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SUBJECT: MEETING OF THE EXECUTIVE COMMITTEE OF THE COUNCIL ON INTERNATIONAL ECONOMIC POLICY, FRIDAY, APRIL 12, 1974, 10:00 a.m., ROOSEVELT ROOM, THE WHITE HOUSE

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THE WHITE HOUSE

WASHINGTON

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April 10, 1974

MEMORANDUM FOR: SECRETARY OF STATE
SECRETARY OF THE TREASURY
SECRETARY OF COMMERCE
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS
PRESIDENT, EXPORT-IMPORT BANK
CHAIRMAN, FEDERAL RESERVE SYSTEM

FROM: PETER M. FLANIGAN PMF

SUBJECT: Meeting of the Executive Committee of the Council on International Economic Policy, Friday, April 12, 1974, 10:00 A.M. Roosevelt Room, The White House

The agenda for this meeting is as follows:

A. U.S. Policy on International Investment. The paper at Tab A has been circulated for agency comment, and presents general U.S. policy and objectives.

B. Review of DISC Program. We expect to circulate a Treasury paper prior to the meeting.

C. International Capital Markets:

1. National Treatment for Foreign Banks in the U.S. (Paper at Tab B).

2. Discussion of the "Foreign Window" for domestic banks. (Paper at Tab C).

D. U.S. Policy Toward Financial Proposals to Assist LDC's to Meet Oil and Other Import Problems. At Tab D is an issue paper outlining present USG policy. We expect to circulate an additional Treasury paper prior to the meeting.

cc: Governor Mitchell

Attachments.

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U.S. POLICY TOWARDS FINANCING PROPOSALS TO ASSIST LDCs
TO MEET OIL AND OTHER IMPORT REQUIREMENTS

I. Issue

It is generally recognized that the increase in prices for oil and other import requirements will create severe balance of payments and economic growth problems for a hard-core number of non-oil producing countries. Are new U.S. initiatives or tactics desirable to deal with the problem? If so, what are they?

II. Background

A interagency study prepared by the IERG is attached with a preliminary analysis of the problem, issues, proposals and alternative positions.

III. Present Position

The following U.S. policy position was agreed to prior to last week's ECG meeting in Brussels.

We need to engage the ECG in an early internal study of the extent and timing of the hard-core LDC problem and of alternative ways of meeting it (particularly through existing international organizations). Any increase in DC assistance should be linked with increased concessional assistance from the oil exporters. One purpose of such an internal ECG study would be to avoid a beauty contest among the ECG countries in the United Nations with each offering some new plan to help the LDCs. Further, either UNGA pressure for new schemes with additional costs for the U.S.

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or extreme LDC rhetoric blaming their problems on the DCs could impact adversely on our ability to get favorable action on the bilateral and multilateral bills now before Congress.

We could repeat existing positions that:

-- DCs should maintain, or if possible increase, their concessional aid in line with planning before the oil crisis.

-- Reductions in oil prices are the preferred solution for much of the LDC problem.

-- Existing concessional flows, bilateral and multilateral, should gradually be redirected away from oil exporters and toward those countries with the most serious problems caused by the change in their terms of trade.

The U.S. would not at this time suggest or comment favorably on any proposal involving SDRs.

There was strong general agreement by the countries in the Energy Coordination Group to the substance of the U.S. position, particularly, with regard to the U.N. Special General Assembly meeting; however, no further studies in this area were approved.

IV. Ongoing Work

The IERG Working Group has two agency studies under way. AID is examining in detail the extent, timing, and nature of the problem in the 15 hard-core countries. Treasury is examining alternative ways and possible adjustments to deal with the problem, particularly, through the international organizations.

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The LDC Payments Problems Related to Higher Oil Prices

Alternatives for United States Tactics

Paper prepared by Ad Hoc Group of IERG Working Group including representatives of State, Treasury, AID, CIEP, CEA, NSG.

March 29, 1974

LIMITED OFFICIAL USE

Recd
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I. The Energy Crisis and the LDC's - The Problem

The increase in oil prices announced in October and December of 1973 will create severe balance of payments and economic growth problems for many LDC's. In order to finance the same volume of imports as in 1973, a much larger volume of capital flows will be required. Estimates of the increase of the oil import bill for the non-oil developing countries in 1974, for instance, are on the order of $9 billion at a $9-10 price (c.i.f.), while the projected current account deficit at this price is about $22 billion, compared with a $10.6 billion deficit in 1973.

The above figures overstate the magnitude of the "real" problem, however, in that most of the increased capital requirement could be on commercial or near-commercial terms. The more difficult financing problem is that presented by many of the poorer LDC's who are hard hit and who do not have access to world capital markets. For most of the countries of South Asia, Africa, and scattered countries in Latin America such financing would only be meaningful on highly concessionary terms. (Specific countries that are hard hit and which would require concessionary assistance are listed in Table A.) It is estimated that at current prices the amount of concessionary financing required would be about $2-3 billion, and that at a $6 c.i.f. price the figure would be about $1 billion.

In addition to the impact of higher oil prices, many of the poorer developing countries are also affected by the reduced availability and higher costs of fertilizer and by higher grain prices in general. The World Bank has recently estimated that LDC imports of cereals increased from an average level of about $3 billion in 1970-72 to over $8 billion in 1973. (Part of this rise reflects an increase in import volumes due to poor harvests in many of the LDC's, although most of the increase is due to higher prices.)

Price increases of other commodities, however, have also benefitted some LDC's. World Bank calculations of additional capital requirements for the LDC's, which take account of other commodity price increases as well as oil plus the adverse effect of lower growth rates in the developed countries on LDC export growth rates, are about the same order of magnitude as figures based on oil price increases alone. Estimates of additional financing requirements on intermediate and concessionary terms are $1.5 billion in 1974 and $3.1 billion in 1975. These figures represent the residual still to be financed after reserves are run down by 20 percent each year, and they also assume that an IMF oil facility is in existence in 1974.

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Estimated Increase in Oil Import Bill of Hard Hit LDC's Requiring Concessionary Assistance ($ millions)

	Oil Import Bill* — Sept. 73 Price & Alternative Price Assumptions ($ per barrel, CIF)				Increase in Import Bill		
	$3.40***	$6.00	$8.50	$10.50	$6.00	$8.50	$10.50
Bangladesh	37	65	92	114	28	55	77
Cambodia	4	8	11	14	4	7	10
Chile	145	256	362	447	111	217	302
Costa Rica	15	27	37	46	12	22	31
Dominican Rep.	29	52	73	90	23	44	61
Ethiopia	19	33	48	59	14	29	40
Guyana	12	21	30	37	9	18	25
Honduras	12	21	30	37	9	18	23
India	387	682	967	1194	295	590	807
Jamaica	45	79	112	138	34	67	93
Kenya	42	73	104	128	31	62	86
Pakistan	107	188	267	330	81	160	223
Philippines	208	367	520	642	157	312	431
Sahel**	10	17	24	30	7	14	20
Senegal	42	75	106	131	33	64	80
Sri Lanka	45	79	112	138	34	67	93
Sudan	39	68	96	119	29	57	80
Uruguay	46	81	115	142	35	69	96
Viet Nam	129	227	322	398	93	193	260
Total	$1373	$2419	$3423	$4234	$1046	$2055	$2861

* Assumes 1973 volume level.

** Chad, Mali, Niger, and Upper Volta.

*** Sept. 1973 price.

A. Proposed Lending Institutions

To the extent that oil producers have expressed plans for directing their new surpluses to LDCs, their current thinking appears directed at the establishment of new development banks or funds which they would control. With the exception of item 2, below (which would offer short term balance of payments support), the proposed institutions are development banks designed to provide concessional assistance for long-term projects. Thus, they would have only minimal impact in alleviating the short-run liquidity problem faced by many LDCs. To some extent, all of the proposed institutions (with the exception of the Iranian proposal) share the disadvantage of inadequate technical and administrative expertise and of the intrusion of a political or sectarian influence on lending. The special fund proposed by Iran would be administered by the IMF and IBRD, and decision-making power would be equally divided among oil producers, developed countries and less developed countries. To date, none of the proposals is beyond the planning stage.

The following institutions have been proposed:

Islamic Development Bank (Capitalization, $1.2 billion)

Arab Oil Fund for Africa ($200 million)

Arab Bank for Agricultural and Industrial Development in Africa ($206 million)

OPEC Development Bank ($1-2 billion)

Iranian proposal ($2-3 billion)

Technical Assistance Fund for Africa ($15 million)

Arab Bank for Development in Asia (unknown).

B. The Role of the IMF

Since the major problem affecting LDCs in the short run is obtaining additional financing for imports, it could be argued that, of all present institutions, the IMF is the most suitable to provide relief for countries facing difficulties.

1. Regular Facilities

The first line of defense available is use of the regular Fund facilities. For the LDCs identified as having the most problems, the IMF could extend an additional $ 1.2 billion over the next three years assuming such countries used their first three tranches. The conditions attached to such borrowing would have to be geared to address energy policy in addition to the conditions applying to such borrowing from the IMF. It has been felt by the IMF that the existing facilities may not be adequate to meet the needs of developed and developing countries affected by the oil price increase. Alternative proposals have been put forward, by the IMF and others, to supplement existing resources. All such proposals have the drawback that, by providing short-term financing, they would remove pressure from the OPEC countries to provide concessionary assistance to the LDCs, give false reassurance that the current oil prices are manageable, and thus indirectly validate the oil price increase.

