

NOMINATION OF DONALD T. REGAN

HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
FIRST SESSION
ON
NOMINATION OF
DONALD T. REGAN TO BE SECRETARY OF THE TREASURY

—————
JANUARY 6, 1981
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Printed for the use of the Committee on Finance



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON: 1981

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S361-19

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NOMINATION OF DONALD T. REGAN TO BE SECRETARY OF THE TREASURY

TUESDAY, JANUARY 6, 1981

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

The committee met, pursuant to notice, at 11:40 a.m., in room 2221, Dirksen Senate Office Building, the Honorable Robert J. Dole (chairman of the committee) presiding.

Present: Senators Dole, Danforth, Roth, Wallop, Durenberger, Heinz, Grassley, Symms, Long, Byrd (of Virginia), Bentsen, Moynihan, Matsunaga, Boren, and Baucus.

[The press release announcing this hearing follows:]

[Press release]

FINANCE COMMITTEE SCHEDULES HEARING ON NOMINATION OF THE HONORABLE RICHARD S. SCHWEIKER TO BE SECRETARY OF HEALTH AND HUMAN SERVICES AND OF DONALD T. REGAN TO BE SECRETARY OF THE TREASURY

The Committee on Finance announced today that it has scheduled hearings on the nomination of the Honorable Richard S. Schweiker to be Secretary of Health and Human Services on Tuesday, January 6, 1981, beginning at 9:30 a.m. The hearing will be held in Room 2221 Dirksen Senate Office Building. Following the hearing on Senator Schweiker, the Committee has scheduled hearings on the nomination of Donald T. Regan to be Secretary of the Treasury.

Written Testimony.—The Committee will be pleased to receive written testimony from those persons or organizations who wish to submit statements on the nominations for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by January 7, 1981, to Robert E. Lighthizer, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

The CHAIRMAN. The hearing will come to order.

I would like to welcome Treasury Secretary-designate Donald T. Regan to the Finance Committee. We all have his biographical material. We know about his great success in the business world and of course we know about his service to our country in the Second World War as an officer in the U.S. Marine Corps. I would also like to welcome Mrs. Regan, the wife of the Secretary-designate. We are happy to have you here too. I understand also that you have a daughter and son-in-law present, and I also want to welcome them.

I would just say in a preliminary way that I have reviewed Mr. Regan's financial disclosure forms, the summary of the full FBI field investigation and the material that Mr. Regan filed with the Office of Government Ethics. I am satisfied that there are no problems in this area. I have also been told that the Director of the Office of Government Ethics will soon send a letter approving of

the nominee's compliance with the Ethics in Government Act. That letter will be made a part of the record when it arrives.

[A letter from the Office of Government Ethics and a reply from Mr. Regan follows:]

OFFICE OF GOVERNMENT ETHICS,
OFFICE OF PERSONNEL MANAGEMENT,
Washington, D.C., January 14, 1981.

Hon. ROBERT DOLE,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In accordance with the Ethics in Government Act of 1978, I enclose copies of the financial disclosure report and letter of recusal filed by Donald T. Regan. President-elect Reagan has announced his intent to nominate Mr. Regan for the position of Secretary of the Department of Treasury.

We have reviewed the report and have also obtained advice from the Department of Treasury concerning any possible conflict in light of the agency's functions and the nominee's proposed duties.

We have been advised that Mr. Regan will disqualify himself from acting with respect to any particular matters in the Department of Treasury involving Merrill Lynch & Co., Inc., and any of the other business entities set forth in his disclosure statement (including the subsidiaries and affiliates of Merrill Lynch).

Further, with respect to his holdings in Merrill Lynch and other appropriate property interests, Mr. Regan is establishing a blind trust which is presently being reviewed by this Office for qualification as such under the provisions of section 202(f)(3) of the Act and the regulations thereunder.

Subject to the above conditions, we believe that Mr. Regan will be in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

J. JACKSON WALTER, *Director.*

Enclosures.

NEW YORK, N.Y.

Mr. J. JACKSON WALTER,
Director, Office of Government Ethics,
Washington, D.C.

DEAR MR. WALTER: I have been an employee of Merrill Lynch & Co. (the "Company"), and its predecessor firms since 1946, and have served as Chairman and Chief Executive Officer of the Company since 1973. Prior to my assuming the office to which I have been nominated, I shall retire from all employment with the Company. Upon my attaining the age of sixty-five years, I shall become entitled to receive pension and deferred compensation payments, the amounts of which have been fixed in accordance with a predetermined formula, and which are independent of the Company's future earnings. All shares of the Company's stock which are now owned by me will be transferred to the independent trustee of a qualified blind trust, and will remain subject to such trust during the period of my federal service.

As Secretary of the Treasury, I would recuse myself and decline to participate in any matter in which the Company is a formal party or in respect of which it is known to me to have a direct and specific financial interest.

In addition, I intend to recuse myself, on a case-by-case basis, in any matter in respect of which, in order to avoid the possible appearance of impropriety, it appears to me desirable that I do not personally or substantially participate, despite the lack of any actual conflict of interest. I believe that this general policy, to which I am committed, will avoid not only the occurrence of any actual conflict of interest, but even the possible appearance of any conflict between my duties as an officer of the government and my personal financial interests, while at the same time enabling me to fully participate in generic policy decisions as Secretary of the Treasury.

Very truly yours,

DONALD T. REGAN.

Now we will follow the customary procedure. We are honored to have Senator Harrison Williams here to introduce his friend from the State of New Jersey.

Pete, do you have a statement to make at this time?

**STATEMENT OF HON. HARRISON WILLIAMS, A U.S. SENATOR
FROM THE STATE OF NEW JERSEY**

Senator WILLIAMS. I appreciate that very much, Mr. Chairman and members of the committee. I want to thank you for this opportunity to introduce to the committee Donald T. Regan who is President-elect Reagan's designee for Secretary of the Treasury.

Let me say at the outset that my appearance represents a victory for the State of New Jersey. It is no small testament to the quality of this nominee that several States found themselves vying to claim Donald Regan. I am happy to report however that Mr. Regan is a legal resident of New Jersey and his home is in Colts Neck. We find ourselves in the enviable position today of presenting this fine nominee to your committee.

I believe that Senator Warner also has a strong case, by the way. Mr. Regan has a home in Virginia and he has a lot of ties to Virginia. His wife, Ann, is a Virginian and in a way Don Regan is coming home again.

He started his career with Merrill Lynch here in the District of Columbia. We are proud to say the nominee hails from our State. As proud as we are to claim Don Regan, I would be remiss if I did not acknowledge that his dedication to excellence knows no boundaries, either national or international. For many years Donald Regan has spoken with one of the most vibrant voices in the financial community. Determination and success as a business leader have earned him respect from people worldwide. Our Nation has always cherished its strong and independent private enterprise system. Donald Regan's achievements within that system are an example of the best which American business has to offer to the world.

His keen insights in financial investment, and his progressive leadership at Merrill Lynch have always been associated with the ideas that are basic to our free market economy. He has demonstrated patience at most difficult times, and creativity at times when new solutions were required. Above all his quality as a person; warmth, concern for the quality of life in the community, compassion for those who are less fortunate; are the qualities that America has a right to expect from those who serve in the highest offices of public trust.

Don Regan has never shirked from responsibilities leveled upon him even when that responsibility was a heavy burden to bear. He served his Nation during one of its most demanding periods as an officer in the U.S. Marine Corps during World War II. He stepped into increasingly greater positions of responsibility and authority at Merrill Lynch at a time when the U.S. securities industry faced a crisis which demanded the most astute and effective leadership.

Don Regan joined Merrill Lynch at the end of World War II and within two decades worked himself up to the top rungs of that concern, serving as executive vice president and president and ultimately chairman and chief executive officer. In 1973 he became chairman and chief executive officer of Merrill Lynch Co., a holding company which owns Merrill Lynch, Pierce, Fenner & Smith and its subsidiaries.

In addition Don Regan's commitment and experience have reached beyond Wall Street and he served in other positions of

leadership in the business and academic communities. As a former chairman of the Senate Subcommittee on Securities, I know how deeply Don Regan has been involved in efforts which have enhanced the health and vitality of that industry. We struggled for many months to develop legislation which protects the rights of investors with the passage in 1970 of the Securities Investment Protection Act which was a landmark step for greater security for the customers served by major brokerage houses and indeed for all those who invest in America's businesses and corporations.

Don Regan well understands the importance of that act, and he was a thoughtful and creative champion with respect to creation of that measure and other securities laws. His concern led to his appointment as one of the original directors of the Securities Investors Protective Corporation, a federally chartered corporation established as a result of the act by the same name.

His leadership throughout the industry has also been acknowledged by his peers and his selection as vice chairman of the board of the New York Stock Exchange. He also served as trustee of the Committee for Economic Development. He is a member of the Policy Committee of the Business Roundtable and Council on Foreign Relations. His concern with other educational and philanthropical pursuits is reflected in his position as life trustee and former trustee and chairman of the University of Pennsylvania and work as trustee of the Charles Murray Child Foundation.

It is quite clear our Nation will need someone with extraordinary talent and wisdom to lead our Nation's policy which affects the lives of all of us and will continue to be one of the principal sources of anxiety and despair for millions of Americans.

These are difficult times and it is important that we have someone with the breadth of leadership and depth of insight and enterprise that Don Regan has shown to guide our economy. No doubt Don Regan will find this Congress to be an adversary and it will examine the policies he espouses with utmost care. That is our duty.

However, given the magnitude of our needs, the desire we all have to seek proper remedies to our problems, I suspect this nominee and new administration will find a new spirit of cooperation here in the Congress which will be crucial to our Nation's economic success. I hope this is something that will come true.

It gives me great pleasure to be able to say to you that Don Regan is a nominee most worthy of your consideration and most deserving of the honor which has been bestowed upon him.

Thank you for this opportunity of presenting Mr. Regan at this time.

The CHAIRMAN. Thank you, Senator Williams.

[The biographical data of Donald T. Regan follows:]

DONALD T. REGAN, SECRETARY-DESIGNATE OF THE DEPARTMENT OF THE TREASURY

Residence: New Vernon, New Jersey.

Career: Merrill Lynch & Co., Inc.—Chairman of the Board and Chief Executive Officer.

Joined Merrill Lynch, Pierce, Fenner & Smith in 1946 as an account executive trainee in Merrill Lynch's Training School. Became a partner in the firm in January, 1954. Managed the Merrill Lynch Philadelphia office from 1955 to 1960. Became Executive Vice President of Merrill Lynch, Pierce, Fenner & Smith on

April 14, 1964, President on April 10, 1968, and Chairman of the Board on January 1, 1971.

Merrill Lynch & Co., a holding company which now owns Merrill Lynch, Pierce, Fenner & Smith and its subsidiaries, was formed on May 16, 1973. Upon that company's formation Mr. Regan became its Chairman and Chief Executive.

Personal: Born in Cambridge, Massachusetts, December 21, 1918. Married on July 11, 1942, to the former Ann Gordon Buchanan of Washington, D.C.

Education: Harvard University, 1936-1940—B.A. University of Pennsylvania—LL.D (Hon.), 1972.

Military service: Major, U.S. Marine Corps, 1940-1946; served in Iceland, Guadalcanal, New Georgia, North Solomons and Okinawa; retired as Lt. Col., U.S. Marine Corps Reserve.

Other affiliations: Trustee, University of Pennsylvania, Trustee, the Charles E. Merrill Trust, Member, Policy Committee, the Business Roundtable, Trustee, Committee for Economic Development, and Member, Council on Foreign Relations.

Publications: Author of "A View from the Street," 1972, New American Library.

BIOGRAPHY

Donald T. Regan is Chairman and Chief Executive Officer of Merrill Lynch & Co., Inc., the holding company formed in May 1973 by Merrill Lynch, Pierce, Fenner & Smith Inc.

Mr. Regan's entire business career has been spent at Merrill Lynch. He joined the firm in 1946 as an account executive trainee in the Merrill Lynch training school. After completing training, he worked as an account executive in Washington, D.C. In early 1952, he was named Manager of the Over-the-Counter Department in New York. Two years later, Mr. Regan became a General Partner in Merrill Lynch.

From 1955 until 1960, Mr. Regan served as Manager of the Merrill Lynch office in Philadelphia. In 1960, he returned to New York as Administrative Division Director.

In April 1964, Don Regan was elected Executive Vice President of the international investment firm and four years later became its President. He was named Chairman and Chief Executive Office of Merrill Lynch, Pierce, Fenner & Smith in January 1971. He relinquished those titles in January 1980. Mr. Regan continues as a Director and member of the Executive Committee of the brokerage company.

Mr. Regan was born in Cambridge, Mass., on December 21, 1918. After graduation from Harvard University in 1940, he joined the Marine Corps. He retired at the end of World War II as a Lieutenant Colonel of the U.S. Marine Corps.

Mr. Regan is the author of "A View From The Street," an analysis of the events on Wall Street during the crisis years of 1969 and 1970 which was published in 1972 by The New American Library, and author of many articles that have appeared in various financial and business publications.

In recent years, Mr. Regan has also assumed several positions that carry with them industry-wide responsibilities. He served as Vice Chairman of the Board of Directors of the New York Stock Exchange from 1972 to 1975, the highest elective office of the NYSE. He was one of the original directors of the Securities Investor Protection Corporation, the federally chartered corporation established to provide financial protection for customers of the firms in the securities industry.

Mr. Regan is a member of the Policy Committee of the Business Roundtable. He is also a trustee of the Committee for Economic Development, and a member of the Council on Foreign Relations.

Mr. Regan served as Chairman of the trustees of the University of Pennsylvania from 1974 to 1978, one of the few non-alumni to serve as Chairman since Benjamin Franklin. He is currently a life trustee of that University. Mr. Regan holds honorary degrees from four universities. He is a trustee of the Charles E. Merrill Trust, a charitable foundation.

The CHAIRMAN. We will now hear from the nominee.

STATEMENT OF DONALD T. REGAN SECRETARY OF THE TREASURY NOMINEE

Mr. REGAN. Thank you, Mr. Chairman.

