031	38,172	54,885
Adjustment to net assistance, Public Law 480											760	1,800	3,600				760	1,500	3,600
U.S. contributions to international financial institutions														255,000	407,305	920,000	255,000	407,305	920,000
(Nonadd total callable capital)[13]														(200,000)	(247,505)	(336,760)	(200,000)	(247,505)	(336,760)
International Development Association														160,000	320,000	[14] 320,000	160,000	320,000	320,000
International Bank for Reconstruction and Development															12,305			120305	
(Nonadd total callable capital)															(110,745)			(110,745)	
Inter-American Development Bank														75,000	75,000	500,000	75,000	75,000	500,000
(Nonadd total callable capital)														(200,000)	(136,760)	(336,760)	(200,000)	(136,760)	(336,760)
Asian Development Bank														20,000		100,000	20,000		100,000

[1] Appropriations based on funds advanced under continuing resolution.

[2] Contingency fund. Includes $20,042,000 for disaster relief in fiscal year 1971.

[3] International narcotics control. Funded from development loan funds in fiscal year 1972. Proposed as a separate appropriation in fiscal year 1973.

[4] Vietnam population program funded from supporting assistance.

[5] Includes $10,500,000 in development loan funds for population. Excludes $4,800,000 of supporting assistance funds for U.N. force in Cyprus and $13,300 of supporting assistance funds for U.N. Relief and Works Agency. Includes $1,000,000 for Arab Refugee Training.

[6] Includes $20,000,000 of population funds. Excludes $2,400,000 of supporting assistance funds for U.N. force in Cyprus.

[7] Includes $6,000,000 of population funds. Excludes $4,800,000 of supporting assistance funds for U.N. force in Cyprus.

[8] Includes $5,000,000 of South Asian relief transferred out for State Department, Office of Refugee and Migration Affairs.

[9] Includes $1,850,000 transferred out for State Department, Office of Refugee and Migration Affairs.

[10] Excludes supporting assistance allocation for program support and interregional activities.

[11] Represents funds advanced under continuing resolution and programed for obligation but not allotted to specific countries or programs at Dec. 31, 1971.

[12] Undistributed population funds.

[13] Callable capital to be kept in the U.S. Treasury as backing for the banks' funds.

[14] Included in supplemental appropriation request.

†U.S. contributions to international financial institutions not broken down by country.

*Included in self-help total.