2. IMF Oil Facility

IMF Managing Director Witteveen has proposed that existing and new Fund resources be used to provide temporary and limited amounts of assistance for developed and less developed countries facing difficult financial prospects due to the oil price increase. Loans would be at 5% for 4-7 years, with eligibility determined in part on the basis of the following formula: a net importer would be eligible for financing the increase in its oil imports cost less 20% of the country's reserves as of December, 1973, subject to a maximum of 75% of the member's IMF quota. This facility could provide 1.3 billion SDRs ($1.57 billion) for all LDCs. Actual use of the facility would depend on each country's demonstrating that it is facing a balance of payments difficulty and cannot borrow from private sources.

As major elements of the proposal remain to be spelled out, particularly the source and terms of new resources, it has not been possible to reach a firm position. At present, however, the proposal does not meet the need of hard-pressed LDCs with limited debt service capacity for highly concessional assistance. The facility would also provide moderately concessionary financing to developed countries which can and should borrow through regular market channels, or at least at market rates. Thus, as a compromise aimed at meeting both LDC and DC needs, the proposal may not be well suited to either.

In addition, there are problems associated with the valuation of the assets held in the facility, particularly if such assets are obtained from OPEC creditors, as well as questions raised as a result of existing Fund resources obtained from members at low interest rates, with new money borrowed from oil producers at 5% or higher rates. If the terms offered to attract new resources to the IMF exceed the proposed loan terms, regular Fund creditors could end up providing a subsidy both to borrowers and to lenders.

In initial discussions of the Witteveen proposal, the U.S. has raised questions about the scope and nature of the proposal. Other countries have done likewise although generally welcoming it and urging early implementation. Mr. Witteveen is pressing for an early decision to permit him to visit the Middle East in April to seek firm commitments from OPEC countries on providing new resources.

3. A Special Issue of SDRs

A quick and apparently simple solution to financing problems of the hardest hit LDCs is to make a special, new SDR allocation for which only the hardest hit LDCs would be eligible. The problem with such an approach is that it would increase world liquidity at a time when the problem is not necessarily inadequate total liquidity but inequities in distribution of liquidity. Special arrangements would have to be made in order to limit issuance of SDRs to countries most affected by the oil crisis. In addition, it may not be desirable to make a new SDR allocation at a time when negotiations towards monetary reform, which include important questions pertaining to the valuation of the SDR and the interest rate that it carries, are still under discussion.

4. Extended Fund Facility

The IMF, in a March 8, 1974 document, discusses the need for an Extended Fund Facility to provide resources for longer (than current) periods, in larger (than current) amounts, for serious payments imbalances and structural maladjustments. The Fund proposes to extend traditional standby credits to six or perhaps eight tranches instead of the usual four, with repayment in three years, following four years' grace. This notion had previously surfaced as an alternative to the link. Now it may be useful in dealing with the oil question, except that it attempts to address longer term problems rather than short-term balance of payments disequilibria.

C. EC Commission Suggestion

The EC Commission has suggested a plan calling for a one-shot fund designed to provide a transition period allowing the poorest LDC's to adjust to the increased costs of the new energy situation. A $3 billion fund would provide concessional assistance to oil importing LDC's with extremely low monetary reserves and which do not export other raw materials whose prices have also risen. Countries in South Asia and Africa would be the principal beneficiaries. One half of the $3 billion would come from the oil producing states; the remaining $1.5 billion would be contributed in approximately equal proportions by the EC, the US and the rest of the developed world. The existing financial institutions, notably the IBRD and the IMF, would play a dominant role in managing the fund.

The Commission has not worked out its suggestion in great detail. Development Commissioner Claude Cheysson, the author of the plan, told Ambassador Greenwald in Brussels that the Commission actually did not intend to design a specific plan or mechanism but rather to indicate willingness to participate in any concrete proposal put forward at world level to aid the most disadvantaged of the LDC's. He stated he was not trying to float a European plan and would welcome U.S. ideas or reactions.

The EC member states were apparently taken by surprise by Cheysson's initiative; the initial reactions of the Germans and British were negative. Nevertheless, the subject has been placed on the agenda of the EC working group discussing EC participation in the special session of the UNGA and may be considered by the Foreign Ministers Council meeting of April 1-2. Cheysson told Greenwald that he would like to have Council approval to take his idea to New York, where he would present it as appropriate during the course of the UNGA.

The Commission suggestion closely parallels our recognition of the short-term needs of the poorest of the LDC's. In its present form, however, it is closely tied to oil price increases and would require significant amounts of US financing.

One course of action for the US would be to indicate agreement with the Commission's general view of the problem; to suggest that the Energy Coordinating Group be used to develop a common US-EC-developed country approach; and to recommend close US-EC tactical coordination in New York during the UNGA.

D. CONCESSIONAL FINANCING FOR LDC IMPORTS OF OIL AND WHEAT

Proposal. Edward Fried of the Brookings Institution has outlined a scheme whereby major exporters of oil and of wheat would provide highly concessional loans for imports of these commodities by LDCs who cannot otherwise finance recent price increases. The financing would cover the difference between a base price and the market price. For wheat, this difference would be the July 1972 price of $68 per ton vs. about $170 per ton currently; for oil the difference is between the August 1973 price of about $2.70 per barrel, f.o.b. the Persian Gulf, and $8-9 per barrel now.

Depending upon the criteria for eligibility and the projection of demand, financing of $1.5-2.0 billion would be required for wheat and $3.0-4.5 billion for oil. Based upon its current share of world exports, the U.S. would contribute about 50% of the financing for wheat. Fried proposes that this be done under PL 480, which would require at least doubling the present level of concessional loans under Title I.

Responsiveness. The scheme would significantly benefit the most severely impacted LDCs. But it would not wholly meet increased food costs, particularly for rice importers. Similarly for oil, the increased cost of the energy component of manufactured goods would not be offset. However, the scheme's underlying assumption may be valid, i.e., that unless the OPEC members and the industrialized countries agree to share the higher import costs of needy LDCs, little will be done. In this case some LDCs would default on their debts, and the entire burden would fall on the industrialized countries.

Consequences for the U.S. By financing the visible part of increased costs to some LDCs from higher oil prices, the proposal would reduce pressure for a general oil price reduction. It also would tend to lend credibility to oil exporter efforts to associate higher oil prices with food price increases--ignoring the contrast between efforts by food exporters to increase production in response to higher prices and the imposition of production restrictions by oil exporters to support higher prices.

U.S. participation in the scheme might be financed and administered under PL 480 without new legislative authority, although this would depend upon how the financing was made available to recipients. The proposal could serve to convert PL 480 assistance to a program that would be countercyclical for recipients, i.e., one in which more, rather than less, funding would be made available as food commodity prices rise. Wheat prices are projected to decline, and the scheme's cost to the US could be nominal one or two years from now. However, operating PL 480 on this basis would require larger appropriations for concessional export financing in periods of high prices and short supply and would reduce financing in periods of surplus when farm prices are low. This would be contrary to strong domestic motivations.

E. Debt Relief

The higher oil import bill which LDCs will face can be expected to aggravate the debt service problems of many LDC's. For this reason it is imperative to obtain concessionary funds from OPEC producers, especially for those LDC's with debt problems.

While it may be expected that some LDC's will request rescheduling of debt payments, such requests should continue to be approached on a case-by-case basis, and rescheduling limited to cases of actual or imminent default. At least for the time being, U.S. policy is that the oil problem should be handled by other means.

III. Key Issues

Effects of Aid to LDCs on Oil Exporters

It could be argued that maximum pressure on oil exporters to role back prices is maintained in a situation whereby minimal or even no supplemental aid is provided to LDCs hard hit by oil price rises. To the extent that international institutions or industrialized countries mitigate the oil-induced balance of payments difficulties of LDCs, the case for a price roll-back is weakened and existing levels of oil prices are "confirmed"; conversely, if we do nothing, the full effects of the financial hardships on LDCs will be manifested in a strong expression of world public opinion aimed at a price rollback.

Such a policy could, however, also have drawbacks. If the economic situation worsens considerably, we might expect certain LDCs to be forced to default on their foreign indebtedness, and since the U.S. is the principal bilateral creditor, we would be most affected. Therefore, it would be in our political interest to promote means to finance the LDCs through this difficult period while we still have some bargaining leverage, i.e., before the situation worsens. Since we will end up paying anyway, we might as well get the credit for it rather than be left holding the bag of an involuntary debt rescheduling.

Moveover, up to what point in human suffering can the rich countries withhold supplementary aid without this policy backfiring on them? The very wealth of the United States, as well as our world leadership role, creates pressures on us to provide some relief, particularly if the situation in some LDCs deteriorates seriously. Adverse effects on us of such a situation include (1) disapproval, condemnation, and possible withdrawal of cooperation on matters of concern to us in various international forums -- by LDCs as well as certain industrialized countries strongly motivated by humanitarian concerns, (2) increase in terrorism and threats to security of travel, (3) internal disruption in LDCs, food riots, etc., possibly leading to local conflicts which could affect our own security.

Finally, we question the wisdom of forcing the LDCs into a condition of long range dependency upon the oil exporters for external assistance.

The problem is basically one of tactics, and requires both fairly precise knowledge of the situation in individual LDCs, and a fine sense of timing. Significant amounts of additional aid from the industrialized countries, beyond currently planned levels, appears unrealistic. The most that could be expected is a reapportionment of aid to the hardest hit LDCs, combined with measures for accelerated disbursement, program lending, local currency financing, etc. Even these techniques, however, should not be used indiscriminately pending concrete financial proposals from the oil exporters, in order to maintain maximum worldwide pressure on them. Moreover, these techniques should clearly be labelled as interim measures, to cushion the shock on individual, hard-hit LDCs, until a more lasting financial resolution of the oil problem is achieved in a global framework. Finally, the strongest efforts should be made to combine any such measures on behalf of the LDCs within a framework of supplementary financial assistance from the oil exporters themselves.

B. Lumping Price Effects of Oil, Grain, and Other Commodities

There are two basic arguments for lumping oil, grain, and other price effects together.