Thank you very much, Senator Williams. I hope I can live up to your kind remarks.

I am Donald T. Regan. I have been nominated by the President-elect to serve as Secretary of the Treasury. It is an honor for me to be here today to meet with you and the other members of the

committee for the purpose of discussing my qualifications to be Secretary of the Treasury. I hope that I may have the opportunity to serve the Nation in that post.

During World War II, I served this Nation in the U.S. Marine Corps. This experience taught me many lessons of character and leadership which have served me well in my subsequent career with one of the world's leading financial institutions. This later experience has given me exposure to many of the same types of problems which the next Secretary of the Treasury will be facing.

Despite some evidences of strength, the short term economic outlook is not bright. While the leading economic indicators were up again in November, the relationship between coincident and lagging indicators is seen by many analysts to be suggesting that the recovery is aborting—led by weaknesses in the housing and automobile industries. Under current policies and expectations, interest rates, inflation rates and unemployment rates are all expected to remain at high levels throughout 1981.

It is important, however, that we not formulate the problems facing the Nation in terms of short term economic forecasts and indicators. Such an approach breeds erratic economic policy—the worst of all policies.

The very serious problems the Nation faces were not created quickly and will not be solved quickly. It has been 23 years since the United States has had balanced budgets for 2 years in a row. Inflation, as measured by the Consumer Price Index, averaged about 1.8 percent during the 1950's, about 2.9 percent during the 1960's and about 7.8 percent during the 1970's. At an accelerating pace inflationary expectations are being built into business and farm prices as well as the behavior of America's consumers.

Our economic problem can be summed up in four profoundly disturbing trends:

First, America's income—as measured by real GNP—is not growing as fast as it should. GNP has been growing at a rate well below the long-term trend line. This means we are not producing at the rate we should those goods and services that would benefit all Americans, and still have the wherewithal for a strong national defense. In fact, in constant dollars the GNP declined in 1980 and will probably do so again in 1981. Our rate of growth is heavily influenced by our rate of investment.

Second, America is not investing enough in its future. The level of investment as a percent of the GNP in the United States is far below that of our major overseas trading partners. Furthermore, a sizeable portion of that investment is for unproductive assets mandated by Federal regulations. Greater investment would mean more jobs and greater productivity. This is of particular importance when our unemployment rate is at the 7.5-percent level and forecast to go higher, and when America's productivity gains have been declining in recent years. Increased productivity is essential to revitalizing U.S. industry and stimulating our exports.

Third, the level of investment is depressed by the interaction of inflationary expectations and erratic fiscal and monetary policies. Inflation has resulted in massive tax increases for American taxpayers—individual and corporate—without any action by the Congress. This must be corrected. Current inflationary expectations

have also resulted in Americans saving less of their income than they have at any time since 1950.

This in turn means less capital is available for investment. Inflationary expectations also result in a large inflation premium being built into interest rates. This means all kinds of productive investments are less attractive because they have become much more costly.

Finally, inconsistent fiscal policies and erratic monetary policies have caused the financial markets to become extremely volatile and unpredictable, thereby increasing investment risks.

Fourth, world financial markets have lost confidence in the Federal Government's ability to bring its spending under control. Lip-service has been given to balanced budgets, but the fact of the matter is that the United States has not had a balanced budget since 1969—the last one before that was in 1960. In July the administration estimated the deficit at \$29.8 billion; and now some are estimating the deficit at well over \$60 billion.

The four trends I have just identified are causes for alarm. They are not causes for panic, because I believe that through the cooperation of the legislative and executive branches of government we will adopt the bold measures that the situation demands. Thus, I do not plan to recommend to the President that we declare a state of economic emergency nor that he ask for special emergency powers. We must have a sense of urgency—not a sense of emergency. We must have a sense of urgency to:

First, restore confidence in our ability to control spending.

Second, hold to steady and consistent fiscal and monetary policies.

Third, lower inflationary expectations.

Fourth, increase our levels of investment.

We can never successfully come to grips with these debilitating trends on an ad hoc basis. We must have an integrated approach consistently applied over a period of years.

The President-elect will give us the outline of such an approach. We will be hearing more after he takes office regarding his economic program. This approach will stimulate savings, investment, growth and confidence through a single integrated long-term program. This program will require tough decisions on spending control and discipline in the tax area, delaying some needed tax changes in order to be able to implement those that are absolutely essential, particularly the Roth-Kemp proposal and some form of enhanced accelerated depreciation for business.

While I am not prepared to go into all of the details of such a program today, if I am confirmed as Secretary of Treasury, I plan to work closely with this committee in developing the kind of program which the President will announce upon taking office. By working together on the basis of the President's program I believe we can give the American people what they have mandated.

I am sorry I have not had the time to meet all of the members of this committee personally. However, due to the holidays and necessary travel this was not possible. But, I do look forward to working with each of you. At this time I would be pleased to answer any questions the committee may have about my background and qualifications, or other questions you gentlemen may have.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Regan.

I have the opening statement of Senator Wallop which I will submit for the record.

[Senator Wallop's statement follows:]

OPENING STATEMENT BY SENATOR MALCOLM WALLOP

Mr. Regan, I want to welcome you to the Finance Committee and let you know that I look forward to working with you and your new team at the Department of the Treasury. I know that we will be working together on a number of difficult and important economic issues facing the nation, none of which promise easy solutions.

You enter office when inflation, interest rates, and unemployment are at all time highs, and by early next year, the U.S. government will face a national debt limit of over one trillion dollars. The first priority of this committee and the new administration is to bring inflation under control, and end the budget deficits and waste that have caused people to distrust their own government. As part of that inflation fight, we look forward to working with you on tax proposal that reduce the financial burdens on working Americans so that they have new incentives to work, save and invest in their future.

I think that we may prove to be fortunate that the President selected a man of your experience and leadership in economic and financial matters. You should have an in-depth understanding of how our tax and general economics policies affect individuals and institutions in the economy. As you know, an understanding of the hard realities of economics has not always manifested itself at the Department of Treasury. I think it is also important to point out that you have not only a perspective on how major institutions operate in the economy, but you have also taken a leadership position in protecting the savings and investments of the small private investors. I am particularly interested in working with you on tax proposals to encourage increased commitments on the part of private investors in our economic system—through increased savings and investment. I know that in this regard, you have been a forceful advocate of capital gains tax cuts, and I hope that as Secretary of the Treasury you will examine the merits of the capital gains tax cut legislation that my colleague from New York, Senator Moynihan, and I are introducing today.

The CHAIRMAN. First, have you discussed possible conflicts of interest with the committee's chief counsel?

Mr. REGAN. I have, sir.

The CHAIRMAN. Was there any problem?

Mr. REGAN. There is no problem as far as he and I know.

The CHAIRMAN. It is my understanding, as I have already indicated, the Office on Government Ethics will send a letter approving the form you presented to them along with the letter you presented to the Director of that office.

Mr. REGAN. I think I have taken care of every possible contingency that I know of in this area.

The CHAIRMAN. Is there any reason that you know of that you cannot responsibly serve in the office to which you have been nominated?

Mr. REGAN. I know of none, Mr. Chairman.

The CHAIRMAN. I want to acknowledge before we go any further the presence of an outstanding public servant, a friend of ours, William P. Rodgers. I am happy to have you here today, too.

Mr. Regan, as has been customary when a person comes up here for confirmation, even before assuming the office, we would like to give you an opportunity to make a little policy while you are passing through town. You have touched on some of the important areas in your statement. I think perhaps the most important part of that statement may have come at the end and that is working with this committee. We have found over the years that Democrats

and Republicans have had close relationship with the Secretary of the Treasury and we have found that it is more productive if we are there for the takeoff as well as the landing.

I am certain from your statement you have that in mind and I know I speak for every member of this committee in appreciation for that sensitivity. We don't have all the answers either, but we like to believe that we may have some of the answers.

Having indicated that, there is no doubt in the minds of any of this committee or anyone in this hearing room or anyone anywhere that the chief focus must be on the economy. We must come forth very early in the administration with an economic package, restraining the growth in spending, as well as providing for the reduction in taxes if we can find a way to do that which is not inflationary.

Do you have any ideas at this early stage on just how quickly we might expect the administration to send us such a package?

Mr. REGAN. It is our hope, Mr. Chairman, that the President will be announcing his economic package within a matter of days and at the most a few short weeks after he takes office. We will be back up here on the Hill with that package.

In the meantime if I may comment on a previous statement you made, it is my intention to cooperate fully with this committee in the making of this package and in the input of ideas. The team I am assembling at Treasury will be so instructed that they are to work very closely with the committee and its staff on this program.

The CHAIRMAN. We appreciate that. I think you have touched on what some of the parts of the package might be. You mentioned the Roth-Kemp proposal. We have a fellow on the committee named Roth who has a deep interest in that proposal. Are you talking about full implementation of that proposal or are you in a position to state?

Mr. REGAN. At the current moment that is our intention, Mr. Chairman. The President-elect in his outlining of his program on September 9 committed himself to it and he intends to carry out his commitment in that area. So we will be back up here with that economic package, having as its centerpiece the Roth-Kemp proposal for individuals and also accelerated depreciation for industry.

The CHAIRMAN. I know Senator Roth appreciates the fact that his name came first in your statement. We appreciate that too on the Senate side.

Mr. REGAN. As a novice, Mr. Chairman, I am starting to learn a few things.

The CHAIRMAN. As is the case many times since your nomination was announced there have been a number of press accounts about Merrill Lynch's involvement with the sale of so-called silver straddles. I would like to ask you a couple of questions on that subject. I understand Senator Moynihan may have a followup question later.¹ What has been your involvement with the silver straddle as chief executive of Merrill Lynch, your personal involvement?

Mr. REGAN. I have never used the straddle as part of my investment procedure nor have I indicated to any clients of Merrill Lynch's whom I have advised to use the tax straddle. This has been one of the many financial services that Merrill Lynch has offered

¹ See appendix.

and as such I am responsible for all of the services that Merrill Lynch offered but I have no direct connection with tax straddles.

The CHAIRMAN. Have you ever personally invested in silver straddles?

Mr. REGAN. No, sir, never, or any other kind of straddles in addition to silver.

The CHAIRMAN. There may be questions on other subjects. There are a number of us on this committee who have an interest in energy, production of oil and gas. Some of us, such as Senator Boren, Senator Bentsen, Senator Long, Senator Baucus, Senator Symms, and I, represent States where we produce energy. It is our hope that since there has been belated recognition that small oil royalty owners were not fairly treated in the so-called windfall profits tax that we might, consistent with statements made by President-elect Reagan, ask you to work with the committee to fashion some permanent relief for small royalty owners and perhaps for some of the small independent oil producers. Are you aware of that interest?

Mr. REGAN. Yes, Mr. Chairman, I am aware in general terms. It is one of the things that we intend at Treasury to work on right away to be responsive to the needs of the small royalty owners and the smaller producers.

The CHAIRMAN. In the reconciliation bill which was passed last year we did provide interim relief of a \$1,000 refund for royalty owners. There are 2 million royalty owners in this country and for the most part they are low on the economic scale. That payment means the difference in some cases of being independent or dependent. We understand the unlikelihood of repealing the windfall profits tax, although some might advocate that, but I do believe there are areas that should be focused upon so far as independents and royalty owners are concerned.

At this time I yield to Senator Long.

Senator LONG. Mr. Secretary, I think that you will find that this committee is about as nonpolitical in its way of doing business as any committee on the Hill. I think it is the most nonpolitical, and that basically is what our record has been in recent years. When we put together our tax cut recommendations we went alternatively, as I recall it, Democrats and Republicans, first one Democrat, then one Republican down the aisle and each one of them made his suggestion and we voted on it. Almost everything we put in the tax cut bill that we recommended, a very substantial bill, was agreed to either unanimously or with only one vote in opposition, the vote of one Senator who thought that we should not be voting on a tax cut that soon.

But generally the decisions were almost unanimous, and other than the feeling of one Senator, Senator Packwood, that it might be too soon to vote a tax cut, we would have been unanimous on practically everything in that bill. At that time Governor Reagan said that if he were President he would have signed the bill. He urged us to go ahead and pass it even while his predecessor was still in the White House.

We have achieved that kind of cohesive support, in many cases unanimity, because we respect each person's suggestions and ideas for what they are, on a very nonpolitical basis.

I would hope that we could continue that relationship with you as Secretary of the Treasury.

Senator Arthur Vandenberg, a Republican, was the architect of what is known as the bipartisan foreign policy back when Harry Truman was President. He used to go down to the White House and say that the Republicans were willing to cooperate, but they thought that they ought to be in on the takeoff if they were going to be asked to be aboard on the landing.

We Democrats want to be part of what happens up here. We want to make our suggestions, along with others. I hope you will communicate with both sides of the aisle and you will try to consider our suggestions, just as you consider the suggestions from those on the other side of the aisle, based on their merits quite apart from politics.

Mr. REGAN. I am very willing to do that, Senator.

Senator LONG. What you are recommending has been described as supply side politics—supply side economics. Maybe a little bit of both.

Mr. REGAN. Is that Freudian, Senator?

Senator LONG. I notice that you are predicting that things are going to get worse, or at least not improve immediately, the way some of us would hope. Assuming we enact the kind of legislation you are recommending with regard to tax cuts, how long do you think it will be before we will see an improvement in the economy?

Mr. REGAN. I am not trying to duck the question but I have learned in Wall Street never to put a finite date on when anything is going to happen because things invariably take longer than you think they will initially. I will say this. It has taken 15 years for us to get into the state of inflation that we are in now. We are not going to get out of it in 15 days or 15 weeks. I would say that we should see gradual improvement in the second half of this year, and major improvement, if this policy and this program is enacted by the Congress, within a matter of let us say 15 months or so.

Senator LONG. I will just submit for the record a statement that President-elect Reagan made as early as 1974 where he strongly endorsed the idea of employee stock ownership.

Over 100 years ago Abraham Lincoln signed the Homestead Act. There was a wide distribution of land and they didn't confiscate anyone's already privately owned land. They did not take from those who owned to give to others who did not own. It set the pattern for the American capitalist system. We need an industrial Homestead Act. * * * It is time to formulate a plan to accelerate economic growth and production and at the same time broaden the ownership of productive capital. The American dream has always been to have a piece of the action.

I notice that the Republican platform also had a provision indicating that the Republican Party favors broadened stock ownership. I think you believe in that. If so, I would like to have a statement from you as to what your attitude about employees stock ownership would be.

Mr. REGAN. Coming from where I do in Wall Street and the firm I represented I have to be in favor of more Americans owning their share of American industry. I think that is a wonderful idea. I will try to do everything I possibly can to further this idea of ownership of American companies by all types of Americans regardless of the size of their particular interest. You might find it interesting that after the employees stock ownership plan was passed Merrill

Lynch took advantage of it when we were divesting ourselves of Lionel-Edie, because the way we divested was not to settle with somebody else. We used stock ownership, letting them buy it, and they have prospered as a result of that. I am definitely in favor of that.

Senator LONG. We will have a lot of suggestions to make to you—at least I hope I will. I am pleased to hear that your firm does have that type of thing. A lot of the companies do. When people find they have enough so that it begins to attract their attention, they begin to feel proud of being an owner. It makes all the difference in their attitude toward their work. It seems to me it has had a favorable result.

I think to the extent we can move in that direction we will make a stronger Nation. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Danforth.

Senator DANFORTH. Mr. Regan, the automobile industry is in very serious trouble right now. Those affected, of course, extend well beyond the auto manufacturers and include suppliers to the industry, dealers, and so on. Has the President-elect designated a person or some team of people in the new administration to address the automobile situation?

Mr. REGAN. Senator, we have established an economic policy task force. This is one of the key issues we are looking at in that economic policy task force. I happen to be a member of that. I am very sensitive to the automobile industry situation here in the United States.

Senator DANFORTH. Who will be the lead person in the new administration on the automobile question?

Mr. REGAN. I suspect that it will be a combination of myself from where I sit in Treasury and also Drew Lewis at the Transportation Department.

Senator DANFORTH. Deciding on, for example, the Chrysler loan guarantee or any tax proposals or whether or not the Small Business Administration should be making loans to dealers and so on, would that primarily be within your jurisdiction or Transportation or Commerce? Will we have a coordinated effort on the automobile industry and if so who will be in charge?

Mr. REGAN. I think I will be making the determination primarily on the tax question, and obviously on the Chrysler question. From that point of fact we will be coordinating with Mr. Baldridge in Commerce and Drew Lewis in Transportation.

Senator DANFORTH. Will the administration have a policy in place by January 20 with respect to the automobile industry?

Mr. REGAN. I cannot assure you of that. It is one of the problems we are currently studying. I think that early on in the administration we will have a policy ready for that.

Senator DANFORTH. Is this being dealt with on a priority basis by the new administration?

Mr. REGAN. Reasonable priority, yes, sir.

Senator DANFORTH. Those who are concerned about it believe that time is very much of the essence and are concerned that the new administration will, instead of having a policy in place at an early date, be engaged in a very lengthy period of review.

Could you give us some idea as to when the administration will have a policy?

Mr. REGAN. Let me submit that in two parts. Chrysler is one special problem and that is coming up early on in the new administration and that will have to be dealt with immediately. On the second part, regarding the entire automobile industry, we should be ready within a matter of weeks after the President takes office to have a policy on the automotive industry.

Senator DANFORTH. There are some who say that the automobile industry should not be dealt with as a special case, that general economic principles should be allowed to run their course, that the nature of the free enterprise system is that if a company can't make it, it should be allowed to go under, that Chrysler should be, for example, just recognized as being hopeless and allowed to go belly up, that no special effort should be made to alter economic policy either for a specific company or for a specific industry.

Do you have any information for us as to what the position of the new administration is going to be along those lines?

Mr. REGAN. Again let me put that into two categories of answer if I might. First of all, with regard to Chrysler I prefer not to comment on that at this particular moment. I haven't been briefed sufficiently by the outgoing administration, by Secretary Miller or Deputy Secretary Carswell, but I am to be briefed on that within the next several weeks. So, I will reserve comment on Chrysler.

As far as the automobile industry itself in general is concerned this is one of the main industries underpinning the American economy. It has to be dealt with on a priority basis, the same as the housing industry. These are two of the great industries in the Nation. Paraphrasing a previous witness before a committee of Congress, what happens to the automobile industry can affect the whole United States. So, we necessarily have to concentrate on what is going on in the automobile industry. I am not certain, I might add this, of what our recommendations or our attitude will be at this particular moment. Certainly we will concentrate on studying it.

Senator DANFORTH. One possibility would be to view the automobile industry as a special case, and tailor make some policies specifically for the industry. For example, we could consider a special, refundable tax credit, or special treatment on the loss carryback, or SBA loans, or some kind of incentive for people to buy automobiles if that is the way the administration wants to go.

The other approach would be to say that the automobile industry essentially reflects basic economic conditions and therefore the administration should address itself not specifically to the automobile industry but to general economic conditions and to try to improve them. As a matter of fact, to the extent that the administration would address itself to the automobile industry specifically, it might tend to set back its more general economic approach.

For example, it would cost revenue to devise a specific tailor-made refundable tax credit or loss carryback provision for the automobile industry. Does the new administration have a position on that controversy?

Mr. REGAN. We do not have a position as definite as that yet, Senator. I would say on an overall basis our first priority is going

to be the economy as a whole. Then how the automotive industry could be helped within that overall framework will be the second part of the study.

Senator DANFORTH. Supposing it takes some special treatment, would you be willing to do that if it were necessary to save the industry?

Mr. REGAN. I am not going to commit to that at this particular moment. I would like to study it a bit more.

Senator DANFORTH. Will you complete the study in the next few weeks?

Mr. REGAN. I shall complete the study in the next few weeks.

Senator DANFORTH. Thank you.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Regan, I think your statement to the committee today is an excellent one. I was glad to see your strong emphasis on asserting that the world financial markets have lost confidence in the Federal Government's ability to bring its spending under control. You accurately point out also that lip service has been given to balance budgets but you point out that the fact is that only once in 22 years has the Federal Government balanced its budget. Then you point out also that a large deficit is foreseen for the current fiscal year.

My question is this. Do you feel that the past accumulated and accelerated deficits are a prime cause of inflation?

Mr. REGAN. There is no doubt of that, Senator. The engine of inflation has been the constant overspending by the Federal Government. This has led to other things that come along as causes. Obviously there are exogenous types of events, OPEC, and the oil situation of course is one of the chief ones. There is no doubt the chief engine of inflation is Federal spending and Federal deficits.

We have monetized all the debt. We have increased the dollars in circulation, therefore inflation.

Senator BYRD. This Senator is very pleased to hear you state that. There have been other nominees for your position who have seen things differently and perhaps that is one reason that we are in the fix that we are in now. Let me ask you this. What are the prospects in your judgment for bringing the Federal budget into balance and when do you see it being brought into balance?

Mr. REGAN. The second part of your question is more difficult. Our plan as we now see it will lead to lessening of deficits over the next 2 or 3 years. If everything works well and if nothing else changes we could see a balanced budget in the fourth year of the Reagan administration. However, I have to again qualify that. As we all know there are things that take place in the Nation and international situations that could cause the thing to go out of whack. It is our intention to get those deficits down to where it is possible, all things being equal, so that we could have a balanced budget.

Senator BYRD. Do you feel that beating inflation should receive the highest priority of the new administration?

Mr. REGAN. It is the highest priority of the domestic policy of the Reagan administration to whip inflation somehow. I don't mean to

infer by that one that we are going back to the Ford administration's plan when I use that verb "whip."

Senator BYRD. You say that we must have a sense of urgency, and I agree with that description, a sense of urgency to restore confidence in our ability to control spending. Would you agree that unless confidence is restored on the part of the American people, as well as the world market, in the ability of the Government to control spending, we are not going to be able to take care of some of the other problems?

Mr. REGAN. You are right, Senator. From the point of view of this administration the first thing we have to do is to start the very difficult job which will be right in this committee to act on. It will not be an easy task for us to try to solve these problems. We will have to do it together, working on what these cuts will have to be, but we are going to have to start cutting. After that we will get in our tax cuts.

Senator BYRD. One final question if I may. Given your background in the securities industry what is the single most important thing that we can do to revitalize American industry and increase productivity?

Mr. REGAN. Cut inflation.

Senator BYRD. Thank you, Mr. Regan.

The CHAIRMAN. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

Mr. Regan, you have really addressed probably two of the matters I am most interested in, one of course being Roth-Kemp. In trying to work out a long-range solution, and I was happy to see you underscore that in your opening statement, that what we are seeking was long-term strategy and not short-term answers to immediate problems, is it not true that it is important that we get some certainty into the picture, particularly the tax picture, so that it makes good sense to have a long-term program including the 3-year tax cut?

Mr. REGAN. As far as business is concerned it is of the utmost importance, Senator, that it be able to plan ahead and know with some degree of definitiveness as to exactly what is going to happen in the tax area. Individuals have the same privilege, if I might call it that, to know what is the intent of the administration and Congress as far as their tax reductions in the future. They can then make commitments themselves with more certainty as to their own expenditures or saving decisions if they know what is going to happen to them.

Senator ROTH. One of the things that I feel especially strong on is that we have to turn this Nation again into a savings nation. I think that means savings on the part of the working people of America, a group that I feel is too often overlooked. There are too many who are willing to say let us give business or something else in the social welfare area. I do hope that you will address in your term of office the serious question of how we get the average working person, man or woman, to participate through savings and investment.

I share the concern of Russell Long that we get the American people involved.

One of the questions I have is that in addition to savings what can we do to revitalize our basic industries? My distinguished colleague from Missouri talks about the automobile industry. I have only one question there I would like to ask you. Under the law you are one of three members of the board that has to determine whether or not Chrysler should be granted further loans. Is there any reason, any conflict of interest that would prevent you from discharging that responsibility?

Mr. REGAN. Based upon my representation to the Office of Government Ethics and to the Department of the Treasury that I would recuse myself and decline to participate in any matter in which Merrill Lynch is a formal party or in respect of which it is known to me to have a direct and specific financial interest, there is no reason that I know of, and I have checked this with my counsel and with the Office of Government Ethics and also with the current counsel in the Treasury. I know of no such circumstances.

Senator ROTH. As I indicated, one of our critical problems in America today is that many of our basic industries, the automobile and housing being leading examples, are under distressed conditions but certainly that is true of steel and other basic industries that are essential to our defense posture.

Do you have any thoughts as to what we can do, to borrow a term, to reindustrialize America? There are those who have suggested we form some kind of new RFC? Do you have any thoughts about steps that the Government might take to create a favorable environment?

Mr. REGAN. Without trying to sound like I know it all because this is a very serious problem and it has many dimensions, I think we should just trust American businessmen to be businessmen, and give them a tax break in the form of accelerated depreciation of some type. The Senate has one version, there is another version in the House. At this point I won't state which of the two is preferable. But if you give business a tax break most businessmen are profit oriented and they will revitalize their own industries in their interest and in the interest of their stockholders.

Senator ROTH. Mr. Chairman, I understand my time is up. I will reserve time for later to ask additional questions.

The CHAIRMAN. I might say to the committee we hope to be able to conclude without having an afternoon session unless somebody strongly objects to that. We will see how it goes the first round.

Senator Bentsen.

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

I have known Don Regan for a number of years. I think he is eminently qualified for the job that we are now considering him for. He certainly knows the marketplace. He knows what it means to bring about the kind of capital formation that we need to start rebuilding America. I was delighted to see him clean up Wilson's quote. I do agree with you on not declaring an emergency. This is no time for histrionics or dramatics. You have chosen the proper word, urgency. But in trying to determine your priorities you talk here about a \$30 to \$60 billion deficit in your comments. You also talked about a tax cut. Then I heard you say we have to bring about budget cuts and then, as I understood it, the tax cut, and

knowing how Congress works and the time it takes, if you are looking at a deficit of \$30 to \$60 billion, would that deter you from proposing a tax cut?

Mr. REGAN. It would not, Senator. I think the tax cut is of the utmost importance. I would prefer to see and would like to see our working on both sides of the street simultaneously in order to accomplish this objective. As we go through the cuts in the budget in the various programs we would also be focusing on the tax cut so that people would know that they are getting both.

I think that is what the American people want. They want Federal spending to be capped and its growth stopped and cut back. At the same time they want to keep more money themselves from their own earnings and I think they are entitled to it.

Senator BENTSEN. One of the problems you will be facing and that the economy will be facing when it becomes credible we are going to have a tax cut will be the effective date, because that will determine the decision of a lot of people as to buying equipment. We don't want to see all of that grind to a halt and decisions delayed waiting for that.

Have you given any thought to an effective date?

Mr. REGAN. Yes, we have given a great deal of thought to that. I think as far as the business side of the tax cut is concerned when we propose it in its final form it will probably have some type of retroactive date so that businessmen will know that as you gentlemen discuss it and as it winds its way through the Congress that due to the retroactivity of it they can start their own planning as to purchase of machinery, buildings or what have you.

Senator BENTSEN. When we get into the question of tax cuts I would like any comments you have as to the Laffer curve and the idea of feedback, I believe in feedback from tax cuts.

Mr. REGAN. You took the words out of my mouth. I also believe in the feedback effect. I think at this moment academically perhaps it cannot be quantified to the degree of certainty. Just plain old reason as a businessman leads me to think that if you allow people to have more of their own money, and take less of it out in the form of Federal taxation, people are going to do one or two things with that money.

One, either they are going to spend it or, two, they are going to save it. Most people are fairly rational. As a result they won't spend all of it, they will save a lot of it. Once they start saving the savings will start the feedback process which is so important.

Senator BENTSEN. As a final comment, I believe in the feedback, I am not as optimistic with the Laffer curve in that regard.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

Mr. Regan, the outgoing administration seemed to suffer from the fact that over their 4 years there was a variety of economic spokesmen. While the characterizations I am about to offer may be inaccurate or general in nature it seems to me that when he first got here Bert Lance may have been the chief economic spokesman. He yielded for a variety of reasons to Charlie Schultze and then Mike Blumenthal became economic spokesman. He was succeeded by Bill Miller. Then perhaps someone, say Phil Klutznick actually had more of a voice than Bill Miller.