First of all, exogenous increases in the price of wheat (and food in general) have increased the import bill of many LDC's. The IBRD, for instance estimates that the import bill of cereals for 40 LDC's increased from an average of $3 billion in 1970-72 to over $8 billion in 1973. From the LDC standpoint increases of the food and grain prices since 1972 have constituted almost as serious drain on foreign exchange earnings as the higher price of oil. Second, from a tactical standpoint it is argued that a compromist solution of this sort may prove less costly to the industrialized countries if the OPEC countries agreed to go along, than if nothing were done to aid the LDC's, eventually necessitating debt reschedulings.

The basic difficulty of the approach of looking at the terms of trade of the LDC's more generally is that it fails to distinguish the oil situation from that of other commodities in international trade. In order for the current price of oil to be maintained, it is necessary for OPEC producers to continue to cut back on production. In the case of wheat, where price has also risen dramatically, on the other hand, the price increases reflected poor harvests in the Soviet Union and in many of the developing countries. U.S. wheat producers are responding by significantly increasing acreage under cultivation which, weather permitting, should result in record harvests.

C. <u>Changing Role of Institutions: Congressional Attitudes</u>

a. <u>New resources from the oil producers</u>. The channeling of significant new resources from the oil producers to existing international financial institutions (IFIs), particularly IDA and the other soft loan windows, remains the preferred -- if perhaps not fully realizeable -- U.S. objective. This would have the primary advantages of utilizing existing staff and technical expertise, ensuring objective and nonsectarian economic criteria for lending, and supporting Administration efforts to achieve Congressional approval of pending IFI funding requests. If new oil exporter capital resources to the IFIs would change voting shares, (i.e., lower ours), we do not regard this as a significant disadvantage, compared to the advantages of having the new resources. We would, obviously, have to reckon with the "new donors" desiring enhanced influence on IFI Boards of Directors, but we expect this could be adequately handled within the administrative framework and institutional traditions of the banks, and would be far less disruptive to development policies than the completely new institutions currently being proposed by some oil producers. In sum, then, the U.S. should continue to press for this course in international forums, but realistically we must be prepared for less than complete success, given indications to date from the producing countries.

There are, however, other ways in which the oil producers can provide resources to existing institutions beyond traditional capital replenishments. We should encourage, for example, prepayment of existing loans, to repurchase by oil country borrowers of new loans made to them, sale of participations in existing IFI portfolios, and reimbursement for technical assistance projects. Whatever the means selected, however, it is important that the resources provided by the oil producers be used for lending additional to what already is programmed for purely developmental purposes.

Another factor to be considered, moreover, is that some of the above-mentioned alternative techniques, e.g. prepayment or loan repurchase by the oil producers, would provide additional resources to the IBRD but not to the IDA, which is the concessional loan window to which the hardest hit LDCs would most naturally turn. Therefore, discussions should be opened with the IBRD on modalities for increasing the amounts transferred from IBRD to IDA. Since loan prepayments or repurchases from oil exporters would represent an extraordinary and unplanned addition to the IBRD's reserves, it would appear feasible for the Bank to transfer additional amounts to IDA without adversely affecting its prime credit rating on international capital markets. Moreover, to the extent that new IBRD lending to oil producers could be reduced, the Bank's demands on capital markets would be correspondingly lowered.

b. Modification of ongoing programs. In the absence of substantial new resources from the oil producing countries, changing the nature of these institutions from development to remedying short-term balance of payments dislocations would expose the U.S. to Congressional criticism which could spell the death knell for pending authorization and appropriations bills for IDA, the Asian Development Bank, the Inter-American Development Bank, and the African Development Fund. Thus, in order to maintain maximum pressure on the oil producers, the U.S. should continue to oppose proposals to modify substantially the lending programs of international financial institutions out of existing resources.

On the other hand, some reallocating of currently planned IFI lending should be considered as an interim measure to relieve extreme LDC hardship cases. In the first instance, of course, funds could and should be diverted from lending levels previously planned for the new surplus countries. Currently, for example, Iran has well over $200 million in prospective projects in the IBRD pipeline, Iraq \$50 million, Oman \$18 million, Algeria over \$144 million, Indonesia \$434 million, Venezuela \$52 million from IBRD and \$213 million from IDB. With the exception of Indonesia, the above figures represent mostly hard loans financed by capital borrowed on international financial markets, and therefore could not be automatically transferred to the concessional loan window, where the most pressing demand will exist. As mentioned in the previous section, however, the IBRD should be able to find means to transfer to IDA resources released from Bank operations. If necessary, some IDA resources could also be diverted from other LDCs not so badly affected by the oil situation, but hopefully this would not be necessary.

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Efforts could also be made to accelerate disbursement on project loans to hard hit LDCs. In addition, program and sector lending could be approved on a cautiously considered, country-by-country basis, for selected hardship situations with no alternatives.

D. Proliferation of Institutions and Their Control

A proliferation of international institutions, special facilities and staffs to channel oil producers' revenues could affect attitudes toward the oil crisis, impact on existing institutions and promote an uncoordinated scramble for resources. Highly visible new mechanisms for using oil producer surpluses could tend to become self-perpetuating, adding certification to and a vested interest in maintaining current oil prices. Potential recipients, particularly LDC's will place increasing pressures on developed countries for significant additional contributions, while domestic legislatures become even more reluctant to sustain assistance to existing institutions. The very proliferation of proposals, with overlapping or conflicting objectives, could lead to an underfinancing of worthwhile proposals which cannot obtain adequate resources from other sources. And a race to line up oil producer funding commitments could lead to an unwarranted escalation of the terms on which producers ultimately make resources available.

E. EFFECTS OF IMPLEMENTING SOME SCHEME ON ONGOING ASSISTANCE PROGRAMS, IDA IV, ETC.

The House vote on January 23 rejecting IDA replenishment was heavily influenced by the twin arguments that any resources provided to IDA would simply pass through to Arab oil producers and that if the LDC's needed development financing, they should seek it from the oil producers. Both because of the easing of the domestic impact of the oil situation in the U. S., and the efforts already made through Congressional consultations, there is probably reasonable basis for optimism regarding a change in Congressional linkage of IDA replenishment and the oil problem. The Administration has sought to emphasize (a) that the funds provided to IDA or to other multilateral institutions are used basically for financing specific projects and cannot be applied to financing of oil costs, and (b) that there are already a number of steps being taken by oil producers (Iran, Venezuela) to put a portion of their oil revenues at the disposal of development institutions, and that the surest way to discourage further such steps would be to reduce the ongoing efforts of developed countries in the development finance field.

To date, there has been little evidence that other developed countries intend to reduce their pledges to multilateral replenishment arrangements in the light of the new problems of the oil situation. While both their perception and ours of the need for development resources through the existing multilateral banks could change if OPEC-sponsored development lending institutions actually come onstream, it is far too early to pass any judgments in this regard. We believe, however, that other donors will continue to share our view that mechanisms adopted specifically to address the oil cost problems of LDC's are quite separate from the need to maintain levels of development type financing.

Thus, from both the standpoint of the U. S. Congressional outlook and the attitudes of other donor countries, it appears that implementation of a scheme directed to the oil price problem can be separated from and leave relatively unaffected plans for the present and the intermediate future as far as multilateral assistance programs are concerned.

As far as direct contributions by Arab oil producers to the Fourth IDA Replenishment are concerned, only Kuwait is presently an IDA donor country. Kuwait will be providing $27 million over three years when the Fourth Replenishment comes into effect, compared with a cumulative Kuwaiti contribution of $22 million to previous IDA replenishments. Reportedly, the Arab oil producers (as well as Iran) are not favorable to channeling concessional loan resources through IDA, whose policies they consider to be dominated by the industrialized countries. The Shah of Iran's proposal of February 21 for a new "neutral" multilateral aid vehicle was explicitly an alternative to IDA contributions. The variety of other aid mechanisms suggested or initiated by the Arab States also tends to confirm that Arab thinking is not running along the line of using IDA as a channel for development aid. vs. US proposed policy

F. The U.S. Bilateral Program and Congressional Concern

1. The Congress

Congressional concern about the oil crisis has already been expressed by Senator Inouye's request that the AID Administrator make a presentation on the implications of the oil crisis for the LDCs and the role of the bilateral program. Senator Magnuson has also expressed concern about the need for a coordinated approach in addressing LDC energy-related problems.

General Congressional attitude at this point seems ambivalent:

(1) There is concern that the U.S. aid program would indirectly benefit the OPEC producers and help finance the oil price increase;

(2) There is considerable understanding and sympathy for the plight of some of the poorest countries which would be most adversely affected by the energy crisis.

B. Bilateral Assistance

Following are the principal guidelines on the role for bilateral assistance:

(1) At a time when a large group of developing countries are facing extraordinary difficulties in pursuit of development objectives, it is essential that the level of bilateral concessional economic assistance be maintained; otherwise, the development problems faced by these LDCs would be exacerbated. Lack of support for the poorest LDCs may also promote the interests of those in LDCs who are calling for restrictive action in other raw materials, to the detriment of the American consumer and industry.

(2) The bilateral program is itself neither well suited nor able to address the extraordinary, oil-induced financing problems faced by the LDCs, because:

(a) It is designed to address long-term development problems in specific sectors.

(b) The limited funds available under the bilateral program cannot make a significant dent in the financing needs of LDCs.

(3) The basic rationale and thrust of the bilateral program should remain unchanged. On the other hand, it is clear that the energy crisis has drastically changed the development picture in many countries and is presenting new problems in a variety of areas in which the bilateral programs can help.

(a) The needs for concessional assistance in some countries where AID has had extensive programs, e.g., Indonesia, have been lessened due to large increases of foreign exchange earnings from oil. Yet the needs for technical assistance and know-how remain large. We would like to reduce the program to these countries in the context of international consultative groups and to tailor it more to the changing needs of these countries. At the same time, the oil price increase will increase financing requirements for our supporting assistance program in Vietnam.

(b) LDCs will have to adjust their economies in response to projected higher energy costs. In carrying out this adjustment they could benefit from technical assistance from DCs. We are exploring the feasibility of new programs designed to assist LDCs in this area.

IV. U.S. National Interests

The oil price problems of many LDCs impacts on three major aspects of U.S. national interests:

-- Political-security interests in the stability and economic development of certain LDCs of particular importance to the U.S. such as South Vietnam, Chile, Korea, the Caribbean; these problems are particularly severe for countries such as those in Indochina, where foreign assistance finances a large proportion of imports.

-- Political-security interests in the more general sense that economic deterioration in LDC areas could result in internal violence and local political tensions or wars which could threaten the structure of peace and draw in the major powers.

-- Humanitarian interest in avoiding deterioration of living standards for very poor people anywhere and in contributing to improved economic conditions in LDCs more generally.

-- Assuming a position of leadership on this issue to reinforce our general worldwide leadership role and cooperating with both developed and developing countries on economic assistance as a means of reinforcing the inter-dependency of economies worldwide in an open trade-monetary system increasing the welfare of all.

These three objectives must be integrated to determine the appropriate U.S. posture on special assistance measures for the LDCs.

Political-security interests in a few countries are an immediate priority for U.S. national interests. To meet these needs there is no requirement for a U.S. initiative or even U.S. support for additional multilateral efforts. In fact the U.S. could concentrate on supporting limited arrangements to funnel funds from certain oil producers to countries of particular concern to the U.S., for example special Venezuelan contribution to a compensatory financing window of the IDB could largely resolve the problem in the Central American and Caribbean area.

The extent of possible political-security problems from economic deterioration depends to a large extent on the internal domestic policies of the LDCs. We have little influence on these policies, but we should maintain a watching brief to assure that situations do not get out of hand.

Humanitarian concerns bring the problems of the Indian subcontinent to the fore and suggest a requirement for substantial additional international efforts, either from the oil producers, the DCs or both.

Concern with the U.S. leadership role suggests a U.S. initiative to offset the oil-related balance of payments problems on a multilateral basis. However, there are positions consistent with leadership which would not necessarily involve the commitment of additonal U.S. funds. We could continue to press for continuation of DC aid levels at previously planned levels and urge a gradual redirection of bilateral and multilateral programs to those LDCs with the greatest needs. We could also take a position urging that the oil exporters assume their responsibilities in the existing international financial organizations.

U.S. efforts toward reduction of the oil price represent a major leadership role serving all three of the above national interests. Because price reductions are of much more value relative to the size of economies for both most LDCs and most other DCs, the U.S. leadership role on price reduction is more an effort to expand and improve the world trading system than to advance our immediate self-interest. Moreover, price reduction is preferable to financial transfers in resolving LDC problems because no more than a modest part of financial transfers are likely to be on a grant basis.

V. Alternative Positions for April 3-4 ECG

A. Listening. The U.S. could state that our position on the hard-core LDC problem is under review and we welcome the views of others. Such a position might be more forthcoming than merely repeating positions we have previously taken because it would suggest we are open to forward movement by the DCs on this issue.

B. Restatement of Positions Taken Previously or Elsewhere.

-- Despite the oil-price-induced problems for DC balance of payments, DCs should maintain, or if possible increase, their concessional aid in line with planning before the oil crisis (position in DAC).

-- Oil prices should come down to relieve the pressure on the LDCs, both the direct pressure from their oil purchases and the indirect pressures that will increase over the next months as a result of the oil-price-induced slowdown in DC economies (ECG position).

-- Existing DC concessional aid flows, bilateral or multilateral, should be redirected gradually away from oil exporters to those LDCs with the greatest balance of payments problems resulting from higher oil prices (position in DAC); at a minimum, concessional aid for oil exporters should not be increased. (This is an optional position cutting particularly against the Japanese, and not yet formally articulated by the U.S.)

C. <u>Harder Positions</u>. The positions above could be modified to harden them by linking current DC assistance to increased oil exporter concessional assistance for LDCs. For example by:

-- Stating that the oil-induced payments problems of the LDCs are not the responsibility of the DCs but of the oil exporters, and they should resolve these problems. (This would be accompanied as necessary with the statement that higher food prices are caused by entirely different factors, i.e., production is being accelerated not curtailed, but that we expect food prices to be lower within a few months.)

-- Stating that not only are the new oil-induced payments problems the responsibility of the oil exporters, but that such problems so seriously disrupt the normal development process in the LDCs that DCs, either the administrations or the legislatures, may cut back their concessional development funding because development now appears futile in some countries until the oil exporters resolve at least a major part of the new problem created by the higher prices.

-- Moreover, it could be argued that the oil exporters must direct some of their investment funds through existing development institutions on concessional terms before DCs can agree to continued funding; for example, the oil exporters could pick up a substantial share in an increased IDA replenishment or set up special concessional funds in the regional development banks before we commit additional funds to the IFIs.

D. Softer Positions. The U.S. could move toward relief for the LDC problems. This might be done by offering increased assistance without any conditions on oil exporter participation or only with such conditions.

With the oil exporter link there are three possibilities:

-- A formula for increased concessional assistance related to reductions in oil prices, for example an offer by the DCs to increase their concessional aid in each of the next three years over the 1973 commitment level by 25 cents for every dollar oil prices (average posted prices) are reduced from current levels.

-- There could be various formula for increased contributions to special funds in existing (or new) institutions (IDA) in which the DCs would agree to match (on some proportional basis) oil exporter contributions. Modifications of the proposed IMF oil facility or the EC Commission proposal could meet such criteria.

-- A special one-time issue of SDRs to go to the LDCs with the greatest oil-induced payments problems provided the oil exporters agree to hold at least half the issue in their reserves for a minimum of six years.

The ad hoc subgroup did not believe a link between DC financing of food and oil-exporter financing of oil is a useful scheme to examine further. It would concentrate the financing burden among the DCs on the grain exporters (U.S., Canada, and

Australia), and would present the dilemma that, should grain prices stay high, we would be asking Congress for large amounts of aid funds when grain and bread prices for the U.S. consumer are a major problem. However, should grain prices fall substantially making it relatively easy to get additional funds from Congress because of support from the agricultural sector, the grain related problems of the LDCs would be much reduced.

Alternative to these specific proposals, the U.S. could suggest that all ECG countries agree to call attention in various meetings and in bilateral consultations to the opportunity for LDC development presented by the availability of large investment reserves in certain LDC countries. These investment reserves -- excess to the early needs of the oil exporters -- should be used not just to offset the oil-induced payment problems of the LDCs but to accelerate their development with concessional loans.

It is also possible to extend more DC concessional assistance to the hard-core LDC countries <u>without a link to the oil producers</u>:

-- A modified IMF fund with more concessional terms but more restricted to hard-core LDC problems drawing on either existing IMF resources or additional resources provided by DC members.

-- Agreement to seek higher assistance levels for bilateral programs with emphasis on program lending on concessional terms.

-- A special one-time issue of SDRs without conditions on oil exporter holdings.

It would be premature for the U.S. to support any one of these softer proposals. However, we might call for a study in the ECG to refine our assessment of the extent and timing of the hard-core LDC problem and to examine ways of meeting it including some or all of the above.

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OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

April 10, 1974

MEMORANDUM FOR: The Honorable
Deane R. Hinton
Deputy Executive Director
Council for International Economic Policy

SUBJECT: DISC Review

At the request of Assistant Secretary Frederic W. Hickman the enclosed staff memorandum has been prepared in response to your memorandum of March 25, 1974. The enclosed memorandum contains a discussion of pros and cons as to whether DISC should be retained in the light of events since its enactment. It then discusses what modifications might be made, including suggestions with respect to problems of commodities in short supply, if retention of DISC is desirable, and procedures for possible elimination of DISC, if that is desirable.

A report with respect to DISC tax returns for 1972 is being completed this week and will be sent to you as soon as it is available.

The Ways and Means Committee in its tentative decisions on the pending Oil and Gas Energy Tax Act excludes "oil, gas, coal, and uranium and their primary products" from being qualified exports under DISC.

Robert J. Patrick, Jr.
International Tax Counsel

Enclosure

April 10, 1974 2b

DISC REVIEW

The DISC legislation was proposed by the Treasury Department in 1970 and became a part of the Trade Act of 1970, which died in the Senate Finance Committee. The DISC proposal was again presented in August 1971, and included in the Tax Reform Act of 1971. It was adopted by the Congress effective January 1, 1972.

The following were the principal objectives of the proposal:

(1) DISC was intended to stimulate export performance by United States corporations at a time when the United States was running a serious trade deficit.

(2) DISC was to meet the objection that our tax structure favored foreign investment and the movement of production abroad by United States companies.

This memorandum briefly discusses the following issues:

(I) Should DISC be retained?

(II) If retention is desirable, what modifications should be made?

(III) If DISC should be eliminated, how should this be done?

I. Should DISC Be Retained?

1. Balance of Trade and Balance of Payments Considerations

History. In the 1960's, the United States had a balance of payments problem. It addressed the problem in a variety of ways:

foreign aid was tied to the procurement of U.S. goods, the Interest Equalization Tax was introduced, and mandatory controls were imposed on direct investment. DISC was an element of this program.

The effect of these programs was to support an overvalued United States dollar. In the case of DISC, the tax benefit was an aid in offsetting the higher price of United States products that made it difficult for United States exporters to compete with foreign manufacturers in foreign markets. In the case of the Interest Equalization Tax, the tax burden imposed on American purchasers of foreign securities was the equivalent of a reduction in the purchasing value of the dollar.