They all seem to be succeeded by Paul Volcker of the Federal Reserve in the spring of 1980. Some cynics would say that the final economic spokesman was Bob Strauss during the President's campaign. All of which suggests that given the success or lack of it by the outgoing administration, that there is some great virtue to having a strong and consistent economic spokesman-decisionmaker leader. Notwithstanding the fact that the President is always the No. 1 man, it is important that he have a designated spokesman, has anybody been to your knowledge designated, have you been designated as the administration's chief economic spokesman?

Mr. REGAN. It has already appeared in the press, Senator, that I shall be the economic spokesman for the administration. This does not preclude other members of the administration from speaking on economic matters because obviously this is a broad subject. It impacts into many areas of the administration. But while many people may be speaking on it, I will be the chief spokesman.

The CHAIRMAN. I note in your statement that you talk about the need for tax reform and tax reduction. You talk about the effect of Government regulation diverting the productive employment of investment. Can I draw from that statement that you would be supportive of some of the things recommended in the so-called Stockman report? For example, as the economic spokesman would you be supportive of some kind of regulatory moratorium for a period?

Mr. REGAN. I think that one of the key elements of the economic package is getting a handle on Federal regulations and in fact getting into deregulation. So I think that one of the things that we will be advocating to the President-elect is that he declare some type of halt to further Federal regulations.

Senator HEINZ. As you are also I am sure more than aware, there are a number of off-budget procedures that have enhanced and enlarged Federal claims on the credit markets. What do you plan to do to curb or roll back all the loans and loan guarantees, Federal financing, bank activities that have become so much of a relatively unmonitored way of life over the past several years?

Mr. REGAN. I would put it this way. I don't think the American public is aware of the huge amount of off-budget financing that has been going on in the United States. Coming from the Wall Street area, the financial markets, I am well aware of how huge the amount of debt that has been put out by many of these agencies including the Federal Financing Bank.

I don't think this was the intent of Congress. It certainly is not the intent of this administration that as much financing as that be continued. One of the things the Secretary of the Treasury will have to put a very high priority on is to cut back on this off-budget spending.

Senator HEINZ. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Matsunaga.

Senator MATSUNAGA. Thank you, Mr. Chairman.

I must say, Mr. Regan, I am very much impressed by your résumé but as is sometimes the case a man highly qualified may have a philosophy which may not be the best for the country. There appear to be little clouds floating over your head as you appear before this committee, clouds which have been called to my

attention, and, I am sure, to the attention of other members of the committee, relative to your position on commodity straddles as practiced by Merrill Lynch. Will your position be to maintain the position of Merrill Lynch or will it be one to pursue the cases as set up by the IRS against Merrill Lynch?

Mr. REGAN. Let us start the answer to your question back a little ways. It is a well-known principle in American jurisprudence that a taxpayer has the right, if indeed not the duty, to minimize his taxes. But the principle that is followed is sometimes a matter of opinion between the IRS and the taxpayer as to whether or not this is a legal thing that the taxpayer is doing. There are administrative remedies to this. There are judicial remedies to this.

In the case of the tax straddle, that is what is happening. The tax straddle has been around 35 or 40 years. This is not something new. It has certainly to my knowledge been in existence for several decades. The particular tax straddle in which Merrill Lynch's name has come up involved a case in 1973, 8 years ago. This particular thing was ruled on by the IRS in 1977 as far as silver straddles were concerned.

As a result Merrill Lynch stopped using silver straddles in 1977 and have done none since. In the particular case where the IRS is challenging a taxpayer who used Merrill Lynch in order to employ straddles using the commodity markets is a matter I suggest that should be allowed to wind its way through the courts.

Senator MATSUNAGA. You do believe so? Then you did not support the position of Merrill Lynch reportedly trying to buy out two of its customers in order not to pursue the judicial process for fear that case might be determined against Merrill Lynch?

Mr. REGAN. Merrill Lynch did not try to buy out, in the words of the press, this particular taxpayer. Merrill Lynch did discuss, as most corporations will who are involved in a lawsuit, whether or not there should be a settlement of the lawsuit if the taxpayer lose. There will be no sense in Merrill paying a taxpayer if he won in the tax court. That is a misrepresentation of Merrill Lynch's position. As far as my particular role in that as chairman of Merrill Lynch, I know nothing of the case. It was not brought to my attention.

I did not interfere with the process in any way, nor would I as Secretary of the Treasury involve myself in anything in which Merrill Lynch particularly is involved in. I have already signed a statement to this effect. Now from the point of view of legislation in this area, if this committee or another committee of the Congress were to decide that this is something they should focus on to see whether legislation is needed I would be more than happy to cooperate and to have my team at Treasury cooperate in setting up the problem, seeing what solution if any is needed for it.¹

Senator MATSUNAGA. You would support the Brodhead-Vanik bill?

Mr. REGAN. I said I would be glad to focus on it and have Treasury officials focus on it to see whether a legislative remedy is needed.

¹ See appendix for subsequent correspondence between Senator Moynihan and Mr. Regan relating to this subject.

Senator MATSUNAGA. I have other questions, but I see that my time is up.

The CHAIRMAN. Senator Durenberger.

Senator DURENBERGER. As I understand your testimony, inflation has been your No. 1 problem, Federal spending causes inflation. For a balanced budget a tax cut ought to be enacted as soon as possible. We came to these conclusions in this committee in August and very quickly, very simply back and forth, as the former chairman has described, put together a tax cut bill. We started with a figure that we did not want to exceed for calendar year 1981 \$40 billion. Do you have a figure like that in mind that you don't want to exceed for calendar year 1981 or 1982?

Mr. REGAN. Not at the present time, Senator. That is one of the items we are focusing on in the economic task force. Recent figures I have seen regarding the budget do two things. The rate of inflation has caused the entitlement programs to shoot up more rapidly than I believe was forecast in the original budget assumption.

Second, high rates of interest have caused interest on the Federal debt to increase alarmingly. As a result the prior figures no longer apply. We are looking at new budget figures at this particular moment. We will have a figure in mind as to what we think is a reasonable tax cut when we bring it back up here on the Hill.

Senator DURENBERGER. Let me get to two questions, first to the element of trust which is inherent in supply side economics as well as supply side politics. You have already testified in response to a couple of questions on the trust we have to have in institutions in this country. I want you to know I am bothered, as some of the other questioners have been bothered, by the statement that says we have to trust business, give them a tax break, give them accelerated depreciation, give them corporate tax rate reduction and they will revitalize the economy.

Particularly, I suppose philosophically I have no problem with this sort of thing. If you are a healthy member of an unhealthy industry you make a lot of money, you make capital investment with that money and you don't pay taxes. But if you are an unhealthy member of an unhealthy industry you don't make money, you don't make capital investments, you don't pay taxes, you go out of business.

This concern with infrastructural industries, particularly energy, transportation and rail industries, is one of the best examples of it. Whether aid in the form of a bailout, Federal loans or loan guarantees or some other method is appropriate, I guess I need a little more of your philosophy about competition in certain infrastructural industries and what the roles of Government and tax policy are to be in maintaining some form of competition in these industries.

Let us use rail as one of the best examples. I know you are in favor of investment tax credits, for example. What is your feeling on refundable investment tax credits?

Mr. REGAN. This is a tough one because you get into the question of subsidies. You know what happened in England as the English tried this idea of trying to subsidize some of their failing major industries. They ended up owning the industries and with socialism. I am a free competitive man, myself, a capitalist, by nature.

As a result I know that we are going to have failures. We are bound to have failures. However when you get into a very sensitive industry for defense purposes or where it is a monopoly, as is the case for railroads, then I think you have to consider how to help that particular industry.

In general though, a part of capitalism for the whole of American industry is that we are going to have some casualties.

Senator DURENBERGER. You are willing to think through the industries like rail and others, where there is either defense or some other reason, to consider the importance of competition and the service that goes with competition?

Mr. REGAN. And also to think through of course the type of subsidy that is given and the amount of it.

Senator DURENBERGER. Let me address one question, if that is possible, on the other element of trust and that is individual tax reduction of Roth-Kemp. What we did last year in Committee was a personal income tax cut and I take it you support reduction in the effective rates?

Mr. REGAN. Right.

Senator DURENBERGER. You also support what used to be referred to as indexing. I think you are appropriately talking about it in terms of reducing bracket creep?

Mr. REGAN. That is correct.

Senator DURENBERGER. As to the issue of what the individuals do with the money they save, what is your position on either getting rid of the word "unearned" from our income tax vocabulary or reducing the maximum unearned income tax rate to 50 percent or having identical tax treatment for both earned and unearned income?

Mr. REGAN. Speaking for myself personally first and later for the administration, one of the things I resent is that term "unearned income." I worked hard for that money. After I accumulated some of that money and put it out for investment everybody says what I earn is unearned. I earned that in the first place. I think the distinction between earned and unearned income is a poor choice of words.

I think all income is really earned by most people in this country. To the extent that one is taxed at a different rate than the other I think is unfair. I would like to see us move as fast as we can, with a degree of sensitivity of course over the amount of cost in terms of tax loss and the like, to tax earned and unearned income at the same rate.

Senator DURENBERGER. Thank you very much.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Thank you Mr. Chairman.

Senator Williams and Senator Warner and others claim you. New York claims you as well.

Mr. REGAN. I work there, Senator.

Senator MOYNIHAN. You certainly do. We are very proud of you and honored to have you considered for this position. I hope, having said that, you won't mind if I press you on some responses you have given to this whole question of tax straddles, which questions were begun by the chairman and continued by Senator Matsunaga.

Sir, I think I heard you suggest a passive approach to this question which I don't think will serve your interest. I want to be candid about this. As you know, tax straddles are devices whereby a taxpayer can avoid paying taxes on an income in a given year and roll it over into the next year.

The Treasury Department has found a taxpayer who in 1976 had a \$10 million gain and who still has not paid taxes on it. We will probably get them eventually. The point is that the Treasury has come to the judgment that there is no legitimate business purpose in these investments. They are only done to avoid taxes. There is no intention of profit or loss, merely an intention to manipulate the calendar for tax purposes. It is conservatively estimated by the Treasury that these devices cost us \$1 billion in unpaid taxes a year.

Now it happened last summer I got into this and I was going to put in legislation. The Treasury asked that I not do so because they were working up a position to protect legitimate commodity transactions while at the same time stopping the avoidance of taxes by people who make a lot of money and don't want to pay what other people have to. The Treasury has worked out a proposal and the very simple summary of it would be to say that they would not allow the taxpayer to treat each contract as a separate transaction. So that you gain here, you lose there, you lose \$1 million in December and then earn \$1 million in January, thus pushing your gain into the next year.

They would only allow the deduction of the net loss of the two or however many combined straddles. Now I wonder if you are prepared to see this thing work itself out in the courts or would you not think it best for the Treasury—and for the budget deficit—to take in another billion dollars I know even you will have to get used to the numbers down here—but 1 billion minutes ago St. Peter was 10 years dead—\$1 billion is a lot of money. A billion dollars you can reach out and put your hands on if we pass this bill. Would you not recommend that this committee take up the bill?

Mr. REGAN. Senator, I did not mean to leave the impression I was going to be passive about it. I mentioned study. Study is not passive. This is a complicated question.

Senator MOYNIHAN. By passive I meant relying on the courts as against legislation.

Mr. REGAN. I read the material which the Treasury Department furnished to you. It is complicated. I want my own team to study it right away to get hold of what can and should be done. What I am afraid of, and that is why I am not making a commitment today, is I don't want to throw the baby out with the bath water. If you start fooling around with commodity markets and say this contract can only be used for this purpose and that contract for another purpose, you are apt to get side effects we don't want.

That is why I am being cautious here as to what could be done on tax straddle. I admit it is one of the most serious of tax losses. On the other hand at this moment it is a legitimate procedure. If it needs remedy through the legislative process then we will be up here recommending that to you.

Senator MOYNIHAN. You will put this as one of the first questions of tax reform you have?

Mr. REGAN. Without being pinned down to the word "first," it will be one of the top priorities.

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

The CHAIRMAN. Senator Symms.

Senator SYMMS. Thank you Mr. Chairman.

Mr. Regan, I am glad to have you here today. I appreciate your strong statement and the recommendations that you have made for a sound, orderly economic program. Earlier, the issue of off-budget items was discussed. Would you have any objection to including all off-budget borrowing items in the total budget figures?

Mr. REGAN. That is one of the things I want to study. I am aghast, myself, in looking at these budget figures closely now in anticipation of this new job, just how far the problem has come. I think it is something that we should tee up so that the American taxpayer is aware of what is going on. Perhaps your suggestion is one of the better solutions, it could of course in times of credit crunch literally exacerbate the problem of crowding out.

It is a very serious matter.

Senator SYMMS. One other question that I did discuss with you privately, but what I want to affirm is the fact that despite what some of us might have read in some news reports, that you are opposed to wage and price controls?

Mr. REGAN. Very definitely I am opposed to wage and price controls under any guise whatsoever. I did testify to this effect last summer before the House Ways and Means Committee. This has been my position right along.

Senator SYMMS. I take it from listening to your testimony this morning that you would look favorably upon legislation which would reduce the burden of the estate and gift taxes presently imposed.

Mr. REGAN. Yes; one of the points that the President-elect made in his September 9 program was that he wants to get the exclusion much higher than it is now, particularly for farmers and small business owners. I am very sympathetic to that.

Senator SYMMS. I will say I am certainly very sympathetic to it also. Being from Idaho, they have had a lot of press this year on having the most millionaires per capita than any other State. We found out in investigating this matter that most of those millionaires are broke farmers. If they have the misfortune to die many of those family farms are literally being broken up.

Mr. REGAN. Yes, raising the cash to pay inheritance tax is anathema for the heirs and I think it is something we should definitely take a long look at.