Con:

A basic argument against the retention of DISC today is that balance of payments problems can now be solved with uniform devaluation or revaluation of the dollar and that this occurs automatically with floating exchange rates. Uniform devaluation is far more effective and equitable than the selective approach of DISC. Uniform devaluation works quickly and uniformly across exports and imports. When the dollar falls in value relative to other currencies, U.S. exports are more attractive to purchasers holding currencies that have risen in value in comparison to the dollar. Foreign imports are less attractive to United States purchasers who must pay dollars to acquire them. On the other hand, DISC operates to provide benefits solely for exporters and not for those competing against imports. DISC is also inequitable because it is a reduction of tax on profits, and therefore promotes exports by giving greater benefits to higher profit exports.

Pro:

The foregoing argument assumes that the immediate problem of payments for vastly more expensive oil and other energy imports does not create a problem that favors continued retention of an incentive for exports to generate additional income to pay for the additional oil imports and to maintain a higher value of the dollar for this purpose. It also rejects the possibility that we may wish to support the dollar to offset the effects of domestic inflation. Similarly, the foregoing argument accepts the proposition that the United States is either better placed or wiser than such countries as Japan and the United Kingdom that have undertaken major export promotion programs at this time. The principal rejoinder, however, is that a regime of flexible rates may not continue indefinitely. If the world returns to a system of fixed exchange rates, the DISC could once again become a useful export promotion tool. This possibility argues for retention of the basic DISC legislation.

The Effectiveness and Cost of DISC in Stimulating Exports.

The 1971 Treasury Department testimony on behalf of the DISC proposal was that the impact of DISC over time would be from $1 to $1.5 billion in increased exports with a revenue loss of $500 to $600 million. DISC was recognized as an expensive way of promoting exports, but deemed necessary under the then prevailing circumstances.

Under a recent price elasticity analysis of DISC, the revenue and export effect remains approximately the same. The DISC benefits proposed by the Treasury were reduced by one-half. Thus, a revenue loss of approximately $250 million will generate approximately $750 million in exports. However, in view of substantially increased exports due to floating exchange rates the actual revenue loss will be substantially more. Returns filed for years ending on or before March 31, 1973, indicate a revenue loss of approximately $250 million for the first year's operations.

Con:

The DISC is a very expensive method of promoting increased export activity viewed from the standpoint of Treasury revenue. Elasticity studies indicate limited responses to reduction of prices or equivalent promotional activity by U.S. companies. The DISC export promotion was geared to a fixed exchange rate system. We no longer have such a system and the revenue cost of DISC could support other and more important government programs.

Moreover, part of the revenue loss can be attributed to agricultural and natural resource exports which are not appreciably stimulated by DISC and the prices of these products have been rising rapidly.

Pro:

When the DISC legislation was adopted, elasticity studies were specifically rejected in Treasury and interagency decisions to recommend DISC. It was believed that the "announcement effect" and the incentive provided by a significant reduction of current taxes on export income would stimulate United States manufacturers, who have traditionally depended primarily upon a large domestic market, to concentrate more resources upon United States exports. To some extent, even with exchange rate advantages, United States manufacturers may be slow to turn to export activities. The elasticity type of analysis was also rejected on the basis that existing studies do not give sufficient weight to different products and markets and are not an accurate measure of potential exports.

It was not believed that the DISC tax deferral would be reflected in lower prices, but that the tax reduction would stimulate an increase in allocation of corporate resources to exports. Industry testimony, while clearly self-serving, presented examples of how a tax deferral could be used to improve their exports. This testimony was heavily relied upon by the Treasury and the Congress.

As will be discussed subsequently, it is also argued that the question is not solely about the cost-benefit of a tax incentive but about a structural change in our taxation of foreign source income to place the taxation of export income of a domestic subsidiary on the same basis as the income of U.S. controlled foreign corporations competing in foreign markets.

DISC Discriminates Against Import Competing Industries.

Con:

To the extent that exports are stimulated by DISC, the dollar will not depreciate as much as it would without DISC. To that extent, U.S. imports will be slightly higher than without DISC. Thus, DISC ultimately serves to redistribute income away from industries that compete with imports and toward export industries. Wages, salaries, profits, as a result, may be somewhat lower in the former and somewhat higher in the latter industries. Likewise, the number of jobs will be higher in export industries. Finally, the potential contribution of import-competing industries to balance of payments equilibrium is lost when all the stress is placed on exports. This discrimination between export and import-competing industries does not occur when balance of payments problems are solved by adjusting the exchange rate.

As previously noted, an exchange rate adjustment downward will make exports more attractive to foreign purchasers holding currencies that have appreciated in relation to the dollar and will make domestic products more attractive than imports for U.S. consumers, since imports will become more expensive.

Pro:

The above argument must be qualified to the extent the international monetary authorities do not allow a perfectly "clean float". Exchange market intervention by monetary authorities may prevent the dollar from depreciating further in the absence of DISC.

An additional reply to this argument is that the alternatives are more complicated. The effect is not solely between exports and domestic sales but also involves decisions to shift production to foreign subsidiaries, in which case there is an elimination of U.S. jobs and production and capital flows abroad.

2. Offsetting Tax Advantages of Producing Abroad.

Competitive Position of U.S. Exporters. A principal purpose of the DISC legislation was to counter the argument that United States companies had substantial tax advantages in producing abroad resulting from our tax structure. DISC was intended to make production in the United States more attractive relative to foreign production.

Our present tax structure provides that United States corporations may establish foreign subsidiaries that do not pay United States taxes and pay foreign taxes under the same conditions as their foreign competitors. The income of these subsidiaries is not taxed until it is repatriated to the United States. Foreign tax rates are frequently lower than United States corporate taxes and foreign countries have permitted favorable tax treatment of export income. Our intercompany pricing regulations on sales by U.S. exporters to foreign affiliates are the most severe in the world.

A tax policy issue is posed as to whether export sales from the United States should be treated more like domestic sales and fully taxed currently by the United States or whether they should be treated more like the sales of controlled foreign subsidiaries of United States corporations so that they compete on a foreign basis rather than being made subject to U.S. domestic tax.

Pro:

DISC was made a domestic corporation to make it easier for smaller corporations to establish and for the Internal Revenue Service to audit. The principal innovation was to introduce an allocation of income rule permitting up to 50% of the combined taxable income of the manufacturer and the DISC to be allocated to the DISC. This avoids the burden of establishing an arms-length price under section 482. As a practical matter, the safe haven usually allocates substantially more than a DISC could ever earn on a section 482 basis.

From the standpoint of our tax laws, United States industry competing abroad might either compete on the basis of neutrality with its foreign competition or on the basis of neutrality with domestic competition. The Administration stated in the February 1974 International Economic Report of the President that "we are determined not to penalize American businesses by placing them at a generally unfair tax disadvantage with respect to their foreign competitors." If export income is taxed more severely than foreign investment income, the argument will be made that our tax laws force our companies to go abroad to compete in foreign markets.

Many countries tax the profits earned on the export of manufactured goods as lightly or more lightly than the United States does under the DISC legislation. Annex A presents one estimate of the tax cost of capital indices for various countries. The indices refer to the tax cost of capital employed in the production of manufactured exports. The indices do not pretend to say anything about the cost of physical plant and equipment in different countries. They do attempt to say something about the tax burden on capital.

An index of 100 means that the effective tax on profits is zero. An index of 100 not only means that capital escapes taxation, but it also means that capital is preferentially treated relative to labor which is taxed. An index less than 100 means that profits are being subsidized, and the lower the index the larger the subsidy. Annex A indicates that the tax cost of capital index is less than 100 in many countries. This is true because subsidies are often provided for plant and equipment expenditures, because generous depreciation allowances can be used to reduce the parent company tax liability, and finally because much of the export income can be sourced in a tax haven country.

Where a foreign producer exports from a foreign country to a third country market by means of an intervening tax haven subsidiary, he may shelter a portion of the sales profits in the sales subsidiary. For example, part of the selling profit may be placed in a Swiss subsidiary selling into Italy on behalf of a Belgian manufacturer. If DISCs were foreign corporations rather than domestic corporations and if they had 100% deferral on their income rather than only 50% deferral, they would be treated in the same manner that virtually every other developed country treats foreign subsidiaries of its domestic corporations. In this sense, DISC tends to place U.S. exporters on the same tax footing as a foreign producer selling through an intervening foreign sales subsidiary.

In the case of foreign manufacturers selling in their domestic markets, DISC offsets lower corporate tax rates or capital cost recovery rules that are more liberal than U.S. rules. On the other hand, since the DISC is free from current tax in the United States on 25% of the combined manufacturing and sales income, a DISC provides a tax advantage over direct manufacturing operations in foreign countries with a tax rate of 36% or higher where no foreign sales subsidiary is used in distributing the products. 1/ An analysis has been made with respect to the comparisons of capital costs. Annex B presents estimated indices for the tax cost of capital which is employed to make manufactured goods for domestic consumption. The figures in Annex B indicate that the estimated tax burden on DISC

1/ The DISC effective tax burden depends upon the allocation of income rules and the prospect of long term tax deferral in the DISC. Where a DISC is controlled by a U.S. manufacturer, 50% of the combined income on the manufacture and export of a product may be allocated to the DISC. One-half of this amount is deemed distributed in the year earned as a dividend to the DISC shareholder. The parent is thus taxed at a 48% rate on 75% of the combined taxable income, for an effective tax burden on the income of 36%. Since the DISC is not subject to U.S. taxation on 25% of the combined taxable income the current tax burden remains 36%.

exports is often lower than the estimated tax burden on manufacturing production in industrial countries.