Senator SYMMS. I appreciate that very much. Just one other idea I might suggest to you for study. Earlier, we discussed the social security system and I think all of us are investigating ways in which to make the system solvent. Would you investigate the possibility of supporting legislation which would provide a temporary cushion to the social security system by abolishing the official gold price and valuing the present gold stock at the market price rate, thereby providing a book profit of approximately \$148 billion to the Department of the Treasury. The book profit could then be shifted

to the social security system over a specified number of years with restrictions and with the understanding that the social security system be changed so that it is financially solvent. I might mention that there is a precedent for this action. In 1934, President Roosevelt established the exchange stabilization fund by raising the official price of gold.

Mr. REGAN. Again, I am not sure of how soon I could have that done but it is something that we will do in Treasury, take a look at that.

Senator SYMMS. Yes; thank you very much.

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. As Treasury Secretary, in your view has the IRS to date been too zealous or too lax in its enforcement of tax statutes designed to collect revenue for the Treasury?

Mr. REGAN. As Secretary of the Treasury I am going to be very zealous in collecting every single nickel that the U.S. Government has coming to it in the way of taxes. We will need it if we are going to achieve these objectives of cutting the deficit and eventually balancing the budget. However, to the extent that the Internal Revenue Service makes policy differing from what is either the intent of this Congress or the intent of the administration, I think that is something that I, as Secretary of the Treasury, will have to referee very closely. I notice in the past there have been regulations put out by the Internal Revenue Service that seem to thwart the original intent of Congress or have side effects that perhaps were not intended by the Congress.

Senator BAUCUS. Merrill Lynch, as you well know, has a very active tax operation to advise its clients of what action they can take to minimize taxes. It is a role that Merrill Lynch has been involved in for years.

I am curious whether, in your experience with Merrill Lynch, the Internal Revenue Service has been too zealous in trying to collect every legitimate nickel?

Mr. REGAN. I am trying to think quickly of how we felt about the Internal Revenue Service. If we are raising municipal bonds to build schools or sewers or something in your State, that is a legitimate tax minimization procedure. I think it would be out of line for the Internal Revenue Service to attack this type of thing.

However, when you come to some of the uses that municipal bonds have just been put to we get to a different question. There I would want the Internal Revenue Service to raise questions as to whether this is a legitimate use of municipal bonds.

Senator BAUCUS. Turning back to Merrill Lynch's involvement in tax straddles, I understand that you have made it clear to the Internal Revenue Service, that as far as you are concerned, the IRS should continue to pursue litigation in the Merrill Lynch case. Is it your personal intention that IRS continue to pursue the case?

Mr. REGAN. I think they should proceed with the case, definitely.

Senator BAUCUS. What is your view with respect to pension fund investments? Merrill Lynch has been actively involved with another company in urging investment of pension funds in farmlands.

As you know, on this committee there are a lot of farmers. As you know, farmers are having a tough time making ends meet, and

it is particularly difficult for young farmers to get into farming. Most farmers survive by continuing farming.

I am wondering what your view is going to be as Treasury Secretary with respect to pension fund investments in farmlands?

Mr. REGAN. That refers back to a situation in 1977 in which a bank in Chicago, one of the major banks, decided that it could help raise capital for farmers who formed a mutual fund. They approached Merrill Lynch to see if Merrill Lynch could be the seller of the funds, not the originator of the fund and not the manager of the fund, merely the selling agent.

We agreed to do so. There were protests raised by many farmers on the grounds this might upset land prices. So, as a result, we backed away from it immediately and we have not touched it since 1977.

To the extent that Merrill Lynch was involved—and this was merely to be another product, if you will, that we would offer for sale—we did not originate it. To the extent that pension funds may or may not own land, I think this could be one of the sources of capital for farmlands in the future if it is needed.

The Senator just referred to the fact that many people are finding it difficult to find buyers when they have to sell their farms. As a result, this would be a source of capital if needed.

At the present there are no real pushes underway to have pension funds buy major pieces of agricultural land.

Senator BAUCUS. The individual farmer—and most farmers are individuals; they are not corporations but rather small family enterprises—would like to own land and maintain the farm itself. The fact that additional capital is available in the pension fund for purchase of farms does not help that small farmer very much.

I am sure you will find that most Members of this Congress are going to be looking out for the small family farmers' efforts to maintain ownership in farmlands. To the degree that institutional investors begin to crowd out farmers, I think you will find the Senate and House reacting against those investments. I hope you will take the same attitude.

Mr. REGAN. Thank you for the advice. I am becoming quite aware that there is land out there besides Wall Street when I come up here. I will be very conscious of that.

Senator BAUCUS. Thank you very much.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Mr. Regan, I feel comfortable with your philosophy on wage and price controls. I agree with it. I was going to ask you about your position on wage and price control but you have already answered that for Senator Symms.

However, I would ask you to comment in regard to the statement you made in "The View from the Street," on page 51, that the Nixon administration did make the right decision on instituting wage and price controls.

You today, then, would say that was a mistake and that your position of support of that at that time was wrong?

Mr. REGAN. Now, in recalling a book I wrote in 1972, and without having the specific page in front of me, I think if you will go on, Senator, I was saying I applauded the decision of some very well-known Republican financial people who for the particular pur-

pose at that time—I am referring now to Charles Schultz, John Connally, as well as President Nixon—under the circumstances they did the right thing.

I think I went on to indicate in the book that price and wage controls as a rule do not work. I would not be in favor of price and wage controls.

Senator GRASSLEY. I have not read the entire chapter, I will have to admit, but I would like to quote for you:

Thus to meet a new situation, new restraints were imposed, including wage and price freeze, a suspension of U.S. redemption of dollars in gold and import surcharge on all dutiable products as of August 15, 1971. No one will ever know whether the classic method which economists generally believe must work in given time would in the end have produced the desired result. My own judgment agrees with that of the administration. I repeat, we live in a political-economic world which dictates pragmatic judgments and the time for forceful action in August 1971, had come.

That is what I was quoting from. You would not feel that strongly today about making pragmatic judgments which would bring about the reinstatement of wage and price controls?

Mr. REGAN. I see no need for wage and price controls at this moment. Short of involvement in war, I would see no need of wage and price control, period.

Senator GRASSLEY. I also feel comfortable to hear your dissertation on the ills of monetizing and how that contributes to inflation. In past administrations, such as the Nixon, Ford, and Carter administrations, it has been customary for the chief economic adviser and/or the Secretary of the Treasury to meet on a regular basis with the Chairman of the Federal Reserve Board. I assume you will reestablish those regular weekly meetings. You will be in a position to advise the Chairman of the Federal Reserve Board of the position of the administration on things like monetizing the national debt.

What, at that point, will be your judgment? Will you be as forceful in presenting the ills of monetizing to others as you were to us?

Mr. REGAN. Very definitely. I have also started that process with Mr. Volcker, meeting with him weekly. It is my intention to bring to his attention the evils that I see in a program of trying to control the flow of money, and the erratic effect on interest rates when the Federal Reserve overshoots the market.

However, it is necessary as part of this program that we do continue to hold down the inflation using monetary means. That has to be part of the overall picture, but we must do it in such a fashion so as not to get interest rates too far out of line.

Senator GRASSLEY. One of the things that bothered me in your answer to an earlier question from Senator Byrd, is that you indicated that, at best, we might be able to expect a balanced budget by the fourth year of this new administration.

I don't like to hear that. It may be a fact of life. I hope it is not. But it sounds to me, quite frankly, that it is too much business as usual. That is exactly the same thing we heard in 1976 from the present administration. There was nothing done during the 4 years to bring about a balanced budget by the fourth year of the Carter administration, and I think that is one of the reasons President-elect Reagan was successful in his election.

I think people from the grassroots are demanding real change. I don't think the people are going to stand for "business as usual" from President Reagan, those of us in the Senate, or even the new Secretary of the Treasury, Mr. Regan.

I think they are expecting more from this administration. I hope we can give it to them.

I would think that one of the first ways of accomplishing a change of direction is to reject a business-as-usual approach toward balancing the budget.

Mr. REGAN. Senator, I did not mean to make an impression on this committee and leave it there that this is to be business as usual. It is far from it. We can balance the budget sooner than that if there are more serious cuts made in the budget.

Now, this is going to mean that this committee, working with us, will have a laundry list of programs to cut. It is going to take a lot of courage; a lot of tough political decisions will have to be made to cut these programs.

If the Congress will cut these programs, cut this budget back, we can balance that budget sooner. But it is going to be a very hard political decision.

Senator GRASSLEY. Then it is your position, and the position of the administration, that they will attempt to bring about a balanced budget before the 4 years are up?

Mr. REGAN. Certainly. As quickly as we can. If we could do it next year, we would; but we were looking at political realities.

Senator GRASSLEY. You will be working to balance the budget not just by the fourth year, but sooner?

Mr. REGAN. Definitely, Senator.

Senator GRASSLEY. Thank you.

The CHAIRMAN. Senator Boren?

Senator BOREN. Thank you, Mr. Chairman.

I apologize; I was detained in another hearing. I will carefully read the transcript of your earlier comments and answers.

I have been very concerned about the effect of high interest rates. I just heard you talk about the danger of overshooting the market and the erratic nature of the present policy; we might sap the economy in very critical areas, that it could do grave danger to our economy before the administration has a chance to begin to work on fiscal policy and other means to get the economy back on track again.

Are there any words of encouragement you can offer in regard to the interest rates other than your regular meetings with Mr. Volcker and your encouragement to him to attempt to stabilize the policy somewhat? What is your strategy for trying to get the interest rates down as much as possible under the current economic conditions and the rate of inflation that we have, and how sensitive will you be as Secretary of the Treasury to the danger of the erratic nature of the interest rates?

Mr. REGAN. What we intend to do is, first of all, is to make sure that we cut spending, and that we start a program of reducing regulations which have added to inflation.

With those two things as the more important parts of the program, we will cut taxes at the same time, encouraging business to

spend for productivity. The more business is productive, the less inflation rates we will have.

I think as the financial markets and individual Americans start to see that this is not just rhetoric, that this is an actual program that is going to be put into action by this administration as quickly as it can possibly do it, within 90 to 120 days, if possible, working with this Congress, then I think the American people will get the sense that we are trying to get inflation down in a serious fashion. That is what they want.

As a result of this, our program will succeed and you will start seeing inflation coming down.

Senator BOREN. I take it, then, you don't think 15 to 20 percent interest rates are merely going to be a fact of life for many, many years, that the economy will simply have to adjust to it, and that the economy could adjust to it and remain healthy?

Mr. REGAN. If this program is enacted, there is no need for interest rates at 15 percent.

Senator BOREN. I also heard you refer just in passing to the inheritance tax, and I like what I heard you say, because certainly in the name of breaking up large concentrations of wealth we have in fact encouraged it.

The family owned newspapers in this country, independently owned newspapers, constituted 70 percent of the newspapers of this country 10 years ago. Now they are down to 30 percent. Because of the high valuation at the time of the death of the owner, the family had to sell the newspaper off to pay the inheritance tax. Ironically, we are bringing about larger concentrations of wealth because of excessive inheritance taxes, rather than preventing them.

Could we anticipate that the administration will not only support increased exclusions and exemptions under the inheritance tax, but will also come forward and make active proposals and might also encourage a program in which people could pay into an account the inheritance tax in advance, perhaps exempt from current income tax; in other words, prepayment of inheritance tax, as well as adding to the exclusion?

Mr. REGAN. I can definitely promise you that we will come forth with some recommendations in the exclusion and exemption provisions in the inheritance tax.

As to the latter part of your statement, that is something I would like to study a little bit more before I comment on that one.

Senator BOREN. Some of us during the debate on the windfall profits tax and some members of the committee and others who are in the room now, for example, had the feeling that in the major change from a measure which was really an energy measure somewhere along the line, to primarily one that was a revenue-raising measure, we lost track of what would produce more energy to the country, that we could demonstrate that an exclusion from the tax would produce more barrels of energy equivalent than perhaps even direct expenditure by the Government in other fields, that we lost track of that and we turned it into a revenue-raising measure. At least the Congress did.

Perhaps this is partly for cosmetic and political purposes.

Now we have those dollars flowing into the Treasury. I know the pressures that you will be under to try to reduce the deficit. I certainly applaud what Senator Grassley said a minute ago in terms of trying to reduce the deficit even more quickly than the last year of the administration, to bring us to a balanced budget.

Will that prevent you, however, from being openminded in looking at possible revisions of the windfall profits tax in areas where we can demonstrate that there would be a sound production response in terms of meeting the needs for greater energy independence in this country? Or will the Treasury merely follow a sort of blind position that sometime in the past it has taken opposing anything that brought about a short-term loss of revenue?

Mr. REGAN. Senator, I think I can assure you that we are not going to be blind to any particular program or dug in on any particular tax that is now in effect.

As I suggested in answer to the chairman's question at the opening of these hearings, the taxes in the energy field are something that have been imposed in a fashion that, I think, defies logic. I think it is something we want to study, to try to make them much more logical and accomplish what we want in this country, rather than having these side effects popping up.

Senator BOREN. Thank you.

The CHAIRMAN. Senator Long?

Senator LONG. Mr. Regan, I received—while this meeting was going along—a letter addressed to me by Senator Proxmire, former chairman of the Banking Committee, and he requests that I ask, on his behalf, a number of questions and obtain your answers.

He says in his letter, "When he comes before the Finance Committee, I ask you to ask him the attached questions on my behalf, or have him answer them for the record. If you were before Senator Proxmire's committee, he would insist on an answer to each one of these questions, and really, although I have been on the Finance Committee for 28 years, I don't know how to answer some of them myself. I think you will have difficulty providing him with a satisfactory answer. It is my judgment you ought to give it your best try.

Let me ask the first one: What are your budgetary goals of the Treasury Department for fiscal year 1982, as against the present fiscal year 1981? Can you give us the answer to that?

Mr. REGAN. I cannot give you a direct answer to that one at this time. You can assure Senator Proxmire that as quickly as we can, the Reagan administration will be up here with its budget.

Senator LONG. I haven't finished the first question: In fiscal year 1981 dollars, what are your goals for the Treasury budget in fiscal year 1982? Will you provide each quarter, beginning June 30, 1981, a record of your agency's expenditures by the quarter? That is the first question.

The CHAIRMAN. How many questions are there?

Senator LONG. He has 32 of them.

Mr. REGAN. I can assure you as soon as we get the information we will furnish it to this committee and to the Senator.

Senator LONG. If I sat here and tried to obtain an answer from you satisfactory to Senator Proxmire, that would take us a couple of hours today, I would like to simply ask you to take these ques-

tions which are 32 in number, look them over and try to give your responses as soon as you can. Just give them to us in writing, I suggest.

Mr. REGAN. With one proviso, Senator, that I am confirmed.

I have no staff at the particular moment, but if confirmed then I will get my staff and answer those questions as quickly as possible.

Senator LONG. I suggested that to the previous nominee, Mr. Schweiker, in responding to Mr. Proxmire's questions. If I were sitting there as a witness, being considered for the job, I think I would say to some of these questions, "Senator, if you confirm me in the job, given a week or two or maybe a month or two, I can give you a pretty good answer to this; but for the moment I don't know if I have the job or not, and I don't have all the information available to me."

I suggest you do the best you can with these questions. I know you will, in good faith.

I would like to ask the chairman of the committee, when the nominee for the Secretary of the Treasury submits his information, would you please release it and submit a copy to Senator Proxmire?

The CHAIRMAN. Yes. I think those that can be answered at this time you should attempt to answer, but I think anything you can reply to at a later time we can make available to the public.

Mr. REGAN. Let me look at the questions, Senator. Those I can respond to immediately, I shall, in writing. Those that I can't, I will defer on them and assure you that as quickly as I have the information I will get it to you.

The CHAIRMAN. I think the first question is the easy one. It gets more complicated as you get down to the twenties and thirties.

I also have a question that I will submit and ask that it be responded to in writing from Senator Chafee concerning sections 911 and 913 of the code, concerning taxation of Americans abroad. I will submit that and you can provide the answer.

I have also been asked to submit a question for Senator Packwood and Senator Moynihan with reference to above-the-line deductions for charitable contributions.

Senator LONG. Senator Byrd left two questions he would like to have submitted for the record.

[Questions submitted by Senators appear as the appendix to this hearing.]

The CHAIRMAN. Do you know of any new spending programs that are in the works?

Mr. REGAN. Spending programs?

The CHAIRMAN. Yes.

Mr. REGAN. No, Mr. Chairman, I don't know of any.

The CHAIRMAN. I didn't think there were any. I did not want to leave the impression that we have talked about some revenue losers as we have gone around the table.

Mr. REGAN. I have not heard of any in the economic task force I am on. No one has suggested anything regarding increases. They were on the decrease side.

The CHAIRMAN. Finally—and I think you may have answered this—is there a Reagan administration plan to be implemented by

Mr. Reagan, and with reference to bringing down interest rates? Is that all part of the package?

Mr. REGAN. That is part of the package. I think, as the American people see our determination and get a look at the entire plan and see that it is working and see that the Congress is cooperating with us to make this plan work, then they will get the understanding that this is for real this time and it is not just lipservice. That will bring interest rates down.

The CHAIRMAN. Do you have any other questions?

Senator LONG. Let me say, Mr. Reagan, you have been a forthright witness. I don't think you have withheld anything except that which you would be wise to withhold, and I think you are wise not to discuss things where you don't know the answer at this moment.

I will vote for your confirmation. I hope you enjoy the work down here. I am not sure that you will find it all that pleasant. Sometimes people ask, why on Earth would a man quit a good job like you had, paying what it paid, to come down here and take all this duff from some of the people you are going to meet.

Mr. REGAN. Senator, that is exactly what my wife has been saying to me, particularly as I prepared for this. I said, "Look, this is probably going to be one of the easier hearings that I shall be involved in." As a result, let me put it this way: Without trying to wrap myself in the American flag, the country is in a predicament at this moment. The President of the United States asked me to be in his Cabinet. How could you refuse when you get a call of duty of that nature?

Senator LONG. I wish every American would take the same attitude, Mr. Reagan.

The CHAIRMAN. Mr. Reagan, is there any other information you want to supply for the record?

The record will be open until Friday, January 9. If there should be questions from Members, we will ask them to get them to you today so that you will have a chance to respond by the 9th.

Any reply, of course, will be made available to the public.

If anyone, present or not present, would like to file statements in support of, or in opposition to, the nominee, the record is open for that purpose, too. The record will remain open until Friday, January 9.

We will meet at an appropriate time to, hopefully, confirm your nomination.

I express the views of Senator Long. I think it has been a good hearing; you have been forthright in your answers. We look forward to working with you in the months and years ahead. We will try to get the economy back on the track for all Americans.

Thank you very much.

Mr. REGAN. Thank you, Mr. Chairman.

[Whereupon, at 1:25 p.m., the committee was adjourned, subject to the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

TESTIMONY ON APPOINTMENT OF THE SECRETARY OF THE TREASURY, SUBMITTED BY THE NATIONAL DEMOCRATIC POLICY COMMITTEE

The Secretaries of Treasury who held office during the past ten years presided over the American economy's worst period of deterioration since the Great Depres-

sion. As chief economic policy spokesman of the new Administration, the new Treasury Secretary will either permit the deterioration to continue past a point of no return, or demonstrate qualities of initiative and acumen worthy of this nation's first Secretary of Treasury.

All the new Administration's tasks in the economic sphere can be summarized in the problem of how to expand credit without inflation. Even before taking office, the new Administration has been beleaguered by monetarists who philosophically oppose the credit and taxation policy on which Alexander Hamilton founded American prosperity. Should the new Administration accept the view that it must begin a period of hardship, including reductions in essential categories of Federal spending and credit availability, the United States will suffer a worse depression than two generations ago, and perhaps disappear, like Great Britain, from the list of industrial powers.

The new Treasury Secretary will inherit a tax system more hostile to industrial productivity than that of any other industrial nation. The base tax rate of West Germany and other more successful nations is higher, but the incentives to investment in manufacturing and other tangible wealth production are correspondingly greater. From the industrial standpoint the United States has the most penurious system of investment tax incentives, depreciation schedules, and inflation accounting in the industrial world. At the same time the tax code left over from the previous administrations embodies a set of tax shelters that force both corporations and individuals in tax brackets in excess of 50 percent into investments that represent pure inflation. Principal among these is the real estate secondary market, which enjoys an actual tax rate of about 5 percent, against 30 percent for manufacturing corporations. In consequence, the value of New York City real estate alone is greater than that of all industrial equipment and structures in the entire U.S. economy.

This makes a farce out of so-called tight monetary policy. In effect, present monetary policy—in its tax context in the real world—is a two-tier credit system favoring tax-sheltered speculation in secondary real estate markets, which are presently the only boom sector in the national economy, and penalizing all forms of long-term investment in production of tangible wealth. The present high interest policy is inflationary not merely because of the added cost of debt service but because it favors investments that have no rationale except speculative capital gains.

Cleaning up this mess without a ruinous crash of speculative values and uncontrollable damage to the nation's banking system is a task demanding great qualities of statecraft. Pushing the austerity program to its extremes would produce such a crash within months and reduce the American economy to a bargain-basement sale of Americans assets.

The implicit priorities of tax and monetary policy must be reversed. Instead of a two-tier system rewarding investment in American de-industrialization, the Treasury Department must revise the tax code to favor basic improvements in American technology, and aid in steering monetary policy toward non-inflationary expansion. The National Democratic Policy Committee has elaborated two sets of proposals to accomplish this result. In summary, the leading measures required on the tax side are major investment tax credit in the range of 15 percent; exemption of savings accounts at thrift institutions from interest taxation where those accounts are loaned for new residential construction; an increase in personal income exemption such that a family of four under \$20,000 gross income pays virtually no taxes; elimination of preferential capital gains taxation rates except for research and development; elimination of tax advantages to real estate except for homeowners and new residential construction; and a system of duplicate tax benefits that permits the individual saver and investor to share in the tax benefits accorded corporations.

The NDPC has further proposed a basic reform of the Federal Reserve System to eliminate the gross malfesance of the System. The Federal Reserve has fostered the most inflationary form of credit expansion, in the \$1.2 trillion Eurodollar market, while pricing credit out of the range of legitimate users. As an emergency measure the NDPC's proposed Federal Reserve Reform Act would suspend open market operations except to smooth temporary fluctuations and instruct the Federal Reserve Banks to accept participations of up to 50 percent in loans made by member banks for the production of tangible wealth, in industry, agriculture, construction, mining, utilities, and transportation. As long as new money supply is created only against the production of new tangible wealth, credit can expand without limit and without inflation. The malfesance of the Fed, which has given this country the wrong kind of two-tier credit system, requires that Congress take tighter rein over

the Constitutional power to regulate the currency, and brings the Treasury back to its original major role in monetary affairs.

Finally, on the international side, the new Treasury Secretary must respond positively to the initiative of our European allies in creating a gold-reserve, fixed-parities European Monetary System. In combination with the internal measures outlined earlier, the EMS provides the basis for correcting the disaster of August 1971, and restoring the dollar's international strength. This requires the creation of a new gold-backed international rediscount facility for world trade, capable of absorbing petrocurrency and other international funds which now constitute a major source of monetary instability and inflation. The Treasury Secretary has the responsibility of repairing the collapse in monetary relations with Europe the began in 1971 and reached its nadir in the outgoing Administration. Our allies have shown more concern in the recent past in restoring American greatness than have our own leaders, and it is time to work with them toward this end.

PUBLIC CITIZEN,
January 5, 1980.

Hon. ROBERT DOLE,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Tomorrow the members of the Senate Committee on Finance will be questioning Treasury Secretary-designate Donald T. Regan, presently chairman of Merrill Lynch. We urge the Committee to consider Mr. Regan's nomination carefully, and to satisfy itself that a number of questions have been adequately answered before recommending to the full Senate that Mr. Regan be confirmed as Treasury Secretary.

We have no doubt as to Mr. Regan's technical competence. He has been with Merrill Lynch, the world's largest brokerage house, for 35 years, having been president since 1968 and chairman and chief executive officer since 1971. He had led Merrill Lynch's expansion into diversified financial services and real estate. Mr. Regan is also a member of the Business Roundtable, the lobbying organization consisting of the CEO's of 192 of our largest corporations, and of its Policy Committee, on which he helps formulate the Roundtable's policy and strategy. As Treasury Secretary it would be Mr. Regan's duty to consider and serve interests much broader than and frequently conflicting with those he has served on the Business Roundtable and at Merrill Lynch. We hope that the Committee will assure itself that Mr. Regan as Treasury Secretary would effectively represent and safeguard the interests of all the American people—both big business and small business, both investor and worker, and both rich and non-rich.

We also urge the Committee to investigate carefully the nature and extent of Mr. Regan's involvement, if any, in Merrill Lynch's thriving commodity tax straddle business. Commodity tax straddles—balanced commodity trading positions designed to create artificial losses to offset income in one year and to convert that income into a capital gain, 60% of which is non-taxable, in the next year—were disallowed by the IRS for tax purposes in 1977. Nevertheless, Merrill Lynch, which for more than a decade has been a leading firm in creating straddles to avoid taxes for individuals in the highest tax brackets, has continued to use and recommend them.

We are particularly concerned about the manner in which Merrill Lynch has conducted its tax straddle business. It has known that tax straddles could be subject to attack by the IRS for at least eight years; it has admitted (on a tape recording made by its "Tax Straddle Department" in 1975) that the only real purpose of a tax straddle is to avoid taxes; and, most notably, it recently paid two clients for whom it had created tax straddles more than \$100,000 to drop a \$57,000 case against the IRS seeking a judicial determination of the legality of tax straddles.

The practical problem raised by Mr. Regan's firm's involvement with tax straddles, of course, is that the IRS has many cases in progress charging taxpayers with evading taxes by using straddles. Should Mr. Regan be confirmed as Treasury Secretary, and thus as the overseer of the IRS, how will he handle those cases? Will he seek to terminate them and prevent others from being brought? Will he seek to isolate himself from any matters involving tax straddles? Can this, as a practical matter, be done? Would Mr. Regan's heading up the Treasury Department compromise the government's position in tax straddle cases?

Perhaps even more important than these practical problems, however, are the questions of tax justice and fundamental fairness raised by tax straddles. At a time when inflation is both continually ratcheting the average American worker into higher tax brackets and eating away at his purchasing power, and when many members of both political parties want to balance the federal budget, a tax avoid-

ance device like the commodity tax straddle—which enables the very richest taxpayers to cheat the Treasury out of an estimated \$3 to \$4 billion a year—must not be condoned.

The Secretary of the Treasury, through the Assistant Secretary for Tax Policy and the IRS, formulates tax policy and enforces the tax laws. We respectfully request that, before the Committee concludes its questioning of Mr. Regan, it satisfy itself that Mr. Regan did not personally create or use commodity tax straddles while at Merrill Lynch; that a Treasury Department and IRS under Mr. Regan would continue to seek to eliminate the use of commodity tax straddles and other devices used by the very rich to avoid taxation; and that the presence of Mr. Regan at Treasury would not in any way compromise any pending or future case involving commodity tax straddles.

Sincerely,

JAY ANGOFF,
Public Citizen Congress Watch.
ROBERT S. MCINTYRE,
Citizens for Tax Justice.

APPENDIX

QUESTIONS SUBMITTED BY SENATORS TO MR. REGAN WITH HIS RESPONSES

COMMUNICATIONS FROM SENATOR MOYNIHAN

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C., January 7, 1981.

Hon. ROBERT DOLE,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: In his testimony before us yesterday, Treasury Secretary-designate Regan said that, with respect to law suits brought against the Internal Revenue Service by taxpayers who had participated in commodity tax straddles arranged by Merrill Lynch & Company, his company had not attempted to dissuade, by payment of money, these clients from pressing their suits but only had discussed compensating them should they lose.

This morning's Washington Post presents this episode differently. According to the Post: "Internal Revenue Service attorneys and the lawyer for the two Merrill Lynch clients involved in the case have given a different version of that settlement. At a court hearing a few weeks ago, IRS officials said Merrill Lynch offered to pay the clients twice as much as they owed the government if the clients would drop their case against the IRS."