The pre-DISC index for the United States was 125 for regular U.S. based firms and 101 for U.S. exporters with sales subsidiaries located in tax haven countries, as compared with an average for industrial countries of 124. The DISC legislation reduces the U.S. cost of capital to 99 or 93, the latter being for the tax haven firms. Thus, U.S. based firms can have a distinct advantage over foreign based U.S. firms which produce for local markets.

Con:

One answer to the problem of the competitive position of U.S. exporters is that no matter what the level of foreign taxes and the U.S. treatment of unremitted profits, the United States can adequately keep jobs at home and promote exports by adjusting the exchange rate. Indeed, from the standpoint of job-creation, it makes more sense to promote exports through a lower exchange rate than through lower taxation of profits. A lower exchange rate encourages the use of both capital and labor in the production of export goods;

the lower taxation of profits preferentially encourages the use of capital.

Pro:

The foregoing answer assumes that the constant lowering of the value of the dollar and consequently increasing the cost of raw materials will not create a substantial dislocation of jobs and production in the United States. It also assumes that lower values for the dollar will not stimulate increased production from controlled corporations in countries such as Germany where the exchange rate gains will be reflected in subsidiary profits.

(3) DISC as an incentive for smaller exporters.

Pro:

Multinational corporations have many opportunities to reduce their tax burden on export sales. These opportunities are not available to smaller companies. The multinational firm can establish an export sales subsidiary in a tax haven country such as Switzerland, the Bahamas, or Lichtenstein. Or it can establish a possessions corporation in, for example, Puerto Rico or Guam. Sales to Latin America and Canada can be routed through a Western Hemisphere Trade Corporation. Finally, the Multinational corporation may have excess foreign tax credits that it can use to shelter the foreign source portion (roughly one-half) of the export profits earned by its plant. These tax preference arrangements are not readily available to small exporting firms. But any firm can easily establish a DISC, and this possibility puts small firms on a more even tax footing with large firms. The 1972 DISC study indicates that DISCs owned by smaller parent corporations grew faster than DISCs owned by larger corporations.

<u>Con</u>:

On the other hand, the DISC legislation is sufficiently complicated and the benefit is so limited that any operating costs or accounting fees destroy any value to small companies. The DISC benefit lies in long term deferral, but the deferral is on only 25% of the taxable income arising from the manufacture and export, <u>i.e.</u>, $12 of tax on $100 of taxable income.

Although DISC may potentially equalize the tax burden of large and small firms, the bulk of DISC tax benefits have so far accrued to very large firms. Annex C shows that 84 percent of all 1972 DISC gross receipts were earned by DISCs whose majority shareholder had assets in excess of $100 million. DISCs owned by corporations whose assets were less than $50 million earned only 5.4 percent of total gross receipts. The distribution of tax benefits closely parallels the distribution of gross receipts.

(4) <u>DISC Discriminates in Favor of Capital-Intensive Exports</u>.

<u>Con:</u>

DISC favors capital-intensive over labor-intensive exports and that this is an undesirable distortion of our tax structure. Exports for major U.S. manufacturers consitute only a fraction of their total activity. For this reason, they are not likely to change their manufacturing techniques and this argument may be largely theoretical. To the extent it has validity it runs as follows: DISC lowers the current effective tax burden on profits from 48% to 36% 1/, assuming that the DISC can maintain a long term deferral of its portion of the profits 2/. Most profits correspond to the use of capital

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1/ When a firm has a pre-existing network of foreign subsidiaries, including tax haven sales subsidiaries, the estimated reduction in the effective rate is from 36 percent to 30 percent. The extent to which this combination is used is open to question. It is believed that some firms are reluctant to attempt this since section 482 rules apply an arms-length price requirement on sales to a foreign affiliate through a DISC.

2/ It is probably that such a deferral can be maintained in most cases for five or six years. There is a question as to whether companies can extend the deferral indefinitely in view of reinvestment requirements in export related assets required by the legislation.

assets: plant and equipment, research and development findings, established brand names and so forth. DISC benefits are provided for through a reduction in the taxation of income earned from capital. Hence, the DISC legislation discriminates in favor of exports which are produced with capital-intensive exports. This discrimination as between different kinds of exports serves to offset the job-creating intent of DISC: firms which use capital-intensive production methods will gain more from DISC and will thus expand relative to firms that employ labor-intensive methods. Moreover, a lower cost of capital relative to labor will eventually cause all firms to substitute capital goods for labor in the production process. This substitution also lowers the relative demand for labor. Again, such discrimination does not occur when balance of payments problems are solved by exchange rate variations.

Pro:

There are arguments on the other hand, that the taxation of capital in the U.S. is excessive, and that this side effect is not, by itself, undesirable. In any event, as noted above the effect on company behavior is questionable.

II. If the DISC Is Desirable, What Improvement Might Be Made?

1. Short Supply

Recent political concern over DISC has focused on the problem of DISC benefits being available for items that appear to be in short supply in the United States or at least subject to rising domestic prices. The present legislation provides that the President may declare that an item he finds to be insufficient to meet the requirements of the domestic economy is a non-qualified export for a DISC. Exercise of this provision presents several practical problems. It is suggested that this problem would be largely resolved by limiting DISC benefits to manufactured products by excluding mineral resources and agricultural products and by making changes in the statutory tax treatment of sales of items declared to be in short supply.

(a) Penalty Problem. Income from the sale of assets declared to be in short supply must be distributed as a dividend by the DISC to remain qualified and retain tax deferral on its other income. Senate amendments created a mechanical problem that can result in a DISC share-holder paying taxes currently not only on the profits attributable to the non-qualified asset but on one-half again the amount of such profit. The Treasury is presently attempting to have this mechanical defect changed as part of the Energy Tax Bill currently before the Ways and Means Committee.

(b) Decision Process. It is difficult to obtain interagency agreement on a recommendation that a particular commodity is in short supply. In the case of agricultural commodities, the failure to act promptly or in advance of the growing season means that contract commitments are made for the crop year and there may have been reliance on the DISC tax benefit, so that failure to recognize commitments would be unfair, but if recognized, would make the declaration ineffective. Concern has been expressed about the likelihood that declaring items in short supply for DISC will increase pressure for embargoes. Finally, if DISC is to be a part of the tax structure, exporters should be able to rely upon it and it should not be turned on and off.

In view of these considerations, if it appears that certain items, such as primary agricultural commodities and mineral resources are likely to be subject to continuing shortages, it is desirable to eliminate them permanently from being qualified DISC exports. This would limit the DISC to goods manufactured in the United States. This is more consistent with the rationale that the DISC is to affect the location of manufacturing plants that might otherwise go abroad.

On the other hand, statutory elimination of categories of products or commodities increases a basically discriminatory approach. In theory, discretionary authority to impose limitations on DISC treatment permits adjustment to take account of changing circumstances, whereas statutory exclusions become permanent fixtures in the law. Greater efficiency in reaching determinations might be achieved by providing that the discretionary authority to remove DISC benefits could be delegated to a specific agency.

2. Smaller Exporters

The original DISC proposal provided for deferral of 100% of the income allocable to the DISC. This amount was cut to 50% of the allocable income (or 25% of the combined taxable income on the manufacture and sale). The impact of this cutback was probably greater on small manufacturers in terms of the significance of DISC to them. DISC could be amended to provide for greater deferral in the case of DISC's owned by smaller United States manufacturers. This presupposes that there is a necessity for creating a greater incentive for smaller corporations to export which is doubtful in the light of the over-all status of exports today.

3. U.S. Shipping Incentive.

A relatively useless provision in the DISC legislation increases the taxable income allocated to a DISC controlled by a manufacturer if the export shipment is made on a U.S. flag carrier. This has aroused the antagonism of other maritime nations, including the U.K., and is a poor precedent. This provision should be repealed.

4. Technical Complexity.

There are technical complexities with respect to the tax deferral of DISCs and producers loans from the DISC where the parent corporation is investing overseas. It would be desirable to simplify the present rules, which are intended to prevent accumulated DISC income from being invested outside of the United States.

IV. If DISC is Undesirable Today, How Should it be Eliminated?

1. Prior Promotion of DISC

If the basic arguments against DISC are accepted, then a further argument can be made that this is a good time for action. United States exports increased more than 40 percent in 1973, and the trade balance improved sharply. Like the interest equalization tax and the foreign direct investment program, DISC could now be dropped with minimum adverse effect.

More than 5,000 DISCs have now been established. In 1972, the Treasury Department distributed more than 75,000 copies of a handbook containing a simplified explanation of the use of the DISC. DISC conferences were held throughout the country with several thousand people in attendance at some 100 meetings, many of them arranged by the Department of Commerce. The Department of Commerce has estimated that less than 10 percent of the U.S. manufacturers are exporters, i.e., an estimated 25,000 out of 300,000 manufacturing establishments. About 50 percent of total U.S. merchandise exports are shipped by 300 U.S.-based companies. It is apparent that the majority of the 5,000 DISCs now in operation represent the medium size segments of U.S. business. There is an element of unfairness in abrupt termination of the DISC provisions for those who have organized DISCs with Government support and encouragement.

There are two aspects of termination of the DISC provisions. One aspect relates to terminating the DISC as to future export earnings. The other aspect relates to the treatment of accumulated untaxed DISC income. The DISC legislation provides that, even if a DISC is disqualified, its accumulated untaxed income will be taxable over a period of ten years or such shorter period as the DISC has been in existence. It would be possible to establish one date for the termination of DISC benefits for future exports and to set a later date as a termination of deferral. Prior to such final termination, accumulated DISC income would be taxable to shareholders over a period of years, thus providing a phase-out of deferral.

It is likely that the Congress will be reviewing the DISC status in the near future. There will be controversy over its continued existence and also over its outright repeal. A suggested approach is to place a specified time limit on its continued existence, with a further phase-out of the deferred income. This would preserve the option that it might be extended at a later date, but more importantly, provides assurance to exporters as to their export planning and should satisfy those opposed to DISC that it is being eliminated. The impact of this step as to GATT and our international position would depend upon the terms of the phase-out.