The transcript of yesterday's hearings is not as yet available, so that I cannot precisely state that there is a clear conflict as between Mr. Regan's testimony and the report in the Post. Even so, I am sure the Committee will want the matter cleared up before proceeding further, and there would seem no reason this cannot be done with dispatch. I have taken the liberty of calling Mr. Regan and putting the matter in this way to him, and he fully agrees. May I therefore suggest that the Counsel of the Committee address himself immediately to this question. Mr. Eaton of my staff, who is an attorney, would be happy to place himself at your disposal if this would be useful.

Respectfully,

DANIEL PATRICK MOYNIHAN.

OFFICE OF THE PRESIDENT-ELECT,
Washington, D.C., January 9, 1981.

Hon. ROBERT DOLE,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: I understand there is some ambiguity regarding my statement during my testimony before the Senate Finance Committee on January 6. I appreciate this opportunity to respond further to the matter. As a preliminary matter, I would like to emphasize that at the time of my hearing I was unaware of the details concerning the negotiations to settle the case involving Merrill Lynch's tax straddle customers.

However, to clarify the ambiguity that may have arisen, here are additional factors:

The litigation between Merrill Lynch and its customers arose in San Diego and is separate from the dispute between those same customers and the IRS. I am informed by the Merrill Lynch attorney working on this matter that Merrill Lynch was attempting to settle the San Diego case because the taxpayer's deduction had been disallowed by the IRS.

This disallowance resulted in the Tax Court hearing on November 3, 1980. I am told that subsequently Merrill Lynch reached conditional agreement with the cus-

tomers in the San Diego suit, which provided for ". . . settlement, prior to trial and without judgment or decision of the Tax Court cases. . .".

The settlement amounts to \$114,000, which is approximately the total of the Federal and State taxes plus interest, penalties and expenses.

As I understand it, this settlement would not prevent the Tax Court from reaching a decision on commodities straddles because there are numerous other presently pending cases involving the same or similar issues on which the court can rule.

Once again, I want to assure you that, if confirmed by the Senate, I most certainly would not take part in nor interfere in any way with any matter involving Merrill Lynch and would take the necessary steps to avoid a conflict of interest in the event a Merrill Lynch matter arises while I serve as Secretary of the Treasury.

I hope this clarifies my earlier comments.

Sincerely,

DONALD T. REGAN.

ADDITIONAL QUESTIONS OF SENATOR MOYNIHAN

Question 1. The budget for the inspection personnel of the Customs Service is seriously inadequate for processing international passengers and cargo. Not only are passengers experiencing several hours of delay during the inspection process in many instances, but the Customs Service has threatened to deny landing rights for U.S. flag carriers because of a lack of inspection personnel. How do you plan to resolve this understaffing problem?

Answer. Thank you for bringing to my attention the understaffing problem of the Customs Service. One of my goals at the Treasury Department will be to improve the performance of the Department's enforcement and operations functions. In this context, I will give early attention to the Customs Service, although it is not appropriate for me to propose a solution to the problem you cite until I can review first hand the dimensions of the problem and the resources available to deal with it.

Question 2. If budget constraints continue to impose Customs inspector staff reductions, then the Customs inspection process itself must be reduced or simplified to permit the most efficient use of available resources. Introduction of the European red door/green door Customs inspection honor system for travelers and expansion of U.S. Customs preclearance to selected overseas locations would reduce or simplify the inspection process. What are your views in this regard?

Answer. I think the European inspection honor system represents an interesting alternative to our current procedures, and if resource constraints persist, I will be sure it receives careful study. However, it would be premature for me to endorse a particular approach to the problem at this time.

Question 3. On December 15, 1980, the Treasury Department issued Revenue Procedure 80-55 which disallows the deduction for interest paid on time deposits made to state and local governments whose deposits are collateralized through the purchase of tax exempt securities. This procedure is of particular interest to New York State and 33 other states which require that these government deposits be collateralized through the purchase of tax exempt securities.

The I.R.S. has ruled that interest paid by bank on these deposits will not be deductible since the banks receive a tax benefit by their ownership of tax exempt securities.

Commercial banks hold about one-half of the approximately \$300 billion of tax exempt state and local debt. This ruling could be a disincentive to further bank participation in this market, thus lessening the demand for these issues and driving up public borrowing costs.

The effective date of this Procedure is January 10, 1981. In the event that the effective date is not postponed will you recommend a postponement so that this action might be further reviewed? What would be the attitude of the Reagan Administration to withdrawal of Revenue Procedure 80-55?

Answer. It is my intention to recommend a postponement of the effective date of Revenue Procedure 80-55 in order to further review the need for and potential impact of this action. I will need to study this matter fully, in the context of past legislation providing for issuance of tax exempt securities by states and municipalities, before advocating a position with respect to withdrawal of Revenue Procedure 80-55.

Thank you for the opportunity to comment on these issues.

QUESTIONS FROM SENATOR BYRD

Question 1. You were recently reported in the press as saying that some U.S. industries should no longer be protected and should just be allowed to die. Which

industries did you have in mind? What is your opinion of the U.S. fiber/textile/apparel industry in connection with your statement that some U.S. industries should no longer be protected and should just be allowed to die?

Answer. Let me first indicate in my remarks about a competitive economy I was referring to individual firms and not entire industries. As a general proposition, however, the United States has long adhered to the theory of international trade that free (and fair) trade is, in the long run, best for all nations and best for the United States. Previous attempts at extensive protectionism have found that they just did not work in practice. On the other hand, the realities of the present world trading situation require that certain steps be taken to ensure that trade is, in fact, fair trade, most notably with East Bloc countries which interfere with the free operation of market forces. It was in this context that I made my comment that the United States cannot be and should not be indefinitely protecting industries, but rather should assist them to adjust to new trading situations. This may in fact require trade adjustment assistance in particular situations, and in some cases no amount of assistance or planning will be able to prevent the inevitable bankruptcies and passing from the economic scene. This country cannot afford, as some other countries have, to continue to support antiquated "buggy whip" industries, and as Secretary of the Treasury I will adhere to that policy.

Question 2. In a letter to Senator Strom Thurmond during the presidential campaign, President-elect Reagan supported a renewed and strengthened multi-fiber arrangement for textiles and apparel. How do you feel about renewal of the MFA? Do you agree that it should be strengthened?

Answer. The multi-fiber arrangement allows for further negotiations and arrangements between various countries to work out, on a bilateral basis, limits to the exports of covered textile products. President-elect Reagan, in his letter to Senator Thurmond, noted that the MFA expires at the end of 1981 and that it needs to be strengthened by relating import growth from all sources to domestic market growth. This goal, which is not adequately reflected in previous bilateral agreements or in the multi-fiber arrangement, is viewed as reasonable by our major textile trading partners, and can be pursued by this Administration in a strengthened agreement. I would favor such an approach.

QUESTION FROM SENATOR CHAFEE

Question. The taxation of American citizens working overseas has been an issue of great concern to me and other members of the Finance Committee. Current tax policy appears to be hindering the ability of U.S. industry to compete in many markets abroad. The reason for this is simply that other industrial nations do not tax their overseas workers as heavily as we do, if at all.

In the interest of promoting exports abroad and jobs at home, will the Reagan Administration be willing to endorse changes in the tax law in this area as part of its economic program for 1981?

Answer. The essential elements of the new Administration's tax program for enactment in 1981 are reduction of marginal tax rates for individuals along the lines of the Roth-Kemp and some form of enhanced accelerated depreciation for business. The President-elect's Task Force on Taxation has recommended a number of other desirable tax reforms that will also receive early attention. Of necessity, they will be reviewed in the context of overall fiscal objectives. It is my intention to give priority consideration to the need for changes in the tax law relating to taxation of American citizens working overseas, but it would be premature for me to endorse a particular stance on this issue until I have time to carefully review the options in the light of other important policy aims.

QUESTION FROM SENATORS PACKWOOD AND MOYNIHAN

Question. Senator Packwood and I have this proposal to allow all taxpayers to deduct their charitable contributions, whether or not they itemize their other deductions.

This concept was heartily endorsed in the Republican platform (though opposed by the Carter Administration). It was also embraced by this Committee three months ago.

Do you expect this will be something that the incoming Administration will be able to support?

Answer. The proposal to allow all taxpayers to deduct their charitable contributions, whether or not they itemize their other deductions, will be studied carefully by the incoming Administration. It is premature for me to indicate what will be the

position of the incoming Administration on this proposal, except to say that we will need to evaluate it in terms of its fiscal impact as well as in terms of its desirable incentive effects.

QUESTIONS BY SENATOR PROXMIRE TO MR. REGAN AND HIS RESPONSES TO THEM

DEAR MR. CHAIRMAN: I am writing in response to Senator Proxmire's questions relating to my designation by President-Elect Reagan to be Secretary of the Treasury. I am not in a position at this time to answer in detail some of the questions posed by Senator Proxmire, either because they pertain to operational matters outside my purview as Secretary-designate or because they relate to policy issues which the incoming administration still has under active review. Please advise Senator Proxmire that, if confirmed by the Senate and after taking office, I will be pleased to pursue further the answers to any questions which in his view require a more substantive response than I am able to provide at this time.

Question 1. What are your budgetary goals for the Treasury Department for fiscal year 1982 as against the present fiscal year 1981? In constant fiscal year 1981 dollars, what is your goal for the Treasury budget in fiscal year 1982? Will you provide each quarter beginning June 30, 1981, a record of your agency's expenditures by quarter?

Answer. Upon taking office, I will expeditiously prepare the Treasury Department's budgetary goals for fiscal year 1982. In addition, I will be pleased to provide, on a regularly scheduled basis, any information that might be of interest to the Senate regarding expenditures incurred by the Treasury Department.

Question 2. What is your goal for full-time permanent civilian employment in the Treasury Department comparing the number on board on September 30, 1981 with September 30, 1980? Will you provide each quarter beginning June 30, 1981, a report of the number of personnel on board?

Answer. I intend to adhere to policies enunciated by the incoming administration with respect to a freeze on hiring with the Executive Branch. My goal for full-time civilian employment in the Treasury Department will be such as to permit the lawful and effective performance of the agency's functions. I will be pleased to provide each quarter beginning June 30, 1981, a report of the number of personnel on board.

Question 3. What other plans, commitments, or reports if any will you make to assure that your Department will progress towards the anti-inflation goal so essential to the economy?

Answer. I am deeply committed to eliminating waste and inefficiency in government and will work assiduously to assure that this ethic is operative in the Treasury Department. This is one way the Treasury Department can support the program of spending control which underlies the President-Elect's anti-inflationary economic program.

Question 4. What are your Budget priorities for your Department? If you were required to cut back budget authority by 10 percent, where would you cut? What are your lowest 20 percent, 30 percent, and 50 percent priorities? Your priorities should include entitlement programs.

Answer. The Treasury Department is not primarily engaged in administering outlay programs. However, one of my early agenda items will be to develop a disciplined set of budgetary priorities and to carefully examine ways in which the Department's budget can be better managed.

Question 5. Presently, banks in the United States are regulated by three different federal agencies; the Comptroller of the Currency who is in the Treasury Department, the Federal Reserve Board, and the Federal Deposit Insurance Corporation. Would you favor combining these three agencies into a single agency in order to reduce regulation and overlapping and to provide less government and more efficient regulation in the banking industry?

Answer. I am interested in proposals to eliminate the redundancy of bank regulatory and supervisory functions performed by the different agencies you cited, and would support efforts to improve the efficiency of bank regulation. However, because the Comptroller of the Currency, Federal Reserve Board and Federal Deposit Insurance Corporation discharge a variety of essential and mutually independent functions, I am not prepared to comment on the merits of the reorganization proposal you cited.

Question 6. What is your position on branch banking?

Answer. The subject of branch banking, to the extent it falls within the federal regulatory purview, will be studied by the Treasury Department. I will need to review the regulatory issues respecting branch banking before advancing an administration position on this issue.

Question 7. Do you favor the Douglas Amendment to the Bank Holding Company Act?

Answer. Due to the dramatic and rapid change during recent years in the character of the nation's financial institutions and financial services markets, there is a general need to continuously monitor the effects of existing legislation and regulations in order to ensure that their original intent is being properly served and that their provisions continue to be responsive to changing economic conditions and societal needs. I believe that the Douglas Amendment to the Bank Holding Company Act should be administered faithfully by the Federal Reserve System in a manner consistent with the legislative intent.

Question 8. What ideas do you have for curbing the rapid growth of federal credit programs, most of which are not counted in the budget?

Answer. One of the goals of the new administration is to curb the rapid growth of the federal credit program. I am working on a task force with OMB Director-designate David Stockman, in considering specific approaches to get the growth in credit programs under control. I favor institution of some form of federal government credit budget, and would recommend the Congress adopt a measure to tie increases in the debt ceiling to the budget process so that the credit implications of spending decisions can be better appreciated.

Question 9. As you know, many of these credit programs are financed by the Federal Financing Bank, an agency of the Treasury. Would you support legislation to put the Financing Bank back in the budget?

Answer. I favor institution of a "federal credit budget" in order to permit more effective monitoring and control of extension of credit by federal agencies. Activities of the Federal Financing Bank should be included in such a budget. Since direct loans made to third parties by government agencies are a principal form of paper purchased from government agencies by the Federal Financing Bank, a simple way to control creation of debt by the federal government would be to limit directly the growth of federal credit programs already on budget.

Question 10. A memo supposedly prepared by Congressman Stockman and Kemp entitled "Avoiding a GOP Economic Dunkirk" has received wide publicity. One of its recommendations is that President Reagan should meet with the Federal Reserve Board and "issue them a new informal 'charter'—namely to eschew all considerations of economic variables like short-term interest rates, housing market conditions, business cycle fluctuations, etc., and to concentrate instead on one exclusive task; bringing the growth of Federal Reserve credit and bank reserves to a prudent rate and stabilization of the international and domestic purchasing power of the dollar." Do you think the President of the United States has any business in issuing charters to the Federal Reserve, informal or otherwise, and would you participate in any such effort?

Answer. I respect the prerogative of independent action belonging to the Federal Reserve Board. I also recognize the need for communication between various government bodies pursuing interdependent objectives and goals.

Question 11. Many banks believe it is time for a wholesale revision to the Glass-Steagall law which prohibits commercial banks from entering the securities business. In particular, banks are pushing hard for authority to offer mutual funds to their customers and to underwrite municipal revenue bonds. How do you feel about the banks getting into these two areas?

Answer. The fundamental purpose of the Glass-Steagall Act, which is to protect depositors and investors from certain abuses, continues to be of paramount importance. The particular issues of commercial bank mutual fund offerings and municipal revenue bond underwritings require careful study, and I would initiate such study as Treasury Secretary with a view towards developing an administration position on the issue.

Question 12. Do you think your former association with the nation's largest securities firm will present any difficulties in advising the President on legislation affecting the securities industry?

Answer. I do not believe that my former association with the nation's largest securities firm will present any difficulties in my advising the President on legislation affecting the securities industry. On the contrary, I believe that my understanding of financial institutions and markets will be a positive asset in helping to develop policies relating to the securities industry. I have been advised by appropriate legal authority that effective with the severance of my employment relationship with Merrill Lynch, I have no conflicts of interest with respect to my prospective duties as Treasury Secretary, and I have agreed in writing to recuse myself in the future from involvement in any issue which is construed to create conflict of interest problems relating to my former employment with Merrill Lynch.

Question 13. Had you been advising the President in 1979, would you have recommended legislation for providing federal loan guarantees to the Chrysler Corporation?

Answer. I do not feel it would be productive for me to speculate now about what I would have recommended to the President in 1979 in connection with Chrysler's request at that time for federal loan guarantees. There is currently legislation on the books that provides explicit guidance for the authorization of loan guarantees to Chrysler Corporation, and my responsibility as Secretary of the Treasury will be to operate within the framework of that litigation.

Question 14. If Chrysler comes to the federal government for an increase in the present ceiling on loan guarantees, what will be your response?

Answer. It would not be appropriate at this juncture for me to indicate what my response would be if Chrysler comes to the federal government for an increase in the present ceiling on loan guarantees. Treasury Secretary Miller is still responsible for the position of the Treasury Department with respect to the Chrysler situation, and is in full possession of the facts on this matter. I am not inclined to speculate as to what Chrysler's future needs for support might be or what response by the federal government would be justified.

Question 15. Do you think the Federal Government has an obligation to prevent the bankruptcy of large companies facing financial difficulty such as Chrysler?

Answer. As a general rule, I do not believe the federal government has an obligation to prevent the bankruptcy of large companies facing financial difficulty.

Question 16. Do you think the Federal Government should prevent the bankruptcy of financially troubled cities such as we did in the case of New York City?

Answer. The federal government lacks the resources to implement an across-the-board policy of guaranteeing the financial viability of states and municipalities that encounter severe financial troubles. Such a policy might also encourage fiscal irresponsibility and thrust the federal government into the management of state and local finances. The Congress of the United States has enacted legislation providing for guaranteed loans to New York City and I intend to work closely with Congress to ensure that the program is properly administered.

Question 17. Your firm, Merrill Lynch, was active in underwriting New York City securities. Why didn't your firm blow the whistle a lot sooner on the City's financial mismanagement?

Answer. It is my understanding that Merrill Lynch acted responsibly in connection with its role as an underwriter of New York City securities.

Question 18. As you know, the financial futures market has grown rapidly over the last several years. Unrestrained speculation in silver almost caused the collapse of a major brokerage firm. Do you favor more controls over financial futures speculation particularly in the areas of gold, silver, and treasury securities?

Answer. The financial futures market serves a variety of useful functions. Speculative excesses are not peculiar to this market but rather have at one time or another been manifest in other markets as well. In view of the tremendous strains to which this market has been subject as a result of rapidly changing commodity values and highly volatile interest rates, I am impressed by the fact that its ability to function under all market conditions has apparently earned the confidence of the investing public. I would, therefore, be reluctant to automatically assume that additional controls are necessary, although it is clear that specific abuses should be studied to determine if tighter regulation is warranted.

Question 19. The Credit Control Act is scheduled to expire on June 30 of 1982. Are you content to let this authority expire or do you plan to ask for an extension?

Answer. I do not plan to ask for an extension to the Credit Control Act.

Question 20. President-Elect Reagan campaigned against the inflationary and stultifying effects of government and government regulations. What specific regulations would the nominee abolish at the Treasury Department? What regulations could be cut or curtailed? How would this be done? Is there a way in which the costs of the regulations could be measured against the public interest benefits? If the nominee has no plan, how does this square with the clear commitment of President-Elect Reagan?

Answer. Would you supply to the Senate by March 1st the specific regulations of the Department, if any, you would eliminate as much information as possible by that date on the regulations to be curtailed, how they would be curtailed and the way you would measure the effects of curtailment?

Answer. The Treasury Department is not primarily a regulatory body. Although it has some involvement in the regulation of financial institutions through the Office of the Comptroller of the Currency, and is engaged in law enforcement through the Bureau of Alcohol, Tobacco and Firearms, government regulation of economic entities is handled in the main by other agencies and independent regula-

tory bodies. To the extent that the President-Elect's commitment to regulatory reform can be implemented within the Treasury Department, I will do so vigorously. It is my intention to study carefully the regulatory functions performed by the Treasury Department, and I will be pleased to report to the Senate at the earliest possible date my specific recommendations for regulatory reform within the Department.

Question 21. The President-Elect pledged to curtail the colossal burden of paperwork imposed by law and department regulations on business, commerce, the public consumers, local and state governments, and the federal government itself.

What does the nominee expect to do to reduce the burden of paperwork at the Treasury Department?

Would you report by March 1st to the Senate your plans to reduce paperwork in its Department and the deadlines you have set to do so?

Answer. It is true that the private sector and state and local governments incur substantial costs in connection with various reporting requirements imposed by the federal government. I will give early attention to this problem from the Treasury Department's point of view, and can assure you of my commitment to the President-Elect's pledge to curtail the paperwork burden. At the request of the Senate, I will be prepared to submit, in an expeditious manner, Treasury's plans for dealing with this problem.

Question 22. What plans if any does the nominee have for shifting costs incurred by his agency to the users of the services the agency provides? If there are no plans, why not? What is the nominee's view on the question of who should pay the costs of the specific services from the Department, the user or the general taxpayers?

Answer. The question of who should bear the costs of services provided by the government—users or the general public—needs to be considered on a case-by-case basis. I intend to review current Treasury practices regarding the handling of costs of specific services provided by the agency in order to determine if there are ways to allocate costs on a more equitable basis.

Question 23. How would you rate the efficiency of the Treasury Department in the past? Are you satisfied with the level of competence and efficiency?

If so, does this mean we can expect little change in the way the Treasury operates in the future? If not, what changes should and will be made, By what date would those specific changes be achieved?

Answer. One of my management goals of Treasury will be to improve the level of efficiency in the performance of the agency's functions. This will probably result in changes in certain phases of Treasury operations, but I am not yet in a position to address the ways in which administrative effectiveness might be enhanced.

Question 24. What programs, if any, at the Treasury Department, would the nominee eliminate? What new or fresh ideas does the nominee have that might achieve the mission of the Treasury Department in a more efficient way?

Answer. Programmatic changes, including proposals to eliminate programs that no longer serve a useful purpose, will be considered in due course by the Office of the Secretary. I will initiate a review of the programmatic activity of the Department, and following this review I will confer with appropriate Congressional committees on the need to modify or terminate particular problems, if such a need exists.

Question 25. Let me ask a question on even handed regulation. Money market funds have experienced explosive growth to about \$80 billion. Savers are becoming more sophisticated and are seeking higher returns. There is evidence that much of the money in the funds comes out of savings at financial institutions; small banks and thrifts. Money market funds reinvest this money into larger banks at higher rates. Money market funds are unregulated, operate across state lines and thus have the ability to do things insured financial institutions cannot.

A—Is the intermediary function performed by money market funds inflationary?

B—Does money market fund investment in large banks drain money out of small banks and thrifts into money center banks?

C—Do large corporate borrowers in this process receive preference for loans during periods of scarce supply over small business, agriculture and housing?

D—How much money from money market funds gets invested in small business, agriculture and housing?

E—Should money market funds be subject to the Community Reinvestment Act as are insured financial institutions?

F—Should money market funds be subjected to reserve requirements when they are accessible by check? Should money market funds be subjected to Regulation Q as long as it is on the books?

G—Should insured financial institutions be able to offer their customers bank or thrift managed money market funds?

Answer. It is not my opinion that the intermediating function performed by money market funds is inherently inflationary. Research still needs to be done regarding the effect of growth on money market funds on overall financial flows in the economy. There is need for more even-handed regulatory treatment of different types of financial institutions, but this is not intended to imply a need for increased regulation. As a member of the Depository Institutions Deregulation Committee, I expect to study carefully the issues you identified relating to Regulation Q and the types of deposit instruments that should be offered by insured financial institutions. I am committed to the orderly deregulation of financial institutions and markets mandated by the Depository Institutions Deregulation and Monetary Control Act of 1980, and will act in the spirit of that legislation in proposing any changes in the regulatory treatment of money market funds.

Question 26. Bank trust department now offer agency services to some extent to pensions funds and others.

It is reported in the press that the American Bankers Association this Congress will press for legislation authorizing banks to offer commingled agency accounts to individuals. This will put the banks in competition with the mutual funds.

Should the mutual fund industry continue to be fenced off from the competition? Wouldn't it appear to improve the market to allow institutions that are capable of offering this service to offer it rather than to prohibit it by regulation?

Answer. The idea you propound regarding the possible utility of permitting banks to compete with mutual funds needs to be carefully studied. I have long been an advocate of regulatory changes that have procompetitive effects without subjecting the consumer or investor to undue risk.

Question 27. The Federal Reserve has approved underwriting of commercial paper and investments advisory services for banks.

Both these decisions are being contested in the Courts.

What is your policy judgement on these issues? If banks are prohibited by regulation that means that regulation gives a monopoly over these services to the securities industry. Why should the government give a monopoly over these services to securities firms, particularly over commercial paper which is a direct substitute for corporate bank borrowing?

Answer. Since these decisions are being contested by the courts, I do not feel it would be appropriate for me at this time to offer an opinion that might improperly prejudice the judicial outcome.

Question 28. Banks and thrifts are heavily regulated—perhaps too much so. But securities firms appear to be underregulated when it comes to competition with insured financial institutions.

Securities firms can open branches nationwide without prior regulatory approval and they are much less constrained than insured financial institutions on the kinds of activities they can engage in. Merrill Lynch even offers a deposit and check withdrawal service that closely resembles banking.

Would a competitive financial system be better served by subjecting securities firms and banks to similar regulatory rules?

Answer. You correctly identify some of the regulatory inconsistencies affecting different types of financial institutions serving similar markets with comparable products and services. I favor the achievement of even-handed regulatory treatment of the various segments of the financial services industry, for the purpose of enhancing competition and maximizing consumer benefits.

Question 29. As Secretary of the Treasury you will be a voting member of and play a leading role in the functions of the Depository Institutions Deregulation Committee whose function it is to phase-out Regulation Q in a little over 5 years.

Do you accept the position that Regulation Q (interest rate controls) should be phased-out. If you do accept the position how important for the economy do you believe such a phase-out is? Would paying market rates to savers substantially enhance the savings rate and capital formation at the expense of current consumption?

Answer. I accept the position implicit in the Depository Institutions Deregulation and Monetary Control Act of 1980 that interest rate ceilings should be phased-out. Such a phase-out will result in continued lessening of the problem of disintermediation during high interest rate periods, a problem which differentially affects the supply of credit to various sectors of the economy and as a result has adverse economic impacts. Accordingly, eventual phase-out of interest rate ceilings is important for the economy. It is my impression that the availability of higher rates of return on savings will result in additional incentives to save.

Question 30. The small saver seems to be the one person getting lost in the shuffle over phasing-out Regulation Q and giving new powers to thrifts.

As you know the minimum denomination on money market certificates offered by banks and thrifts is \$10,000.

Would you as a member of DIDC pledge to vote for lowering the minimum denomination to \$1,000 in 1981?

Answer. As a member of DIDC, I will give sympathetic consideration to a proposal to reduce the minimum denomination of money market certificates from the current \$10,000 level.

Question 31. Small bankers argue that with thrifts having checking powers and consumer loan powers they will be under a severe competitive disadvantage because the law gives the thrifts a rate advantage over what they may pay to passbook savers.

What is your view of the differential? Should it be eliminated even before the Regulation Q phase-out period ends?

Answer. It is the responsibility of the DIDC to determine the timing of the elimination of interest rate differential as between banks and thrifts. As a member of that committee, I will take into account the competitive disadvantage faced by small banks as a result of thrifts' expanded asset and liability powers.

Question 32. I would like to hear your thoughts on government bail-outs of financial institutions.

There are constant reports in the press that the thrift industry needs to be subsidized by government purchase at current market prices of older lower yielding mortgage loans.

This in effect would have the government subsidize billions in low yielding home mortgage loans.

The alternative of course is to let some institutions fail and others accommodate themselves to the market by changing their portfolios.

What is your attitude with respect to government subsidies for thrift low yielding asset portfolios?

Answer. I think there is a great danger in an across-the-board policy of government bail-outs of private sector entities, including financial institutions. The essential function of the protection of depositors' funds afforded by the FDIC and FSLIC, among other insuring agencies, must in no way be affected by the viability of specific institutions. Their viability should be determined by their competitive performance in the marketplace. With respect to the thrift industry, I believe there are workable solutions to the problem of individual cases of failure short of a government bail-out program that violates a basic premise of the free enterprise system: the market must be permitted to penalize failure as well as to reward success.

I was honored to meet with the Finance Committee on the occasion of my confirmation hearings, and hope to have the opportunity to continue the dialogue we have begun on the many pressing economic problems facing our country. Thank you for your support.

Sincerely,

DONALD T. REGAN.