2. International Negotiations

The DISC proposal provided for tax deferral in order to maximize the legal case that the DISC did not violate existing GATT rules. If DISC were a foreign sales corporation, the U.S. law on the DISC would actually be stricter than the laws of any foreign country with respect to the taxation of foreign sales subsidiaries of their domestic corporations, i.e., only 25% of the combined manufacturing and sales income remains free from current domestic taxation. DISC thus serves as a focus for examining the rules of international behavior with respect to direct taxes on exports.

In proceedings before the GATT, the United States would defend the DISC on the basis that a corporation in any EEC country could set up a foreign sales subsidiary and probably attain a greater tax savings. We believe that the Office of the Special Trade Representative would find some utility in

DISC in trade negotiations on export practices and that the DISC raises an issue for multilateral resolution of policies on investment and export incentives. It therefore has some value to be traded away since it has been the object of criticism and attack by Canada and the E.E.C.

3. Tax Equity for Exports

While the DISC, as a new piece of legislation, has drawn substantial critical analysis, less attention has been given to the fact that Western Hemisphere Trade Corporations are entitled to export in this hemisphere and pay tax at a reduced 34% rate. Similarly, while we have a 1962 tax haven legislation that purports to tax currently the income of controlled foreign subsidiaries selling goods on behalf of related corporations and located in tax havens, there is a major exception from this provision that operates where the U.S. controlled group has extensive foreign manufacturing operations. These manufacturing operations permit the group to maximize the use of tax havens because they are producing abroad. It appears appropriate in considering whether the DISC provisions should be eliminated to consider (1) eliminating the foreign tax haven provisions from United States law to permit the use of any foreign selling subsidiaries by large or small U.S. corporations, or (2) eliminating exemptions under the existing tax haven legislation which favor both large U.S. corporations over smaller ones as well as foreign production over domestic. Similarly, consideration of tax incentives for exports should consider the favored status of exporting through Western Hemisphere Trade Corporations.

Annex A

Tax Cost of Capital Engaged in Producing Manufactured Goods for Export

Country Type of export corporation	(1) Proportion of total profits assumed allocated to export corporation	(2) Regular corporate tax rate	(3) Cash grant or tax credit per dollar of capital expenditure	(4) Present value of depreciation allowances discounted at 7-1/2% per dollar of capital expenditure on: Buildings	(5) Equipment	(6) Estimated tax rate on total export profits for different rates of distribution of export corporation profits to parent corporation: 0%	(7) 50%	(8) 100%	(9) Estimated index of cost of capital engaged in export production relative to zero tax case for different rates of distribution: 0%	(10) 50%	(11) 100%
ited States											
Tax-haven sales subsidiary	0.500	0.480	0.070 a/	0.460	0.675	--	0.360	0.480	--	101	125
Western Hemisphere Trade Corporation	0.500	0.480	0.070 a/	0.460	0.675	--	--	0.340	--	--	98
Domestic International Sales Corporation 55/45 split e/	0.550	0.480	0.070 a/	0.460	0.675	--	0.348	0.348	--	99	99
55/45 split and tax-haven sales sub. e/	--	0.480	0.070 a/	0.460	0.675	--	0.300	--	--	93	--
stralia											
Tax-haven sales subsidiary	0.750	0.475	0.020	0	0.745	0.119	0.297	0.475	81	101	135
[illegible]											
[illegible] sales subsidiary	0.750	0.420	0	0.510	0.759	0.145	0.151	0.157	83	83	84
nada											
Tax-haven sales subsidiary	0.750	0.500	0	0.400	0.657	0.125	0.125	0.125	80	80	80
nmark											
Tax-haven sales subsidiary; plant in non-development area	0.750	0.360	0	0.511	0.746	0.090	0.158	0.226	83	89	97

Cost of Capital Engaged in Producing Manufactured Goods for Export

Country Type of export corporation	(1) Proportion of total profits assumed allocated to export corporation	(2) Regular corporate tax rate	(3) Cash grant or tax credit per dollar of capital expenditure	(4) Present value of depreciation allowances discounted at 7-1/2% per dollar of capital expenditure on: Buildings	(5) Equipment	(6) Estimated tax rate on total export profits for different rates of distribution of export corporation profits to parent corporation: 0%	(7) 50%	(8) 100%	(9) Estimated index of cost of capital engaged in export production relative to zero tax case for different rates of distribution: 0%	(10) 50%	(11) 100%
ax-haven sales subsidiary; plant in development area	0.750	0.360	0.250	0.383	0.560	0.090	0.158	0.226	62	67	73
ince											
ax-haven sales subsidiary	0.750	0.500	0	0.493	0.797	0.125	0.134	0.144	73	74	75
many											
ax-haven sales subsidiary; plant not in West Berlin	0.500	0.330 b/	0	0.260	0.721	0.165	0.227	0.290	96	103	112
ax-haven sales subsidiary; plant in West Berlin	0.500	0.330 b/	0.075 c/ 0.200 c/	0.260	0.721	0.165	0.227	0.290	75	81	89
eland											
Domestic export corporation in Dublin area	1.000	0	0	0	0	0	0	0	100	100	100
Domestic export corporation outside of Dublin area	1.000	0	0.400 d/	0	0	0	0	0	60	60	60
aly											
Tax-haven sales subsidiary	0.750	0.438	0	0.672	0.640	0.109	0.274	0.438	74	90	117
pan											
Tax-haven sales subsidiary	0.750	0.314 b/	0	0.380	0.770	0.079	0.197	0.314	86	98	115

Annex A

Cost of Capital Engaged in Producing Manufactured Goods for Export

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therlands											
Tax-haven sales subsidiary; plant in non-development area	0.750	0.478	0	0.550	0.638	0.119	0.119	0.119	80	80	80
Tax-haven sales subsidiary; plant in development area	0.750	0.478	0.150 d/	0.550	0.638	0.119	0.119	0.119	63	63	63
rway											
Tax-haven sales subsidiary	0.750	0.265	0	0.304	0.608	0.066	0.133	0.133	92	103	103
ain											
Domestic corporation with export reserve; plant in non-development area	0.500	0.328	0	0.302	0.647	--	--	0.164	--	--	97
Domestic corporation with export reserve; plant in development area	0.500	0.328	0.150 d/	0.302	0.647	--	--	0.164	--	--	80
itzerland											
Tax-haven sales subsidiary	0.750	0.250	0	0.386	0.725	0.063	0.063	0.063	89	89	89

Annex A

Cost of Capital Engaged in Producing Manufactured Goods for Export

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United Kingdom											
Tax-haven sales subsidiary; plant in non-development area	0.500	0.400	0	0.662	0.887	--	0.300	0.400	--	95	111
Tax-haven sales subsidiary; plant in development area	0.500	0.400	0.200	0.662	0.887	--	0.300	0.400	--	67	78

Office of the Secretary of the Treasury
Office of Tax Analysis

a/ The U.S. investment tax credit applies only to equipment.

b/ The German and Japanese tax rates are averages for retained and distributed earnings.

c/ The average cash grants in West Berlin are 7.5 percent for buildings and 20 percent for equipment.

d/ These figures represent averages of cash grants available for development areas.

e/ Assuming that DISC receives 55 percent of total export profits (parent plus DISC). In the second instance the assumption is made that the DISC sells to a tax haven sales subsidiary.

2d

ANNEX B

Tax Cost of Capital Employed in Producing Manufactured Goods for Export by the U.S. or for Local Consumption Abroad

Country Type of Corporation	Capital cost index
Mean value for all countries a/	124
United States	
Domestic corporation	125
Tax-haven sales subsidiary	
with 50 percent of income distributed to parent	101
Western Hemisphere Trade Corporation	98
Domestic International Sales Corporation	
55/45 split c/	99
55/45 split plus tax-haven sales subsidiary d/	93
Australia	140
Belgium	122
Canada	140
Denmark	117 b/
France	128
Germany	119 b/
Ireland	132 b/
Italy	117
Japan	115
Netherlands	135 b/
Norway	127
Spain	121 b/
Switzerland	112
United Kingdom	111 b/

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Office of Tax Analysis

a/ The mean value includes the U.S. domestic corporation.

b/ The capital cost indices for investment in "development areas", which is encouraged by cash grants, are as follows: Denmark, 88; Germany (West Berlin), 94; Ireland, 56; Netherlands, 106; Spain, 99; United Kingdom, 78.

c/ Assuming that the DISC receives 55 percent of total export profits (parent plus DISC) under the 50 percent rule plus a 5 percent allowance for export promotion expenses.

d/ Assuming that the DISC sells to a tax haven sales subsidiary.

Annex C

2e

DISC and Related Persons Gross Receipts by Type and Size of Majority Shareholder 1/
(In millions of dollars)

Type and asset size of majority shareholder	Returns with income	DISC and related persons 1972 gross receipts	Percent of total
All with income	703	$12,318.1	
Corporate shareholder, total	588	12,193.3	99.0%
Under $10 million	159	428.4	3.5
$10 to under $50	72	237.8	1.9
$50 to under $100	14	150.9	1.2
$100 to under $250	87	7,385.2	60.1
$250 or more	20	2,960.7	24.3
Corp. not classified	236	1,030.3	8.4
Noncorporate	107	107.2	0.9
Unknown		17.6	0.1

Office of the Secretary of the Treasury
Office of Tax Analysis

1/ Note well that only 703 out of roughly 3,300 active DISC returns are included here.

CIEP Roosevelt Room - 10 am [2f]
April 12

Shultz
PMF + DH + Cooper + RA + RE + DW + RS + JN + RS
Eberle
Stein + Kvasnicka
Tabor - Katz
Rush + Weintraub
Burns - Mitchell
Volcker
Casey

Pre formal meeting
Volcker doubt that make big issue of I at OECD ministerial

PMF - Introduct:
Volcker concerns NAK speech re LDC's and aid to LDC's

Intl I:
PMF - refer to paper on I which believe accord w. trade + $. Reform of intl econ syst - I now lag. Refer to XCSS discussion and say not broad effort + no broad US policy. Recognize pos. initiative in $ + trade (eg trade bill daily) + recog desirability of having another area of taking to open world w. our broader trends.

PMF propose that we put this goal to OECD Ministerial - say that XCSS work slow down + we need new impetus. Of paper correctly state Admin pos, PMF + whether not good thing to make statement at May ministerial to step up pace, fit w. other reform discussion in intl econ system.

(1) Substance of paper

(2) Speech at Ministerial mtg

Burns - Cong concern in strategic industry
Dorf - Yes we have techniques & pointed out protection available ~~to~~ (defense powers) covered in power under national sec and except.

At short concern but say ~~not~~ only ~~[illegible]~~ senior trade one to get more info. Refer to recent Rol bill.

ACTION
Burns want ~~cont~~ contrasts

Rush - statement is good but pts out US greatest culprit - Johnson Votes - Dorf FX1 & substantially re Argentina; AT Noble ICI invest
sales of ... in NY + ... dos.
Dorf - says - thinks that while we sin, others (except Wg) are worse.

Shultz - if we push, then we set pts of vulnerability is discussed

~~Stein~~ Rush
~~Aust~~ - AT is most flagrant extraterritorial application.
Stein:

Dorf: except that one problems & need to grandfather. Say here set forth a policy & begin to work on the existing restrictions and grandfather.

Eberle: (1) endorse grandfathering of existing + III (3)

(2) invest incent that Δ trade patterns

have a prob under state law + need to grandfather some of our practices

Speaker feels that ~~would~~ we couldn't live w. "elim or harm"

Volcker

(1) major issues are Tactics + priority

(2) Volcker ~~is~~ good summary of where we are + our posit. ~~Some~~ No prob as a gen statement. — ~~Some~~ Hard to negotiate + some may hit on us.

Volcker, Rush, Tolor all agree that excellent statement of our aims

Shultz — get Sneiguis to Post to be review in light of prob.

Tactics — Volcker

not useful to ~~use~~ these big stones in this on basis of this doc. Volcker believ prog proceed in areas where prog seems most feas. + most prom. is to proceed the way we have. New statement from such a sweeping doc, may raise quests + could set work back by raising suspicions (i.e. that we ∆ mind by starting over), ~~Could~~ Should cont. to push along in XCSS + not

need to be careful
on how present

Corey: feels could be a threat
at this meeting. Not much enthusiasm in OECD
& US only keep it alive. Only two things
alive on (1) north-south (2) invest dispute
& all this is report is some generality
on consultation. Feels should continue
to push to get something more favorable
- refer to Gonzalez re (1) new forum re LDC
& Corey feels some pressure from Cong
out of UN.

Corey feels a worthwhile initiative
for US to take at this - need to
be careful on how present.

Enders: adds to Corey - soon need to move on
firm positive way. We have held
back. If we can't move in firm,
way, the TNC's & wg will resent.
We will get negative.

Feels need to move ahead - concern for
tactics - could gain and would
at best prevent negative.

Rush agree w Paul Volcker.
1. no. of matters moving well
2. If a broad proposal, could be
counter productive -
a) upset existing work
b) accelerate TNC work -
refer to ?? LDC's.

3. Seals good statement of broad objectives but not toss out a big bomb at this.

Corey – This statement tuned to what go on

Pdof:

Big perception of how things move in OECD & needs a major infusion if ~~keep~~ keep it moving. PdoF not evidence a new init a Δ minds.

not use this stato but broader

1. response to what go on in post mo now.

2. say other areas for work as no winding down of OECD efforts but broader effort re I to complement trade & I

Volcker:

1. not much progress or real opposition & resistance
2. Say XCSS set up largely to do this & in our int to keep it going.
3. no great discernment in saying something at this
   But if take new hard approach may get others to back off.
4. what say at XCSS? – push where progress is possible
5.

Think: if broad new approaches, consult beforehand on big new initiatives

For: PMF, WC, WE, HS
Against: WRush, Volcker

Stein – not a big new initiative
We agreed two years ago & dribble along
&

Shultz.

1. Paper – gen subscribe to & a few problems to take care of. Regard as internal statement or mutual guidance for Admin

Comments on paper - relevant as internal policy guideline.

2. Want to keep issues moving & use Pri[illegible] to extent poss, to do it. Best way to do it is tactical. & gen CM is not [illegible] strong & need a group to consider what tactics for the [illegible] & what power we need to do this.

Sug State take lead on this subject w. a working group. CIEP & Treas

Use OECD & [illegible] CIEP group chaired by State to work on tactical aspects.

3. need consultat w. those on our side.

Foreign Banking

Mitchell:

A. Fed program: 1. non-discrim (often opened to reciprocal but dropped as couldn't yet agree)

2. Fed membership to insure maintain US $ control over foreign Bks

3. Federal option to entry

B. Fed draft proposal circ to foreign central bank & CB's - Reactions of Foreign Bks

1. How much cost the bank in sterile funds?

2. Present activities - a. take away

b. grandfather - temp or perm

UK & Jap feel location should be grandfathered & would like to retain ability to expand in these states.

(US Bks not have these priv)

NY
Calif
Illinois
Mass
Oreg
Wash

3. WE Bks ~~want to~~ (not Jap) want to be able to continue ~~...~~ non-banking (GW & Sec)

- want these activ grandfather

4. Fed membership

a. All large foreign Bks would be member bank in the U.S.

b. Foreign understanding becoming clearer & more tranquil.

c. What to do?

1. Since first of this year accel of FB get a foothold & grandfather

2. if delay and → ↑ foreign presence, the more dif for setting grandfathering activities by Cong & states.

if not setting US grandfather → retaliation abroad.

3. Judgment issue: need to settle quickly in a way satisfactory to foreign banks.

Burns: ① if wait, problem more acute & may get restrictive action by states.

② Some US banks prefer no action as fear foreign retal.

Burns feel best way to prevent is to give generous grandfathering & same treatment as foreign bks.

Burns - oppose permanent grandfather. not see much practical dif in 15 years

Mitchell: reaction from foreign central banks:

a. If grandfather setting according to their desires, he feel no retaliation

Shultz: (1) no contrary of view re fed proposal

(2) grandfathering of Glass-Steagall
J.P.

(1) Mitchell - says foreign bks want this
(2) Rush - State study treaties

Permanent Fund
Philadelphia Fed is important

~~Volcker~~:
Volcker: dif views in Treas
(1) current sit is good as → compet for US banks and may → moves by state to permit interstate banking. Shouldn't "freeze" the sit.

(2) no pos of legislation this year. So don't propose legis now but review in conjunct w. Δ in US laws. Logic now that no pos of pass needlessly upset foreigners.
(c) ~~Not~~ Introduce this session sets grandfather date even if not passed.

(3) natl legislation re foreign bks is not natl treatment as override state laws re foreign bks. Appears to be discriminat

(4) Volcker comes down against for delay

Eberle: (1) great fear of retaliation:

(2) way to trigger grandfather date / do must find way to trigger grandfather date
(3) consultation w. WE:

pos general bill in hopper.

Burns: agree that no chance of legis this year.

Shultz: (1) net effect → get legislation to establish a date
(2) for grandfather
(2) let people know that intend to discuss

Foreign Window:

Burns says a paper coming soon. And thinking against a foreign window now.

Mitchell: (1) problem: what kind of fence can build to prevent eroding domestic monetary policy?

(a) Pos set up sale of US DRs that could lead to erosion of monetary control.

(b) if accept deposits at FW, how do meld them into your money supply?
- could be in the $ supply w/o controls
- relative erosion as is same erosion thru London.

prof soap
winston would
use it.

Burns: (1) no serious int in part of US banker
(2) new hazards involved in control of
both credit and money supply.
(3) degree of erosion is speculative but
a problem
new route for evasion of reserve
reg and int rate controls.

Shultz:
(1) Fed power soon

another issue:
Volcker: pos get WE to put reserve req on
Eurodollar. UK no but some pos in Ger.
London not want to give it up.

Burns: (1) pos account deposit in foreign
currency at foreign window which
raises fewer probs:

LDC Problem in fore of oil sit

Volcker: (a) say revery a problem + many sugg sol

premature (b) can US contrib anything by sug forum
for discuss + sort out proposal.

(c) what is US contrib + what our
attitude to this effort? — i.e. substantive
~~positio~~ position.

If no US posit, then HAK should finesse

Shultz: we do have a posit. Hold our level of
support to levels projected in budget. Shultz
feel if get more we doing well. Can't go
beyond this because of Congress problem.

Cooper: uncertain about:
(a) magnitude
(b) timing

IMF: (1) Careful country studies (being done)
(2)

Volcker: (1) should we accept posit of no addit aid?

WE: (1) don't lock door on pos of more aid
(2) but don't flinch and accept
high price.

~~Volcker~~

PMF: why bring issue forward in intl forum before we know our own point?

Wash (1) AID country work:
(2) Treasury:

Cooper: informal talk & oil producer wider gives US time to decide on point.
(1) need to get picture on timing of the problem.

Volcker feels uneasy re informal, unusual approach.

PMF: ~~[illegible]~~ not exercise leadership if
(1) [illegible] parameters
(2) Any wait until others decide

Peter [illegible]
(1) talk w Cooper:

Invest - Wash

Bob: (1) [illegible]
(2) Fdg [illegible] -

LDC:

DISC: