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JANUARY 1965 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-NINTH CONGRESS

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THE PRESIDENT'S ECONOMIC REPORT

FRIDAY, FEBRUARY 19, 1965

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Joint Committee met, pursuant to notice, at 10 a.m., in room AE-1, U.S. Capitol Building, Hon. Wright Patman (chairman), presiding.

Present: Representative Patman (chairman) presiding, Senators Douglas and Proxmire, Representatives Boggs, Reuss, Griffiths, Curtis, and Ellsworth.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

This morning we begin the 16th set of hearings which this committee has conducted on the Economic Reports of the President. We have before us the President's Economic Report for 1965 which is the 19th report since the passage of the Employment Act. We open this hearing at a time when the economy has enjoyed one of the longest economic expansions in the history of the Nation, with output, employment, and purchasing power at new records.

We have with us this morning the Council of Economic Advisers. Dr. Gardner Ackley, Chairman, accompanied by Otto Eckstein and Arthur M. Okun, members.

Gentlemen, I believe you are to be congratulated on your report. It is a very excellent analysis of the economic aspects of the President's vision of a Great Society. Of course, the committee may not agree with everything you have proposed, but this is the normal circumstance in any free society. In this Nation we need a consensus of views, not a totalitarian agreement by coercion. Your diagnosis of the health of the economy and the prospects for 1964 were again excellent last year. You predicted a gross national product of about $623 billion, and it came out at $622.6 billion.

We shall listen with interest to your diagnosis this year. I am sure it will be of great assistance to the committee in preparing its annual report.

Gentlemen, you may proceed in your own way. Mr. Ackley.

STATEMENT OF GARDNER ACKLEY, CHAIRMAN, ACCOMPANIED BY OTTO ECKSTEIN AND ARTHUR M. OKUN, MEMBERS, COUNCIL OF ECONOMIC ADVISERS

Mr. ACKLEY. Mr. Chairman, members of the committee, a new Council Chairman, accompanied by two new Council members, appears with some trepidation before this committee, some of whose members, including the chairman, have been concerned with its work almost since the committee and the Council were created as the twin progeny of the Employment Act of 1946.

As a new Council, we should perhaps take a moment to indicate our conception of our role in relationship to the Congress. As you know, past Councils—and past Presidents—have had rather divergent conceptions of the appropriate extent and nature of the Council's testimony before the Congress, as well as of the Council's role in other respects. I can best and most fully indicate our conception by saying that we subscribe completely to the statement made in this regard by Messrs. Heller, Gordon, and Tobin when they appeared before this committee on March 6, 1961. Briefly, we are prepared to discuss, in on-the-record testimony, our views concerning the prospects for the American economy and the policies that will advance the objectives of the Employment Act. We assume, however, that you will not expect us to indicate the nature of our confidential advice to the President.

Our opening statement today, Mr. Chairman, is brief and does not attempt to summarize all aspects of the President's Economic Report nor the Council's own annual report. Rather, we focus on some selected issues that will, we assume, be of particular interest to the committee.

OVERALL SUMMARY

It is a pleasure to report that the American economy in 1964 responded vigorously to tax reduction and lived up to the high expectations we had for it. In an unprecedented fourth year of strong peacetime expansion, the unemployment rate fell significantly, and growth of output and incomes accelerated; meanwhile, our remarkable record of price stability was extended and the balance of payments showed further improvement. With a $39 billion gain in GNP, a rise of more than 1½ million in employment, a decline in unemployment of 300,000, a rise in corporate profits of 12 percent before taxes and 18 percent after taxes, the record of the year speaks eloquently for itself. Although any official of the administration is bound to feel a strong urge to linger over the gratifying improvement last year, I shall try to resist the temptation.

It can never be equally pleasurable or comfortable to confront the uncertainties of the future. Many of our economic problems are still with us despite our progress; others not now on the scene could reappear. But a realistic appraisal of our prospects leads to the judgment that we should witness further gains and new progress this year in the pursuit of the Employment Act's objectives of "maximum employment, production, and purchasing power," while maintaining reasonable price stability and dealing effectively with our balance-of-payments problem.

We can summarize some of the findings of the President's Economic Report and the Council's annual report on the prospects, problems, and policies for 1965 in the following eight propositions, each of which we then develop in a paragraph or two:

(1) We expect further brisk expansion this year.

(2) There is ample room for the expected growth of demand; it will generate increased output and will not strain the productive capacity of the American economy.

(3) The unemployment rate, which averaged 5.2 percent in 1964, is expected to be lower in 1965; but unemployment will remain a major economic problem.

(4) The prospects for further gains in 1965 are much improved by a fiscal program that will be reinforcing, rather than restraining, the strength of private demand.

(5) The uncertainties in the outlook underline the importance of flexibility in fiscal policy.

(6) Despite the limitations placed on its freedom by our balance of payments, monetary policy can be expected to continue to support a noninflationary expansion.

(7) It is essential for private decisions on wages and prices in 1965 to recognize the vital public interest in price stability.

(8) A significant reduction in our balance-of-payments deficit can and will be achieved in 1965.

PROSPECTS FOR BRISK FURTHER EXPANSION

We foresee a gross national product of $660 billion in 1965, as the midpoint of a range from $655 to $665 billion. At this midpoint, we would experience further improvement from the 5.2-percent unemployment rate of 1964, along with a 6-percent rise in personal income, another year of rising corporate profits, and an overall increase in production that almost matches in dollar amount—although not in percentage terms—the strong gains in 1964. This has been interpreted as an optimistic forecast. But its optimism, we believe, is supported by the evidence: The Revenue Act of 1964 is continuing to yield increasing benefits in production and income; business investment plans are strong and have a solid base for further advance; and new measures proposed in the President's budget promise to strengthen the economy in the second half of the year.

If the committee wishes, Mr. Chairman, we can go into more detail regarding the basis for our forecast for 1965.

ROOM FOR FURTHER EXPANSION

Last year, the Council judged correctly that the economy had the manpower and industrial capacity to meet a speedup in demand with increased production. The same analysis leads to a reffirmation of that conclusion today. Operating rates in manufacturing are still generally below preferred rates of peak efficiency. Unemployment rates show the feasibility for increasing jobs in nearly all labor markets. Even adult experienced male workers have higher unemployment rates than they had in 1956, despite their relative shrinkage as a fraction of the total labor force.

The difference between our actual output and the potential output that would have accompanied an unemployment rate of 4 percent is estimated at $27 billion in the fourth quarter of 1964. Moreover, our real, potential output will expand by about $25 billion this year growing more rapidly than in the past because of larger inflows of new entrants into the labor force and a possible strengthening of our productivity gains.

Obviously, strains and bottlenecks can develop, while the economy is still below full employment, if it forges ahead too rapidly or if its advance is especially concentrated in a few sectors. The half-point reduction in the overall unemployment rate achieved in 1964 was clearly not too rapid a rate of progress. And the advance was widespread and balanced. We can use more of the same this year—to move our output closer toward our potential and to keep pace with its growth.

UNEMPLOYMENT: PROGRESS AND REMAINING PROBLEMS

The employment gains of 1965 should approach those of last year, and should permit some reduction in the unemployment rate. But, with the anticipated rise of new entrants into the labor force, the reduction is likely to be moderate and unemployment will remain too high in 1965. Because the number of teenagers in the labor force is expected to rise by 500,000 this year, unemployment among young people will not fall readily.

It was particularly gratifying last year that a larger share of new jobs went to teenagers, Negroes, and people in chronically depressed areas. Young people with little job experience and members of minority groups tend unhappily to stand at the end of hiring lines. Job opportunities open up most rapidly for them after most of the experienced, adult, and white applicants have already found jobs. Thus, the disadvantaged have a heavy stake in the maintenance of strong overall business activity and generally low unemployment.

Manpower policies to improve skills and job information, programs to aid regional economic development, and measures to curb racial discrimination all play an important role in producing job opportunities for the disadvantaged; and these occupy a prominent position in the Council's report. These programs, however, are properly viewed as a complement, not a substitute, for expansionary fiscal policy in promoting full employment opportunities.

EXPANSIONARY FISCAL PROGRAM

The prospects for further expansion and the needs of the economy are well served by a fiscal program that will reinforce—rather than restrain—private demand in 1965. The President's budget calls for a reduction in excise taxes amounting to $1¾ billion annually to take effect at midyear. Excise tax cuts should be reflected in lower prices to consumers and should then have essentially the same effects on overall spending, dollar for dollar, as the income tax reduction in 1964. The President also proposes an increase in social insurance benefits, to be effective retroactively to the start of 1965, thereby concentrating more than $1¼ billion worth of additional social insurance benefit payments in the second half of this year. The timing of these measures should provide the fiscal stimulus when it is likely to be most needed, and should help to sustain smooth expansion within the year.

UNCERTAINTIES AND THE NEED FOR FLEXIBILITY

The range of $655 billion to $665 billion projected for 1965 GNP conveys our recognition of the uncertainties in assessing the outlook. The range covers only 1½ percent of GNP but it spans the divergent possibilities of a speedup in economic activity on the one hand and a slowdown on the other. At the top of the range, we would still be below our potential output throughout the year, but production and incomes would advance even more rapidly than in 1964. That rate of advance could prove to be too rapid and might call for restraining measures during the course of the year. The bottom of the range would still imply continued expansion throughout the year, but it would mean a marked and regrettable slackening from our recent rate of progress, and it, too, would call for a reevaluation of our policies in the course of the year.

As the Council's report notes, even the midpoint forecast is subject to the risks of an uneven quarter-to-quarter advance during the year, which could require adjustments in policy.

These uncertainties underline the need for flexibility and for careful analysis of economic developments as the year unfolds.

The current program of economic policies recommended by the President is appropriate in light of the available evidence. It offers a good prospect of supporting sustained balanced expansion throughout 1965. That, and a commitment to vigilance, are all one can reasonably ask of an economic policy program at the present time.

MONETARY POLICY

It is clear that monetary policy decisions must be taken this year as last with a full recognition of the impact of our interest rates on our balance of payments. Although monetary policy has therefore not been completely free to pursue the domestic objectives of expansion and growth, it is a tribute to the ingenuity of our monetary authorities that they have been able to support domestic expansion with readily available credit at reasonable interest rates while meeting international requirements. This was true in 1964 when the acceleration in output and investment necessarily and appropriately generated increased demands for credit. We can count on these same principles guiding monetary policy in 1965, and we look forward to a year of essentially unchanged long-term interest rates.

To assure the full and unquestioned freedom of the Federal Reserve in carrying out its responsibilities for meeting the sound credit needs of a growing economy, the President asked the Congress to eliminate the requirement for a gold certificate reserve against the deposit liabilities of Federal Reserve banks. We are gratified that this legislation has now been approved by both Houses of Congress.

WAGE-PRICE POLICY

Both the President's and the Council's report emphasize the importance of responsible wage-price decisions to sustain noninflationary expansion. We begin with the fundamental premise that this Nation must be able to enjoy the benefits of both high employment and price stability. We conclude that the wage-price guideposts offer the best opportunities for encouraging behavior which will reconcile these two key objectives.

Most price and wage decisions in recent years have been consistent with the guideposts, but there have been some disturbing exceptions. On the wage side, these are reflected in a rise in total compensation per man-hour of 3.8 percent for 1964, fractionally above the guideposts, but significantly below the 4.6 percent figure for 1959 and a far cry from the 6-percent increases of 1956 and 1957. On the price side, the key departures from the guideposts are seen—or, rather, too often unseen—in the absence of significant price reductions in certain industries with especially rapid productivity gains. Still, the overall correspondence of wage-price behavior with the guideposts has given us a fine record of price stability and is a demonstration of the effective operation of a free economy and of public policies that have promoted steady balanced expansion.

The recent success of our price-wage record has created a firm foundation for future good performance by curbing inflationary expectations, by eliminating the need for significant "catchup" adjustments in wages and prices, by implanting more firmly the standard—and the good habit—of responsible wage-price decisions. At the same time, our success in narrowing the margin of idle resources has necessarily increased the opportunities for unjustified price increases and for excessive wage increases. It becomes all the more important for the public interest in responsible wage-price decisions to be fully recognized in private actions this year.

BALANCE OF PAYMENTS

The major gains in our exports last year and the mild increase in our imports were made possible by the excellent record of price stability achieved in the current expansion. Thanks to these advances, we were able to score another improvement in our balance-of-payments situation, despite an unusual combination of factors that led to a marked increase in our capital outflows during the closing months of the year.

In his message to the Congress last week, the President assesssed our balance-of-payments position and set forth the policies needed to assure significant progress this year. The President's program deals decisively with the capital outflows that proved troublesome last year and, with prompt action by the Congress and the full cooperation of the business and financial communities, it will guarantee the continued soundness of the dollar while preserving the strength of our domestic expansion.

CONCLUSION

Many of the points I have just summarized tie into the general theme and fundamental premise that recessions are not inevitable features of a free economy. The duration of the current expansion is setting new records; meanwhile its strength and vigor is undiminished by the passage of the months. It should be our objective to maintain the momentum of expansion and to promote a continued balanced advanced of productive capacity and final demand.

As we accept the challenge to sustain expansion, we must also recognize the possibility of miscalculations and unforeseen events that can jar our progress. Hence, the President has emphasized the need to review our defenses against recession during the current year while the prospects for expansion are bright. One review, to be undertaken within the administration, will evaluate the opportunities for accelerating Federal spending in case of threatened recession; it will establish criteria for the selection of programs and activities which can most readily and most efficiently speed the flow of purchasing power without requiring additions to the budget once prosperity is restored. A second area for review lies in the jurisdiction of Congress. The President has asked the Congress to evaluate its procedures for delivering a verdict on a Presidential request for a temporary tax cut in order to assure that a prompt response can be forthcoming. By mapping out now our strategy for dealing with recession, we can carry out a far more effective antirecessionary policy, when and if it is needed in the future.

Before concluding, I should like to call your attention to the discussion in the Council's report of some of the economic aspects of the Great Society. The problems of our cities, the need for better education and health, full opportunity to disadvantaged groups of Americans are all broad challenges to our society having many dimensions. But all of them have a significant economic dimension, as chapter 4 of the Council's report makes clear.

I have mentioned some of the highlights of the Economic Report, stressing areas which I expect are of particular interest to the committee. My colleagues and I now welcome your questions on these or any other matters.

Chairman PATMAN. Thank you, Dr. Ackley. Without objection, each member when called upon will have 10 minutes to ask questions and get answers. We will alternate from side to side. Dr. Ackley, I would like to read three questions I have and ask you to comment on them when I have read the three.

The first, you point up the need for stability on long-term interest rates. I, for one, am pleased to see this. You know there has been a campaign for some time to raise the 4¼-percent ceiling that has prevailed since Woodrow Wilson's time in 1918. The campaign seems to be pretty strong right now. I hope that you will take a strong position against this kind of increase because clearly it would have a very bad effect on our economic well-being. And I will ask you to comment on that question later.

In regard to the improvement of education, the reduction of poverty, and the elimination of slums, which are necessary to the Great Society, has the Council given any thought to the need for a broad based financing program for these purposes? I have in mind some kind of direct Government assistance that would be available extensively for school construction, slum clearance, and many other projects that are needed; as it is now, much of this has to be done now by private financing and at considerable cost.

As you observe in the report, interest rates in recent years are higher than at any period since the early 1930's. What is your thought on that?

In your report interest rates are cited as a factor influencing the balance of payments. Now, I have listened to a good deal of testimony before this committee and the Banking and Currency Committee of the House on the subject, and I have never seen convincing proof that higher interest rates have helped to stem a balance-of-payments deficit. As a matter of fact, the reverse seems true. Switzerland attracts capital in spite of low interest rates while England lost more capital after boosting her discount rate to 7 percent than they did before.

Will you give us the benefit of your opinion on this subject? Now, if you will take them up in the order in which I gave them, Doctor, it will be appreciated.

First, what is your thought on raising the interest rate to 4¼ percent?

Mr. ACKLEY. Mr. Chairman, I do not think that an increase in the ceiling interest rate on Government bonds is required at this time. I do not think it is a major issue because, as I have suggested, I do not believe that long-term interest rates are likely to rise significantly in 1965. As a strictly personal matter, I would have to admit that I would feel happier if we did not have a ceiling on long-term interest rates.

I believe that the freedom of the administration to use all policies, monetary and fiscal, to fight both inflation and unemployment ought not to be limited by arbitrary restrictions of this sort.

But, as I say, this is only a personal position, and I do not think it is an active issue at this time.

As to your second question, Mr. Chairman——

Chairman PATMAN. About the financing program—now, may I elaborate just briefly on that. As it is now, commercial banks, that create the money for investment purposes as well as loans, have gone in for investing heavily in tax-exempt securities, municipals, which means that if people want to build a schoolhouse costing a million dollars, they have got to pay almost a million dollars in interest before it is finally paid, in tax-exempt money, tax exempt to the banks. And it occurs to me that in fighting poverty and in building schools for education and spending money for other educational purposes, there should be some sort of a financing program that would permit the Government to use its own credit at a very small minor rate of interest constituting what might be called a service charge.

Would you elaborate on that particular statement, Dr. Ackley?

Mr. ACKLEY. Mr. Chairman, the existence of the tax exemption on interest from municipal securities obviously does provide municipalities and other public authorities with a lower interest rate than could be obtained in the market otherwise. Indeed, it is interesting that during the last several years rates of interest on tax-exempt municipal securities have been declining and stand at a rather low level.

Now, whether additional encouragement ought to be given to State and municipal capital expenditures by a further subsidy of interest costs is a very complicated and difficult question. Indeed, we do provide direct support in various ways, and the President has proposed further support—particularly through direct grants to local units—for State and local governments to expand their activities in the areas to which you refer.

I believe it is more desirable to pursue the course that we now follow of direct and above-the-board subsidies for these important public purposes on the State and local level rather than to do it through a subsidized interest rate. If the Federal Government were to provide funds to State and local governments at a nominal service charge as you suggest, it would constitute a subsidy that would be hidden rather than obvious.

Chairman PATMAN. Dr. Ackley, may I interrupt you just briefly there? It is really a subsidy to the banks now. The banks render no service to the Government when they create the money to buy those bonds. The Federal Reserve could own them just as well as the commercial banks, and by raising the reserve Reserve requirements of banks offset any inflationary trend.

Mr. ACKLEY. Well, it is clear that the fact that municipal bonds sell at much lower yields because of the tax-exempt privilege does represent——

Chairman PATMAN. Just one other question: What about the tax money that we lose on that? Do the local communities get enough reduction in the rate to justify the Federal Government foregoing the taxes?

Mr. ACKLEY. But it seems to me, Mr. Chairman, that the proposal of direct subsidy also involves the Federal budget but in a different way.

Chairman PATMAN. I am not advocating a direct subsidy.

Mr. ACKLEY. It seems to me——

Chairman PATMAN. I am trying to get rid of the system we have here of having to pay the bankers a million dollars every time we spend a million dollars for schools or every time we spend a million dollars on facilities to reduce poverty, we have to pay the bankers a million dollars. I have a feeling in cases like that—I won't take the time now to expand on it too much—we could provide a better way in the use of our own credit.

Mr. ACKLEY. It seems to me that a subsidy is involved either way. I am not sure that bank profits are excessive from their current operations. The banks, of course, pay higher interest rates today to their depositors and I really don't see the advantage—and I think I can see some disadvantage—of subsidizing State and local activities through interest rates rather than through——

Chairman PATMAN. I don't agree with you at all that it would be a subsidy. As it is now, the banks use the credit of the Nation—the mortgage on your property, mine, income, everything else. They issue the credit that is necessary, including the money to buy these securities, and they get—if you call it a subsidy—they get the subsidy now; but letting the local communities have a nominal interest rate would certainly not be a subsidy. It is just encouraging education, encouraging the fight against poverty, and not requiring them to pay the bankers as much as they spend.

Mr. ACKLEY. I believe, Mr. Chairman, that whether we call it a subsidy or not, the effect is the same. Federal revenues are reduced or Federal costs are increased in either way in providing assistance for local communities for school construction. The banks are competing with each other to secure the deposits of businesses and individuals for the funds which they lend for all purposes, and I think I would simply prefer to have the interest cost explicit and the subsidy explicit.

Chairman PATMAN. Don't overlook the fact that the banks get most of their deposits without cost and under a law that makes it unlawful for them to pay interest on the deposits.

All right, Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman. Before beginning my interrogation, I hope that Senator Javits will be along, but he asked me if, pending his arrival, I could have his opening statement placed in the record after your opening statement.

Chairman PATMAN. Without objection, so ordered.

Representative CURTIS. This statement has been distributed, so I won't read it. And I would like also unanimous consent to have placed in the record right after Senator Javits' statement, my opening statement which has likewise been circulated and given to the witnesses here.

Chairman PATMAN. Without objection, so ordered.

(The documents referred to follow:)

STATEMENT BY SENATOR JAVITS

The 1965 Economic Report of the President and the Council of Economic Advisers is long on optimism and self-praise, but short on recognition, analysis, and proposed solutions to a number of towering economic problems which could tumble our domestic prosperity like a house of cards. Most seriously, the report fails to deal in a constructive way with the Achilles heel of the domestic economy—the dangers of near-collapse in this Nation's foreign economic policies. In fact, no other economic report in my memory gives such short shrift to international economic problems as this one, particularly at a time when those problems are pressing in upon us as they are today.

This administration came to power with a promise of a new era of leveling the barriers to the international movement of goods and services, people and capital. Instead it is moving steadily toward restrictions and controls, as has been most recently illustrated by the meat import control legislation and the interest equalization tax. The Trade Expansion Act, nearly 2½ years after its passage, has produced no visible progress in reducing trade barriers, while prospects for the success of the Kennedy Round of trade negotiations are far from sure.

Now in a desperate and what will ultimately prove to be a self-defeating effort to eliminate the chronic balance-of-payments deficit, the administration has applied the interest equalization tax to bank loans of over 1 year and has asked for legislation to extend the tax for 2 years and broaden its coverage to include nonbank credit of 1 to 3 years. The President also asked for legislation to limit the duty-free exemptions of American tourists returning to the United States to $50 and to remove tax deterrents to foreign investment in U.S. corporate securities and has embarked on a voluntary program to encourage American business to limit its direct investments abroad. But even this so-called voluntary program carries with it the threat that Government will use its vast powers as the economy's largest buyer to force compliance if it is not voluntarily forthcoming. Further, there should be no doubt that if a voluntary program does not work, in its present frame of mind the administration will ask for direct controls over U.S. private oversea investment.

Such action will not solve the fundamental causes of the balance-of-payments problem. But it could well signal the beginning of the end for the dollar as the world's leading reserve currency as well as the beginning of the end of the more open world which the free nations have so laboriously constructed since the end of World War II. In economic policy, this administration appears to be drifting toward a new and dangerous form of isolationism.

While moving boldly in the area of restrictions and controls over international transactions, the administration has thus far shown little or no real enthusiasm for basic reform of the international monetary system, which is essential to any meaningful and long-lasting solution of our balance-of-payments problem. Apparently, we can only pray that the periodic shocks to the world monetary system, most recently the weakness of the pound, can continue to be dealt with on an ad hoc basis without the entire structure collapsing and with it the domestic prosperity of every nation of the free world.

I share the concern of the President and the Council of Economic Advisers over the continuing high level of domestic unemployment and have supported a number of their proposals to deal with it. In fact, many of the measures designed to deal with structural unemployment has been suggested over the past several years by the minority members of this committee. However, I would suggest that unless the administration gives more constructive and farsighted attention to our foreign economic policies than is evident in the Economic Report or the special balance-of-payments message, we may be headed for a world economic collapse that will cause economic distress at home greater than anything we have seen since the 1930's. It is our duty to help to avoid any such debacle.

(The following letter and response were submitted for the record:)

FEBRUARY 2, 1965.

DR. GARDNER ACKLEY,
Chairman, Council of Economic Advisers,
Executive Office Building,
Washington, D.C.

DEAR DR. ACKLEY: On page 64 of the 1965 Report of the Council of Economic Advisers there appears a chart, "Federal Surplus or Deficit: Actual and Full-Employment Estimates." As you will note this chart supplies information only through the end of calendar 1964. In order to help in assessing the President's economic program, I would appreciate it if you could provide the actual and full employment estimates for calendar 1965 and the first half of calendar 1966. It would be particularly helpful if this information could be made available when the Council appears before the Joint Economic Committee later this month.

With best wishes.

Sincerely yours,

JACOB K. JAVITS,
Ranking Minority Member.

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
Washington, D.C., February 18, 1965.

Hon. JACOB K. JAVITS,
U.S. Senate, Washington, D.C.

DEAR SENATOR JAVITS: In your letter of February 2, you asked for our projections of the actual and the full employment Federal surplus or deficit (on the national income basis) for calendar year 1965 and the first half of 1966. We agree fully that these are helpful guides in assessing the President's economic program and are happy to supply the information in the tables below.

Estimated full-employment Federal receipts and expenditures (national income basis)

Calendar year	Receipts	Expenditures	Surplus (+) or deficit (−)
1964	121.4	118.7	2.7
1965—Full year	124.9	123.7	1.2
1st half	124	121½	2½
2d half	126	126	0
1966—1st half	133½	127	6½

Estimated actual Federal receipts and expenditures (national income basis)

Calendar year	Receipts	Expenditures	Surplus (+) or deficit (−)
1964	113.9	119.2	−5.3
1965—Full year	117.8	124.1	−6.3
1st half	117.5	122.0	−4.5
2d half	118.1	126.3	−8.2
1966—1st half	124.0	127.6	−3.6

The sources of stimulus in 1965, over and above 1964, may be identified as follows:

	Billions of dollars
1. Corporate tax rate reduction of Jan. 1, 1965, as provided by Revenue Act of 1964	$1.0
2. Personal tax reduction in 1965, as provided by Revenue Act of 1964	1.6
3. Excise tax reduction, net of rise in user charges, proposed to take effect July 1, 1965	.7
4. Increase in social insurance benefits, as proposed by President	1.3
5. Other increases in Federal expenditures (from administrative budget and trust funds)	3.6
Total	8.2

The $8 billion sum of these expansionary influences for 1965 is approximately $1½ billion larger than the normal full employment growth of Federal revenues.

This accounts for the estimated decline of the full employment surplus from $2.7 billion in 1964 to $1.2 billion in 1965. The increase in payroll taxes scheduled for January 1, 1966, is the chief element in the rise in the full employment surplus estimated for the first half of 1966.

Projections of the timing of budget flows within the fiscal year are particularly difficult to estimate. Nevertheless, I hope these "best judgment" calculations are helpful to you.

Sincerely yours,

GARDNER ACKLEY.

STATEMENT BY CONGRESSMAN CURTIS

Economists have long recognized that the seeds of future recession and economic instability are sown during the preceding period of prosperity. Although we meet this year amid many signs of a growing economy, it is vitally important that these hearings point up the economic boobytraps that may pose real problems for the Nation in the period just ahead.

The biggest threat to our domestic prosperity is our continuing balance-of-payments deficit and the related gold outflow. Despite repeated assurances and the application of restrictive nostrums, the problem grows worse, not better. And now it is becoming increasingly evident that the administration proposes to cure it by what ultimately could amount to a return to the economic nationalism of the 1930's.

At home, there is a growing recognition—even by the administration—of the growing danger of inflation in the coming year. There is also a remarkable admission by the administration that, in spite of the tax cut and this year's expected expansion in the economy, the unemployment rate for the year as a whole will show little or no improvement over 1964. The continuation of large budget deficits during periods of high level economic activity and the problems of managing the growing Federal debt can also threaten the basis of our prosperity. The possibility of a steel strike in the spring and a letdown from the current buildup of inventories in anticipation of a strike are additional factors which cloud the outlook.

The Economic Report is a self-congratulatory document which seems designed to induce a state of public euphoria rather than to mobilize thinking to meet these problems. Not only is it short on solutions to emerging problems, but it also obscures sound thinking about those problems by misreading the lessons of the recent past. The recent growth of the economy has not arisen because the administration's economic theories put forth in the tax cut debate prevailed. The expansion has been well balanced to this point because of the administration's belated acceptance of the Republican position that expenditure control was an essential condition for a well-balanced, growth-stimulating tax cut.

Representative CURTIS. I want to question you on what I regard as a basic economic theory underlying the Economic Report. First, I will go back to 1960 when the present administration pointed out the weaknesses in our economy, specifically those in the area of the balance of payments and unemployment. Judged by the guidelines that were used as criticism, the efforts in the last 4 years toward achieving a solution to these two problems have not produced glowing results.

Now, I pose this question just as a test. It seems to me that judged by recovery in the area of employment and unemployment, this is the poorest recovery of the post-World War II recessions. I am talking about the period of recovery from February 1961 to the present date measured by unemployment figures in relation to the same figures for other recoveries.

Is that a fair observation?

Mr. ACKLEY. We can supply the figures for the record, Mr. Curtis, but I would not accept that as a correct comparison of the achievements of this expansion.

Representative CURTIS. Well, may I say this, Mr. Ackley? In your Economic Report you use other kinds of criteria to measure recoveries and I am pleased to have them in here. That is very proper. But the crucial point is that you don't have the comparable charts to show how well we did in recovering from this recession.

In fact, I find in your semantics a failure to distinguish this recent period as one of recovery rather than one of normal growth. There is a big distinction, of course, between a period of recovery, which is measured from a nadir to a zenith, and one measured from peak to peak or from valley to valley. I would be pleased if you would supply for the record the charts that are available showing the recovery measured by unemployment, which at the end of calendar 1964, was still 5——

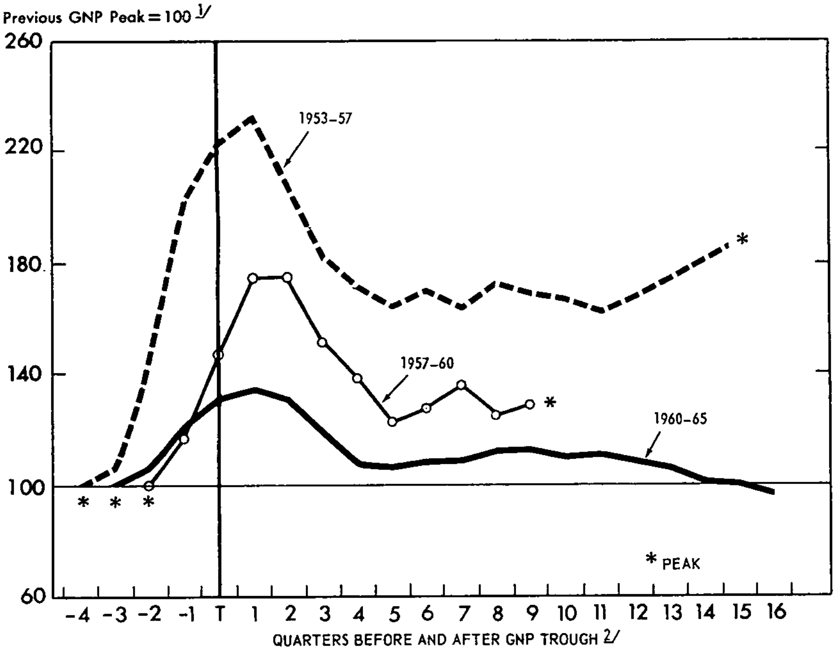
Mr. ACKLEY. The rate in December was 5——

Representative CURTIS. No. I said for the year. I know this business of taking out a month that you like to look at, but I am talking about the year now.

Mr. ACKLEY. The year was 5.2 percent.

(The following charts were supplied by the Council of Economic Advisers:)

Unemployment in Three Postwar Periods

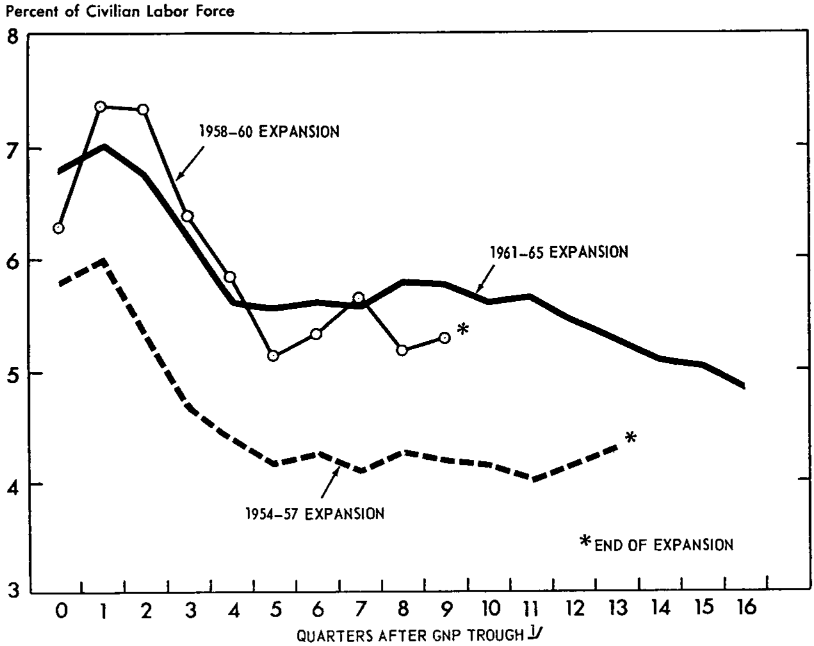


1/ BASED ON SEASONALLY ADJUSTED DATA. GNP PEAK QUARTERS WERE 1953 II, 1957 III, AND 1960 II.

2/ TROUGH QUARTERS FOR GNP WERE 1954 II, 1958 I, AND 1961 I.

SOURCES: DEPARTMENT OF LABOR AND COUNCIL OF ECONOMIC ADVISERS.

Unemployment Rate in Three Postwar Expansions



1/ TROUGH QUARTERS FOR GNP WERE 1954 II, 1958 I, AND 1961 I.
SOURCES: DEPARTMENT OF LABOR AND COUNCIL OF ECONOMIC ADVISERS.

Representative CURTIS. Yes; 5.2 percent. Well, we can go on from that. The second thing, of course, relates to the balance of payments, and there seems to be very little awareness of this most unfortunate fourth quarter we have just experienced. I would ask this question. Aren't the preliminary figures for the first quarter of this year in the balance of payments quite alarming and comparable to the last quarter that we just experienced?

Mr. ACKLEY. The Economic Report had to be prepared, of course, before the fourth quarter figures were available and first quarter figures are not available at all at this time.

Representative CURTIS. No, but there are preliminary figures. There are some estimates.

Mr. ACKLEY. We do have the trade figures, but only through December. As a reader of the report could observe, our discussion of the balance of payments was prepared in an awareness of a deterioration which could not be fully documented at the time.

Representative CURTIS. That is right.

Mr. ACKLEY. And it was partly for this reason that the President decided that his evaluation and his recommendation concerning the balance of payments could not be made in the Economic Report but would have to be delayed until figures became available.

The figures for the fourth quarter—and these are still not detailed and are only preliminary—were released only about a week or 10 days ago, as you know, and we don't have comparable figures for the first quarter.

Representative CURTIS. But the fourth quarter figures, if multiplied out for a full year, would indicate a $6 billion deficit, wouldn't they?

Mr. ACKLEY. Yes. The deficit in the fourth quarter was about half of the annual deficit. There were, of course, a number of special factors operating in the fourth quarter, as you know.

Representative CURTIS. May I say this, Mr. Ackley. Yes, they were special because you were buying time in the first quarter and I observed that all the boasting that the administration indulged in by the first quarter was going to be disproved later, and so I am not too interested in this, although I do agree with you, that there were special factors which made the fourth quarter look bad. However, if we will stop this boasting and start dealing with the serious problems involved here, I think we will get along better. Now, what I was particularly referring to, for the beginning of this quarter, was the continued private capital flow. I want to look at that in the light of what happened just yesterday on the floor of the House, where there was a most strange presentation by the administration, which asked for an increase in the amount going to the International Development Bank by $750 million. Suddenly, when it is Government capital, it doesn't affect balance of payments. If it is private capital, it seems to.

Now, I wonder if you can explain why it is that Government—U.S. Government—capital for investment abroad doesn't affect the balance of payments, while private capital does.

Mr. ACKLEY. Let me first remark that I don't believe there is any complacency in the administration about the balance-of-payments situation. There may have been some optimism about the balance of payments earlier in 1964. But whatever satisfaction there may have been about the seeming achievements in the first part of the year was fully reversed as the story of the fourth quarter began to unfold.

Now, as to the distinction between private and Government capital outflows, there certainly is no question that they both enter into the balance of payments. They enter in different ways and possibly with different effects. The financing of the International Development Bank is, of course, a way of providing funds for support to underdeveloped countries.

Representative CURTIS. Well, let me interrupt to cite the Alliance for Progress. Under the Alliance, a $20 billion increase in capital investments in South America over a period of 10 years was to be a mix of $10 billion private capital and $10 billion public. When we talk about the overall thrust, we are not distinguishing too much between private and Government investment. I personally wish we could because I have observed, as I call it, Curtis' corollary to Gresham's law, that Government money drives out private investment money. We had better start watching this because what we want to see in South America is the total picture of capital investment increased. While the administration was boasting about how we have increased Government investment in South America, the latest figures showed a very anemic response on the side of private capital investment. Indeed, one year there was a minus quantity.

I think it was the year 1963. And not only are U.S. private capital investments in South America not responding but also investments of the Latin American people themselves in their own countries have a way of moving down. But I only bring this up to illustrate what seems to be a blindness on the part of the administration when it argues as it did yesterday on the floor of the House, through its spokesman, that this $750 million that they are asking to go into the IDB which—and I happen to favor the theory of this—doesn't affect the balance of payments, quoting Secretary Dillon. Yet the President just last week asked for a further implementation of the interest equalization tax to prevent private capital from going abroad because it is this flow, as he says, that is creating the dangerous situation.

And let me say that this is buying time because we know that in the long run one of our greatest assets in the balance of payments is the return we are getting from our private investment portfolio abroad. So we are cashing in on the future by curtailing this fine operation of private investment abroad. I worry greatly when we have the administration presenting a proposal that permits increased Government investments abroad, as exemplified by yesterday's action, and yet, at the same time, we have the administration coming in and asking my committee, the Ways and Means, to further tighten up on the interest equalization tax. I would like your response in this context.

Mr. Ackley. The relevant distinction is not one between private and public capital but between capital flows to underdeveloped countries and capital flows to the developed countries. The administration continues to encourage private investment and—through its aid programs and its lending programs—makes public investments in the underdeveloped countries. Now, as to the relative balance-of-payments impact of these: in the case of AID programs to the underdeveloped world, these are now tied almost entirely to American exports so that their balance——

Representative Curtis. Oh, now wait. I can't let that go by because, if there is anything that disgusts me, it is this kind of argument. I pointed this out on the floor of the House in addition to the reports and statements of the Secretary of the Treasury about this tie-in. Look, these moneys are actually spent for teaching teachers, for building homes out of native materials, and there is very little of that money that goes to buy things like generators or something that could be obtained in the United States.

Ninety percent of this money isn't tied in and if it were, it would be defeating the very purpose that you have in mind of building infrastructure in these societies.

Now, this kind of rhetoric has gone too far. There is no strict tie-in.

Mr. Ackley. I would only point out that 86 percent of our aid programs are now currently tied to expenditures in the United States.

Representative Curtis. And I would categorically deny that, sir, and I have tried to document this on the floor of the House. The administration spokesmen have not come back to show me their working papers. This is not true. And you and I can carry this one on. I see my time has expired.

Chairman PATMAN. Would you mind pursuing that when we get back to you, Mr. Curtis?

Representative CURTIS. I was going to say this. My time has expired but let's pursue this if we may through an exchange of letters. This is a figure that I challenge as incorrect, and I am afraid that those who are developing this figure know it is.

Mr. ACKLEY. May I just comment?

Representative CURTIS. Certainly, you should be permitted.

Mr. ACKLEY. We are not the people who prepare those figures.

Representative CURTIS. I know you are not.

Mr. ACKLEY. And I can't speak personally as to their accuracy. They certainly have been transmitted to us as being an accurate representation. Obviously, aid is not 100 percent tied. The balance that is not tied—including spending or some of the things to which you referred—provides additional dollars for the underdeveloped countries. The great bulk of these dollars, as the statistics show, are in fact spent in the United States.

Representative CURTIS. No. There, you see, is our disagreement.

Mr. Chairman, I would like to ask permission to submit some questions in writing to the Council.

Chairman PATMAN. Would you be willing to answer them, Mr. Ackley, and also the questions of any other committee member who wishes to submit written questions?

Mr. ACKLEY. Yes, sir.

(Written questions, submitted by Congressman Curtis, and Council's answers, follow:)

Replies of the Council of Economic Advisers to questions submitted by Congressman Thomas B. Curtis:

Question 1. "Has the administration adopted the policy that budget deficits are necessary not only to attain high levels of prosperity but also to sustain a high level of economic activity?"

Answer. Whether budget deficits are necessary to attain and to sustain high levels of prosperity depends on the strength of private demand in the economy. Given the existing state of private demand, the administration is convinced—as your question implies—that the present health and progress of the economy would be imperiled by the restriction of purchasing power that would be involved in an attempt to balance the budget for fiscal year 1966. On the other hand, if the economy were at a satisfactorily high level of activity corresponding to the interim target of a 4 percent unemployment rate, the budget on a national income basis would have shown a surplus in 1964 and would again this year.

There are good reasons to expect a significant strengthening in private demand in the years ahead, as discussed on pages 92–96 of the Council's report. Later in this decade and in the 1970's, appropriate fiscal policy may well call for budget surpluses. The administration remains determined to achieve a balanced budget as soon as it is consistent with a balance between overall productive capacity and total demand.

Question 2. "The Council of Economic Advisers uses as a tool of economic analysis the concept of the 'full employment budget.' Assuming the model is correct, which I think is doubtful, is it true, as reported by Business Week of February 13, that 'the administration's new spending and tax plans would cut the full employment surplus in the second half of 1965 to minus $1 billion'? If true, then doesn't this mean that the administration no longer seeks to attain a budget surplus, even at maximum levels of employment, but will run a deficit at the highest levels of activity as well as at low levels?"

Answer. Our own best current estimates place the full employment surplus in the second half of 1965 at zero rather than minus $1 billion. The administration's proposed legislation to cut excise taxes and to increase social security benefit payments effective July 1, 1965, does reduce the full employment surplus.

In view of the inevitable uncertainties about the precise future time-pattern of Federal outlays and personal tax collections, we do not rule out the possibility that the President's program may imply a negative full-employment surplus for a portion of the fiscal year 1966. Neither would we attach particular significance to whether or not the surplus dips a bit below zero temporarily.

We are not yet operating at "maximum levels of employment," nor will we be during the second half of calendar 1965. When the economy is not operating at full utilization, appropriate actions to pursue maximum employment might generate a temporary full-employment deficit, while still permitting a full-employment surplus to be restored as the economy moved to full employment.

Unfortunately, we cannot realistically expect either full employment or a budget surplus to be attained within 1965, but both remain objectives of the administration's policies.

Question 3. "The Council has called attention to the success of the tax cut in promoting a well-balanced expansion during 1964. Although the tax cut theory is said to have worked, nothing has been said to note that the tax cut went into effect along with a holddown on Government expenditures. Originally the Council said that holding down expenditures while cutting taxes would virtually eliminate the stimulative impact of the tax cut. Republicans conditioned their support of the tax cut on holding expenditures to $97 billion in 1964 and $98 billion in 1965, as was detailed in their recommittal motion when the tax cut was before the House. Essentially this Republican position has now been accepted by the administration. If the tax cut had gone into effect on time and if it had been accompanied by large increases in Federal spending on the order of the previous 3 years, as the Council of Economic Advisers was recommending, isn't it likely that we would have experienced a serious inflationary overheating of the economy?"

Answer. To begin with, it should be made clear that the Council did not recommend "large increases of Federal spending" to accompany the tax cut. Nor would it have ever judged that holding down Federal expenditures—to the degree actually accomplished during the past year—"would virtually eliminate the stimulative impact of the tax cut." The Council has pointed out, we think correctly, that a sufficient reduction in Federal expenditures can offset the stimulus of tax reduction.

When both expenditures and tax reductions are considered for the past year, we find that the Federal budget provided a net fiscal stimulus of about $7 billion in 1964, larger by far than in any prior peacetime year. The general stability of Federal outlays for 1964 was anticipated a year ago. Because of this, in the Economic Report of January 1964, the President proposed immediate reduction in the withholding tax rate to 14 percent, thus giving greater initial impact to the tax cut than was called for by the original tax reduction proposal.

Although the analysis must be conjectural, we see no reason to believe that the tax cut would have created "serious inflationary overheating of the economy" had it gone into effect in 1963 as initially proposed. On the contrary, if the tax cut had been enacted on time, we judge that the Nation would have benefited and would have enjoyed that much sooner the stepped-up gains in employment and production that actually took place last year.

Question 4. "The continued piling up of budget deficits adds to our problems of debt management and thus to the problems of monetary policy, which is especially critical now because of the balance-of-payments problem. In fact, because of the balance of payments, the Federal Reserve has pursued a policy of holding up short-term rates while holding long-term rates stable. What are the effects of the problems of debt management, which to some degree tie the hands of the monetary authorities, on the climate of investment in the United States? Is it true that the outflow of capital from the United States, even in spite of our own 'Berlin wall' designed to curb such investment, is related to a weakness of our domestic climate?"

Answer. Debt management policy in recent years has been carefully integrated with other economic policies to support noninflationary expansion. As Secretary Dillon outlined in detail in his statement before the Joint Economic Committee, the maturity structure of the debt is well balanced. Moreover, while the Government has been successful in its efforts to achieve some lengthening in the average maturity of the marketable debt, long-term interest rates to private borrowers (which are of major importance for private investment) are currently lower than they were in 1961, as shown in chart 10 of the Council's report. These developments have been favorable to the climate for domestic investment.

The reasons for the outflow of capital from the United States are complex, as was indicated in the discussion of this subject on pages 75–77 and 110–111 of our report. In part, the outflow of direct investment has been connected with the unusual investment opportunities arising from the creation and growth of the Common Market in Europe. The actual level of capital outflows might well have been larger, had it not been for the substantial improvement in the domestic investment climate which is reflected in the 40 percent rise of U.S. plant and equipment outlays since the first quarter of 1961.

Chairman PATMAN. Senator Douglas?

Senator DOUGLAS. Mr. Ackley, on page 47 of the New York Times for this morning, there is an article with the heading "Wall Street Is Convinced Reserve Is Tightening Supply of Credit."

It goes on to recite the fact that the free reserves fell to a minus $59 million.

A minus $59 million. And then it goes on to say that the experts on Wall Street believe there have been two reasons for this. First, to prevent excessive exuberance in the economy and, second, to diminish the flow of dollars out of the United States.

Now, I would like to ask, first, do you believe this analysis is correct, that the Federal Reserve is making credit "less easy" which means making it tighter, or, and second, do you think these—the reasons which the Wall Street authorities give justify this action.

Mr. ACKLEY. Senator Douglas, I think it is always difficult to try to interpret Federal Reserve policy by looking at a single week's figures. As you know, free reserves fluctuate widely from week to week. So we will probably have to wait a few weeks to judge what may have been happening to the free reserves of the commercial banking system.

Senator DOUGLAS. Should this turn out to be true, would you regard this as desirable to check excessive exuberance in the economy?

Mr. ACKLEY. No. I believe that interpretation was ascribed to Wall Street observers rather than to the administration or even to the Federal Reserve System. I have not understood it to be the purpose of the Federal Reserve System to tighten credit for domestic reasons, either now or in the recent past. I would suppose that if the Federal Reserve has made any adjustment in its target for free reserves it would have been an adjustment prompted by balance-of-payments problems rather than by any overheating of the domestic economy.

Senator DOUGLAS. Have you made any estimates as to the amount of fluid money which shifts back and forth across national lines because of changes in interest rates?

Mr. ACKLEY. As you know, Senator, this is a very difficult question. Chairman Patman referred to it also. A number of studies have been made with rather divergent conclusions. Nevertheless, I think it is the opinion of almost all who have studied this problem, either private scholars or in the Government, that there is indeed some volume of sensitive funds.

Senator DOUGLAS. Of course, there is some. But how much?

Mr. ACKLEY. How much is a very difficult question.

Senator DOUGLAS. It is the important question. Now, the new Under Secretary of the Treasury testified before the Finance Committee a few weeks ago that it was somewhere between $500 million and a billion dollars and implied that $600 million would probably be the closest guess. Are your figures greatly at variance with that?

Mr. ACKLEY. I don't think I would be prepared to support a numerical estimate, though those magnitudes do sound reasonable. Of course, it would depend on the size of the interest rate movements that might be involved.

Senator DOUGLAS. Well, the gross national product is now $630 billion, is it not? You estimate that this year it will be $660 billion. One billion dollars would therefore be one-sixth of 1 percent of the gross national product. Do you think that this fluid money is of such importance, particularly in view now of our greater supply of gold to strengthen the position of the dollar, that it is sufficient to justify an increase in interest rates which might hold back domestic expansion and prevent us from reaching the goal which you set out?

Mr. ACKLEY. No indeed, Senator Douglas. I don't believe that it is anyone's view that we ought to try to slow down the domestic economy in order to solve the balance-of-payments problem.

Senator DOUGLAS. While an increase in shorttime rates is certainly not as effective in slowing down the economy as an increase in longtime interest rates, still does it not have some dampening effects upon output, increasing the cost of financing inventories and current expenditures?

Mr. ACKLEY. The administration clearly rejects the notion that we should solve our balance-of-payments problem primarily through a tightening of credit to attempt to attract funds back to the United States. We have had, however, a very large outflow of short-term funds, some of which are thought to be interest sensitive, in the past year. There are complex reasons for this.

Senator DOUGLAS. How much do you estimate that to have been?

Mr. ACKLEY. The increase in short-term capital outflows in 1964 was in the order of $1½ billion above 1963. It occurred at various times in the year and fluctuated irregularly. It was obviously influenced by a lot of factors other than interest rates, but interest rates had some part to play in it.

Senator DOUGLAS. Didn't that partly occur after the British raised their bank rate from 5 to 7 percent and similar increases went into effect on the continent?

Mr. ACKLEY. Certainly, to some extent, higher interest rates abroad have made the problem more difficult. I doubt if the British attracted very many dollars from the United States by this procedure.

Senator DOUGLAS. What about the continental banks?

Mr. ACKLEY. The difficulty here is that there are so many different kinds of capital outflows and they occur for so many different reasons. One has to distinguish between an increase in bank lending, on the one hand, where I would suppose that the interest rate differentials are not the primary factor and the outflows of short-term liquid balances of corporations on the other. These may be invested abroad instead of at home because of an interest rate differential of as little as a quarter of a percent. To attempt to deal with all of these various kinds of outflows by the rather bludgeon method of tight money is obviously a course which has been rejected both by the administration and by the Federal Reserve Board.

Senator DOUGLAS. Rejected by the Federal Reserve Board or rejected by the White House?

Mr. ACKLEY. I would say rejected by the Federal Reserve Board as well. Indeed, the program——

Senator DOUGLAS. Have you any proof of that?

Mr. ACKLEY. The program of voluntary restraints which the Federal Reserve Board is administering is an attempt to do by voluntary methods and by consultation and conference what others have advocated should be done by substantially tighter money.

Senator DOUGLAS. Let me ask this question. Suppose we were to increase shorttime rates, would not this be an incitement to the continental countries to increase their shorttime rates and would we not get into the competitive position of various countries bidding against each other in order to attract this fluid money and therefore a relatively small amount of fluid money would be used to raise the interest rates in the various countries? And while I never subscribed to Mr. Martin's theory which he held for many years, that shorttime rates determined the longtime rates, and which I understand he has now virtually abandoned, nevertheless it has some influence on the longtime rate.

Mr. ACKLEY. You have questioned—and I do as well—whether large volumes of funds are attracted across borders by minor interest rate differentials. Yet, nevertheless, there is some attraction of this sort, and the fact that interest rates have tended to rise this year in other countries has complicated our problem.

I agree that attempts to solve the problem by interest rate competition could in the end succeed only in driving up interest rates in all countries without much effect on the net flow of funds.

In the Council's report this year we do suggest that it might be advisable in today's world—in which some of the European countries are no longer as concerned about inflationary pressures as they were, and in which expansion has slowed down in several of the main centers—for all of us to hold interest rates lower and to deal with our domestic problems by other means, instead of engaging in this interest rate competition.

Senator DOUGLAS. I am glad to hear you say that. I hope the Federal Reserve Board will listen.

Chairman PATMAN. Mr. Ellsworth?

Representative ELLSWORTH. Thank you, Mr. Chairman.

Dr. Ackley, you started your statement off by saying that this was the first time you had appeared before the committee. I want to say that I am newer on the committee than you are appearing before the committee, so we have something in common this morning in any case.

I would like to start off by referring to a New York Times story yesterday morning that reported that the United States was strongly criticized by the OECD for not applying sufficient economic restraints to balance our international payments. I understand that you were our representative at that meeting and I would like to hear what you replied to them when they offered that criticism.

Mr. ACKLEY. Mr. Ellsworth, the reports that you saw in the New York Times were rather speculative reports because the meeting is not open to the press, and so far as I know, no members of our delegation discussed the matter with the press. I think it is easy to speculate on some of these matters because some of the continental countries and their officials have made their views known in the past. And I would guess that the reporter who wrote that story was guessing about what might have gone on.

Since the meeting is a closed meeting and there is no official press release on it, and since those attending it have agreed not to discuss publicly what went on, I think I should not comment in detail on the exchanges that occurred. But the writer of the New York Times story might legitimately speculate that some European bankers and central bankers strongly recommended that the United States should tighten money as an aid to its balance-of-payments program, because this advice has been given in the past and may continue to be given.

But I would say that most of the Europeans with whom I discussed this matter privately welcomed the balance-of-payments program which the President has announced. They believe as we do that the principal problem for the U.S. balance of payments is one of capital outflows, and that in focusing on this part of our balance of payments we are moving in the right direction. And I think it is generally believed that the program will be effective.

There are those both in the United States and abroad who are unhappy that along with the voluntary program of restraint on capital outflows, we have not decided to engage in a major tightening of monetary policy. But this is not a new complaint. We didn't hear it for the first time yesterday in Paris. We have been hearing it for a long time and I think that we will continue to hear it.

But I believe that the program which has now been developed should be effective in restraining capital outflows.

Representative ELLSWORTH. On another point of the President's program. Of course, I know that you are aware there is a substantial body of opinion that the longrun evolution of our balance of payments may well require that a higher percentage of our receipts be earned by U.S. investments abroad.

Now, what do you think is the likely longrun effect on our balance of payments of the President's efforts to discourage U.S. capital flows in income-earning investments overseas?

Mr. ACKLEY. It is true that an increase in returns from foreign investment has contributed an improvement of $1\frac{3}{4}$ billion to our balance of payments since 1960. It is also true that in the long run the further improvement of earnings from American investments abroad should be one of the major factors in the ultimate restoration of equilibrium in our balance of payments.

I think it should be pointed out, however, that the President's program does not call for a cessation of investment abroad. It does call for a cessation of the increase of this investment. And it is particularly directed at the increase in bank lending which has, in the last couple of years, been the largest single factor in the increase of capital flows abroad.

Restraining temporarily the further increase in direct investment abroad will, of course, ultimately result in perhaps a slightly lower future increase in our income from investments abroad than would have occurred if direct investments continued to increase without limit at the present time.

I would point out, though, that one aspect of the program is an effort to get businessmen to finance abroad a larger proportion of their direct investment. To the extent that American companies can continue with their plans for building plants abroad by using foreign bank loans or other borrowing abroad, this does not affect in any major way the investment income of American corporations and the improvement in our balance of payments from that source.

Representative ELLSWORTH. Now, I noticed at the end of the President's message to Congress the other day on the balance of payments that he endorsed in principle basic reform of the international monetary system. What specific recommendations in that area would you make to him or are you making to him or are you thinking about?

Mr. ACKLEY. The longrun reform of the international monetary system is a most complex matter and one which has been under study for the past 2 years by representatives of the countries in the so-called Group of Ten. There are a number of ways in which the international monetary system might evolve and all of these are under rather intensive and detailed scrutiny in the Group of Ten.

I think we have to recognize that this is not a matter in which the United States can make a unilateral determination. We might have our own preference about the way in which the international monetary system should evolve, but it is nothing that we can establish unilaterally.

Representative ELLSWORTH. I appreciate that. But what I am interested in is your own views on it and the administration's views on it.

Mr. ACKLEY. The administration has not committed itself in detail to the changes that it would like to achieve.

Representative ELLSWORTH. Well, in a general way what are your own thoughts on it and in what directions does your thinking run?

Mr. ACKLEY. In general, the United States has indicated that it would support improvements in the international monetary system which are based upon the evolution of the International Monetary Fund rather than through the creation of new machinery as some of the Europeans have proposed.

We believe it is possible to build upon existing features of the International Monetary Fund so as to provide a steady growth in world reserves to support the needs of advancing trade, to do it on a multilateral basis, and at the same time to strengthen the existing currencies, including the dollar, against speculative attack.

This is the general direction in which U.S. policy is tending, although as I say, we are in essentially a negotiating position and we have to proceed in directions in which agreement is possible.

Representative ELLSWORTH. I appreciate that. You are not able to be any more specific than that this morning, I take it.

Mr. ACKLEY. I think not, Mr. Ellsworth.

Representative ELLSWORTH. Thank you very much.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Boggs.

Representative BOGGS. Mr. Chairman, I have one or two questions. Maybe they have been testified on prior to my coming, but has anyone asked you, Mr. Chairman, about General de Gaulle's position on the gold standard?

Mr. ACKLEY. No one has.

Representative BOGGS. I am talking about this hearing this morning. If no one has, I will.

Mr. ACKLEY. General de Gaulle's statements on the gold standard and those which were contained in a later speech by the Finance Minister, Mr. Giscard d'Estaing, are rather full of ambiguities. Some things are clear, namely, the desire to strengthen the role of gold in the international monetary system. But it is not entirely clear that General de Gaulle or the French Government wishes to return completely to the old-fashioned gold standard of the pre-World War I variety.

The views being advanced by the French in these international studies that are now being conducted run in the general direction of strengthening the role of gold in international settlements and supplementing it where necessary by new kinds of reserve units based on and closely tied to gold.

In general the United States has preferred, as I have suggested, an alternative approach of working through the International Monetary Fund.

Representative BOGGS. Well, what is your interpretation of what General de Gaulle has proposed?

Mr. ACKLEY. I suppose that there are elements both of economics and of international politics in General de Gaulle's approach.

Representative BOGGS. What do you mean by international politics? You mean an attack on the dollar, and if so, why?

Mr. ACKLEY. Let us say there is an effort to enhance the role of France in the world. His views on international finance are associated with his views on other matters. Actually it is not at all clear, as I have indicated, to what extent General de Gaulle and the Finance Minister were announcing essentially new policies in their recent speeches.

If it should be true that the French Government is now indicating its desire to return to the old-fashioned pre-1914 gold standard, I think we would hold this to be a most unfortunate kind of development, and we would oppose it.

The gold standard implies that the growth of world reserves should be tied to the rate at which new gold is mined, less whatever amount of new gold may be added to private hoards. This volume of reserve accretion is obviously inadequate to support the very rapidly growing volume of world trade. If we were under a gold standard, many countries would very frequently find themselves with a shortage of reserves and have to adopt drastically deflationary policies which would slow up their domestic economies and slow up the growth of the world economy.

This we would regard as very much a step backward.

Representative BOGGS. We are the only country with a policy of selling gold on demand to foreign claimants. Would not a similar policy be something to consider by these other countries?

Mr. ACKLEY. Well, in a sense that was what General de Gaulle seemed to be suggesting; namely, that hereafter all settlements by all countries be exclusively in terms of gold.

Representative BOGGS. Yes. All.

Mr. ACKLEY. Under the Bretton Woods agreement establishing the International Monetary Fund, each country is required to support its own currency—to maintain its parity within very narrow limits—and it can do this under the regulations of the International Monetary Fund in any of several ways.

Most countries maintain the international value of their currencies by buying and selling foreign exchange, typically the dollar. If France should run out of dollars to support the value of the franc, it would be obliged under the International Monetary Fund to sell gold instead.

At the moment this isn't their problem.

Representative BOGGS. It seems to me that one of the real problems of the free world is the development of the so-called underdeveloped areas.

Now, if each country is going to be required to adopt these restrictive measures on the flow of capital, how is that going to come about?

Mr. ACKLEY. The United States has been very careful in all of its programs to restrain capital outflows to make sure that it restrains such capital outflows only to the developed world. It continues to support the movement of capital to underdeveloped countries.

Representative BOGGS. Is that your interpretation of the more recent recommendation?

Mr. ACKLEY. Yes, indeed. There is an exception made in all cases, in the interest equalization tax and in the voluntary program which the President detailed yesterday. There is an explicit exception for investment in underdeveloped countries.

Representative BOGGS. That is all, Mr. Chairman.

Chairman PATMAN. Mr. Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Gentlemen, I would like to ask you the same question I asked Secretary Dillon the other day about the use of industrial revenue bonds. This, of course, is very much a concern of yours because you devote several pages of your economic report to the problem of area development. The situation is this. Some 27 States now enable their localities, either directly or through an industrial development corporation, to buy up land and erect buildings by issuing bonds which are exempt from the Federal income tax and thus are very desirable for investors selling at a point or two less interest than regular corporate industrial bonds.

Then, typically, the bond issuing locality invites a corporation to use the land or occupy a plant. This has the result of disturbing the pattern of economic development in this country.

Another result is that there is a good deal of pirating of industries from one area to another.

Many States, including my own State of Wisconsin, which have not allowed these bonds are now contemplating using them, claiming that they are driven to it by the competition of other States. And the Treasury, of course, is finding its revenues damaged to the extent that financing is done by means of federally tax-exempt bonds rather than by corporate bonds which pay Federal taxes.

In view of all this, would it not be a good idea if by legislation the federally tax-exempt features of these industrial bonds were withdrawn, while, of course, continuing the traditional tax exemption for ordinary municipal bonds?

Secretary Dillon's view, which I will quote was—

> Yes, I think this is a dangerous practice to continue and it would be wise for the Congress to put an end to it.

I would like the views, perhaps, of all three gentlemen on the proposition.

Mr. Ackley?

Mr. ACKLEY. I will speak very briefly, first. This is a problem which the Council has not itself analyzed in any detail. Indeed, the magnitude of the problem was first drawn to my attention through your exchange with Secretary Dillon the other day.

It seems to me that Secretary Dillon is right in suggesting that this problem may require legislation. And may I say that I think you have done a public service in drawing this problem to public attention.

Representative REUSS. Thank you.

Mr. Eckstein?

Mr. ECKSTEIN. On a matter such as this, the Council has an organizational view. My personal feeling is that as the volume of the securities rises, the problem becomes more pressing. Of course, any remedy one would propose for it would have to be fully consistent with the sensitive relations between the Federal and the State and local governments and with the long tradition of not taxing State and local securities.

Representative REUSS. And thus there should be, in your opinion, a clear exemption for the traditional nonindustrial State and local securities.

Mr. ECKSTEIN. Yes. One would have to be very careful not to disturb that.

Representative REUSS. Mr. Okun?

Mr. OKUN. It will be no surprise to you to hear that I agree with my colleagues on this: that, having looked at this situation since you raised the issue, we feel it is a problem of concern and a possible subject for corrective legislation.

I think there are also opportunities for looking at the whole pattern of State taxation and its influence on location decisions of firms. These should be considered within the context, as Mr. Eckstein put it, of the whole range of Federal-State-local relationships.

Representative REUSS. Thank you. In view of this gratifying expression of individual views, Mr. Ackley, would you develop a collegial view of the Council and present it so that we can find it at this point in the record of the proceedings?

Mr. ACKLEY. I will be very pleased to prepare a brief statement on the subject.

Representative REUSS. Thank you.

(The following statement was subsequently supplied by the Council of Economic Advisers:)

The Federal Government has not taxed interest income from State and municipal bonds. This tax exemption has made it possible for States and municipalities to meet their enormous financial requirements of the postwar period at low-interest costs. The ability to issue tax-exempt securities has strengthened State and local governments.

Since World War II more and more States have provided statutory authority for localities to issue tax-exempt bonds to finance private industrial development. The publicly constructed buildings using the low-interest charge of tax-exempt bonds can be rented at low rates to private companies and serve to attract them to the localities.

The tax-exemption privilege for industrial bonds is not limited to depressed areas, and hence can simply become a subsidy to companies willing to rent the plants so built without serving any particular public purpose. Furthermore, as more and more States permit their localities to issue these bonds, and as these very favorable terms become generally available to businesses, the effect in attracting industry is nullified.

In the last few years, the Federal Government has embarked on major programs to help regional recovery and development through more direct methods. The Area Redevelopment Act, and in the future the Appalachian program, will help communities to attract industry through a variety of measures, including improved public facilities, transportation, retraining of workers, and low-interest loans to private companies. In general, these more recently developed methods promote area development more effectively per dollar of cost to the taxpayer.

As our programs to redevelop areas and regions in distress become more effective, the need for the tax-exempt industrial bond device diminishes. Further, as companies become more expert in the use of these bonds, the possibilities for abuse become more prevalent.

For these reasons, it may become desirable for the Congress to reconsider whether it wishes to permit the continued issuance of tax-exempt bonds for the full range of industrial purposes for which they are now being used.

Representative REUSS. Another subject. In your excellent prepared statement this morning, Mr. Ackley, you pointed out that even though the President's program be enacted, and here I quote, "unemployment will remain too high in 1965."

I am constrained to have to agree with you and this imposes a problem on us here because our job is to do our part in seeing that we have maximum employment, production, and purchasing power, and too high unemployment is obviously inconsistent with that.

I am wondering, therefore, if the Congress perhaps should not aim at a somewhat higher rate of expansion than that envisaged by the President's economic message in order to fulfill this goal of maximum employment. Should not we aim, for example, at as fast a rate of improvement as we had last year? For example, if the existing proposed tax cut in excise taxes of $1.75 billion will not do the job, what can we legislators do in order to meet the goals of the Employment Act?

A larger tax cut? Different expenditure policy? A policy of lower interest rates? The mix can be infinite, but I would like some advice on how we go about this.

Mr. ACKLEY. As we indicated, the year 1965 offers more uncertainties about economic developments than was the case, for example, last year. It is quite clear that the first half of 1965 is going to be good, and that we will maintain the progress we have made in reducing the rate of unemployment. The fact that we surround our forecast with a range of $5 billion on either side reflects, this year, our uncertainties about the second half.

As our statement suggested, if gross national product for the year should be at the upper limit of our range, we would be advancing at a rate as rapid or even more rapid than last year. As the situation develops we will be able to get a better estimate on the second half. At the time the Congress is discussing excise tax reduction, it will be possible to have a firmer view of what the requirements of fiscal policy should be this year. I am sure that you and your colleagues in the Congress will be watching the situation very closely and taking whatever action seems appropriate as that time approaches.

Representative REUSS. I am awfully glad to hear that and it makes good sense to me. As you know, the Employment Act specifically invites the Council and this committee to take a look in midyear or any other time when projections do not seem to be working out as planned. So I think we should bear it in mind.

Mr. ACKLEY. The President promised explicitly in his Economic Report a review of his policies and his proposals if events failed to develop as seemed most likely at the beginning of the year.

Representative REUSS. Now, finally, I have here another one of these newspaper "dope" stories about what went on in Paris; this one by our friend Bernard Nossiter in this morning's Post saying, Mr. Ackley, that you and Under Secretary Deming at Paris indicated, and I am quoting:

> That the Federal Reserve might mop up extra bank funds by selling bonds without disturbing interest rates.

I am certainly not going to ask you whether you in fact said that behind closed doors, but what about it? We know from the textbooks that there are two ways of tightening money, mainly. You raise the rediscount rate or you sell bonds in the open market.

Now, already the Federal Reserve a couple of months ago has raised the rediscount rate and the administration view is that this is not going to cause higher interest rates. But would you really believe that the Federal Reserve can go in and start selling securities in its open market policy and that this would have no effect on long-term interest rates?

Mr. ACKLEY. Well, clearly there are degrees of action that need to be distinguished. The Federal Reserve, of course, is continually buying and selling in the market to even out the supply of reserves to meet credit needs.

I might indicate, by the way, that Mr. Nossiter was not at the meeting nor did I talk with him at all, so he is not reflecting——

Representative REUSS. As I say, I am not asking whether you said this but I am just asking whether you think this would be a good policy for the Fed on balance in this current situation, to be tightening bank reserves. It is one thing that the Fed might want to slow the rate of increasing bank reserves but do they want to pursue a restrictive monetary policy?

Mr. ACKLEY. I have no evidence that the Federal Reserve is interested in reducing the volume of bank reserves. Indeed, to the extent that the officials of the Federal Reserve do talk about these matters—and their public discussion is rather limited—Chairman Martin and others have made clear that they have no intention of pursuing a restrictive policy. They are concerned as we are with the balance of payments and with the possible outflow of liquid funds. Their adjustments from day to day and week to week in the volume of free reserves in the banking system are made with a number of objectives in mind but particularly, these days, with an eye on the danger of outflows of short-term funds.

It is remarkable that in the past year the rate of interest on Treasury bills has risen from about 3½ percent early in the year to over 3.9 percent today, with no essential change in the level of long-term interest rates. And I think it has been their purpose to attempt to protect long-term interest rates from the variation that may become necessary from time to time in the rates of interest on short-term obligations.

Representative REUSS. Thank you. My time is up.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Ackley, not only was your presentation excellent but your report accompanying the Economic Report of the President was particularly useful. I am happy to see the endorsement of the "truth in credit" proposals which I interpret from your remarks on page 137 and "truth in packaging" on page 138. As far as I know, this is the first time the Council of Economic Advisers has done this. The forthright support here is encouraging.

I would like to ask, however, about the section that you have here on agriculture. It is short. It is on pages 155 and 156. I did not notice anything in your remarks this morning on what I consider to be the No. 1 economic shame in the country.

I would like to just suggest a few statistics to you and ask you why the Council on Economic Advisers and others in our Government are not counseling some more far-reaching kind of action.

Farm output per man-hour between 1952 and 1964, according to the tables in the back here on page 280,[1] has increased 100 percent; that is, productivity or efficiency rose from 68 to 137. Investment on the farms has increased 35 percent, from $165 to $223 billion. At the same time farm income has dropped—and dropped very sharply. Farmers are perhaps the only element of our society who are getting less now than they were in 1952 and they are getting a great deal less, as you know. Net income dropped from $15.3 billion down to $12.7 billion.

Now, even allowing for the terrific exodus from our farms which, as you know, has been very sharp—farm population has dropped from 21,748,000 in 1952 to 12,954,000 last year, almost cut in two,

[1] 1965 Economic Report of the President.

and I think few people in America realize that—even allowing for that, the per-farm income is only up 12 percent.

The fact is that farmers have doubled their productivity. They have increased their investment three times as much as their income has gone up. But compare farmers' income with nonfarm income, manufacturing workers, for instance, where the average weekly income has gone up 54 percent since 1952, retail workers, which has gone up 44 percent since 1952—these are people who have increased their productivity, their efficiency, about one-third as much as farmers have. They do not work the long hours farmers do. They do not make any investment in their work. And yet they have been rewarded since 1952 with three to five times the improvement in income.

Now, in your analysis here you offer almost nothing that would encourage the farmer very much. You say at one point:

> The only way out of this problem, short of a major new source of economic activity and employment, is for such communities to search for and cooperate in the creation of centralized institutions serving wider areas—

and so forth. The President has offered us a farm message which is an earnest message and it is in accordance with the proposals President Kennedy offered us in the past. But do you not feel that there is a graphic and dramatic imbalance between the income that people receive on farms with all the investment they have to make and the efficiency that they have demonstrated and the income off the farm?

The Department of Agriculture's latest figures on the disparity show that farmers' incomes are about 60 percent per capita of those off the farm.

It seems to me to be a terrible injustice and certainly an economic injustice that you and your panel should be concerned with.

Mr. ACKLEY. The problem of American agriculture is as you have outlined it. It arises from the fact that agriculture has been very progressive and has achieved large increases in productivity and output, in an economy in which people with growing incomes spend only a small part of their additional income for food and other farm products.

The agricultural industry obviously has been going through and will have to continue for a long time to go through a major readjustment in use of resources.

I think it is far easier to recognize the basic nature of the farm problem than it is to prescribe solutions. We have depended in our agricultural programs primarily on supporting the prices of individual commodities. Yet these benefit primarily the large commercial farmer. In all comparisons that we make between incomes in the industrial sector and on the farm, to make any sense at all, we must break out segments of the farm population.

I think it is true that the large commercial farms have continued to do reasonably well. To be sure, they have done it only because of the existence of our commodity support program. We suggest in our report—although only hesitantly, because the problem is so difficult and so complex—that the approach to the support of farm income and the assistance to the underprivileged and disadvantaged segments of our rural population now has to widen beyond the old approach through commodity prices.

Senator PROXMIRE. Let me interrupt at this point to ask, this is quite a drastic and perhaps a radical kind of alternative but has any thought, any discussion been given to the recognition of the fact that the reason that agriculture has not done better is that it is so poorly organized? Labor is now organized and doing quite well. Business has been organized for years in trade associations and other kinds of ways. I am not talking about a Wagner Act as for labor but some kind of an encouragement on the part of the administration for some kind of farm organization so they could do what everybody else in our society does, which is to limit their production to what they can sell at a fair price, or is this concept—with the weakening political position of the farmer, that is, as his numbers decrease—is this concept too far out to be discussed seriously?

Mr. ACKLEY. Farmers producing certain crops have organized privately to improve their market position. This has been fairly successful for crops which are produced in highly localized areas and where the number of farmers involved is relatively small.

I think it would be generally agreed that this kind of approach is not feasible for most of the major crops where the area involved is very large, spreading over a large segment of the country, and where hundreds of thousands of farmers may be involved.

Of course, the Federal Government has in various ways given support to organization of cooperatives which have tended to some extent to increase the efficiency of markets, and the market power of the agricultural sector. But I am not clear as to what other ways the Federal Government might use to enhance the private bargaining power of the farm community.

Senator PROXMIRE. Well, I won't press you much further on this point. I would like to suggest that you might consider the marketing order approach which has been used in fluid milk and which has worked quite well, and if this can be applied to fluid milk, it seems to me there is an opportunity to consider this in applying it to other crops, too.

I would like to ask you about your analysis of the impact of the tax cut. I wondered if each of the members of the Council could tell me how strongly they feel about the firm figures they give as to the precise impact of the tax cut. Your analysis suggests that the increase in the gross national product of a litle less than 5 percent in real terms, about 3 percent you said, would have taken place without any tax cut at all. Two percent, however, was the result you feel of the tax cut, about $18 billion, is that about right?

Now, did you feel that these figures are firm and pretty unquestionable or do you think that they are figures that necessarily are a guess and that other economists might question them quite seriously?

Mr. ACKLEY. I want to ask Mr. Okun to answer you in more detail, but I would say to start with that it is very difficult—either prospectively or retrospectively—to analyze what the effect of a single measure has been in a world in which all kinds of other things are happening at the same time.

Our estimate, on which there is no disagreement among ourselves, but considerable uncertainty as to the precise magnitude, was that about 2 percent of the growth in gross national product last year was the product of the effect of the tax cut on consumer expenditures alone. We explicitly stated that we were not attempting to assess the direct and indirect effects of the tax cut on investment expenditures. Perhaps Mr. Okun can give us a little more detail on the nature of that estimate.

Mr. OKUN. I would certainly agree that this is a statistical estimate which is reasonable, and is the best judgment we could make. We thought the figures were interesting and worth presenting. They certainly would not foreclose any other estimates. Indeed, if you asked other economists to do the same job, they might well come out with slightly different numbers. But I don't think they would come out with radically different results.

Senator PROXMIRE. Let me just say the reason I am pressing this is because if you can give this kind of assurance, it seems to me this is an enormous advance in economic policy. After all, if you can say that with a certain size tax cut you can get a certain increase in the gross national product and perhaps also in employment, this is very encouraging. I realize you have to keep other things such as interest rates and credit policy, and so forth, fairly stable but still this is quite an advance over economics of 5 or 10 years ago.

Mr. OKUN. At the same time we are saying that this is over and above what otherwise might have been. While I do think we have a better feeling for the quantitative impact of policies, as a result of research on the response of consumers to increases in their incomes—the pattern in which they adjust when their incomes go up, and the speed with which they make the adjustment—we haven't solved all the problems by any means and we are only properly humble about our ability to nail down these figures, either prospectively or retrospectively.

Perhaps the best support for the particular estimates that we show in our report is that these worked prospectively. They were an essential ingredient in the forecast of $623 billion GNP for 1964 which we made last January and, since the whole estimate worked out well, we think that is some support for the use of that ingredient.

Senator PROXMIRE. Just what you say at the end gives me a little feeling that this is what we predicted would happen and now that it is over, who is to refute us? You could have said, if after the tax cut business had gotten worse, the GNP had dropped, that it would have dropped that much more without the tax cut. It is hard to refute it, but I take it you would say the economic profession as a whole would tend to concur. There may be a few minor differences but the best judgment of the professional economists is that this is about right, you feel. You haven't heard too much disagreement to this.

Mr. OKUN. No. I think we could have a seminar within the profession in which there would be enough disagreement to create some interest. But I don't think they would be very wide apart.

Senator PROXMIRE. Mr. Chairman, my time is up.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much. I am especially pleased to see you here, Mr. Ackley.

I would like to ask you which in your judgment in the long run would be more inflationary, increasing the price of gold or relying more heavily upon the IMF and other such institutions?

Mr. ACKLEY. Mrs. Griffiths, I am not sure that the issue is properly posed by asking which is more inflationary. I think that we are all interested in international monetary arrangements which will permit a rapid and balanced growth of the world economy at essentially stable prices. Those who advocate raising the price of gold—as you know some have suggested a doubling of the price of gold by all countries—see it primarily as a means of increasing the volume of world reserves at a stroke. Those who oppose it, and we certainly would, oppose it because it increases world reserves in an awkward and indiscriminate way and with penalties and benefits to individual nations that bear no particular relationship to their just merits in other respects.

A doubling of the price of gold would double, in effect, the monetary reserves of each country to the extent that it kept its reserves in gold. It would penalize those countries which for one reason or another have preferred to hold their reserves in the form of foreign exchange, and favor those whose reserves had been primarily held in gold.

More than that, it would reward particularly those countries in which gold mining is a major activity. At present this effect would be most pronounced in South Africa and the Soviet Union.

It would increase their ability to command international resources simply because of the fact that they happen to be the places where gold is principally mined. It seems to us that there are more efficient and, in the long run, more effective ways of obtaining the appropriate increase in the volume of world reserves, such as through the IMF.

Representative GRIFFITHS. In your judgement is the IMF inflationary or not? The use of this method?

Mr. ACKLEY. No. I certainly do not think it is inflationary if you mean by inflationary, tending to raise world price levels. It is inflationary only in the sense that its activities are designed to supply an increasing volume of world reserves to meet the legitimate needs of a noninflationary world expansion.

Representative GRIFFITHS. To what extent is our balance-of-payment problem due to tourism in Europe?

Mr. ACKLEY. Of course, it is always possible to say that our balance-of-payments problem is created by any one of a large number of factors.

Representative GRIFFITHS. Yes, but what is the amount of tourism in Europe?

Mr. ACKLEY. Our total tourist deficit at present—that is, the difference between what we spend abroad as tourists and what we receive from foreign tourists here—is of the magnitude of $1¾ billion. This has increased somewhat since 1960, but I do not have at hand figures showing the extent to which the increase in the tourist deficit is associated with travel in Europe.

(The Council of Economic Advisers subsequently supplied the following paragraph:)

[Later figures show that the total tourist and travel deficit for 1964 was $1.6 billion, of which between $900 million and $1 billion was associated with Western Europe. There was an increase in the total deficit of $300 million since 1960 and an increase of about $100 million for Western Europe.]

Representative GRIFFITHS. Is it assumed that reducing the amount that any tourist can bring back—how much is this supposed to affect the problem of the balance of payments?

Mr. ACKLEY. Estimates of the effects of reducing the duty-free allowance from the present $100 at wholesale prices to $50 at retail prices are difficult to make because one has to make assumptions about what tourists will do, whether they will simply spend more abroad instead of bringing items home.

The best estimates that have been made—and I believe they are relatively conservative—suggest that the benefits to our balance of payments from this measure might be from $50 to $150 million in the course of a year.

Representative GRIFFITHS. How much money goes into Europe to pay for our Armed Forces, if this isn't confidential?

Mr. ACKLEY. No. I don't believe the figures are confidential, but I don't happen to have them at hand. We do have the total.

(The following paragraph was subsequently supplied for the record:)

[U.S. military transactions in Western Europe in 1964, as estimated on the basis of data for the first 3 quarters, involve expenditures of $1.5 billion and receipts of $575 million. Thus, net military expenditures in Western Europe were $925 million or 44 percent of our worldwide net military expenditures.]

Mr. OKUN. The total figure is slightly above $2 billion for our military expenditures abroad, net of sales of military equipment to foreign countries.

Mr. ACKLEY. And these, of course, are worldwide.

Representative GRIFFITHS. When we reduce the amount that a tourist can bring back from Europe, it will, of course, hurt the economies of those countries, isn't that true?

Mr. ACKLEY. To some extent, yes. Indeed, it is impossible for one country to improve its balance of payments without some other country's balance of payments deteriorating.

Representative GRIFFITHS. How much 480 money goes into Europe? How much do we make in sales in 480, or do we make any, where we are selling surplus?

Mr. ACKLEY. Very little of it goes to Europe. There are some to Greece and Turkey but none to Western Europe.

Representative GRIFFITHS. Why don't we try to make an arrangement with Europe that the money that our tourists bring over there we will take back in trade. Let me buy a third money. They can spend all of it they want to but Europe can only rechange it by sending over their own tourists and buying our products.

Mr. ACKLEY. Countries with balance-of-payments problems have used many devices that involve essentially special exchange rates and exchange controls. Actually, of course, we have a very large trade surplus with Europe. We sell to them substantially more than we buy. So one could say that we really should add together the tourist and the trade accounts in Europe to——

Representative GRIFFITHS. But part of the problem is we are also supplying the military forces. We are putting in money there. So this is reducing their own tax problem. If part of this money could be earmarked that they must bring it back in trade, actually it doesn't hurt them and it helps us.

Mr. ACKLEY. I think that if we were in a desperate situation perhaps we would be ready to consider expedients of this sort, essentially exchange controls. That is really what you are suggesting.

Representative GRIFFITHS. This is a less desperate situation than the tax on the capital outflow, isn't it?

Mr. ACKLEY. No. The attempt to have, in effect, separate currencies for separate kinds of transactions is the essence of exchange controls and this involves a far more detailed regulation of private activities and is far more desperate in that sense than the kind of things we are proposing to do.

Representative GRIFFITHS. But the other arrangements actually hurt us in the long run. This is not going to hurt us.

Mr. ACKLEY. I do not know that——

Representative GRIFFITHS. Even to reduce the amount that a tourist can bring back hurts Europe. Let them buy anything they want, but let them bring back the money and buy our goods.

Mr. ACKLEY. I would repeat again that we cannot improve our balance of payments without having someone else's deteriorate. We believe that the kinds of proposals we have made involve the least disturbance to our economy and to the economies of other countries of any alternative that we might have considered. It should be recognized that many Europeans as well as many Americans feel that the volume of American capital flows to Europe is disturbing not only to our balance of payments but to their economies. The fact is that the ability of many of the European economies to deal with their own inflationary problems by practicing rather severe credit restraint has been somewhat weakened by the fact that American bank lending has often substituted for domestic bank lending.

Europeans, I think, are not resentful of our attempts to control the outflow of capital, but, indeed, welcome them.

Representative GRIFFITHS. But is not the main reason that they do not want our money to control their business?

Mr. ACKLEY. That would relate to direct investment expenditures, and indeed there is some of that feeling in Europe.

Representative GRIFFITHS. Much more so than anything else, so that when we restrain our business from going over there, we are really indeed playing their game.

Mr. ACKLEY. We are playing their game and our game, Mrs. Griffiths. We need to solve our balance-of-payments problem.

Representative GRIFFITHS. Yes.

Mr. ACKLEY. And this is one of the places where we can be most effective. We are dealing with capital outflows which have expanded rapidly, and which have largely created the current problem.

Representative GRIFFITHS. But it does bring back money, and the tourists bring back souvenirs, right?

Mr. ACKLEY. The tourists bring back, I trust, more than souvenirs. I think the value of foreign travel is important.

Representative GRIFFITHS. I am sure that is right, and I am for their going, but it seems to me that we could arrange it so that it was very effective for us, too.

Mr. ACKLEY. We could specifically tie the use of dollars in particular ways. This would involve a very drastic rearrangement of international monetary functioning in ways that I think most of us would—when we were through—feel were undesirable.

Representative GRIFFITHS. Thank you very much.

Chairman PATMAN. I would just like to comment on the questions you raised in the beginning, Dr. Ackley. You mentioned a free market, in regard to the marketing of municipals, for instance, or our Government bonds. In Government bonds, where the transactions involve each year more than all the other markets combined, including the stock exchange, both the American and the other stock exchange, do you believe there is an absolutely free market in the purchase and sale of Government bonds?

Mr. ACKLEY. Certainly it is one of the most actively competitive markets.

Chairman PATMAN. I will agree to that, but is there a free market, a 100-percent free, genuine free market?

Now I will preface that with this. I have interrogated all of the members of the Federal Reserve Board over a long period of time, from Mr. Eccles, Mr. Martin, and the rest of them, and I have never had one of them yet to say that there was absolutely a genuine free market. They would say it is almost a free market, and most of the time it is a fairly free market, but not one of them has ever said there was absolutely a genuine free market in Government bonds.

Mr. ACKLEY. I think that is probably true. I think that could be said of any market that we know. Certainly there is not a free market in the sense that public policy does not attempt to influence it. The Federal Reserve is one of the participants in that market, pursuing the objectives of our monetary policy. But aside from that I believe that this is one of the most competitive, and in that sense, the freest markets that we have.

Chairman PATMAN. Of course, in municipals that is true now because of the tax exemption. Take the question I raised awhile ago about financing these programs only, education and aid to poverty, without going into the mechanics of it, just simplified so as to put over the point that I am trying to make. If we were to decide that we are going to have to spend $25 billion in those two programs, just education and antipoverty, and if we issued the bonds, whether to construct a schoolhouse or whether to make work or do other things in the antipoverty campaign, we would have to pay probably about 4 percent on those bonds, and $25 billion would be about $1 billion a year.

What would be the disadvantages and what would be wrong if the Government were to decide we are not going to pay the moneylenders or the banks that just create the money in particular? We are going to finance this through the Federal Reserve, and we will require the Federal Reserve banks to take the $25 billion at a nominal rate of interest, say one-fourth of 1 percent.

Now, of course, the other way would be to sell the bonds to the banks, and the banks would receive the interest on the bonds, $1 billion a year. This other way of course the interest would not amount to much and would save a lot of money that way, and at the same time for two very good causes, education and antipoverty.

Now, so far as our economy is concerned, and banking theory in particular, what is the difference in the Federal Reserve extending the credit to the Government for $25 billion, or letting the banks buy the bonds, and then the Federal Reserve buy them from the banks as they are doing now? They own $36 billion worth of bonds now that they have bought from the commercial banks. What would be the difference there, the advantages and disadvantages of that plan, Dr. Ackley?

Mr. ACKLEY. I believe I have commented on that already, and perhaps we might find it useful to ask my colleague, Mr. Okun, for his comments if they are different.

Chairman PATMAN. I did not get your definite reply on that. What is the difference in selling them to the Federal Reserve banks and getting the credit that way, and selling them to the commercial banks? You expand the credit $25 billion either way you do it. Just on that one thing, what would be the advantages and disadvantages to the Government and to the public on handling the $25 billion in that way?

Mr. ACKLEY. I am not entirely clear on the precise kind of contrast you are drawing between the two.

Chairman PATMAN. What I am driving at is that we would be selling them direct to the Federal Reserve, $25 billion in bonds. The Federal Reserve gives the U.S. Government credit for $25 billion, a check on that credit. Naturally, not much money is involved because people do not want to use actual money. It goes right back into the banks, of course, but the credit is outstanding, and if the banks bought them, it would still be $25 billion credit outstanding.

One way the Government would save $1 billion a year, and the other way it would be out $1 billion a year. I would not advocate that for everything, just these two particular programs.

Mr. ACKLEY. The resources of the Federal Government are involved one way or the other.

Chairman PATMAN. Both ways. Both are issued upon the credit of the Nation. If the Federal Reserve does it, it is done upon the credit of the Nation. If the commercial banks do it, it is done upon the credit of the Nation.

Mr. ACKLEY. Let me ask Mr. Okun, who is our expert on monetary affairs, if he can clarify this matter.

Mr. OKUN. As Mr. Ackley said Mr. Chairman, we are interested in supplying good financial support from the Federal Government to important State and local projects where it is appropriate.

Chairman PATMAN. Just talk about this particular type, if you please.

Mr. OKUN. Yes, but I think that is the issue, whether the most efficient kind of financial support is given through trying to conserve on the interest cost rather than by other means.

As I understand you, the saving comes from asking the Federal Reserve to hold bonds at lower than market interest rates?

Chairman PATMAN. Sure. In other words, practically free. They could do it free. They have an income now of over $1 billion a year from Government bonds that they paid nothing for.

Mr. OKUN. But most of that does get paid back into the U.S. Treasury.

Chairman PATMAN. Except what they spend. They spend all they want to, which runs to about $200 million a year, and then the rest of it flows over into the Treasury.

Mr. ACKLEY. So, really, the effect of what you are proposing would be to reduce the ability of the Federal Reserve banks to support their own staff activities.

Chairman PATMAN. Oh, no, that does not enter into it at all.

Mr. OKUN. But aside from that, the profits——

Chairman PATMAN. They would still get the $1 billion on the bonds that they now have. The taxpayers are paying it. They are spending it for any purpose they want to, and nobody knows what they are spending it for. They spend all they want to spend, and the rest of it goes over to the Treasury.

This would do the same thing. If it is one-fourth of 1 percent there, they would collect that, and what they did not spend would go over into the Treasury, but the Government would save a lot of money for the program that way.

Thomas A. Edison, one time when he visited Muscle Shoals, commented. He said:

> Now this is a great project, and they are proposing to spend $30 million to build Muscle Shoals, to develop Muscle Shoals.

He also said:

> I am in favor of developing Muscle Shoals, but why issue bonds, give the bankers $30 million interest in order to have $30 million to develop Muscle Shoals?

Now, of course you could not apply that to everything, and I am not asking that it be considered for everything. But in the program for education and antipoverty, what is wrong in using our own credit to the extent necessary, say $25 billion for those two programs, and not pay the banks $25 billion in order to get $25 billion?

Explain that, Dr. Ackley, if you will, please.

Mr. ACKLEY. It seems to me, Mr. Patman, that what we are talking about are alternative ways of a financing——

Chairman PATMAN. No, just one way, just one way.

Mr. ACKLEY. Which all involve transferring real resources to State and local governments for State and local purposes.

Chairman PATMAN. Credit and money for education and antipoverty.

Mr. ACKLEY. That is right, and if the purpose of your proposal is to secure a more rapid increase in the money supply, and in that way to——

Chairman PATMAN. You are getting off on that age-old bugaboo about inflation. There would be no more inflation that way than the other way.

Mr. ACKLEY. There would be no more inflation that way than the other way if, indeed, the volume of total resources transferred to the State and local governments for expenditures for the desirable purposes would be the same in either way. And if it is to be the same, then it is indeed only a choice as to how you want to grant the subsidy.

Chairman PATMAN. It is no subsidy. It is the Government using its own money, its own credit; instead of letting the banks use it free of charge and collect 4 percent a year, the Government in this case will use it itself, its own credit, and if there should be too much money, as you suggest there, there are always ways to do that, to offset it, you know.

You could even raise reserve requirements of banks. That is a perfect way of doing it.

Mr. ACKLEY. I do not think that I can usefully comment further.

Chairman PATMAN. All right, sir. Fine.

Did you want to comment further, Mr. Okun?

Mr. OKUN. At the risk of protracting this, I do think it is important to recognize that most of the interest that flows into the banks flows again out of the banks to many small savers as well as large ones, and that——

Chairman PATMAN. I do not consider that an argument. Excuse me. Respectfully I say that, but we are talking about two methods here now. One would save the people $1 billion a year, one would cost them $1 billion a year. In each case they are using the Government's credit. The banks use the Government credit. The Federal Reserve would be using the Government credit.

Would you like to comment, Dr. Eckstein?

Mr. ECKSTEIN. I probably should quit while I am ahead on this one, having said nothing. But if I understand the plan correctly, presumably the Federal Reserve would then have to sell some of the bonds they now have.

Chairman PATMAN. Oh, no. Of course they could keep them all. The Federal Reserve could own half the national debt if they wanted to. They would apply it all if they wanted to under existing law. I am not advocating it. I would not want them to do it, but they have the power to. No, they would keep the bonds they have, just buy these $25 billion.

Mr. ACKLEY. It seems to me, Mr. Chairman, that it comes down to the fact that either you are proposing a different basic monetary policy——

Chairman PATMAN. No.

Mr. ACKLEY (continuing). Or else a different way of subsidizing the State and local governments for desirable purposes.

Chairman PATMAN. If you want to put the word "subsidy" in there, apply it to the banks. They get a subsidy. They do not pay anything for this credit that they use from the Government to buy these bonds.

Mr. ACKLEY. They pay the interest rate.

Chairman PATMAN. They are getting about $2.4 billion a year. Now that is a subsidy which is all right. I am not objecting to all that. It is in the public interest some time, and if it is not, it should be. But now I am talking about two well-deserved special programs. They are worthy programs. We should do something about it at minimum expense. We are operating on a deficit. So why should we not use our credit up to a limited amount, say $25 billion, and not pay interest, rather than do it the other way and sell the bonds to the banks and pay the banks $25 billion while we are getting $25 billion for education and antipoverty?

Do you want to comment further, Dr. Eckstein?

Mr. ECKSTEIN. If there are going to be $25 billion of resources invested in physical or human investment fields, somebody is going to have to surrender the use of $25 billion.

Chairman PATMAN. Oh, no, they will not. These are new bonds.

Mr. ECKSTEN. These bonds somehow have to command a purchasing power. They have to be able to take resources away from somebody at some point.

Chairman PATMAN. The banks would do that. You see, banks manufacture money. They have a franchise from the Government that is a very fine thing for them. They can make money and not go to the penitentiary. Most people who try to manufacture money have to go to the penitentiary. The bankers do not, which is all right. I am all for it, but, you see, they create money just the same as it would be created on this $25 billion. There is no difference there in the creation of purchasing power—none.

Would you like to ask some more questions?

Vice Chairman DOUGLAS. I will merely say it is very hard to get economists to admit that banks create monetary purchasing power.

Mr. ACKLEY. I do not think it is hard to get economists to admit that. I think we all are quite clear on the way in which our money supply is created. But the question at issue here seems to be whether in fact this results in a subsidy to private banking or whether indeed the interest is paid to savers who hold bank deposits.

Chairman PATMAN. Well, as it is now, of course, they operate on the reserve system, 16 percent on demand deposits, and 4 percent on savings deposits. That 16 is the highest. Some banks operate on about 12, I believe, 10 or 12. But they commingle these reserves. They put them together, and they have as much in time deposits as they have in demand deposits.

So the net effect is that the average reserve is about 10 percent, so they create money $10 for every $1 they have in reserves. That is a pretty good privilege. You know about the only way anybody could get a better franchise from the Government would be to get a contract to collect the Government's taxes on the halves, 50-percent commission. Of course the banks would claim they do not have a contract that lucrative, but they have one almost that lucrative, and I am not objecting to it. If they work in the public interest, all right. But now and then the public interest says we ought to save money on these antipoverty campaigns and education.

That is the reason I suggested that.

Mr. Ellsworth?

Representative ELLSWORTH. Thank you, Mr. Chairman.

I have a couple more questions.

Going back to Mr. Reuss' comments—and I notice that you agreed that the Council would get into this question of tax-exempt local bond issues for industrial development—if the Council is going to get into that, I hope that you will keep in mind the overall view which takes into account these various direct subsidy development programs which Congress is grinding out from time to time including the Appalachia program, which I think gives an unfair advantage to the cattle industry in Appalachia as distinguished from traditional cattle areas, and other problems of a similar nature that come up.

Then, on tourism to Europe, your figure of $1¾ billion, I wonder if there are figures available, and if not, if you could get them up, that would show the net on that taking into account the purchase of these tremendous American aircraft, including the financing of them, and what effect that has on the net figure, if any, what effect it has on that figure of $1¾ billion.

(The Council supplied the following supplementary statement to clarify questions of Representative Ellsworth regarding the U.S. tourist deficit and aircraft exports.)

The total U.S. tourist deficit with all areas, including net payments to foreign air and ocean carriers, amounted to approximately $1.6 billion in 1964. American tourists spent approximately $750 million in Western Europe last year. Western Europeans visiting this country spent $160 million here. In addition, net U.S. payments to European transatlantic carriers amounted to between $300 and $400 million. Thus, our tourist deficit with Western Europe in 1964 was between $900 million and $1 billion.

Total U.S. exports of civilian aircraft were about $300 million in 1964, of which $100 million were sold to Western Europe. It is debatable whether it is appropriate to net aircraft sales against tourist expenditures; in any case, total aircraft exports, and such exports to Western Europe, are relatively minor compared with our deficit on tourist account.

I would like to say also, following up Senator Proxmire's comments on the farm problem and your comments, too, from a farm area—and I am very concerned about the farm problem, in that I hope that sometime somebody, and soon, will make an overall study of that problem from the standpoint of the way we are letting our markets overseas for American farm products be taken away from us at the bargaining table. I have particular reference to the Kennedy Round of trade and tariff negotiations taking place now in Geneva where evidently France is getting itself into a position where it is going to be the exclusive supplier of wheat to all of Europe, and that on a very massively subsidized basis. The entire wheat industry in France, of course—fertilizer and the whole thing—is massively subsidized by the French Government, and it is very inefficient. It is going to result in higher prices to all of Europe for their bread.

That is all I have, Mr. Chairman. Thank you.

Chairman PATMAN. Senator Douglas, I cut you off awhile ago. I am sorry.

Vice Chairman DOUGLAS. Yes.

I would like to ask a question as to whether we have any immediate means of defending raids on the dollar by France and possibly by Germany. I would like to start off by saying that as I read General de Gaulle's statement, he has served notice that any increase in the dollar claims of France against the United States will be called for in gold. Now, this increase, as I am informed, is approximately $500 million a year, partly derived from travel, military expenditures, and from the African associated states. I find that France holds $1,300 million of outstanding dollar claims.

If this is true, we would get annual dollar claims from them of $500 million and a potential threat for a part of this $1,300 million as well. Dr. Abs of the Deutsche Bank of West Germany has made a statement implying that he believes this policy is correct. It might be done by Germany.

Do we have any means of defense against this? We have lengthened our tether by close to $5 billion by the reduction in the gold cover on deposits in Federal Reserve banks, but with the expansion of the money supply which will absorb about $250 million a year plus these demands of France—and possible demands by Germany—we may be in a very difficult position.

Now, must we sit supinely back and allow this to happen, or do we have means of action?

Mr. ACKLEY. I believe it has been the policy of France for many years to hold the great bulk of its reserves in gold, and that except for the exceptional $150 million conversion which was announced earlier this year——

Vice Chairman DOUGLAS. And some this month.

Mr. ACKLEY. I beg your pardon?

Vice Chairman DOUGLAS. Some this month.

Mr. ACKLEY. I think France regularly has been and undoubtedly will continue to cash in excess dollar holdings of the Bank of France for gold. I think we have to recognize that if we have a gold exchange standard, which we have and which we defend as a useful standard, it necessarily implies our willingness to convert excess dollars into gold at all times.

Indeed, the system could not operate if there were any limitation on our willingness to do so.

What we basically have to do, if we are worried about the size of our gold stock, is to get our balance of payments into surplus or at least remove the deficit so as to stop creating additional dollars which flow into the central banks of Europe and become potential calls on our gold supply. As long as we are operating under the gold exchange standard, we have to play it according to the rules.

Vice Chairman DOUGLAS. But it throws a very heavy burden on the two countries which guarantee to meet claims against their currencies in gold; namely, the United States and Great Britain. There are outstanding, now, claims of somewhere between $22 and $29 billion against us. If, as an instrument of national policy, we should be raided, do we have any means of protection?

Mr. ACKLEY. I think we have to distinguish between what is a desirable longrun international monetary standard from how we play under the rules of the existing standard. Europeans, of course, call to our attention, frequently, the fact that although we sustain the burden, when necessary and when called on, of converting outstanding official dollar claims into gold, we have for many years enjoyed the reverse of that; namely, the ability to finance deficits in our balance of payments by creating additional dollar claims which foreigners have been willing to hold. This $22 billion——

Vice Chairman DOUGLAS. You mean they have conferred a great favor upon us by accepting our military aid and accepting the investments of capital, that this has been an act of abnegation on their part?

Mr. ACKLEY. I think this is hardly a question on which we can express value judgments about the behavior of others or of ourselves. It is a system which has permitted us, in the past, to run very large deficits without being forced to curtail our imports or our military expenditures or our aid expenditures or our tourist expenditures abroad. We have been able to finance recurrent deficits by——

Vice Chairman DOUGLAS. You see, if the other countries were to follow France's example, and convert the some $26 billion of foreign exchange, nearly all of that in dollars, and demand that that be redeemed in gold, and with only $40 billion of gold in the international reserves, we would be stripped, and the gold exchange standard would break down. It would move from a gold exchange to a gold standard.

Now, in the first place, if one adopts a world point of view, and I think that is proper in part to do so, it would mean that the total volume of international currency would fall from around $66 to $40 billion. That would immediately cause a shrinkage in international prices and, in my judgment, a world depression.

You speak of the rules of the game requiring us to convert foreign exchange into gold, and that is true. That is part of the agreement.

But isn't an implicit rule of the game that the other countries will not call for their dollar holdings and demand they be redeemed in gold? Just as in the old bank runs, there wasn't enough gold ultimately to meet the deposits, indeed not enough currency to meet the deposits. And there was a certain moral obligation upon people not to demand that the credit structure be converted into money or the currency be converted into gold. Now, is there not an obligation upon the other nations that they will accept dollars and not demand that they be converted in large amounts into gold?

I mean, are not the rules of the game reciprocal in this matter?

Mr. ACKLEY. Yes, indeed they are, and I think most European countries are quite aware of the fact that the continuation of the existing reserve currency system—which is to their advantage—does depend on the willingness of many countries of the world to continue to hold their reserves in the form of dollars.

Vice Chairman DOUGLAS. But France does not agree.

Mr. ACKLEY. France has followed a different policy.

Vice Chairman DOUGLAS. And apparently the head of the German banking system does not.

Now, those are the two big countries in Europe. If they start raiding the dollar, we are in trouble, even with our lengthening gold supplies by reducing the gold cover, which I supported and indeed would have gone further than the administration.

A few weeks ago I made a speech on the floor of the Senate, in which I suggested that we did have a means of protection; namely, that France has a debt to us from World War I of $4½ billion, it might be $6½ billion but $4½ billion seems to be the basis. If they persist in this policy, every time they ask for payment in gold we should ask for payment on the debt of the First World War. Now, that is rough medicine. One hates to do it. But I simply want to say I do not think we are without defenses, and if driven to the wall, in the national interest of preserving an international monetary system, we have to protect ourselves.

Now, I know that is not for the Council of Economic Advisers to pass upon. That is a high-level policy decision. But I take this occasion to throw it out again. I come to this very reluctantly. But I think General de Gaulle should know that he is endangering the international monetary system and endangering the friendly relationships between ourselves and France.

We have been very lenient with France. We would like to be friendly with them.

We certainly have helped West Germany. We have built up postwar Germany, over the doubts which many of us had.

Mr. ACKLEY. There is, as you suggest, an inherent contradiction or a potential instability in a world system which involves two kinds of reserves, one of which is always convertible into the other. The problems of this system are always with us. It has worked because and to the extent that other countries were confident of our willingness always to convert our dollar liabilities into gold, and because of their confidence that we would ultimately control our balance-of-payments deficit and thereby be able to maintain our volume of reserves and convertibility.

Vice Chairman DOUGLAS. If we control our balance-of-payments deficit they will have to run a balance-of-payments deficit in order that the international monetary medium keeps pace with the increase in world trade. It is only because of the increase in dollar claims which other nations have against us that the total volume of international currency has been able to keep any kind of relationship with the increase in world exports.

If you say that every country must balance its payments, then you are restricted, as I think you indirectly pointed out, to the increase in the gold supply to meet the increased volume of trade. The increase in gold supply, and I have got the figures right here, is not as fast, anywhere near as fast as the increase in the volume of trade.

My time is up, but I think we are going to be driven either to measures of self-defense or to the development of a new international monetary currency, one or the other.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I would just like to follow up and reinforce what Senator Douglas has said. I think the statistics are just overwhelming. The growth in world trade in the last 15 years has been what—about 180 percent, 150 percent, from $60 to $160 billion? If we have the same growth in the next 15 years it would be from $160 to $400 billion, and, in addition, if we have an increase in our monetary supply, which we anticipate with the growth of our economy, we are just going to need far, far more international liquidity than gold can give us. We are going to need some solution other than these painful and from most standpoints very, very harmful and wrong solutions of trying to cut down on people who want to invest abroad and are doing so very constructively, travel abroad freely as all Americans like to do to be free, having our troops serve the cause of liberty, and so forth.

That is why I think the question of Mr. Ellsworth was so very helpful.

Along this line, why is it that when the President applied the interest equalization tax to bank loans of more than a year—is that correct?—why is it that there hasn't been more consideration given to applying interest equalization tax right across the board; that is, to maturities of less than a year, in view of the fact that the short-term outflow seems much more interest sensitive, in view of the fact there is a great temptation to have a loan turnover, in other words, just get a 1-year loan and turn it over each year, and you can extend it at this rate to really be a 4-, 5-, 6-, 8-, 10-year loan. Why shouldn't we apply the interest equalization tax to all loans?

Mr. ACKLEY. Senator Proxmire, I think the basic reason is that short-term lending of the conventional sort is highly associated with the financing of exports, and the effort to apply the tax to short-term bank lending with an explicit export exemption would be extremely complex.

Senator PROXMIRE. Let me just interrupt at this point to say what this means if it is so closely tied to exports, that it is probably not very interest sensitive, that the thing that is attracting the capital isn't the higher interest rates abroad and the too low interest rates in this country, but it is the export activity and trade activity. If that is the case, it seems to me it is a pretty weak reed for us to say we have to increase interest rates here, at great pain to our economy, and slowing down our economy and prolonging unemployment, because we don't want capital to go abroad.

Mr. ACKLEY. The short-term lending activities of banks involve a number of kinds of transactions, including export transactions and interest sensitive funds. It appeared to those who are most familiar with it—and I think the conclusion is correct—that it is far more effective to decrease the outflow through persuading each bank that is involved in foreign business to maintain a target for its total outflow. If this can be done effectively, it certainly is much more efficient and flexible than the attempt to apply the tax.

Senator PROXMIRE. This was part, then, of the President's meeting yesterday, for example, as I understand it, of the bankers. Is that correct?

Mr. ACKLEY. Yes. Each of the major banks is being asked to hold its outflow of bank lending abroad in 1965 to a 5-percent increase over the amount outstanding at the start of the year.

Senator PROXMIRE. Are we keeping track of what they do?

Mr. ACKLEY. They report monthly on all of their transactions, and it should work quite effectively and quite efficiently so long as all the banks are willing to cooperate. So far they have all indicated their willingness to do so.

Last year I believe there was a 25-percent expansion in bank lending abroad. If we held the expansion this year at 5 percent, it would result in a very substantial decrease in our deficit.

Senator PROXMIRE. Thank you very much.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

Thank you very much, gentlemen, for your statement. We appreciate it, and we will certainly carefully consider everything you have said.

Monday we will have Mr. Douglas Dillon, Secretary of the Treasury, at 10 o'clock in this room.

Without objection, the committee will stand in recess until 10 o'clock Monday.

Thank you very much, again.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 10 a.m., February 22, 1965.)

THE PRESIDENT'S ECONOMIC REPORT

MONDAY, FEBRUARY 22, 1965

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Joint Committee met, pursuant to recess, at 10 a.m., in room AE–1, U.S. Capitol Building, Hon. Wright Patman (chairman), presiding.

Present: Representative Patman, presiding; Senators Douglas (vice chairman), Sparkman, Proxmire, Miller, and Jordan; Representatives Reuss, Griffiths, Curtis, and Ellsworth.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

On this second day of the committee's hearings on the President's 1965 Economic Report, we have as a witness the distinguished Secretary of the Treasury, Mr. C. Douglas Dillon. The committee always welcomes these opportunities to obtain his wise and forthright counsel.

Mr. Secretary, you have fought a courageous and patient battle against those abroad who would undermine the dollar. You and your colleagues are to be congratulated on the efforts you have put forth to try to deal with these difficult problems without interfering with domestic policies to attain the objectives of the Employment Act: maximum employment, production, and purchasing power.

Though certainly not every member of this committee has always agreed with every step you have taken, we have admired your courage, patience, and skill, and again welcome your analysis and recommendations.

You have a prepared statement, Mr. Secretary. You may proceed in your own way, sir.

STATEMENT OF HON. C. DOUGLAS DILLON, SECRETARY OF THE TREASURY

Secretary DILLON. Yes, Mr. Chairman. Thank you, sir.

Mr. Chairman and members of the Joint Economic Committee, we meet after a year of substantial progress and accomplishment. But we have no cause for complacency.

At home too many of our workers—particularly younger people just entering their productive years and those who suffer from inexperience, lack of education, and racial prejudice—are without jobs. As we enter the fifth consecutive year of economic advance, we must be alert both to the dangers of price pressures and of any flagging in the forces of expansion.

At the same time, our balance of payments has not shown the improvement we must have. Further action—as outlined by President Johnson in his message on the balance of payments—is essential to the continued strength of the dollar. And, on that solid foundation, we must press forward, in cooperation with our friends and trading partners, with our effort to assure the capacity of the international monetary system over the years ahead to provide the reserves and credit facilities needed to support the vigorous and balanced growth of the free world economy.

FISCAL POLICY AND A PROGRESSIVE ECONOMY

Maintenance of a healthy rate of domestic economic expansion, free from inflation, will continue to require the coordinated use of the tools of fiscal, monetary, and debt management policy. But, within that framework, fiscal policy, and particularly, tax policy, has unquestionably come to assume a more crucial role than ever before in sustaining our forward momentum and carrying out the mandate of the Employment Act of 1946.

The first important steps to spur more rapid growth through tax policy were taken in 1962. The Revenue Act of 1962, you will recall, provided for a tax credit of 7 percent on new investment in machinery and equipment, and in the same year the Treasury reformed and liberalized the tax treatment of depreciation, bringing up to date badly outmoded procedures that served as a drag on new investment. Coupled with the two-stage reduction in the corporate tax rate contained in the Revenue Act of 1964, these measures provided a powerful stimulus to business investment in plant and equipment, increasing the profitability of a typical investment in new equipment by more than 30 percent.

Just last week we improved and liberalized the reserve ratio test procedures that accompanied the 1962 liberalization of depreciation. This action was taken after extensive studies. It will make certain that businesses which truly wish to adapt their replacement practices to the new shorter lives announced in 1962 can obtain the full tax benefits of the 1962 guidelines. For 1965 it will mean that additional taxes will amount to a maximum of $100 million rather than the $800 million that would have been the case under the original 1962 reserve ratio test procedures.

The response of private investment to tax incentives and to expanding sales and profits has been remarkable indeed. Producers' outlays on durable equipment, after correction for price change, amounted to $26 billion in 1961 as compared to $26.6 billion in 1952. But in the 3 years since 1961, those same outlays, again corrected for price change, have risen to $35.1 billion, an increase of over one-third in the space of only 3 years. Yet, the expansion of investment has been closely geared to requirements for new productive capacity and no unsustainable capital goods boom on the 1956–57 model has been allowed to develop.

Along with the invigoration of private investment that is so basic for longrun growth, the individual tax reduction of 1964, as it becomes fully effective, is releasing $11 billion of consumer purchasing power at 1965 levels of income. The size, composition, and timing of last year's tax cut were carefully planned, and the results were almost exactly as predicted in the 1964 Economic Report of the President.

A year ago that report projected a gross national product of $623 billion as the midpoint with a $10 billion range. The actual result is now estimated at $622.6 billion. A year ago the report estimated that with tax reduction the unemployment rate could be expected to fall to approximately 5 percent at the end of the year—as it actually did, before falling even further to 4.8 percent in January. The behavior of personal income, corporate profits, and other measures was also in line with our expectations.

The tax reduction enacted last year continues to spur consumer and business spending, although the large initial thrust is now behind us. Later this year we will further improve the tax system, encourage price declines, and give the economy another measured and timely stimulus through the reduction and elimination of some of our excise taxes. The President's budget provides for excise tax reductions effective on July 1 that will total $1.75 billion a year when fully effective. The President will spell out the details of this program in ample time to permit consideration by the Congress before midyear.

Over the past 4 years, as this record suggests, we have come to a far greater appreciation of how fiscal and tax policy can help achieve our economic goals. But much remains to be done before we can be satisfied that this policy tool can be used with the flexibility that is essential should recessionary tendencies gather force.

To meet that need, the President has urged that the Congress review its own procedures to assure prompt action on temporary tax cuts, if and when required. The lengthy and painstaking deliberations by the Congress, which are entirely necessary and appropriate before undertaking a lasting structural change in the tax structure, are not relevant to purely temporary, across-the-board, antirecessionary cuts. We simply must be able to count on procedures that insure an early decision in response to a Presidential proposal, or else we must give up the strongest antirecessionary weapon in our whole arsenal.

At the same time, we must, of course, develop programs that will attack structural problems of unemployment and depressed areas at their roots and solve them within a framework of overall price stability. These deep-seated problems will only yield to a concerted attack aimed directly at their causes. We are mounting just such an attack.

In a modern industrial society, those without skills, or with skills no longer in demand, suffer a heavy disadvantage. Training programs such as those now being conducted under both the Manpower Development and Training Act and the Economic Opportunity Act can make a key contribution to individual and national welfare. The Appalachia program, now under congressional consideration, is an ambitious effort to deal in a coordinated way with a particular depressed area problem. An improved Area Redevelopment Act would be helpful in spurring growth. Carefully designed programs such as these will play a steadily increasing role in reducing unemployment and widening job opportunities.

MONETARY AND DEBT MANAGEMENT POLICIES

The timely use of fiscal policy enables us to make far more effective use of the tools of monetary and debt management policies in meeting our internal and external economic goals. For instance, the stimulus from tax reduction, by lifting some of the burden for promoting economic expansion from monetary policy, has made extremely easy money policies at home unnecessary—policies that would have been totally out of keeping with our balance-of-payments problem.

The fact is that, in a world of increasingly free trade and payments, we cannot expect to insulate our domestic money and capital markets entirely from those of other countries, nor would that be consistent with our longer range goals of a liberal world economic order. As the President emphasized in his Economic Report, monetary policy must and will remain free to respond if the stability of the dollar is threatened, either from domestic inflation as a result of excessive demand, or from outflows of money and capital that undermine our balance of payments. But, if monetary policy is to play that role effectively, and without potential damage to the internal economy, we must also recognize the corollary need for dynamic, flexible fiscal policies in promoting domestic prosperity.

So long as we are willing in the future, as during the past few years, to use all the varied tools of financial policy flexibly, and in complementary ways, intolerable conflicts need not arise between our commitment to defend the dollar and our commitment to sustained domestic growth and prosperity. Effective economic policy does not require that every tool be pushed hard in the same direction and at the same time. What is required is that, in seeking our varied goals, we achieve a blend and a balance among our policy tools—taking advantage of the strong points of each—that will permit progress in several directions simultaneously.

THE DEBT MANAGEMENT RECORD

The use of our policy instruments in the pursuit of multiple objectives is well illustrated in an area for which I have had direct responsibility and which affects the economy almost daily: The management of the public debt.

Debt management has in recent years helped keep our market interest rates in the short-term area reasonably competitive with rates in major foreign money centers, thus minimizing interest rate incentives to the transfer of short-term funds abroad. Thus, we increased the volume of Treasury bills $5 billion further during 1964, helping to raise the 3-month bill rate from about 3½ percent at the close of 1963 to just under 4 percent today.

At the same time, however, it has been important to insure that this action, undertaken for balance-of-payments reasons, did not clash with other objectives. With persistent unemployment and unused industrial capacity, we have wanted to avoid upward pressures on the structure of long-term interest rates, and to assure the availability of investment funds adequate to support the steady rise in domestic investment and economic activity.

In addition, the Treasury also has continuously before it the need to maintain a well-balanced maturity structure in the national debt, a prerequisite for flexibility in its financing decisions. This requires sizable placements of new intermediate and longer term securities in the market in order to offset the shortening effect of the passage of time on the term to maturity of outstanding issues. Otherwise, debt would soon pile up in the short-term area, not only risking an inflationary potential but also straining that sector of the market and using up some or all of the short-term borrowing capacity which it is prudent to hold in reserve for emergencies.

To achieve this balanced debt structure and avoid any excessive buildup of liquidity, the Treasury last year reduced outstanding short-term debt other than Treasury bills by an even larger amount than the rise in the volume of bills. As a result, the total marketable debt due within 1 year actually declined by $1 billion. And, as in the preceding year, the Treasury's borrowing was done, on balance, without recourse to the commercial banking system—making it the third successive year in which bank holdings of Treasury securities showed no increase. Actually, commercial bank holdings of Government debt as shown in the attached table were slightly lower at the end of January than they were 4 years earlier. Thus, all of the large increase in bank credit over the past 4 years has been used to finance private borrowers and State and local governments.

The great bulk of the Treasury's debt extension has continued to be achieved through advance refundings, a technique initiated during the preceding administration and further developed and extensively utilized during the past 4 years. One important advantage of this technique is that it minimizes the impact on the market and on interest rates of our debt extension operations. Investors responded to three advance refunding offers, in January and July 1964 and January 1965, by exchanging existing short-term holdings for $4.2 billion of bonds maturing in 20 years or more, for $7.5 billion of bonds maturing in about 9 years, and for $10.3 billion of bonds maturing in 5 to 7 years. An additional $1.5 billion of 10-year bonds was issued in the regular refunding in May 1964.

Reflecting these operations, the marketable debt due in 5 years or more rose $7.1 billion in the 12 months that ended on January 31, exceeding the $5.8 billion increase in the entire marketable debt over this period. As the attached table indicates, an amount larger than the entire $25.1 billion increase in the marketable debt since January 1961 has been financed over that period in longer term issues; marketable debt due in 5 years or more is up $26.9 billion. Accordingly, the average maturity of the marketable debt as of January 31, 1965, was 5 years and 5 months, 4 months longer than its year-ago level and 11 months longer than in January 1961.

Moreover, if we add the $2.6 billion increase in the outstanding volume of savings bonds since January 1961 to the $26.9 billion increase in the portion of the marketable debt due in 5 years or more, we get a total of $29.5 billion, well beyond the $28.4 billion rise in the entire public debt over these 4 years. This is a clear record of noninflationary finance not often recognized by those who like to talk of loose fiscal policies in Washington.

It is noteworthy that these efforts to finance the Government at long term have been achieved without any noticeable upward pressure on long-term yields. Most long-term interest rates important to private economic activity are now well below the levels touched in 1961: average conventional mortgage rates are currently 5.8 percent, down nearly three-eighths of 1 percent; offering yields on new high-grade corporate bonds have recently been under 4½ percent, one-eighth of 1 percent or more below levels of the spring of 1961; and a widely used municipal bond yield average which was as high as 3.55 percent in 1961 is currently at 3.10 percent.

This is an impressive record when one considers the increase of about 1¾ percent in short-term yields that has taken place since the lows of early 1961, as well as the record demand for funds. The volume of funds raised during the past 4 years totals about $240 billion, nearly 50 percent higher than the total of the preceding 4 years. A major part of the explanation lies, of course, in the high and rising flow of savings for longer term investment generated out of the steadily rising incomes that have accompanied our prosperity. The smooth flow of these savings into investment has been greatly assisted and encouraged by confidence in continuing price stability and by the increases in interest rates paid by savings institutions and commercial banks.

Clearly the Treasury's program of noninflationary debt management has been entirely consistent with continued full availability of credit to private borrowers at stable or declining long-term interest rates.

IMPORTANCE OF COST-PRICE STABILITY

Fiscal incentives and sound financing of the national debt have helped account for the remarkable degree of price stability that has accompanied our vigorous expansion. In contrast, earlier postwar expansions have typically been marred, after the initial recovery period, by rapid increases in costs and narrowing profit margins. The bidding up of prices and costs dissipated the forces for expansion; maladjustments and distortions soon developed, and recessionary forces gathered strength.

We have avoided that pattern during the present expansion. The rise in productivity associated with more rapid growth and an expanded scale of investment, along with moderation in wage demands, has caused manufacturing labor costs per unit of output to decline more or less steadily throughout the current expansion. As a result, there has been no squeeze on profit margins and little upward pressure on prices. With costs and prices stable, and productivity rising steadily, we have maintained a good balance throughout the economy and no drastic tightening of money has been necessary to curb overexuberance.

We must not allow the dismal cycle of inflation and recession of the earlier postwar period to reappear. The challenge is clear, for experience shows that the task of maintaining cost-price stability becomes more difficult as expansion whittles away margins of unused plant capacity and selective labor shortages begin to appear. Moreover, some signs of price pressures—fortunately confined to limited sectors of the economy and in some cases reflecting temporary interruptions in the flow of raw materials from abroad—were apparent in the closing months of 1964.

These pressures by no means signify that our long period of price stability is ending. They do, however, reemphasize the need for vigilance.

Our financial policies afford assurance that total demand will remain well within our growing capacity to produce, and we do not face excess demand inflation. But, in addition, we must recognize that—even at a time when overall demand is not excessive—costs and prices may be pushed up by pressures of wage bargaining and the pricing policies of large firms.

The record of labor and industry in recent years in this respect has been good, although we are all aware, I think, that it has not been in every instance as good as it could have been. The price-wage guideposts, endorsed by both President Kennedy and President Johnson, point unambiguously to the responsibilities of both labor and management if key wage settlements and pricing decisions are to serve the public interest. The acceptance by all sectors of our economy of their continuing responsibility for noninflationary policies is the key to steady expansion at home and a stronger competitive position abroad.

BALANCE OF PAYMENTS

Cost-price stability has contributed to a marked improvement in our already favorable balance of trade. Commercial exports, excluding those financed by the Government, rose to $22.4 billion in 1964, an increase of 16 percent over 1963, and fully 28 percent over 1960 levels. As a result, our commercial trade surplus widened from 1963's $2.3 billion to an estimated $3.7 billion in 1964, despite the larger demand for imports generated by our rising levels of economic activity.

The 1964 results were, of course, aided by the special grain sales to both Eastern and Western Europe early in the year, and we cannot count on equally favorable overall trends in 1965. But, there can be little doubt that the relative stability of our own costs and prices since 1958, while most foreign costs and prices have been rising more or less steadily, is at last beginning to count in our favor.

Our improved trade balance has been paralleled by further savings in net Government spending overseas, and by an unprecedented increase in income from our rising volume of foreign investments. These factors combined to reduce our deficit on regular transactions to an annual rate of about $2 billion over the first three quarters of 1964—about in line with earlier expectations despite rising levels of capital outflows.

However, as you know, progress in reducing our deficit for the year as a whole was disappointing. A sharp deterioration during the fourth quarter pushed our deficit on regular transactions up to $3 billion for the year as a whole. While some of the fourth-quarter results can be traced to temporary factors, analysis of the results for the year made it perfectly clear that new measures needed to be taken to achieve a more rapid reduction in the underlying deficit and to maintain the international strength and stability of the dollar unquestioned.

As a consequence, President Johnson has announced a 10-point program to intensify our effort to reach an early balance. Export promotion will be pressed even harder and the oversea dollar cost of Government programs will be reduced even further. In addition, legislation will be sought to narrow the gap on tourist expenditure by reducing the duty-free exemption on our returning tourists, and our "See the U.S.A." program will be greatly intensified. But, the major thrust of the President's program is in the area of capital movements.

The reason is simple. The bulk of our difficulty can be traced to accelerating outflows of American investment and loan funds to a rapidly growing outside world that desires capital and that apparently is still incapable of mobilizing its own savings with full effectiveness. Since 1960, gains in our trade balance, net savings in our aid and military programs overseas, and rising investment income have benefited our balance of payments by about $3.9 billion. But over that same period, private capital flows abroad increased by about $2.5 billion to a record $6.3 billion, washing away most of the gains in other sectors of our accounts.

This huge capital outflow is in one sense a reflection of our basic strength as a nation—the huge savings we are capable of generating, the steady increase in our holdings of productive and profitable assets abroad, and the worldwide usefulness of the dollar. But, at this point in time, it is also evident that our balance-of-payments position cannot afford accelerating outflows of capital at the expense of our international liquidity. Nor can we afford a heavy outflow of the gold that stands behind our pledge to maintain the value of the dollar at $35 an ounce. And just such an outflow is inevitable unless we take the steps that will hold the outflows of capital within our capacity as a nation to finance them.

The success of this program rests on the cooperation of the business and financial communities in a voluntary program to limit the flow of dollars abroad arising from their own operations. Such a voluntary program, designed in the public interest, can be an enormously effective instrument in assisting the early balance in our payments that is so urgently needed. Only last Thursday, the President, together with Secretary Connor, Chairman Martin, and I, outlined to a group of distinguished business and financial leaders the nature of this voluntary program. I am sure they will respond to the challenge quickly and effectively.

INTERNATIONAL FINANCIAL COOPERATION

Early and decisive reductions in our balance-of-payments deficit are essential not only to protect the dollar, but also to permit calm and orderly study and appraisal of the most effective approaches toward assuring the adequacy of the international financial system to meet the needs of a growing world. The capacity of the present system to meet shortrun strains has been impressively demonstrated—most recently when sterling came under heavy pressure. The massive credits extended to the British amounted to a collective endorsement—backed by $3 billion of hard cash—of existing exchange parities by the major industrial countries. The speed and effectiveness with which these credits could be assembled was a product of the close international financial cooperation built up over recent years.

Meanwhile, we are exploring with other leading nations how best to meet the longer range needs of the world for international liquidity and for more effective processes of international balance-of-payments adjustment. These studies are complex and difficult, and it is not surprising that some differences of approach among the major countries are evident at this stage. Certainly, we cannot afford to look back nostalgically and seek a solution in the rigid mechanism of a pure gold standard—a mechanism that even in an earlier and simpler day was prone to breakdown and deflation. Instead, the challenge is to build upon the system that has served the world so well over the postwar years—with full awareness of its problems and shortcomings, to be sure, but also with healthy respect for its resiliency and flexibility in responding to varied and never fully predictable needs.

While this longrun effort is being pressed to a satisfactory conclusion, the planned expansion of IMF resources provides tangible assurance that the financial support needed to facilitate expansion in world trade and payments will be available.

The Executive Directors of the International Monetary Fund have now agreed in principle to submit to member governments proposals for a general increase of all quotas by 25 percent, plus special increases for a relatively small number of countries whose quotas are out of line with their economic importance. Together, these increases, if accepted by the member countries, would total $4.8 billion, and when completed would bring the total quotas of the Fund up to $20.9 billion, an overall rise of approximately 30 percent. The U.S. quota, which would be subject only to the 25-percent general increase, would rise from the present $4,125 million to $5,160 million. It is expected that legislation providing for this increase will be introduced next month; full provision for it has already been made in the President's budget.

The Fund proposals will provide that 25 percent of each country's quota increase must be paid in gold. The United States has been prepared at all times to pay this 25 percent from its own gold holdings, but we had been concerned that such payments by others would lead to large purchases of U.S. gold. I am glad to say that this possibility will be forestalled by measures agreed upon in the Fund. I believe that the understandings that have been reached will fully protect the interests of the United States, the payments system as a whole, the Fund, and its other members.

CONCLUSION

I have touched upon several key challenges for economic policy in 1965—maintaining price stability while reducing unemployment—achieving a decisive reduction in our balance-of-payments deficit—and progress toward a stronger international payments system. Each of these problems we approach from a position of great strength.

Business is moving ahead with good momentum, but without inflationary pressures on supplies or speculative excesses. Our international competitive position is slowly but surely improving, and standing behind the dollar is the world's largest gold stock and a huge volume of foreign assets. The international financial system has withstood a series of shocks and strains, while demonstrating its ability to finance a further large increase in world trade.

Given a continued willingness to use all our tools of economic policy in flexible and imaginative ways—and with the vital support of industry, labor, and finance—I am confident that the challenges of today will become the successes of tomorrow.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Dillon. I notice that you state that the holdings by commercial banks of the Government bonds was reduced from 62.7 to 62.3 during the last 4-year period.

You don't take into account there the municipals, the tax-exempt bonds. My information is, just seeing the record occasionally, that the banks have been going in for larger and larger purchases of tax-exempt bonds; is that right?

Secretary DILLON. Yes, that is what I stated. That is what I meant when I said the entire growth in bank credit has been used to finance State and local governments and private enterprise.

Chairman PATMAN. Yes. I just wanted to ask you to correct this table and put the municipals in there, the tax exempts; will you do that please?

Secretary DILLON. I will be glad to add that to the table. I don't think I can correct it.

Chairman PATMAN. No, I wouldn't ask you to correct it. I would ask you to change it to show that while they have not been buying so many Government bonds they have been going in for the municipals for an obvious reason.

Secretary DILLON. That is right. We will be glad to submit a table showing that.

(Table referred to, subsequently filed, follows:)

The structure and ownership of the public debt, January 1961 and January 1965

[In billions of dollars]

Debt structure	January 1961	January 1965	Change
Marketable public debt:			
Due within 5 years	$146.4	$144.7	−$1.8
Due after 5 years	42.9	69.7	+26.9
Nonmarketable public debt:			
Savings bonds	47.2	49.8	+2.6
Special issues and other	53.6	54.4	+0.8
Total public debt	290.2	318.6	+28.4
Ownership:			
Commercia banks [1]	62.7	[3] 62.3	−0.4
Other publicly held debt [2]	146.4	[3] 160.5	+14.1
Total publicly held debt	209.1	222.8	+13.7
Government investment accounts	54.6	59.1	+4.5
Federal Reserve banks	26.6	36.7	+10.2
Total public debt	290.2	318.6	+28.4

[1] Commercial bank holdings of State and municipal securities for this period have been estimated at: January 1961, $17.7 billion; January 1965,[3] $33.8 billion; change, +$16.1 billion.
[2] Includes State and local governments, individuals, private investment institutions, corporations, all other private holders.
[3] Preliminary.

Note.—Details may not add to totals shown due to rounding.

Chairman Patman. Yes, sir.

Now, oftentimes we have discussed the national debt and the interest costs on it. I have contended that if we had the same interest rates since 1952 that we had in 1952 the national debt would be $40 billion less and our annual interest charges would be $5½ billion a year instead of $11 billion a year.

I noticed in the morning paper that the Fed adopted a firmer credit policy by one vote back in August. It says here that the Federal Reserve System's policy shifted toward slightly firmer credit last August. It squeaked through by a single vote, the annual record of the Fed's Open Market Committee showed yesterday. According to the record, six members voted for tightening money-market conditions and five voted against.

It occurs to me, Mr. Dillon, that this should alert people like yourself, who hold such important positions in Government and who are obligated to save the taxpayers as much money as possible on interest rates and other expenses. In order to keep from having these manmade recessions or depressions every third of fourth year, you need an adequate money policy. This episode doesn't tell the whole story—this was at the Open Market Committee which is every 3 weeks, and they have not only the 7 members of the Board, but they have 12 members of it who are presidents of the Federal Reserve banks, and who are selected by the private banks themselves, by representatives of the private banks. They make the decisions about our money supply and interest rates.

Now, if we were to read this afternoon that they had greatly increased freight rates at the Interstate Commerce Commission, and five presidents of railroads actually voted to increase the rates on a divided vote, we would be astounded. It would be shocking to us. Well, that is a comparable situation, except here it is worse, because in the Open Market Committee, while they have the seven members of the Board, they don't have just the five representatives of private banks. They have 12 representatives of private banks there, and in all the discussions, all 12 participate, make their arguments, but when they come to a vote, of course only 5 of them can vote. But the number is 12 to 5. I just invite to your attention the fact that it should be considered very difficult for the people to get just exactly everything that they are entitled to get in the way of a square deal when the people who profit the most from tight money and high interest are actually sitting in at secret conferences, in the Government right here in Washington—and New York—secret meetings not published for months and sometimes years later as to what they did. I think that is enough to shock us a little bit.

Don't you think that it is difficult to justify private people who are selected by private banks, Mr. Dillon, sitting in conferences like that, here in Government buildings in Washington, in secret meetings?

Secretary DILLON. I would like to just make two comments if I may, Mr. Chairman.

I think that the record shows that when that vote was taken, the members of the Board divided evenly, 3 to 3, and the five members of the Open Market Committee from outside—the bank presidents—divided also, 3 to 2.

Chairman PATMAN. Three to two, that is right.

Secretary DILLON. So it was a very close division. I think that indicates that they do have the public interest fully at heart, representing their own areas and the different interests that may have come to mind. The real question is the extent to which these gentlemen, who as I have understood it have been generally nominated and in fact chosen by the Chairman of the Federal Reserve Board, actually are merely representatives of private bankers.

Chairman PATMAN. Now, Mr. Dillon, you are not making that statement as a fact, are you?

Secretary DILLON. As far as I know that is the way that has happened.

Chairman PATMAN. You just heard that?

Secretary DILLON. Well, the Chairman has told me that at the times there have been changes he has recommended so-and-so to be the president and he is then elected.

Chairman PATMAN. That would make it more under the control of the Board, wouldn't it?

Secretary DILLON. That is right.

Chairman PATMAN. They are not kicking him out?

Secretary DILLON. That is true.

Chairman PATMAN. If they want tight money they have a better chance of getting it.

Secretary DILLON. If the Board should, but the Board divided 3 to 3.

Chairman PATMAN. Yes. Anyway, does it appear to you to be absolutely fair that on the boards to fix interest rates or to deal with any other agency of Government or the volume of money, are people who are privately interested, selfishly interested, and who make money out of tight money, which, of course, causes depressions and hard times. Some people make a lot of money out of that. Interest rates are at the point where we are paying twice as much now as we should be paying under the rates of 1952.

Don't you think it is unusual that we should allow people who are privately interested that way to sit on these boards, secret boards in Washington?

Secretary DILLON. Well, I would say if they were totally private—for instance, if one were the president of the Chase Bank—I would agree with you. But my understanding is that these gentlemen consider themselves, despite any technicalities in the way they may be chosen, as representatives of the public interest at large, and I think that is the way they conduct themselves.

Also, of course, on this basic question of interest rates, there is a question as to what is high. Certainly the present rates are high compared to 1952 or earlier, but if we go back some 85 years in our country's history, we can see that except for the very exceptional 25-year period that marked the great depression, World War II and its aftermath, average rates have been about where they are right today, over that period of time; so, I would think this was probably a more normal average rate based on historic facts than the rates that were in force during this 25-year period.

Chairman PATMAN. Well, I don't buy your statement at all, Mr. Dillon, and I am sure you didn't expect me to, when you say that these presidents of the banks are performing a public function. I think their votes generally indicate differently. You take Mr. Hayes. Look over the votes last year and I think you will find that sometimes he is the only one voting for tight money, tight money every time. Now, Mr. Hayes runs the Federal Reserve System. You know he has charge of the Federal Reserve Bank in New York, and the law says that every person in that bank is under his direction and guidance. The law says that, not regulations. The law says it. Therefore, all those people who operate the Open Market Committee, they are under his guidance and direction, supervision, and control absolutely. They are obligated only to him. The biggest business in the Nation today in bonds is right there in the Open Market Committee, under the direction of Mr. Hayes.

Now, Mr. Hayes is selected by nine directors, six of whom are selected by the banks in that area, in the New York area. Of course, six out of nine, naturally they have their will, their way, and they select Mr. Hayes. I don't think that you could consider very well that he would be expected to keep the public interest in mind as much as if he were selected by a vote of the people or some other way, where he would have a direct obligation to support the people. I will not take up any more time.

Secretary DILLON. No. All I can say is I know Mr. Hayes personally, and I think that he is a dedicated public servant. I don't agree with him all the time. In fact, many times we have had some disagreements, because his major concern has been with the balance-of-payments problem—which is very serious—and probably with less thought of the domestic economy all the way through.

Chairman PATMAN. Yes, sir.

Secretary DILLON. And he has been the representative, as you point out quite correctly, of those on the Open Market Committee who were inclined to favor, over the past 4 years, somewhat more restrictive policies. But he also, even though the New York bank conducts open market operations, has followed the directives of that committee in these operations, even at times when it didn't agree with his own thinking.

Chairman PATMAN. Well, you have read those directives.

Does that look like gobbledygook to you? Can you understand in what direction they are going?

Secretary DILLON. They are a little difficult to understand but I understand they give more precise informal instructions to the people who are operating the desk.

Chairman PATMAN. Who gives them that?

Secretary DILLON. The Open Market Committee.

Chairman PATMAN. Mr. Hayes?

Secretary DILLON. The Open Market Committee.

Chairman PATMAN. He is in direct charge. I am not impugning Mr. Hayes' motives. I know Mr. Hayes is a very fine man.

Secretary DILLON. That is all I wanted to point out.

Chairman PATMAN. He is not dishonest or anything like that but he owes an obligation to the private banks in New York. He owes an obligation to them. They selected him. They put him in down here.

In regard to this refunding, I do want to mention that. You mentioned 4 years regarding the refunding. I had that looked into and I discovered that by reason of these refunding issues, before they were due, of course, that the taxpayers were required to pay $1.4 billion a year for each year in excess of what they would have had to pay if no refunding had gone on. And it only reduced the length of the entire debt by only about 2 months. Is that correct or approximately correct?

Secretary DILLON. I can't answer to the $1.4 billion figure. We are trying to make those computations. It is very difficult to do.

The point is that over the years we have had advance refunding of about somewhere between $60 to $70 billion, and of those, a little under two-thirds of the issues that were eligible for offer for exchange in refundings have already come due. Therefore, they would have had to have been refunded in the normal course anyway.

If we would have tried to refund them in that normal course and at the same time to maintain a similar debt structure to what we have achieved, I am certain that we would have paid more in interest and put greater stress on the interest rate structures than resulted from the course we followed. I think that the use of the advance refunding technique is the principal reason why we have been able to maintain and improve somewhat the maturity of the debt without upward pressure on all interest rates across the board.

Chairman PATMAN. Thank you, sir.

Mr. Curtis?

Representative CURTIS. I didn't think I was ever going to pick up on one of your issues, but I certainly do on this. I have favored advance refunding, Mr. Secretary, but in your discussion of debt management, I think that you ought to set out clearly just what that does cost us. You say that you save money over what it would otherwise cost by advance refunding. Yet your semantics would lead the ordinary reader to think that you actually had lowered the interest rate of our debt.

Secretary DILLON. Well, no, that wasn't what was intended.

Representative CURTIS. Well, in your prepared statement, you say "one important advantage of this technique is that it minimizes the impact on the market and on interest rates of our debt extension operations."

Secretary DILLON. Oh, yes; that is right.

Representative CURTIS. Well sure, but let us realize that it is costing us more in interest rates when we have to refund. Your argument is that advanced refunding will make it less.

Secretary DILLON. That is right. You are quite correct. That is what I was trying to say. Maybe my English didn't express that well enough but I stand corrected.

Representative CURTIS. The only reason that I refer to this is because throughout this discussion of debt management I find similar difficulty in dealing with what the actual facts are. The one thing you do not stress is the fact that, in 1963, the average length of maturity was 5 years, 1 month, and in 1964 it declined to 5 years even. And yet one would have to search these glowing phrases to find that 1964 was actually a poorer year than 1963 toward extending the maturity. Is that right?

At this point Mr. Curtis submitted the following table:

Average length and percentage maturity distribution of marketable, interest-bearing public debt, 1946, 1955–64

End of fiscal year	Amount outstanding (In millions of dollars)	Within 1 year (percent)	1 to 5 years (percent)	5 to 10 years (percent)	10 to 20 years (percent)	20 years and over (percent)	Average length	
							Years	Months
1946	189,606	32.68	13.06	22.04	9.20	22.99	9	1
1955	155,206	32.02	25.19	22.06	18.43	2.27	5	10
1956	154,953	37.89	22.20	18.65	18.44	2.80	5	4
1957	155,705	46.21	26.11	7.91	16.95	2.79	4	9
1958	166,675	40.66	25.53	12.88	16.59	4.32	5	3
1959	178,027	40.98	32.75	9.57	12.14	4.54	4	7
1960	183,845	38.32	39.68	11.01	6.86	4.16	4	4
1961	187,148	43.34	31.20	14.12	5.46	5.85	4	6
1962	196,072	45.10	29.09	13.28	4.75	7.76	4	11
1963	203,508	41.91	28.51	18.37	4.10	7.09	5	1
1964	206,489	39.43	31.69	16.91	4.04	7.90	5	0

Secretary DILLON. That is right. Every year we didn't make the same progress. Some years we just held even.

Representative CURTIS. Well, you have done fairly well.

Secretary DILLON. Thank you. I would like to submit a statement on this for the record:

(The following statement was subsequently supplied:)

The Treasury necessarily has continuously before it the need to maintain a well-balanced maturity structure. Maintaining a balanced maturity structure requires timely offerings of intermediate and longer term securities in order to offset the shortening effect of the passage of time on the term to maturity of outstanding debt issues. Otherwise the public debt would soon pile up in the short-term area, not only risking a potential inflationary excess of liquidity but also using up some or all of the short-term borrowing capacity which it is prudent to hold in reserve.

Experience strongly suggests that advance refundings—far from adding to our interest costs over time—are the most economical method yet devised for issuing the required volume of new intermediate and longer term marketable securities. Moreover, because of their minimum impact on market rates of interest and on other flows of credit, advance refundings have had a beneficial effect on the costs of other, regular Treasury financings which have been less expensive than they would have been otherwise.

Calculating the precise cost of advance refunding is an exceedingly complicated task. Nevertheless it is possible to make estimates. An essential prerequisite, of course, is to be sure that one measures the cost of advance refunding as a method of debt extension, in comparison to other methods of debt extension, rather than the cost of debt extension itself. Accordingly, a completely satisfactory estimate of the cost of advance refunding would involve a comparison with the cost of achieving the same degree of debt restructuring through sale of intermediate and long-term issues in cash financings or refundings of maturing issues. But the same net amount of debt extension through cash offerings or regular refundings might be achieved in a variety of different combinations of securities and maturities so that there could be a large number of estimates of the cost of these alternative methods of debt extension. While any of these would probably differ only moderately from any other, no one approach could be defined as the cost of alternative methods of debt extension.

However, experience in managing the debt clearly suggests that whatever the precise choice of issues, if buyers had to be attracted into a volume of longer issues sold for cash or in regular refundings in volume at all comparable to those sold in advance refundings, very much larger concessions from preexisting levels of market prices and yields would be required to attract sufficient investor interest, adding importantly to the cost of the financing. This is true partly because essentially new buyers would have to be found for the whole issue, whereas in an advance refunding many of the existing holders of the refunded issues can be induced to extend their holdings, and partly because the Treasury has much greater flexibility in timing and designing advance refundings for favorable market junctures. Consequently, an equivalent volume of conventional cash or refunding operations would over time entail both higher cost and considerably more market disturbance.

An approach which is more statistically manageable is to estimate the budget cost of advance refundings on the restrictive assumption that the Treasury would defer efforts to achieve debt extension comparable to that resulting from advance refundings until the securities eligible for such advance refundings had themselves matured. In that connection, it must be emphasized that this assumption would imply a substantial cost in terms of a less satisfactory debt structure. Some indication of this cost is found in the fact that without advance refundings, the average length of the debt would have declined by now to under 3 years, about 2½ years less than the actual average of 5 years and 5 months at the end of January 1965.

The computation below assumes that the eligible issues involved in advance refundings would be refunded at final maturity into the same issues that had actually been offered earlier in the advance refundings. The assumed pricing of the refunding issues, on this assumption, is related to prevailing market rates at the time of maturity of the eligible issues.

Nearly $40 billion of the $67¾ billion total exchanged in the advance refundings to date have already matured. In a large number of cases, under the assumption mentioned above, the replacement issues would have entailed substantially higher interest costs than the issues actually offered in the advance refundings. Taking this into account, the successive annual budget effect of all advance refundings through January 1965 for each fiscal year from 1960 to 1965 is as follows:

[In millions]

1960	$1.0	1963	$219.0
1961	98.5	1964	156.2
1962	93.2	1965	121.3

The lower figures for 1964 and 1965 reflects the fact that more issues eligible for advance refunding have now matured, and would have had to be refunded in the ordinary course at higher rates than were paid in the portion advance refunded.

It will be noted that these figures, even in the year of largest impact, 1963, are far less than the $1.4 billion per year figure cited in the question, the derivation of which is not known.

At this time, these computations are, of course, clearly incomplete. They do not take into account adequately the fact that many of the securities offered in advance refundings carry much lower rates of interest than prevailing market rates. The Treasury, in the absence of advance refundings, would have had to pay these prevailing rates over many years into the future when the time came to refinance the securities eligible for advance refundings at their final maturity. For example, a number of 3½-percent bonds have been issued in the advance refundings, and these 3½-percent bonds will be outstanding for another 15½ to 33½ years. Financing for this term on today's market would cost about three-fourths percent more per year. In fact, assuming the current structure of market rates is unchanged, an extension of the computation cited above would soon show substantial net annual savings in interest costs—savings that would over time far exceed the initial costs through 1965 cited above.

It is also worth noting that the computed average annual rate on the entire interest-bearing debt has risen only modestly since the first advance refunding. In early 1960, before the first advance refunding, the average rate rose substantially above 3 percent. The rate on the marketable debt, the major factor in the increase, reached a peak of 3.58 percent in February 1960. Rates on shorter term issues declined thereafter during the 1960–61 recession but beginning in 1961 rose again in response to efforts to make our short-term rates more competitive with those abroad for balance-of-payments reasons. Longer term rates on Government issues increased much more moderately. But they would have been pushed up much further with any determined attempt to offer larger amounts of longer term securities through cash offerings and regular refinancings to improve the structure of the debt.

Instead, this was accomplished mainly through advance refunding. Partly as a result of this advance refunding technique and the consequent easing of the impact of longer-term financings on the market, the average rate on the marketable debt at the end of last year was only about one-tenth of 1 percent higher than in February 1960.

In summary, advance refunding has been a truly effective technique for debt structure improvement, once which is significantly less expensive and troublesome than conventional financings. Use of this technique has made it possible to obtain a well-balanced debt structure. The impact of Treasury financings on long-term rates has been minimized, and the flow of funds needed to finance private or State and local projects has been maintained.

Another important result of advance refundigs has been the sizable reduction of public holdings reaching maturity. This has made possible far greater latitude in handling regular refundings and new cash financing, substantially adding to the flexibility of the Treasury and tending to reduce the interest costs of the regular refundings that have remained necessary.

Representative CURTIS. But the thing that bothers me is the net result that we are getting in this field of debt management. In my judgment, the important point is the impact of debt management on monetary policy. The two are so interwoven that we can't discuss one without the other. Yet, when I try to discuss the problems of increasing the absolute size of the debt, and what it does to further restrict monetary policy, I have difficulty in getting the administration economists to discuss this. I don't find any discussion in here of that. Again, you say that fiscal policy and tax policy, as well as debt management, has taken over and lifted the burden off monetary policy. What I would say is that you have really preempted monetary policy from being effective in these areas because of our problems in the field of debt management. I would also mention the problems in the field of tax policy in conjunction with its impact on our economic structure.

If I could put it this way, Mr. Secretary. I have often argued that we need a tax cut to remove impediments to economic growth, not to stimulate the economy. There is a difference.

Secretary DILLON. I agree with you.

Representative CURTIS. Well, I am glad. Maybe I ought not to pursue this.

Secretary DILLON. No; we have always felt that way. I would say that the only comment I would like to make is that monetary policy was already hampered—constricted—by the balance-of-payments facts and pressures, so it couldn't be used so expansively as it might have been in other circumstances.

Representative CURTIS. Yes; but I would go even further to the fundamental thrust of the basic economic theory of the administration: That deficit financing in periods of high economic upturn is perfectly all right, and is not aggravating this very serious difficulty. The administration doesn't go along with my views, which is their privilege. But let's get it out in the open.

Secretary DILLON. Sure.

Representative CURTIS. Today we continue to increase the Federal debt, even in these times of high economic upturn. We have abandoned the more classical theory which supports deficit financing during periods of economic downturn on the assumption that losses will be recouped in periods of economic upturn. Instead of economic upturn, we use a phrase "full employment," whatever that might be.

Incidentally, I have posed a question to the Council of Economic Advisers in writing, pointing out that going by their own theories of full employment, we still wouldn't balance the budget in the second half of 1965. This is a question of getting these figures in line. But I think that, superimposing full employment on our economy for this year, you won't balance the budget.

Let me go back to the second point in my interrogation. I have three.

One was debt management.

Mr. Chairman, if I may do as we have done in the past, and if it is agreeable with the Secretary, I would like to pose a series of questions in writing.

Secretary DILLON. Very much so.

Representative CURTIS. To have them answered.

Chairman PATMAN. The Secretary has kindly consented in the past for the committee to do that. It will be all right for any member to submit questions in writing to you preceding the time that you look over your transcript and you will answer them?

Secretary DILLON. Most certainly; yes, Mr. Chairman.

(Representative Curtis' questions and Secretary Dillon's answers begin on p. 69.)

Chairman PATMAN. Thank you, sir.

Representative CURTIS. This way we can get some of these more complicated and detailed things discussed and obtain a better understanding than we can through this kind of interrogation. I will do the same thing in tax policy.

I have got three items: debt management, tax policy, and balance of payments.

On tax policy—I am rather confused when you point out how the size composition and timing of last year's tax cut were carefully planned. Actually, as originally planned, the tax cut was to occur in 1963, not 1964. Am I not correct?

Secretary DILLON. You are correct as to the exact timing; that is correct. I should have said the size, composition and general timing, considering the state of the overall economy as looked at over a longer period. But certainly as regards the exact time, it was delayed by about 6 months from what we had hoped.

Representative CURTIS. Yes. I think it was a little more than that.

Secretary DILLON. Maybe a little more.

Representative CURTIS. You were talking about cutting taxes in 1963 and I think, as a matter of fact, there is proof that the timing wasn't right. Then, as far as the timing in 1964 went, was this underwithholding the cause of the problem that is facing a lot of our people in April? Was that part of this careful plan?

Secretary DILLON. I am glad you raised that. We have watched and looked at this, and technicians in the Revenue Service and the Treasury have studied this as carefully as possible. Their conclusion is that this problem has been highly exaggerated, one reason being that the witholding taxes that we have received in the Treasury, based on their comparisons to salaries and wages and all the other comparisons we ordinarily make are running about $700 million higher than they would normally be expected to. It is our feeling that this can only be attributed to the fact that people have responded to the widespread publicity last spring, and have made adjustments in their own personal withholdings so that they have increased the withholdings to bear that much of the changeover.

It is our best estimate now that the amount of additional taxes that will be due this year as a result of a combination of factors—early enactment of the bill, and the relationship of the withholding rate, even leaving aside early enactment, to last year's rate schedules—will now result in something like $400 to $500 million of additional payments on April 15. This is out of a total of about $5 billion of final payments each year. Actually, we expect that total final payments this year will be slightly less than last year due to the basic tax reduction in spite of this $400 to $500 million increase.

In the past, even in the past 4 years, these totals of final payments have swung back and forth by as much as $1 billion a year, so we don't think that this particular thing will be a major impediment to the economy, or will cause major hardship.

Representative CURTIS. This will be sad news for "friendly Bob Adams." He is doing a lot of advertising right now telling people where they can get the money to take care of their underestimations of their income taxes. I think that, if this was part of your careful planning, I wouldn't take credit for it.

The other point here is very important and very basic because it got to be a political matter. This was the question of whether you actually would benefit the economy by this tax cut if it was not implemented in conjunction with expenditure reform. That was the issue, and the Republican motion to recommit the bill was limited to one thing; which was reporting it back immediately with the expenditure levels held to $97 billion and $98 billion. I am very happy to see that, as the Biblical story went, the son said he wasn't going to follow the advice given, but then he went out and followed it anyway.

I am most pleased that the expenditure levels were held even below that—I think to $97.4 and $97.8 billion.

For those who are interested in following economic theory, this was not the theory advanced by Dr. Heller before this committee. His theory precluded any cutback of Federal expenditures because what he was after was to increase total purchasing power. I wish that, in some of the glowing claims of the administration in the Economic Report and in your own statement, you would have pointed out that this tax cut was carried out in conjunction with holding levels on expenditures, and that it did not follow the theory that Federal expenditures had to increase at a constant rate.

Would you comment on that?

Secretary DILLON. Yes, I would be glad to. I think the best comment is to say that this was always an essential ingredient of administration policy. I can only, if I could, quote just a couple of very brief excerpts from President Kennedy's 1963 tax message.

First he said:

> As the economy climbs toward full employment, a substantial part of the increased tax revenue thereby generated will be applied toward a reduction in the Federal deficit.

Then he said, and maybe this is more to the point:

> I do not favor raising demand by a massive increase in Government expenditures. In today's circumstances, it is desirable to seek expansion through our free market processes—to place increased spending power in the hands of private consumers and investors and to offer more encouragement to private initiative. The most effective policy, therefore, is to expand demand and unleash incentives through a program of tax reduction and reform, coupled with the most prudent policy of public expenditures.

So I think this has always been the administration policy. It certainly was our Treasury policy in promoting this tax bill. You will remember before the Ways and Means Committee, the letter that the President wrote to the chairman of that committee in August 1963, which restated these positions and strengthened them.

Representative CURTIS. Yes.

My time has run out, but I want to make this one comment. Perhaps the trouble is that the administration says other things at the same time it says this. I would say that what you hear and read doesn't follow this particular line. But if the administration feels as you say it does, why, then, did it fight so bitterly the Republican motion to recommit the bill, which would have accomplished this same result? There is the interesting thing.

Secretary DILLON. I think the only reason for that is that we thought that the levels projected in the motion to recommit were such that it could not be certain that they could be accomplished. As it turned out, one of the levels was accomplished, and another one I hope will be accomplished, and the other one will not be by a small amount.

Representative CURTIS. One you got a little lower.

Secretary DILLON. That is right.

Representative CURTIS. $98 billion.

(The following questions and answers were supplied for the record:)

Question 1. Under the Alliance for Progress, $20 billion in new capital was to have been supplied to Latin America during the current decade. Half of this was to have been private and half public. Since the Alliance began, what has been the trend in private capital inflows? What has been the trend with regard to investment by Latin Americans in their own countries? What studies have been made indicating the probable effects of increased flows of Government development funds on the flows of private investment funds?

Answer. It was never envisioned that new capital supplied to Latin America during the current decade would come equally from public and private sources. Rather it has been clearly understood that most of this capital—more than three-quarters—would come from public sources. Major reliance on public funds was recognized in the Charter of Punta del Este, establishing the Alliance for Progress (title II, ch. 1, par. 4).

I also indicated this in my testimony before the Senate Committee on Appropriations on August 23, 1961. At that time, I said that the $2 billion annual figure for external capital resources expected for Latin America would be comprised, on the average, of about $1 billion or $1.1 billion in U.S. Government assistance, $300 million in private U.S. investment, and the remainder in capital provided by the World Bank, IDA, the Inter-American Development Bank, and by public and private sources in Europe and Japan. (Foreign assistance hearings on H.R. 9033, Senate Committee on Appropriations, p. 212.)

Data on non-U.S. private capital flows are not available in sufficient detail to provide a useful response. U.S. net private direct investment outflow to the Latin American Republics has been as follows:

[In millions of dollars]

	Net outflow to Latin American Republics [1]	Net reflow [2] from Venezuela	Net outflow to Latin American Republics excluding Venezuela
1961	173		173
1962	−32	−199	167
1963	63	−36	99
1964 (January through September)	91	(3)	(3)

[1] Data do not include reinvested earnings of U.S. subsidiaries which were $225,000,000 in 1961, $268,000,000 in 1962, and $173,000,000 in 1963.
[2] Reflects reflows of an exceptional nature, largely related to petroleum investments.
[3] Not available.

Total external assistance to Latin America amounted to about $2 billion in fiscal 1964. This was equal to approximately 20 percent of total investment in Latin America. Because the Latin American countries do not compile data on domestically financed investment, no further detail is available. The figures cannot be derived from national accounts and balance-of-payments statistics since different concepts of investment are used.

Many studies have been and are being made on investment developments in Latin America. The Economic Commission for Latin America (ECLA), the Inter-American Committee on the Alliance for Progress (CIAP) as well as U.S. Government and private groups are among those involved. Extensive studies have, of course, been made and published in connection with the hearings before the Subcommittee on Inter-American Economic Relationships of the Joint Economic Committee.

Although no specific study, as such, on the subject of the effect of foreign assistance on private investment flows in Latin America comes to mind, many of the aforementioned studies deal with this subject. It is difficult to think of a way in which foreign assistance does not promote and assist both United States and Latin American private investment. The loan or grant money provided will increase the amount of foreign exchange which the borrowing country can use for the purchase of goods and services. By contributing to the general growth of a country, and thereby helping to raise the level of per capita income, foreign assistance helps to increase not only the country's, but also the individual's demand for goods and services. Foreign assistance thus increases the size of the market for the goods which private investment produces.

Many of the projects themselves directly assist the development and expansion of private enterprise. There are a number of projects whose purpose is to increase the availability of long- and medium-term credit. Other projects are designed to build the infrastructure which private enterprise must have if it is to expand. The building of roads can also provide the means for bringing the large unintegrated portions of a country's population into the money economy, again increasing the size of the market and stimulating private investment to expand further. Other loans are made directly to a particular company in order to help it grow.

The beneficial effects on private investment of the expenditure of Government development funds are clearly acknowledged and welcomed by U.S. business leaders. The Government has worked in harmony with private interests in this respect, and the outlook is very encouraging. David Rockefeller, president of the Chase Manhattan Bank, recently announced, for example, the merger of three separate U.S. business organizations, with interests in Latin America, into a single organization known as the Council for Latin America. About 175 major U.S. business corporations are members of this new council. Its chairman is Mr. Rockefeller and Mr. John F. Gallagher, vice president of Sears, Roebuck & Co., is senior vice chairman. A recent statement by Mr. Rockefeller, on behalf of one of the merged groups—the Business Group for Latin America—in support of an increase in the resources of the Fund for Special Operations of the Inter-American Development Bank, may be of interest. In the statement he submitted, Mr. Rockefeller said (hearings on S. 805, Senate Foreign Relations Committee, Feb. 5 and 8, 1965, p. 125) :

"At first glance, the $750 million contribution for use by an international organization in support of social progress and economic development might appear to have a distant relationship to the success and future of American investments with and trade with Latin America. In fact we have learned from experience that there is a direct relationship between the quality of life and the standard of living of the peoples of Latin America and the success of industry and private enterprise in those countries. As local industry and enterprise prosper, so is there greater opportunity for American investors and exporters * * *

"Not only is it right that all people should enjoy a better life, but it also happens to be good business. We have found this to be true here in the United States. Businessmen realize that we are all better off now than we have ever been in our history, because all have shared in the general prosperity * * *

"Private money can certainly not provide all the necessary infrastructure. We are developing an effective partnership between public and private investment in the developing countries, with public investments going primarily to infrastructure and, as I have indicated, to social progress, and private money going in part to infrastructure and more especially into industry. This is a healthy and growing partnership * * *."

Question 2. "The administration has taken a number of steps to curb the flow of private investment overseas while, at the same time, asking for a $750 million increase in the U.S. contribution to the Inter-American Development Bank. It has been asserted that loans made by the Bank will not adversely affect the U.S.

balance of payments because most of the loans will be tied to U.S. exports. How much of the loans will be tied to U.S. exports? How much of the loan funds will be used for materials, much of which might be purchased in the United States, and how much will be used for local costs, such as for wage and salaries? In view of the high local costs inherent in the kinds of projects financed by the Bank's Fund for Special Operations, how does the administration conclude that 80 to 90 percent of the loan funds are tied to U.S. exports and thus without adverse impact on the balance of payments?"

Answer. It should be noted that the steps provided in the balance-of-payments program to restrain our outflow of capital relate to the advanced industrial world. It is here where increased flows have endangered our progress toward balance and where increases in dollar reserves to financially strong countries lead to potential calls on our gold. The Latin American countries which would be the recipients of loans made possible by the expansion of the Fund for Special Operations (FSO) of the Inter-American Development Bank, on the other hand, typically have a low level of reserves and a great need for dollars for imports and development. Nevertheless, to assure that any possible impact on our balance of payments arising from the U.S. contribution to the FSO is minimal, these contributions will be tied to U.S. exports in the same way our contributions to the Social Progress Trust Fund are now tied.

While it is not feasible at this time to forecast the portions of the U.S. contribution that will be used for loans involving the importation of materials directly for the particular project financed or for local costs, all available data indicate that well over 80 percent and possibly over 90 percent of the loan funds will be tied to U.S. exports, and thus without adverse impact on our balance of payments.

This will be true regardless of whether the project requires direct imports of goods and services from the United States or requires—as do a substantial number of projects of the type financed by the FSO—mainly goods and services purchased locally. In the latter case, dollars would permit the acquisition from the domestic banking system of local currency for local expenditure. But the dollars themselves, instead of being freely available to the local banking system, would be available only in the form of letters of credit on banks in the United States. These dollars can therefore only be used for payments to U.S. exporters through normal U.S. commercial banking channels, and only with the usual bills of lading and other documentation that guarantee that U.S. exports have actually taken place. In exceptional cases—probably less than 10 percent of the U.S. contribution—dollars might be used for purchases in other Latin American countries. This has been the experience under the Social Progress Trust Fund. Even in the case of this small portion, normal trade patterns indicate that roughly half of these dollars would be spent for U.S. goods. The overall expectation is, therefore, that 80 to 90 percent of the U.S. contribution to the FSO would come back to the United States in payment for exports.

It is sometimes suggested that, granted the effectiveness of the tying arrangement, its effect might be to release other Latin American dollar earnings for expenditure in Europe. However, the latest figures for Latin American trade and payments show that Latin America is in payments deficit with the United States, but has net earnings from Europe and the rest of the world. Accordingly, free dollars obtained by Latin America would be used to meet payments to the United States, not to Western Europe where Latin America is already receiving more than it is paying out.

Question 3. In their recent report on the U.S. balance of payments, a group of economists from the Brookings Institution noted that "the longrun evolution of the U.S. balance of payments may well require that a higher percentage of U.S. receipts be earned by investments abroad." In light of this opinion, what will be the likely longrun U.S. balance-of-payments effect of the measures recently announced by the President aimed at discouraging U.S. capital flows and income earning investments abroad?

Answer. We recognize that, over a sufficient period of time, U.S. investments abroad more than pay for themselves through the return flow of dividends, interest, and loan repayments which they generate; and that, in the long run, these outflows thus become a source of strength for our balance of payments.

Our profits and interest on past investments abroad are indeed an important, and growing, plus factor in our international accounts. Such earnings last year—from our total accumulation of private investments abroad—amounted to an estimated \$4.8 billion, and that is \$1.8 billion more than we had earned from such investments in 1960.

We also realize that the new measures to restrain capital outflows announced in the President's message can, in future years, have some adverse effects on the extent, or the pace, of potential further increases in our balance-of-payments income from such investment earnings.

In the short run, however, these new investments abroad represent a very heavy drain on our balance of payments; and the problem plainly confronting us is that our capital outflows have been growing too fast, in relation both to the inflows they generate and to the gains we have been achieving in other areas of our international payments. Last year these investment outflows swelled to a total of nearly \$6½ billion, which is \$2 billion more than the 1963 level and \$2½ billion above that for 1960.

The immediate effect of such capital outflows—during the period of some years which must be expected to elapse before very many of them can, and do, generate an equal return flow of earnings and repayments—is to add further to the accumulation of liquid claims by foreigners on the United States, which if permitted to continue, will inevitably lead to further gold outflows. Under present circumstances, it is these immediate, shortrun effects of U.S. investments abroad on our international payments position which must be our primary concern.

Question 4. How is the President's pledge in the Economic Report "to continue and strengthen measures to promote U.S. exports" served by his desire to reduce U.S. loans and investments abroad, many of which finance U.S. exports?

Answer. The interest equalization tax enacted by the Congress last year and the several new measures to restrain capital outflows outlined in the President's recent balance-of-payments message have all been carefully formulated with a view to avoiding any possible interference with the financing of U.S. exports.

The basic provisions of the Interest Equalization Tax Act explicitly exempted from the tax credits arising out of export sales of U.S. goods and services as well as certain other export-related loans.

The Gore amendment to that act, pursuant to which the tax has now been applied by Executive order to bank loans of 1 year or more maturity, also contains a provision exempting export-connected loans by banks from the tax.

Likewise, the broadening of the covering of this tax to apply to nonbank credit of 1- to 3-year maturity, which the President requested from the Congress in his message, would of course be expected to be subject to the same or similar exemptions for export financing.

Under the broad program of voluntary cooperation by banks to limit their lending abroad being undertaken pursuant to the President's balance-of-payments message, an overall quantitative objective has been expressed, statistically, in terms of total outstanding credits to foreigners—but the basic qualitative guideline is and will continue to be the request by the Federal Reserve System, as stated in its press release at the time of the President's message, for "all banks to limit credits to foreigners that are not clearly and directly for the purpose of financing exports of U.S. goods and services."

In the case of the parallel program for voluntary cooperative action by nonfinancial corporations, the guidelines outlined for these firms by the Department of Commerce are directed, on the capital flows side, toward reductions in those types of investments and asset holdings abroad which neither serve to finance exports nor can otherwise be expected to result quickly in increased exports. Moreover, both these guidelines and the reporting being requested on results achieved also give a strong positive emphasis to further expansion of exports from the United States—as one major means, among the several possible alternatives, through which individual companies may find it most feasible and desirable to accomplish the basic objective of a substantial improvement in the net impact of their total foreign transactions on our balance of international payments.

Question 5. It was unequivocably stated by the administration during the debate on the tax cut that more forceful use of tax policy in support of economic expansion would give greater freedom to use monetary policy to strengthen our balance-of-payments position. Has monetary policy been used more vigorously in correcting the balance of payments? How does the President's recent statement that he "expects" (and, in effect, warns the monetary authorities) that a continuation of essential stability in interest rates is necessary mesh with the administration's earlier pledge at the time of the tax cut that monetary policy would have great freedom and usefulness?

Answer. The question infers that President Johnson's recent statement that he expects a continuation of essential stability in interest rates involved a warning to the monetary authorities. This altogether misinterprets what the President actually did say in his recent balance-of-payments message. The relevant passage is worth quoting in its entirety:

"I am confident that the Federal Reserve, in carrying out its responsibilities for monetary policy, will continue its efforts to maintain short-term rates of return in the American money market. The Treasury will fully cooperate. At the same time—and in view of the heavy flow of private savings into our capital markets—I expect the continuation of essential stability in interest rates."

Far from "warning" the monetary authorities, the President's statement clearly affirms the responsibility of the Federal Reserve for the determination of appropriate monetary policies. His statement directs specific attention to short-term interest rates because of their obvious influence upon flows of liquid funds between our own and foreign money markets. His accompanying reference to the continuation of essential stability in interest rates was explicitly linked to an expectation that heavy flows of private savings into our capital markets would be continuing in the future, as they have during the current economic expansion. These observations are in no way inconsistent with administration policy before or after the tax cut.

Despite the view expressed in the first part of your question, it was not the administration's position in advocating passage of the Revenue Act of 1964 that more forceful use of tax policy in support of economic expansion would necessarily give rise to more restrictive monetary policies to strengthen our balance-of-payments position. For example, President Johnson stated in his 1964 Economic Report to the Congress that it would be self-defeating to cancel the stimulus of tax reduction by tightening money. He pointed out, however, that monetary policy must remain flexible so as to be able to shift if, unexpectedly, inflation threatened or if required in defense of the dollar internationally. The consistent administration approach was not that tax reduction should be accompanied by credit tightening to improve the balance of payments, but that tax reduction would remove some of the burden of supporting and facilitating domestic expansion from monetary policy, thus leaving monetary policy in a position to respond more flexibly, when and if needed, for balance-of-payments purposes. At the same time, the stimulus of tax reduction helped create an environment in which monetary and debt management policies could play a continuing role in keeping our own short-term interest rates, important for the balance of payments, in reasonable alinement with key rates abroad, without jeopardizing healthy business expansion. A number of steps, including an increase in the discount rate to 4 percent, have been taken to increase short-term rates since the tax cut was created.

This same approach was reiterated in President Johnson's 1965 report with explicit reference to the possible use of monetary policy to prevent an outflow of liquid funds which could worsen our balance of payments. At the same time, however, it was noted that long-term borrowers could reasonably plan on the essential stability of long-term interest rates in 1965.

Monetary and debt management policies have cooperated in achieving a gradual increase in short-term interest yields since early 1961 of about 1¾ percent. During that same period most long-term interest rates have remained relatively stable or declined somewhat. The rise in short-term yields has made an important contribution to the balance-of-payments problem while stable long-term rates and ample availability of credit have facilitated domestic expansion.

There is no inconsistency between President Johnson's statement that essential stability in long-term interest rates is expected to continue, and the view expressed at the time of the tax cut, and before, that our own short-term interest rates would have to be held in reasonable correspondence with rates in other major money markets. Furthermore, the fact that monetary policy must be free to meet unforeseen contingencies, whether domestic or international, has been and remains to be administration policy.

Question 6. What is your assessment of the recent concern that has been expressed about a deterioration of the quality of credit, particularly mortgage credit? It has been noted, for example, that the foreclosure rate has been rising steadily and that the total of foreclosures is higher than at any time since 1939.

Answer. It is clearly essential to be alert to trends in the quality of mortgage or other credit to guard against developments that could culminate in serious difficulties. This responsibility must be felt with particular force by those agencies that are actively engaged in the supervision of mortgage lending and insuring activities as well as by the lenders directly concerned. Despite somewhat less favorable experience in recent years than during the earlier postwar period, however, any deterioration does not now appear to be cause for unusual concern. This does not mean that complacency is warranted. The entire matter of the quality of credit must, and will, be kept under close review.

The fact that total nonfarm real estate foreclosures last year appear, on the basis of incomplete data, to have exceeded those in any year since 1939 is by no means necessarily indicative of any worsening of the quality of mortgage credit over that period. In 1939, when there were 100,410 foreclosures, the total value of nonfarm mortgage debt outstanding is estimated to have been about $28.9 billion. By the end of last year, the volume of outstanding mortgage credit had increased more than 10 times to an estimated $291.6 billion; yet the total number of foreclosures was probably not a great deal above the 100,000 level (there were an estimated 81,696 foreclosures during the first three quarters of 1964, fourth quarter data are not yet available). It is true that nonfarm real estate foreclosures expressed as an annual rate per thousand homes mortgaged have shown a more or less steady tendency to increase in the last 10 to 12 years, with a good bit of the increase occurring in more recent years.

Some increase in foreclosure rates is probably to be expected as a normal consequence of a greatly expanded scale of mortgage lending on easier terms at a time of price stability, following the period of increasing prices and very low unemployment in the early postwar years. Current foreclosure rates are still very low in contrast to those that ruled in the depressed 1930's and as such they are not a cause for great concern.

Furthermore, it also appears from other data that the delinquency rates experienced by private lenders have recently stabilized and in some cases shown declines. It is reasonable to suppose that some of the recent improvement in these delinquency rates is also reflected in the higher rate of foreclosures to which the question refers. Hence, the figures on foreclosures are not readily subject to simple interpretation.

While it is not believed that there is convincing evidence, statistical or otherwise, of any serious deterioration in the quality of mortgage credit, the overall situation will continue to demand close attention. There has been an increase of about one-third in the volume of outstanding mortgage credit in the past 4 years. This testifies to the strength of the current overall economic expansion and to the large flow savings available for mortgage lending: both of which are causes for great satisfaction. At the same time, it is important that lending institutions not lose sight of the need for ample margins of capital and liquidity to support their increased lending activity. Finally, the quality of credit, in the last analysis, depends upon our ability to maintain the forward momentum of the economy, for the capacity of borrowers to meet their obligations is related to their ability to find jobs and to maintain their incomes.

Question 7. Concern is being felt that 1966 could bring a recession. Since a number of deflationary factors may be at work at that time, is it wise for the stability of the economy to propose an increase in payroll taxes to take effect at the beginning of 1966? Doesn't this proposal account in large measure for the deflationary increase in the full employment budget surplus which is expected for the first half of 1966?

Answer. It should be observed that the people most interested in social insurance programs, namely, the potential beneficiaries, are willing to carry the burden of payroll taxes in order to obtain the assurance of benefits that this whole system provides and to avoid a means test. Granted this consensus, the extension of new benefits and the extension of additional payroll taxes are not on balance deflationary. At a particular time when the benefit increases and the tax increases go in at slightly different times, there can be in one year an expansionary influence and in another year a deflationary influence. By and large, we should regard these policies in terms of just what kind of social insurance system we want, and we should regard the expansionary or deflationary consequences associated with the timing as subsidiary factors which must be taken care of as they come along in our overall fiscal program.

Eliminating both the expanded benefit programs and the payroll tax increase under social security would not overall change our fiscal situation in 1965 and 1966 taken together. If the thrust of the question is that perhaps we should extend benefits under the social security program, but pay for these through the general budget rather than through increased payroll taxes, all I can say is that there are some who feel that this would be an improvement in our social security financing. The administration is satisfied with the principle of self-financing of social security and we are not making any recommendations in this direction. This issue can be given further consideration.

Question 8. The administration's program includes reduction of excise taxes, the imposition of user taxes, and some plans relating to altering tax rates in order to combat economic instability. Little or no mention is made of the need for basic tax reform. Has the administration abandoned this goal?

Answer. The administration has not abandoned the goal of basic tax reform. The program for elimination of some unjustifiable excise taxes and the imposition of some defensible user costs is itself a step in the basic reform of our overall tax system.

As you know, part of this rate reduction enacted in the Revenue Act of 1964 only takes effect in 1965. In addition, there are a number of new rules which tax practitioners must become acquainted with as a result of the Revenue Act of 1964. These reasons alone would suggest that the Congress might do well to refrain from further large-scale income tax revision in 1965. I might add that this schedule also fits in with the situation within the Ways and Means Committee. We have rather deliberately postponed the consideration of many excise tax matters pending the completion of the major income tax projects that occupied our attention since 1961. Quite reasonably, the Congress should turn to these problems when they consider tax legislation this year. It is also significant that a major piece of the President's program; namely, social security revision, must be dealt with by the Ways and Means Committee and by the Finance Committee which would preclude undertaking large-scale tax projects over and above excise tax and user charge revisions.

I would like to add that the Treasury Department is continuing to study basic tax reform. I might call your attention in particular to the recent report on private foundations.

Question 9. The table below indicates the decline, since 1957, in the percentage of total interest-bearing debt accounted for by nonmarketable issues and the rise in the percentage accounted for by marketable issues. What is the immediate and longrun significance to debt management and interest policy of the increasing reliance that is being placed on the market in raising funds to finance Federal budget deficits?

Percentage distribution of interest-bearing debt

End of fiscal year	Total interest-bearing debt	Percentage marketable	Percentage nonmarketable	Percentage special issues
December:	*Millions*			
1957	$268,486	58	25	17
1961	285,672	66	19	16
1964	313,553	68	18	15

Answer. The increase in marketable debt over the 7 years from 1957 through 1964 is $48¼ billion, about $7½ billion more than the rise in the total interest-bearing debt. Special issues to the trust funds increased slightly ($0.3 billion) and public nonmarketable issues decreased by about $8 billion.

The $8 billion decline is mainly due to the voluntary exchange of nonmarketable issues by private investors for marketable securities. Investment B-bonds, for example, which were offered in the early 1950's in exchange for long-term marketable bonds, carry an escape clause permitting a holder to turn them back to the Treasury on demand, but only for low-coupon (1½ percent) 5-year marketable notes. About $6 billion of the investment bonds have been exchanged for these notes during the past 7 years, increasing marketable debt as well as reducing nonmarketable debt by that amount. In addition some $9½ billion of discontinued series savings bonds (F, G, J, and K) have been redeemed since 1957. A substantial portion was redeemed before maturity as the relatively low earning rates on these obligations became increasingly less attractive. Some of these redemptions were reflected in increased sales of series E and H savings bonds (which grew by $6¾ billion in amounts outstanding during this period). Of the $9½ billion discontinued series turned in, $1¼ billion of maturing F-and G-bonds were exchanged for marketable notes and bonds in special offerings.

Aside from E- and H-bonds which are attractive to all classes of Americans largely on the basis of safety, convenience, thrift, and patriotism—nonmarketable obligations issued to the general public have a number of potential disadvantages to the Treasury. It has generally been Treasury practice to sell such securities on demand (the investment series bonds are a notable exception) and to grant holders an option also to redeem them on demand, either in cash or in other securities. When such issues were available, sales fluctuated widely depending on competing rates of interest and redemptions in cash were heaviest when it was most inconvenient for the Treasury to replace these securities through market borrowings. Frequent changes of rates and terms on such securities present no solution to these problems in view of the likelihood of investors switching out of lower earning rate issues into higher rate issues with relative impunity.

In addition to series E and H savings bonds, the major categories of interest-bearing nonmarketable debt which have been expanding are the foreign series and foreign currency series securities, issued to foreign governments and central banks. These securities were designed to meet official foreign needs and to reduce gold outflow resulting from balance-of-payments deficits. However, they are closely tied to marketable issues, since they provide rates of return based on marketables of similar maturity. About $1¾ billion are currently outstanding.

Of the $48¼ billion growth in the marketable debt during the past 7 years, the Federal Reserve System acquired $12¾ billion and Government investment accounts about $5¾ billion. The Federal Reserve System added to its holdings of marketable Treasury securities as part of its continuing objective of maintaining a reserve base for bank credit expansion attuned to the needs of a growing noninflationary economy. Purchases of marketable instead of special issues by the Government investment accounts have benefited those accounts since these acquisitions in all cases carry equal or greater rates of return than statutory requirements for special issues.

The remaining $29¾ billion increase in marketable securities during the past 7 years was absorbed by private participants in the broad Government securities market. These include domestic banks, savings and loan associations, pension funds, insurance companies, State and local governments, charitable organizations, nonfinancial corporations, and individuals, as well as foreign official and private investors.

Many of these buyers find Treasury securities particularly suitable for their "secondary" reserves. Treasury issues are ideal for this purpose since they are liquid assets, easily salable, riskless as to principal, and yield a competitive rate of return. In addition corporations hold shorter term Governments as a reserve against tax liabilities and pension funds are steadily increasing their investment in longer term Treasury issues.

The Government securities market including all of its participants has amply demonstrated its capacity to absorb readily very substantial amounts of new marketable obligations. As an integral part of the money and capital markets it has been able to do this—despite record additions in recent years, to outstanding mortgage debt and corporate and municipal securities—due to the vast amounts of savings generated by our economy. Thus, while 3-month Treasury bill yields have been increased by 1¾ percent since 1961 for balance-of-payments reasons, long-term yields increased relatively little and there has been no noticeable upward impact at all on interest rates in the longer term private capital markets. In fact average conventional mortgage rates are three-eighths of 1 percent lower than in 1961, recent offering yields on new high-grade corporate bonds are about one-eighth of 1 percent lower than levels in the spring of 1961 and a well-recognized municipal bond yield index which is currently at 3.17 percent was at 3.55 percent in September 1961.

It appears safe to say, therefore, that the capital and money markets will continue to have the capacity to absorb reasonable additional amounts of marketable Treasury obligations in the foreseeable future.

Chairman PATMAN. Senator Douglas?

Vice Chairman DOUGLAS. Mr. Secretary, for the first three quarters of last year the deficit in the balance of payments was running at the rate of $2 billion, or a total of $1½ billion. In the fourth quarter, the deficit, as I understand it, ran at the rate of $6 billion, or a total of $1½ billion, making the figure for the year $3 billion. Why was the fourth quarter experience so unsatisfactory?

Secretary DILLON. Those figures are essentially correct, Senator. I think the latest Commerce figure shows a rate of $5.8 billion for the fourth quarter, but that is essentially the same as 6.

There were a number of reasons. I think I can mention two in particular, or three.

One was the fact that there apparently had been a number of provinces and private entities in Canada which, until the interest equalization tax was actually enacted and the President had approved an exemption for Canada, had not wished to do financing which they had planned to do and wanted to do. So there was a big bunching of Canadian financing in the months of October and early November that was extraordinarily large. That has since fallen off, and we don't know of any continuing financing at that sort of a rate for this year. The Canadian authorities don't expect it. That is one thing.

The second thing was the continued sharp rise and continued large outflows in long-term bank lending abroad, which is one of the things——

Vice Chairman DOUGLAS. To what countries?

Secretary DILLON. The largest part, two-thirds of it, went to Europe. This bank lending was the reason that the President has invoked the Gore amendment regarding bank loans. Probably most important is the third point, the crisis in Great Britain, a sterling crisis, which had a number of side effects. The lack of confidence in sterling apparently had some repercussions on the dollar, and there was a strain and a movement out of the dollar on a short term basis in a larger amount than we had foreseen or expected.

However, the British, as part of their program, and in view of their obviously difficult situation, exercised their right under a law passed in the mid-1950's to defer their debt payment, of something like $140 million, equal to $560 million at an annual rate, that was due otherwise at the end of the year.

I think these are the three main causes. I think the general feeling is there would have been some deterioration anyway right across the board, but it would not have been anywhere near that size. We still would have come out with a deficit.

I would say upward of half the worsening was due to special causes.

Vice Chairman DOUGLAS. The last gold reserve figures for the United States that I have seen at the end of December 1964 I think was $15.1 million or $15.2 million. What was the loss of gold in January and in February up until this date?

Secretary DILLON. Well, the Treasury gold stock has declined by $450 million since the first of the year.

Vice Chairman DOUGLAS. Since the first of the year? Has nearly all of that gone to France?

Secretary DILLON. I wouldn't say so.

Vice Chairman DOUGLAS. Has most of it gone to France?

Secretary DILLON. I would say about half. There was $150 million, which we are all aware of, and then the regular monthly purchases.

Vice Chairman DOUGLAS. I have seen some estimates that the direct annual claims which France has against the dollar amount to approximately $500 million each year. Are those estimates correct?

Secretary DILLON. The French balance-of-payments surplus, which is accumulated either in dollars or gold, last year was about that—on an official accounts basis, their official reserves rose by about $650 million.

Vice Chairman DOUGLAS. If France carries out the policy of General de Gaulle, as I presume it will, it will ask for its increase in balance of payments in gold rather than accepting it in foreign exchange, and since their claims are nearly all, as I understand it, against the dollar rather than against the pound, this would expose us to a potential loss of somewhere around half a billion dollars of gold each year.

Secretary DILLON. If the situation stays the same and France continues to have such a surplus, which I don't think will be the case if we bring our balance of payments into balance or near balance.

Vice Chairman DOUGLAS. And you need around $300 million a year of gold to provide for the increase in the Federal Reserve notes?

Secretary DILLON. Maybe a little more than that, possibly a little more than that. Certainly in the next few years we need a little more than that, as we retire silver certificates and replace them with Federal Reserve notes.

Vice Chairman DOUGLAS. That would be, say, $350 million a year?

Secretary DILLON. It is running higher than that. About $500 million a year for a year or two until this silver certificate problem is finished. Once that is finished, it will drop back.

Vice Chairman DOUGLAS. So you have got $500 million there. It looks like a claim of $500 million from France. There is a billion a year. In a few years you are going to face the problem, unless something is done, of whether this lengthening of the gold tether is going to be adequate.

Secretary DILLON. Certainly the important thing there, Senator, I think, is what you mentioned "unless something is done." The intent of the President's balance-of-payments program, is to really do something that will reduce this outflow of capital to manageable proportions, and bring our payments back into such a state of balance that we don't lose any more gold on an overall basis—although we still may to some countries—and instead, actually, if anything, gain some gold from the new production in the world.

Vice Chairman DOUGLAS. If the voluntary system doesn't work, what then?

Secretary DILLON. We don't want to look forward to that.

Vice Chairman DOUGLAS. You always have to provide for contingencies. You must at least have some plans for contingencies, in case things don't work. You can't always assume that you are going to be successful.

Secretary DILLON. Well, I think that one has to realize that the protection of the dollar has to be an overriding policy objective of the President. I think he has made that very clear. He made it clear in the text that was released to the press of his statement to the businessmen and bankers that were present at the White House the other day.

If these measures don't work, he would have to look and see what else was necesary.

Vice Chairman DOUGLAS. My final question is about the international gold exchange standard in which the funds for international liquidity consist not merely of the $40 billion in gold but the $26 billion in foreign exchange, nearly all of it claims against the dollar.

The pound and the dollar are the only two currencies which internationally are convertible into gold, isn't that true?

Secretary DILLON. Only the dollar.

Vice Chairman DOUGLAS. Only the dollar?

Secretary DILLON. That is right.

Vice Chairman DOUGLAS. You mean the pound is not now convertible?

Secretary DILLON. It hasn't been; no.

Vice Chairman DOUGLAS. Since when?

Secretary DILLON. Well, they don't make the same agreement. They don't give gold to people that turn in sterling—not since the war. They give them dollars instead.

Vice Chairman DOUGLAS. Then we bear the full burden of that $26 billion of foreign exchange, and we alone then are subject to the liability of converting it into gold. If there should be a raid on the dollar, as happened to the pound in 1931, causing a shrinkage in the total supply of international currency, and a fall in international price levels followed by an international depression, what could we do?

Secretary DILLON. I would say that that would be a catastrophe not only for the United States but for the rest of the world, and that is the reason it is essential to take the strong action that we are now taking to bring our payments into balance, so that won't happen.

Vice Chairman DOUGLAS. Do you think there is a need for a better international monetary system?

Secretary DILLON. Yes, I do. The problem with that, if I may say a word or two about it, is we have not made much progress except for the enlargement of the resources of the IMF, which is now agreed to. But even that was difficult and took a longer negotiation than would have seemed to have been necessary.

The problem is that we and a few other countries, in looking at this problem are looking to the day when our balance of payments is in order, and when the supply of liquidity in the world to finance swings in world trade and swings in the balance of payments of different countries has to grow but is not going to be continually supplied by substantial U.S. payments deficits. So we are trying to find some alternative way to handle what is an obvious necessity for increased credits and liquidity.

A great many other countries, including certainly the majority of those on the Continent, even when they will theoretically agree that this is desirable and something ought to be done about it—will agree in writing to that—have a different objective which is paramount in their minds at the moment. That is taking some action, if any action at all is taken, that will force a prompt end to what they consider the excessive deficits in the U.S. balance of payments, and to the excessive accumulation of dollars in the last few years in the world.

So it has proved impossible to really negotiate, because every time we sit down, we are talking about different things.

I think that the only way we can negotiate to improve the monetary system internationally is first to bring our payments into balance. That will bring a certain amount of pressure on these other countries of a different nature from that which they have been subjected to up until now. I think then they will be ready to talk. I think that is what the experience of the last few years shows.

Chairman PATMAN. Senator Miller?

Senator MILLER. Mr. Secretary, somewhat connected with Senator Douglas' question, last year I understand our favorable balance of trade grew by $1.6 billion. In other words, our export balance over imports improved as against the year before by $1.6 billion. All things being equal, we might expect as a result of that to have our balance-of-payments deficits improved by $1.6 billion, but actually the balance-of-payments deficit dropped from only $3.2 to $3 billion. So it only improved by $200 million; $1.4 billion of that favorable balance-of-trade increase was absorbed by some problems. Would you say that the answers you gave to Senator Douglas regarding those special situations, I believe you mentioned three of them, would be primarily the reason for the failure of the increased trade balance to improve our balance-of-payments deficit?

Secretary DILLON. Yes. Last year we had an improvement on our commercial trade balance, which excludes exports financed by the Government. The figure I have is about $1.450 billion. In view of that, we should have had an improvement overall. But, at the same time our capital outflows went up by about $2 billion in this one year, and that not only absorbed the trade improvement but absorbed more besides. We also had a sharp increase in our return on our investment abroad, and that is what enabled us to improve silghtly our overall performance—improved it by about $250 million over the year before.

Senator MILLER. The point I want to bring out is that back in 1962 at the time of the Trade Expansion Act consideration, we were told that the best guarantee of eliminating, or at least getting down to manageable proportions, the balance-of-payments deficit problem was by increased trade, and this indicates that there is much more to it than that, I believe.

Secretary DILLON. Oh, it is much more complex than that, although I think we have felt that, as long as we can maintain price stability as well as we have, particularly in comparison with the rest of the world, a freer trade pattern is in our interest, in our national interest, and that expanded world trade brings good to everybody.

But, of course, it is not the sole answer to this problem by a long shot.

Senator MILLER. Thank you.

You say:

> Maintenance of a healthy rate of domestic economic expansion, free from inflation, will continue to require coordinated use of the tools of fiscal, monetary, and debt management policy.

That word "continue" bothers me a little bit. You also say:

> This is a clear record of noninflationary finance.

Now, according to the President's Council of Economic Advisers in their economic report to the President, last year saw an increase in gross national product of $38.4 billion, but reduced to real dollars it only came to $27 billion, which means that there is $11.4 billion of inflation last year. That is 30 percent of our increased gross national product.

I am wondering how you can talk about a noninflationary finance system and talk about continued freedom from inflation in the face of those figures.

Secretary DILLON. Well, it depends on what figures you are using. There are various ways one can measure the value of the dollar. You can measure it in terms of the gross national product deflator which is the concept you are using. You can measure it in terms of the Consumer Price Index, where prices have gone up about 1.2 percent a year—one of the best records, of course, anywhere in the world. Or what is particularly important for our balance of payments, and that is the area I am particularly interested in, you can measure it in terms of wholesale price indexes, where for the last 6 years our prices have increased on the whole only half a percent.

Actually, at the end of the year, they were the same as they were 6 years before. They may be slightly higher now, a half percent or something of that nature.

That certainly is, I think, a noninflationary record in the area in which it is most important; namely, the area that directly affects our balance of payments. The record shows that it is a result that is unequaled by any other industrial country in the world.

Senator MILLER. In other words, you are saying that when you talk about the noninflationary financing and the record, the continued freedom from inflation, you are really talking about the stability of the wholesale price index?

Secretary DILLON. Primarily, I think, that is right. There is an upward bias in the Consumer Price Index and in the GNP deflator because of the inclusion of large elements of services, and also in the case, particularly, of this GNP deflator. I think there are probably difficulties in the way it is put together. This would require some very careful economic analysis, but in computing that index there is no provision for any improvement in the productivity of government employees. Changes in the whole government pay scale are directly reflected in the deflator, and strongly. When there is a rise in government salaries, either State and local or Federal, that causes a big jump in that price deflator.

Now, ordinarily when wages go up, it is accompanied in industry by an increase in productivity, and the price deflator may not be affected. Certainly I know from my own experience in my own department that there have been continued and steady increases in productivity of the Government as it mechanizes and does more effective work, and this has been continuing for the last 15 or 20 years. I think it will continue to improve. And so I think until some method can be found for adjusting for that increased productivity and output, which I know is very difficult—that is probably the reason that they haven't done it—the GNP deflator will not be a completely accurate measure of change in prices and costs.

Senator MILLER. I think it very well to make it eminently clear that what you are primarily talking about when you are talking about this noninflationary financing, and this continued freedom from inflation, is the wholesale price index.

Secretary DILLON. I think that is right.

Senator MILLER. Now, of course, when I would talk about it, I might tell you that I would not be talking about the wholesale price index, because I do believe that the consumer retail price index is generally regarded as what is the test of stability in the purchasing power of the dollar. But I am interested in pursuing what you were just talking about to this extent. You have been talking a little bit about wage-price guidelines. Now, as you well know, there are some major industries which are operating under escalation clauses in the labor-management contracts, and those escalation clauses to the best of my information relate to the retail price index, and they have nothing to do with the wholesale price index. Because of this upward bias that you have referred to, and because of this increased productivity that you have referred to, would it be your suggestion that these escalation clauses not be carried into effect, or at least not negotiated because of the fact that they are based upon something with an upward bias, and do not take into account the increased productivity of the services of government?

Secretary DILLON. No. When I mentioned all that, I was talking about the GNP price deflator, which shows a larger element of inflation or price change, if you want to mention it that way, than does the Consumer Price Index. The Consumer Price Index, of course, does take the effects of productivity change into account to the extent they are reflected in measurable prices of consumer goods. It doesn't take account of all quality changes, particularly in the field of services.

For instance, take medical care. You get improved medical care, and the price goes up. That higher price may reflect the fact you are getting better medical care than you used to, but the index takes no account of that. But even putting all that aside, again the record of the United States over the last 5, 6, or 7 years in consumer price stability is unequaled by any major industrial country in the world. The average in the last 4 or 5 years has been—I think it would go back 7 years, too—an increase of only about 1 percent or 1.2 percent, something like that, a year. I think that it is perfectly proper to have that sort of an increase in the labor contract, in the sense that labor productivity goes up more than that.

When the contract runs out, there can be a negotiation as to what a proper wage scale should be. Certainly that negotiation should take into account these escalations that have been taking place based on Consumer Price Index, and should take them fully into account. If you didn't take them into account in setting the overall wage package, you would be quite right. Then it would be an inflationary element.

Senator MILLER. Thank you. My time is up.

(Senator Miller supplied the following questions for the record and the Treasury Department submitted the accompanying answers:)

Question. With the purchasing power of the dollar steadily diminishing, is it not natural to expect a continued outflow of gold while we are in a balance-of-payments deficit position? Granted that this slippage is not great, we should recognize that the dollar was worth 46.6 cents (compared to a 1939 dollar worth 100 cents) 4 years ago, and today it is down to 44.4 cents in value. Would the outflow of gold have been as great if the dollar had remained at 46.6 cents in its purchasing power?

Answer. Certainly it may be expected that gold losses will continue as long as the U.S. balance-of-payments position is in deficit, whatever the reason. The question is therefore, whether a lessening of the purchasing power of the dollar would cause a further imbalance in our payments and lead to a greater gold outflow.

The effect which changes in the internal purchasing power of a country's currency may have on its external accounts depends, other thing remaining equal, on the changes which may also occur in the respective purchasing powers of other currencies. As a practical matter, when compared to other currencies the dollar has been among the most stable in terms of purchasing power.

For purposes of international comparison the wholesale price indexes provide one of the best indicators of changing competitiveness. The International Monetary Fund, in its annual report for 1964 included data which shows that since 1958, wholesale prices in the United States have remained unchanged, while wholesale prices in the United Kingdom and the European Economic Community (Belgium, France, Germany, Italy, Netherlands) increased approximately 10 percent. This stability covers 8 years including the 4 years referred to in the question. The favorable competitive position of the United States is also demonstrated in the large surplus which the United States has in its balance of payments on trade account. The decline in the purchasing power of the dollar which did take place between 1939 and 1958 was, of course, far less than that sustained by the currencies of the European and other countries devastated by war and reconstruction costs. As a result, during the late 1940's and 1950's, there were numerous devaluations of other currencies in order to bring them into a better relationship with the dollar.

Clearly, however, it would be unwise for us to depend on more than proportionate price rises abroad to offset inflationary movements here. Therefore, as stated in the President's balance-of-payments message, it is of utmost importance that we maintain price stability.

Question. What specific improvements should be made in the Area Redevelopment Act? Should it not be improved to include those areas which have lost a substantial amount of farmworker population?

Answer. It would be inappropriate for the Treasury Department to comment in detail at this time on any specific proposals the President may shortly make for improving the Area Redevelopment Act. In his budget message, however, the President urged prompt congressional action to extend the Area Redevelopment Act program, now scheduled to expire on June 30, 1965, with amendments that will allow Federal aids to be concentrated in areas of greatest need, as measured by unemployment and family income, and permit emphasis on the most effective types of assistance. Broadly, it is contemplated that special incentives would be provided to multicounty development regions which include areas especially suited to serve as centers for broader economic development. More liberal grants and substantial increases in funds would be made available for those public facilities most essential for economic development. A special fund would be established to help local communities meet part of their share of the cost of projects undertaken under other Federal grant-in-aid programs. And, Federal guarantees of working capital loans would be authorized for eligible industrial projects.

The Report of the Council of Economic Advisers (pp. 140–141) discusses experience with the Area Redevelopment Act and points out that four great principles have emerged from this experience: First, the scale of assistance must be sufficient to make a significant impact on the economic structure of the area. Second, the regions to be aided should be large enough to include a resource base for self-sustained growth and to support the full range of community services and public utilities. Third, new programs must place major emphasis on investment in those community facilities that are commonly deficient in depressed areas. And, fourth, the region must develop a plan for its progress if there is to be assurance that Federal aid to a region is to lead to recovery.

Question. What is the present rate of interest for short-term money in the London market as compared to that in the United States? Is it expected that this difference will continue for some time, and how will it affect our balance-of-payments deficit?

Answer. In comparing the possible effects which differences in short-term rates between two centers may have on the flow of funds between the two, the cost of forward exchange cover must also be taken into account. On this basis, there is presently a slight advantage in favor of the United States in the Treasury bill comparison and a slight advantage favoring the United Kingdom on other short-term paper.

There is constant fluctuation in the components; but a representative current quotation shows U.S. bills yielding 3.97 percent, United Kingdom bills yielding 6.32 percent, and the cost of cover at 2.82 percent. In this calculation, the interest arbitrage advantage favors New York by 0.43 percent, all on a per annum basis, for 90-day bills.

Yields on 90-day negotiable certificates of deposit in the secondary market in the United States are currently quoted at around 4.25 percent, compared to 7.5 percent for British hire purchase (finance company) paper. When the cost of cover is deducted, the difference favors the British paper by 0.43 percent per annum.

We have no information indicating that these differences have resulted in any significant flows of funds in either direction so far this year. It is not expected that differences will be allowed to develop between the two markets which would seriously affect the balance of payments in either country.

Question. The point is made that the large increase in bank credit of the past 4 years has been used to finance private borrowers and State and local governments. I am not sure I understand how the point is important. What difference does it make if the money supply increases at a faster rate than true economic growth, won't there be inflation regardless of whether the financing is of private borrowers or in the public sector?

Answer. The rate of growth in member bank reserves, which is an important determinant of the overall rate of growth in bank credit and the money supply, is determined independently by the Federal Reserve authorities in the light of their appraisal of such factors as the credit needs of the economy, the overall trend and outlook for business activity, and the state of the balance of payments. As the money supply and bank credit are adjusted to the needs of the economy, banks of course are free to place the limited funds at their disposal with competing borrowers, whether public or private. But when the financing needs of the Treasury are met, on balance, without resort to the commercial banking system, the entire increase in the volume of credit can be used, as it has been during the past 4 years, to finance private borrowers and State and local governments, helping to support the growth of those sectors of the economy.

Purchases of Government securities by commercial banks do not necessarily entail an inflationary expansion of money and bank credit—Treasury securities in fact provide an important element of bank liquidity, and when competing credit demands are low, a potentially important investment outlet. However, an expansion of bank credit and the money supply in excess of amounts required to support the growth of the economy simply to facilitate Treasury financing could lead to inflation. Clearly, this has not happened during the past 4 years, as the statement cited conclusively demonstrates. The question is apparently concerned not with a situation of the sort just described, but with one in which the monetary authorities increase bank reserves and the money supply so rapidly that the overall increase in bank credit is excessive and contributes to an inflationary situation, whether this were done to accommodate private or public borrowing. Actually, it is by no means self-evident that an increase in the money supply at a faster rate than "true economic growth" would always cause inflation, but undoubtedly there are many situations in which it would, particularly if the disparity in rates of growth were to persist over a fairly long period of time.

In any event, this has not been the situation over the past 4 years. The rate of growth in the money supply, on the usual definition of demand deposits adjusted and currency in circulation, has been much below the rate of growth in real national output. Since the beginning of 1961, the money supply has increased by 12.5 percent, or at a compounded annual rate of 3.0 percent, while gross national product corrected for price change has increased by 20 percent or at a compounded annual rate of 4.7 percent. Measured from the cyclical trough in the first quarter of 1961, the rate of growth in real gross national product has been 5.1 percent; that in the money supply has been 3.1 percent. Over these same periods, the growth in real output as measured by the Federal Reserve Board index of industrial production has exceeded the growth in constant dollar gross national product.

Question. Increased gross national product is of interest, but what is of deeper interest is true economic growth. How many billions of dollars in true economic growth does the administration claim we had in 1964? What annual rate of true economic growth did we have? How did this compare with the rate of increase in our money supply?

Answer. Gross national product in constant (1963) dollars increased in absolute terms by $27.4 billion between calendar years 1963 and 1964. This was a relative increase of 4.7 percent and compares with a 3.8 percent increase in the money supply over the same period. Between the fourth quarters of 1963 and 1964, the absolute increase in constant (1963) dollar gross national product was $24.5 billion, less than the calendar year increase because of the temporary effect of work stoppages upon output in the fourth quarter of 1964. The relative increase in constant dollar gross national product between the fourth quarters was 4.1 percent, while the relative increase in the money supply over the same period was 3.9 percent.

Question. What is considered to be "excess demand inflation"?

Answer. Excess demand inflation refers to a situation in which the aggregate of scheduled expenditures, private and public, exceeds the total output that can be made readily available at the current level of prices without shortages and bottlenecks in productive capacity or manpower. As a consequence of this excessive total demand, there will be a general tendency for prices to rise. My statement (p. 55, this volume) notes that, even where total demand is not excessive, costs and prices may be pushed up by pressures of wage bargaining and the pricing policies of large firms.

Chairman PATMAN. Thank you, sir.

Senator Sparkman?

Senator SPARKMAN. Mr. Secretary, I shall be very brief with my questioning.

I note with interest your discussion of interest rates, how the long-term rates have come down. You give the exact figures with reference to private rates. I don't believe you give the decrease in rates on long-term Government borrowings. But I note that you refer to the increase in the short-term yields as being 1¾ percent. And you say that that is a low price to pay for the savings that have come about, the things that have been accomplished.

Now, here is a thing that has been giving me some trouble recently. We are considering, at least there is to be submitted to Congress very soon, to the two Banking and Currency Committees, a housing bill.

One of the great problems that we have always had in housing is trying to get housing at a price that the lower income people could afford to pay.

In 1961 we adopted section 221(d)(3) that really provided, to some extent, a subsidy on housing that could be built for use by low income people. The formula we set in that was one that the interest rate would be the combined interest rates of short- and long-term borrowings.

Chairman PATMAN. The average.

Senator SPARKMAN. The average, yes.

By the way, that formula prevails with reference to housing for elderly, too, and it prevails with reference to college housing, loans to colleges very badly needed and extensively used throughout the country in order to make dormitory space available for students.

Now, every one of these is going to be adversely affected. In fact, I have just done a little figuring here; if my figuring is correct that 1¾ percent interest rate increase on a $10,000 mortgage would be $175 a year. That is almost $15 a month that is taken off this low-income group.

In other words, it pushes a great number out of the market. They are not able to get into the market. The same thing happens in the case of the elderly. May I say that this section 221(d)(3), housing, which has been a 3-year experiment, has been most successful. It hasn't reached as far down as we want, but now, with the increased short interest rates, and the calculations will have to be made on that basis the next time the adjustment is made, it is going to push the price still higher, which will push more and more people out of the possibility of using that type housing.

The program for elderly housing, with the direct loans provided for in the 1961 act, likewise has been successful. It has met with fine response throughout the country. Now, it is going to make that more and more difficult for them. The same thing is true, as I say, with the college housing. Now what is the answer to that?

Secretary DILLON. Well, part of the answer to that is, Senator, that our average interest rates on Government securities have not moved anywhere near this change——

Senator SPARKMAN. The one and three-quarters?

Secretary DILLON. The one and three-quarters, that you mentioned.

Senator SPARKMAN. I realize that that is a possibility, and I said I couldn't calculate it because you don't set out what the long-term average rate is.

Secretary DILLON. Yes.

Well, the advance rate of all of our——

Senator SPARKMAN. Borrowings?

Secretary DILLON (continuing). Outstanding debt is now 33 basis points higher than at the end of fiscal 1960. In fiscal 1961 there was a decline and a low point was reached. The average rate is about a half of 1 percent higher than at the end of fiscal 1961. I think that covers practically this entire increase in short-term rates, and that change in average is what we are really talking about. I think you said that law was passed in 1962.

Senator SPARKMAN. 1961.

Secretary DILLON. 1961, sometime during the year.

Senator SPARKMAN. Yes.

Secretary DILLON. Yes. Well, rates were moving somewhat upward at that time. I would say probably since that law was passed until today that the average rate has been changed by a little more than a half of 1 percent in terms of the total interest-bearing debt. What has happened is that the same time the average cost on mortgages without any subsidy has declined about three-eighths of 1 percent, which should benefit these types of housing when not financed through these programs.

So, one could say that the average cost to these individuals as a group has gone up much less than one-half of 1 percent. The subsidy for these particular projects has gone down in comparison with the other nonsubsidized rate. But you are comparing a rate of 5.8 percent for nonsubsidized funds with something like 3¾ percent under the Government program. They still have about a 2-percent subsidy.

Senator SPARKMAN. I don't follow you there on your figure about where you bring them into private rates, because these are rates charged on direct loans from the Government, and, therefore, they are not affected by the conventional mortgage.

Secretary DILLON. That is right. I meant the difference between what they pay the Government and what they would have paid in the private market.

Senator SPARKMAN. Well, of course, they are excluded from the private market. They don't have enough income to get into it.

Secretary DILLON. That is right.

Senator SPARKMAN. But what we are trying to do is to make it possible for them to get into it.

Now, let me say while I don't know just what the effect is, I had estimated that 1⅜ percent, which would be $137.50, of course, if you take a half a percent even that is better than $4 a month, and when you are talking to these people, $4 a month makes a world of difference.

I do know this. I know that our people, and I know the chairman of the House Banking and Currency Committee knows this is true, that the people down in the Housing Agency are very much disturbed about the ability to carry on these programs. It is something we can give thought to, anyhow.

Secretary DILLON. Certainly they are excellent programs.

Senator SPARKMAN. I invite your attention to it.

Secretary DILLON. If they are being impaired by this modest increase in our overall rate structure, I think we will just have to find some way to make sure they are effective and are carried on because they mustn't be stopped.

Senator SPARKMAN. I think we certainly owe it to this class of people to try to get decent sanitary housing within the range they can afford.

Secretary DILLON. I agree wholeheartedly with that, sir.

Senator SPARKMAN. Even if it does call for additional subsidization.

(The Treasury Department submitted the following additional statement for the record:)

Interest Rates on Federal Housing Loans

Senator Sparkman, during Joint Economic Committee hearings on February 22, expressed concern over the increased borrowing costs since 1961 in three housing loan programs under which interest rates charged long-term borrowers are tied by formula to the average interest rates or yields on all Treasury obligations. These three programs are as follows:

1. *Rental housing for low-income families.*—Section 221(d)(3) of the Housing Act of 1961 authorized loans with 40-year maturities at a rate not less than the average market yield on all marketable obligations of the United States, which was then (June 1961) 3⅛ percent. This formula rate is currently 4 percent. On a $10,000 loan, the monthly loan payment is $5.30 higher at 4 percent than at 3⅛ percent.

2. *College housing.*—The Housing Act of 1950 authorized loans with 50-year maturities at an interest rate not to exceed the average annual interest rate on all interest-bearing obligations of the United States plus one-fourth of 1 percent. The rate produced by this formula was 3⅜ percent in June 1961; it is currently 3⅞ percent. On a $10,000 loan, the monthly payment is $3.30 higher at 3⅞ percent than at 3⅜ percent.

3. *Senior citizens housing.*—Same loan terms as in college housing loan program.

The principal reason for the increased borrowing costs since 1961 under these programs is that the statutory interest rates are determined on the basis of the average rates or yields on all interest-bearing Treasury obligations outstanding, including short-term borrowings on which interest rates have increased substantially since June 1961. The average market yield on long-term Treasury obligations, however, has increased only one-fourth of 1 percent since June 1961, from 3⅞ to 4⅛ percent.

In general, administration policy is and has been that interest rate formulas in Government loan programs should be related to the current market cost of Treasury borrowing for comparable periods rather than to average yield of all interest-bearing obligations. Such a formula would have resulted in increases 50 to 70 percent smaller than have occurred under present law.

The cost of Treasury borrowing provides a benchmark for the cost of risk-free capital necessary to support the program. A formula of this type is not designed to eliminate a subsidy, where Congress desires to provide such a subsidy, but rather to clarify and isolate the subsidy element in a lending program over time, and to maintain the desired subsidy as interest rates change in the market.

The use of a formula based on market yields rather than on coupon rates is necessary to reflect the current cost of new Treasury borrowings; an average based on coupon rates is heavily weighted by interest rates prevailing in earlier periods when a large share of the presently outstanding Federal debt was issued. This approach of relating rates in Federal credit programs to current Government borrowing costs was recommended by the President's Committee on Federal Credit Programs in order to facilitate evaluation of the costs of Federal credit programs and their effects on the use and allocation of resources. Moreover, rates charged long-term borrowers under Federal loan programs (as in the Federal housing programs) should, consistent with this approach, be related to market yields on long-term Treasury securities. Since short-term rates typically fluctuate more widely than long-term rates, this effectively minimizes fluctuations in the cost to borrowers.

Under this approach, any interest rate subsidy deemed necessary or desirable can be provided by authorizing a deduction of a fixed percentage from the current Treasury borrowing rate when computing the cost to the borrower. This method of providing the subsidy would mean that the cost to the borrower would fluctuate as market rates fluctuate, but in the case of long-term borrowers, the range of fluctuation would usually be narrow. On the other hand, the subsidy itself remains constant, and can be properly evaluated in relation to other Government programs and needs for funds. A fixed rate to the borrower, in contrast, would mean the amount of the subsidy would vary, leading to sharp changes in the demand for funds as market rates change, and obscuring rational appraisal of the true costs and benefits of the program over time. It might also be noted that a fixed rate tends to impart a cyclical bias into credit programs, since expenditures under the program would rise during periods of prosperity, when market rates tend to rise, and decline in recessions as market rates fall.

It appears that the intent of Congress in enacting section 221(d)(3) of the Housing Act of 1961 was to provide for an interest rate which would be relatively low (3⅛ percent in June 1961) and would vary over time with Treasury borrowing costs. If the rate had been set at the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of loans made under the program, less three-fourths of 1 percent per annum (3⅞ percent less ¾ percent equals 3⅛ percent), the same 3⅛ percent rate would have been provided at the time of enactment and the subsequent increases in the rate would have been limited to one-fourth of 1 percent as compared to seven-eighths of 1 percent under the formula in the 1961 law; i.e., this preferred formula would currently produce a rate of 3⅜ percent. Thus, on a $10,000 loan for 40 years, the increase since June 1961 in the required monthly payment would be only $1.50, compared with the $5.30 increase during this period under the present section 221(d)(3) formula. Under the preferred formula, also, the estimated net interest cost to the Government on these long-term loans would remain constant over the life of the program at three-fourths of 1 percent, and the rates charged the borrowers would fluctuate only to the extent of the relatively small fluctuations in long-term Treasury borrowing costs. A change to a formula of this type, with the precise subsidy element to be determined by Congress on the basis of its evaluation of the existing need, would appear to meet the kind of problem cited by Senator Sparkman, and would be fully consistent with the principles urged by the administration.

Senator SPARKMAN. Now, I want to ask you a little bit about this. I know there has been a lot of discussion and there will be more about this gold situation. But isn't it true that the United States is the only country that has a policy of selling gold on demand to foreign monetary authorities?

Secretary DILLON. That is right.

Senator SPARKMAN. Wouldn't the situation be greatly relieved if other countries would adopt that policy?

Secretary DILLON. It might.

Senator SPARKMAN. And is there anything we can do to get them to?

Secretary DILLON. Well, that is part of one element in the French proposal that has recently been made, but the rest of the elements in it make it impractical, because they wish, as part of this, to do away with all the dollars, of which nearly $15 billion are in official reserves, now held by other countries. The only way to do away with that that I can see would be to impose quite a deflation on the world. Once that is done, then they say they would then be prepared to assume this burden of gold payments, but not until that time. Of course, our policy of selling gold on demand isn't only a burden to us, although it appears that way now. There is an element of truth in the French thesis, which is that a reserve currency country such as the United States—which does have its currency held as a reserve, and the reason it is held as a reserve is because of this agreement that we will sell gold at any time for dollars—can pay its deficits simply in its own currency, whereas other countries when they run balance-of-payments deficits, typically have to give up a foreign currency—usually dollars—or gold. These are equivalent reserve assets to them, so they have to accept the loss of revenue. So we do get a benefit which is a very real one, and I think that this is what has excited some of the countries.

They feel this has gone too far, particularly when they say this U.S. deficit and the corresponding increase in their dollar holdings are making possible very extensive investments in their own countries. They think they are financing on a short-term basis and to an unlimited amount very profitable long-term investments for the United States and they don't think that is good business as far as they are concerned.

Senator SPARKMAN. My time is up, Mr. Secretary. Thank you very much.

Chairman PATMAN. Mr. Ellsworth?

Representative ELLSWORTH. Thank you very much, Mr. Chairman.

Mr. Secretary, yesterday afternoon on TV the French Foreign Minister was talking, and when he was asked a question in another context about the advisability of cutting down on the American military presence in Europe, he, I thought, reacted pretty definitely along the lines that that would not be appropriate under all the circumstances.

Now, I understand that, due in large part to your own efforts in the last 2 or 3 years, some of the support of our military presence in France and in Europe is paid for by the currencies of the host countries, is that right? And if so, to what extent does our military presence in France contribute to our balance-of-payments problem?

Secretary DILLON. It isn't quite that way. What we have been able to accomplish is to make certain agreements, the largest and most important of which is with Germany, whereby they have agreed to buy from us—and they have bought from us over the last 4 years—enough military equipment, paid for in dollars, to offset the entire balance-of-payments cost of maintaining our forces in Germany. That has amounted to about $675 million a year over these past years.

Without having quite as hard and fast agreement, actually on the same basis Italy has done the same thing, and about $100 million of equipment has gone to Italy.

We have no such agreement with the British, and there have been substantial expenditures every year in the United Kingdom. But this recent very substantial British order will be very helpful in achieving something similar with the United Kingdom.

As far as France is concerned, we have no such agreement, and purchases in the United States are only made by the French when it is something they figure they can't get anywhere else, and the United States is a unique or a sole source of supply. They have bought from us military equipment over the past few years, maybe as much as $50 million a year. Our costs of keeping our troops in France are running between $200 and $225 million a year, so there has been a definite outflow to France of up to $200 million a year. Part of their surplus has been due to the maintenance of American forces in France, and at the moment under their policy they will be converting that surplus into gold.

Representative ELLSWORTH. If I remember a figure you used earlier, that would be about half of their annual surplus, would it not?

Secretary DILLON. Around a third.

Representative ELLSWORTH. A third.

Turning to another subject, you said earlier this morning that the three main reasons for the bad fourth quarter we had last year were the Canadian financing surge which you said would be a nonrecurring thing, and the President in his message didn't say anything about controlling that; the bank loan problem which the President touched on in his message by invoking the Gore amendment, and you said the most important part of our fourth quarter problem was the sterling crisis in Britain. I don't recall that the President touched at all on any proposals to do anything about forestalling anything like that in the future, did he?

Secretary DILLON. No, not in his message; the only way we can forestall that is for two things to happen: that the British adopt and pursue successfully economic policies that will lead to a reduction in their very large deficit in their balance of payments, and that we achieve a further strengthening of the entire international monetary system. This is always and continues to be an objective of ours, and was mentioned in the balance-of-payments message, but as I have said, I don't think it can be effectively carried out until we bring our own payments into balance.

On the subject of Canada, I would like to point out that was treated in the President's message. His third item was "To stop any excessive flows of funds to Canada under its special exemption from the equalization tax, I have sought and received firm assurance that the policies of the Canadian Government are and will be directed toward limiting such outflows to the maintenance of a stable level of Canada's foreign exchange reserves."

That was the basic arrangement that we had with the Canadians at the time of the interest equalization tax proposal, that they would not allow the exemption to become an avenue through which their reserves would increase.

Unfortunately, they weren't entirely successful in that last year, and there was a moderate increase, nearly $150 million or a little more in their reserves during the course of the year. But they are very aware of this, much more aware of it maybe than they had been earlier. They can see the importance we have attached to this and they have certainly in the last 2 or 3 months taken what actions they could—and they are definite actions—to bring their interest rate structure into a better alinement with ours so that funds will not flow to Canada so readily.

Their bill rate now for the first time is some 30 points below ours, and their long-term rate is about as close to ours as it has been in many years. That reflects a conscious effort of the Canadian Government, because they do operate successfully in the long-term area of their capital markets. Because of the big volume of Canadian Government bonds outstanding, they are able to influence the Canadian long-term market rates in a way that we are not able to do without infinitely larger operations.

Representative ELLSWORTH. One of the main sources of our favorable trade balance has been commercial sales of agricultural products, particularly bread grains and feed grains to Western Europe.

Has the Treasury Department made any assessment of what effect the proposed changes in the agricultural grain prices of the Common Market are going to have on that particular contribution to our favorable trade balance?

Secretary DILLON. Well, we think that unless we get some improvements in the Kennedy Round negotiations, that we will be in for a very difficult time, particularly with grains. We accept, I guess, the estimates of the Department of Agriculture, who are the experts in this area, that if nothing is done and the present Common Market system continues, the end result after a few years would be that we would lose the bulk, if not all, of our grain markets within the Common Market. This is because their present policies, unless changed, would stimulate production in France to such an extent that it would probably be able to supply the entire needs of the Community at a level of prices considerably higher than our prices or world prices. With the restrictionist policies which they have adopted so far in the field of agriculture, this would keep out world produce not only from here but from Canada and from anywhere else. That would be a very serious blow to our overall trade program, maybe half a billion dollars a year, or something like that.

Representative ELLSWORTH. That is right, and isn't it true that it has been France's purpose to establish itself as the exclusive supplier of grain within the Common Market?

Secretary DILLON. I think that is correct.

One of the main reasons that France went into the Common Market was that they would benefit their agriculture at the same time they might risk some damage to their industry. But I must say this: that the French have consistently fought hard for a lower price for grains than was finally agreed on. They were at the low end of the scale. It was the Germans who were at the high end of the scale, because their agriculture is not as efficient as the French, and they were trying to protect that inefficient agriculture. Finally, the result was a compromise somewhere in between the two.

Even the proposed French price would have been in our view too high, but it would have been a lot better than the price finally realized, and, of course, that is also a lot better than the price the Germans want.

Representative ELLSWORTH. Now, in a broad general way I have gathered from your testimony that your feeling is that the expedients we are embarked on to control our balance-of-payments problem right now are more or less temporary expedients, and that in the long run there will have to be some reform in the entire international monetary system so as to get away from the problems that have given rise to what we are faced with now. I understand also from your testimony, that what you have in mind is an increase in the IMF's reserves.

Is that an accurate statement so far? I have a question to follow.

Secretary DILLON. No, I think it is a misunderstanding. There are two separate problems.

We do not think that the international monetary system has had anything to do with deficits that we have run, or could cure these deficits. We think that it is a separate problem to cure our own deficit and get it back into balance.

What is needed in the way of an international monetary system is one which will allow countries that get into deficits or surpluses an adequate period of time to readjust their own economies without too violent actions. And certainly we have already had, by any reasonable measure, an adequate amount of time, so it is up to us now to take that action ourselves.

Once we have taken it, and have our payments in balance, the extra dollars that have been the counterpart of our deficit and have served to increase liquidity in the world will no longer be there. Then we think there will be a real problem for world trade, so that simultaneously with this balance which we have to achieve for ourselves—or very shortly thereafter, not necessarily simultaneously, but within 2 or 3 years thereafter—it would seem highly important to have an improvement in the overall payments system of the world.

So the two are interconnected in the sense that you cannot get a better world payments system until we balance our own accounts, but that improved world payments system is not being sought as a means of solving our own problem. We have to fix our own problem first.

Now, as far as the IMF quota increase, that was generally agreed by all the countries who are working on this problem as appropriate. The IMF charter says there shall be a review, every 5 years, of the size of quotas in relation to world trade and so forth. This is what has just taken place. The increase that is recommended is supposed to take care of the situation up to 1970. So it is a relatively moderate increase. There was a 50-percent increase in quotas in 1959, which was the last time. This time, despite the very large rise in world trade, the increase looks as though it will average about 30 percent, which we think will be adequate, but just adequate.

Representative ELLSWORTH. Thank you very much. Thank you, Mr. Chairman.

Chairman PATMAN. Senator Proxmire.

Senator PROXMIRE. I want to follow up that—the crucial question that Mr. Ellsworth asked. Before I do, is it not true that our price policies since World War II are a matter of handling a situation which has historically been deflationary? What I am talking about is this: After every war, since the Revolutionary War, the War of 1812, Civil War, World War I, there was a very, very sharp deflation, dramatic deflation, a deflation in which the price level dropped more than 50 percent in most cases. Now this is the only time we have had a major war, with all of the similarities and so forth, in which we have not suffered deflation. We have gone 20 years now. I think that the Employment Act of 1946, and its implementation, is something for which we can be proud and happy, and the success of this administration and past administrations, Republican and Democratic, in preventing that kind of very serious and painful economic process, it seems to me, is something to be proud of.

Secretary DILLON. It certainly is extraordinary and you are right. It is a historical first. Always before we have had inflation during the war or immediately thereafter, followed by this very severe deflation, in an attempt to get back to the old price levels. I think that the net results of these have been extreme hardship on all sorts of people that were not able to bear that hardship, and I think we have handled the matter in a much fairer and better way this time.

Senator PROXMIRE. We have an extraordinary kind of situation in our unfavorable balance of payments it has been noted by some economic commentators recently. That is because we have a higher favorable balance of trade, the usual kind of policies that are adopted to correct an unfavorable balance of trade which runs parallel with an unfavorable balance of payments are not appropriate. That has been brought out to some extent in the questioning, but I think that what this suggests is that if we follow policies in which we would keep our price level down sharply, which we would usually do to correct an unfavorable balance of trade, we aggravate the problems of other countries, of other nations.

Robert Marjolin, the chief economist of the Common Market, estimates the adverse balance of trade for the Common Market this year will be about $3 billion. If we are going to correct quickly and drastically an unfavorable balance of payments, is this not likely to have a serious adverse effect, deflationary effect on these other countries, unless there is a simultaneous, not a 2- or 3-year lag, but a simultaneous correction in the resulting deficit of international financing?

Secretary DILLON. I do not think it probably has to be quite simultaneous, but what you touch on is very interesting, because, of course, all the pressures have been coming from the Common Market, from members of the Common Market, on us to put an end to this balance-of-payments deficit. The French are only the most public and outstanding in this area, but there has been similar feeling on the part of most of the other members.

At the same time, once these measures were announced, I was rather interested to read an article from Brussels where one of our correspondents interviewed authorities of the Common Market who had been advocating that we put our payments in order right away, and their reaction was that if we were successful in doing this, it was going to cause considerable difficulties for them. So to that extent you are right.

I do think we have a little more time, because they do have extensive reserves, maybe more reserves than they need in most of these countries, and so they could well endure some difficulties for awhile. It would not upset the general payments system or the general efficiency of world trade or effectiveness. But my only feeling is that quite rapidly after we get our payments in balance, if they are going to stay there, we will have to have a better world monetary system, some better way to add reserves.

There is one thing I would like to say at this point which I think is interesting. To the extent our deficit, as drawn in the overall accounting we now use for our balance of payments reflects dollars that flow out and are used and needed by private persons to handle their own business transactions, that part of our deficit might well, for the good of the world, be allowed to continue.

What is bad is the accumulation of excess dollars in the hands of monetary authorities. This brings to the forefront the question of the proper way of accounting for our balance of payments. There has been a lot of discussion of that recently.

If we used a method more comparable to that used by the IMF and by practically all other countries, over a period of years our deficits would average maybe something like $800 million less than the figures that we have been reporting. We have had a very distinguished committee of economists, all outside Government, studying this matter, and their report is finished and is being printed now, and some time within the next month or so it will be made public. I think it will make some suggestions along these lines that personally I think would be helpful in clarifying the extent and nature of the problem.

Senator PROXMIRE. Then you say that we should try to follow a policy of not restraining private productive investment any more than absolutely necessary to assist in bringing our balance of payments into balance. This part is productive and essential, and, as you say (see p. 56, this volume), the outside world desires capital but apparently is still incapable of mobilizing its own saving with full effectiveness. These investments would not be made if they were not productive. As you say, they are private. They are made on the basis of the best return that can be found anywhere in the world. From almost every standpoint, viewed conservatively or liberally, they are to be encouraged.

But are we not to discourage this? Are not the policies of the President likely to have some restraining influence on this?

Secretary DILLON. Oh, yes. The real problem is that these outflows have just been larger than our short-term liquidity position can stand. This is particularly true in the area of loans, bank credit, where the return to us is not so great. It is mainly whatever the interest return is on the loan, something like 5 percent in most cases, I guess, or 5¼ percent, something like that.

On our direct investments, investments by our companies abroad, of course the return is considerably greater over time. A profit margin of 15 percent or maybe even more is the usual objective, so this is very attractive and very useful in the long run.

Of course we are in a position of strength. We have some $45 billion of direct investment overseas. We have something between $70 and $75 billion of total private investment overseas, and a total of something like $95 billion, counting our Government investment. And these are all, or the great bulk of them, good assets. That is what is the situation of great strength. The more we can do of that, the stronger we are going to be.

The only problem that we face is that we cannot, even in that area, do it too fast or it will cost us money. Actually, on our investments in Europe, which are going to be good in the long run, more U.S. investment money has flowed into Europe than has come back out for every year of the last 5 or 6 years. So it has actually been a net cost to us and still is, quite substantial. About twice as much money is flowing into Europe as is coming back in earnings and dividends every year.

On an overall basis the picture is quite different when you look just at direct investment. Our return is much bigger than our outflow, but the reason for that is largely the extremely high profitability of our petroleum and also some of our mining investments in underdeveloped areas of the world.

Senator PROXMIRE. I would just hope that there is some way that we can persuade other countries to recognize the great importance of increasing international liquidity. All of our short-term actions are going to have to be aimed at reducing that.

Secretary DILLON. That is right.

Senator PROXMIRE. At a time when world trade is so important, when it is expanding and increasing. And I just hope we do not have to go through a serious deflation and that somehow governments throughout the world can learn cooperation without having to go through another disastrous experience to do so.

Secretary DILLON. I certainly agree with you. It is important. As I said, the only way we can apparently do this is to reach balance ourselves, and then countries will talk with us, I am sure, on the basis of a world problem. Now, when we talk about this, they are inclined to think that we are just trying to find some way to avoid bringing our own international payments into balance rather than trying to really improve the world system, which is what we are trying to do.

Senator PROXMIRE. Thank you. My time is up.

Chairman PATMAN. Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Secretary, back through the years you have been very active in trying to persuade our allies of the free world to share a greater part of the burden for mutual security, and also a part of the burden for economic aid to underdeveloped countries. Just how successful have we been in that effort?

Secretary DILLON. There has been some increase—a considerable increase—in what these foreign countries have done over the past 4 or 5 years. I think it has been something that we can be pleased with, but I do not think it is enough. I think we still have to press that way and ask for more.

I would be glad to submit for the record some facts and statistics on this which I do not have at my fingertips.

Senator JORDAN. I wish we could have that, Mr. Chairman.

Chairman PATMAN. Without objection it is so ordered. You will put it in the record.

Secretary DILLON. Yes.

(The statistics referred to follows:)

With reference to your question with respect to the participation of other free world nations in providing mutual security assistance, the Treasury Department has no readily available statistical information which would be helpful. The Department of Defense, however, is currently preparing a report on other free world military assistance. It is expected that this report will be completed by the middle of March. To the extent that this report can be furnished on a helpful basis to the committee, the Treasury will see that copies are made available for the information of the members.

The following tabulation of aid commitments to developing countries shows that the U.S. bilateral share of the aid burden has declined from 60 percent in 1960, to about 55 percent in 1961 and 1962, and to 49 percent in 1963. Thus, in 1963, U.S. bilateral aid was for the first time less than half of the total assistance received by the less developed nations.

If the U.S. share of multilateral aid—that given through the international agencies—is added to its bilateral aid, the U.S. share of the total aid effort by developed free world nations rises above 50 percent. However, even this figure (59.9 percent) compares favorably with the U.S. share of the total free world GNP.

Aid commitments to developing countries[1]

[In billions of dollars]

	1960		1961		1962		1963	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
United States	3.9	60.0	4.4	54.3	4.7	55.8	4.0	49.4
Other DAC[2]	1.8	27.7	2.4	29.6	2.5	29.7	2.7	33.3
International agencies[3]	2.8	12.3	1.3	16.0	1.2	14.5	1.4	17.3
Total	6.5	100.0	8.1	100.0	8.4	100.0	8.1	100.1

[1] Grants and loans of over 5 years maturity.
[2] The members of the Development Assistance Committee are: Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Portugal, the United Kingdom, and the United States.
[3] Includes the International Bank for Reconstruction and Development (World Bank) and its affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC); the Inter-American Development Bank (IDB): the European Development Fund (EDF) and the European Investment Bank (EIB) of the European Economic Community (EEC).

The United States is persisting in its efforts: (1) to put more aid on a multilateral basis; (2) to improve coordination of bilateral aid; (3) to increase the share of the burden borne by other free world nations; and (4) to improve the terms on which aid is extended.

Senator JORDAN. Mr. Secretary, one of the contributing factors for a poor balance-of-payments position is the fact that U.S. citizens traveling abroad spend sums of money. Now, would it be possible, and perhaps it is, for these travelers to buy local currencies or counterpart funds from the U.S. Government? Is that possible for them to do that now?

Secretary DILLON. It is possible, and there is a specific provision in the law for using excess local currencies for this purpose.

There are two problems with it. In the first place, these local currencies only exist in some eight or nine countries in the world, and, secondly, even in these countries, since the law has been in effect, we have found that American tourists find it may be less convenient to go to the embassy and collect these local currencies that we have there than it is just to go to the hotel lobby desk and cash traveler's checks.

So even where it is available, they do not make the use of it that we have hoped, although we try to bring it to their attention.

Senator JORDAN. I think an effort along that line might be productive with the same reasoning back of it that we ask American investors to curtail on a voluntary basis.

Secretary DILLON. I agree with you entirely.

Senator JORDAN. Now, Mr. Secretary, some several months ago when the British pound was under pressure and many of the industrial nations of the world came to the rescue in a sense by putting up $3 billion of hard cash that had the effect of getting Britain over a very difficult time apparently. But the reaction of Britain was a little surprising to me, because they proceeded immediately to impose some import taxes. Would you care to comment on that?

Secretary DILLON. Well, I think they imposed import taxes before they had the full benefit of this assistance. The import taxes were their first reaction to their difficulties.

Their second reaction, when the first actions in their interior budget were not very well received—and it was obvious they had to do something further—was to increase their bank rate from 5 percent to 7 percent. It was only after that—when in itself that did not seem to be having the effects that they thought it might—that the $3 billion was put together. And it was put together because the world felt that it would be very disadvantageous for the world to have a forced devaluation of sterling occur. And so to maintain the stability of currencies, all major countries joined in this $3 billion standby authority, which has been drawn on to some extent, and that was to give the British time to develop a more longrun program which would be designed to make the necessary corrections in their own internal economy.

I think everyone hopes and expects that that will be forthcoming. The eyes of the world—the financial world—are currently on the development of the British budget which will be submitted in April, to see what British policy is going to be, and whether it is going to be adequate to meet this very difficult problem which they face.

Senator JORDAN. Do you think the time might come when we might have to ask the same cooperative effort in defense of the dollar?

Secretary DILLON. Theoretically it could come. I would not like to see us ever get into that sort of a crisis, and that is again why I feel it is so important that we should move rapidly and firmly now, with these measures which the President has outlined, to bring our payments into balance. I think that is just what we are in the process of doing. It is certainly not a pleasant experience to have to go around hat in hand to a lot of countries and ask them for help for your currency. Naturally at that time they might say, "All right, we will do it if you do this, that, and the other thing." It is much better to make your own choice yourself and take the proper steps ahead of time so you do not have to go through that experience.

Senator JORDAN. Now, on another line, Mr. Secretary, you have said that in the past 4 years we have come to a great appreciation of how fiscal and tax policy can help achieve our economic goals. You indicate that the procedure of getting a tax reduction through the Congress is lengthy and painstaking, which is entirely appropriate, but you go further to suggest—I use your words here: "We simply must be able to count on procedures that insure an early decision in response to a Presidential proposal," that is with respect to the purely temporary or across-the-board antirecessionary cuts. Just what procedures do you have in mind, Mr. Secretary?

You are not suggesting that the Congress grant blanket authority to the executive branch to cut taxes?

Secretary DILLON. No. All we are suggesting here is that the Congress itself, and presumably largely the tax-writing committees, reexamine their own procedures and satisfy themselves that they are in the position to act very rapidly in a matter of 30 to 60 days at the most, on a Presidential request in this area, should it ever be necessary or felt necessary, because if you are going to use this tool of reducing taxes to avoid the onslaught of a recession, time is of the essence.

If you wait until you are at the bottom or are already coming out the other side, all you will do is substantially increase your deficit, and you won't have avoided the recession. So it is highly important to be able to move rapidly.

We are not suggesting in any way how the Congress should undertake this review or what the end result would be other than a feeling or assurance from the Congress that it would be prepared to act rapidly. This doesn't necessarily mean a rules change or anything of that nature at all. It may just mean that the appropriate committees would decide that, if we had this sort of a problem, they are going to act fast, and that is their intention.

Senator JORDAN. Again, on a voluntary basis, when everyone is cognizant of the urgency of the situation?

Secretary DILLON. That is right, and the President's request would be a very simple request. It might be that if the Ways and Means Committee, where these things originate, could find the time—they have so many urgent matters that it is difficult—to have some hearings concerning what would be the best kind of a cut, the best formula for having such a temporary cut, and could reach some sort of agreement on it in advance, that might be helpful.

But that isn't even necessary because there is not too much difference between the formulas.

Senator JORDAN. Yes.

Mr. Chairman, my time is about up. I would like to put one question which the Secretary might choose to answer in writing.

With respect to price stability, I am concerned about the instability of agriculture prices. This is the one segment of the economy that is really taking a beating. The alltime low for prices of agricultural commodities in about 25 years as a percent of parity is now with us, and those who come from agricultural States are alarmed at the mortgage borrowing of farmers which has increased substantially in the last 4 years, and the prices he pays for the things he buys are up in relation to the prices he gets for what he sells.

If you would care to comment on that in writing for the record, I would appreciate it.

Secretary DILLON. I would be glad to.

(The following statement was subsequently supplied in response to Senator Jordan's invitation:)

AGRICULTURAL PRICES

As noted elsewhere, average wholesale prices have remained relatively stable since 1958. While this remarkable performance portrays the course of the general average, in some selected sectors prices have advanced while in others they have declined. Indeed, a large number of price changes are continually emerging within the price structure in both the nonagricultural and the agricultural economies in response to changing supply and demand conditions.

This is a natural concomitant of price adjustments in a market economy. Over the past year, for example, increased demand for nonferrous metals and for machinery and equipment resulted in higher prices for these commodities.

Elsewhere, prices of rubber and rubber products, fuels, and pulp and paper in 1964 averaged lower than in 1963 due to adequacy of supplies and large margins of utilized resources, relative to demand. Prices in the agricultural sector were among those which declined from 1963 to 1964. As table 1 shows, nine of the major groups of the wholesale price index rose between 1963 and 1964, while six of these groups declined.

The decline in average farm prices between 1963 and 1964 represented an adjustment to a change in supply conditions, relative to demand. On the demand side, consumer spending for food and farm products rose substantially in 1964 due to increased disposable income from expanded economic activity, as well as the tax cut on personal incomes. However, as a result of an unusually large increase in the supply and marketing of livestock, agricultural prices declined 2.5 percent between 1963 and 1964. Prices of crops in 1964 were about unchanged from the previous year, in fact remaining higher than any year since 1954. However, due to lowered prices of livestock and livestock products, which fell 4 percent from 1963, average prices of all farm products declined. (See table 2.)

Lowered livestock prices mainly reflected a one-tenth drop in prices received by farmers for marketing of cattle and calves. The production of cattle tends to follow a cycle, which in 1964 reached the seventh straight year of buildup. During this process, the growth in beef supply typically surpasses growth in demand, with resultant unfavorable prices to producers. In 1964, cattle slaughter rose 12 percent over 1963 to a new record. As cattlemen adjust inventories in better alinement with consumer demand, recovery in cattle prices may be expected. Some stiffening in these prices already has been reported since July. With respect to other livestock, hog prices in 1964 were about unchanged from 1963, while lamb prices rose 8 percent.

Mortgage borrowing by farmers continued to rise in 1964, although this appears to reflect mainly the financing of the increased investment made by farmers to produce more efficiently. Farm mortgage borrowing rose to $18,731 million in early 1965, compared with $16,803 million a year earlier and $15,167 million in 1963. These steady advances in debt appear to reflect part of a longrun uptrend in capital requirements of farms. Production assets per farm in early 1964 were valued at $54,791, compared with $51,125 in 1963 and $47,578 in 1962. In addition, delinquency rates on mortgage loans appear remarkably steady through 1963. While no figures are available for all of 1964, reports of any sudden, widespread rise in delinquency rates have not appeared.

Not all farmers are able to make these investments to become more productive. The President's message to the Congress on February 4 analyzed the causes of low farm income which affect many of our farms and proposed a program providing parity of opportunity and income for rural America.

TABLE 1.—*Wholesale price indexes by major commodity groups (1957–59=200)*

Year or month	All commodities	Farm products	Processed foods	All commodities other than farm products and foods (industrials)														
				Total	Textile products and apparel	Chemicals and allied products	Rubber and rubber products	Lumber and wood products	Hides, skins, leather, and leather products	Fuels and related products, and power	Pulp, paper, and allied products	Metals and metal products	Machinery and motive products	Furniture and other household durables	Nonmetallic mineral products	Tobacco products and bottled beverages	Miscellaneous products
1950	86.8	106.4	92.6	82.9	104.8	87.5	83.2	94.1	99.9	90.2	77.1	72.7	72.6	85.6	78.6	80.5	104.1
1951	96.7	123.8	103.3	91.5	116.9	100.1	102.1	102.5	114.8	93.5	91.3	80.9	79.5	92.8	83.5	85.1	113.1
1952	94.0	116.8	100.9	89.4	105.5	95.0	92.5	99.5	92.8	93.3	89.0	81.0	81.2	91.1	83.5	87.0	116.7
1953	92.7	105.9	97.0	90.1	102.8	96.1	86.3	99.4	94.1	95.9	88.7	83.6	82.2	92.9	86.9	89.8	105.4
1954	92.9	104.4	97.6	90.4	100.6	97.3	87.6	97.6	89.9	94.6	88.8	84.3	83.2	93.9	88.8	93.8	110.5
1955	93.2	97.9	94.3	92.4	100.7	96.9	99.2	102.3	89.5	94.5	91.1	90.0	85.8	94.3	91.3	94.6	99.1
1956	96.2	96.6	94.3	96.5	100.7	97.5	100.6	103.8	94.8	97.4	97.2	97.8	92.1	96.9	95.2	95.1	98.1
1957	99.0	99.2	97.9	99.2	100.8	99.6	100.2	98.5	94.9	102.7	99.0	99.7	97.7	99.4	98.9	98.0	96.6
1958	100.4	103.6	102.9	99.5	98.9	100.4	100.1	97.4	96.0	98.7	100.1	99.1	100.1	100.2	99.9	99.7	101.5
1959	100.6	97.2	99.2	101.3	100.4	100.0	99.7	104.1	109.1	98.7	101.0	101.2	102.2	100.4	101.2	102.2	101.9
1960	100.7	96.9	100.0	101.3	101.5	100.2	99.9	100.4	105.2	99.6	101.8	101.3	102.4	100.1	101.4	102.5	99.3
1961	100.3	96.0	100.7	100.8	99.7	99.1	96.1	95.9	106.2	100.7	98.8	100.7	102.3	99.5	101.8	103.2	103.9
1962	100.6	97.7	101.2	100.8	100.6	97.5	93.3	96.5	107.4	100.2	100.0	100.0	102.3	98.8	101.8	104.1	107.3
1963	100.3	95.7	101.1	100.7	100.5	96.3	93.8	98.6	104.2	99.8	99.2	100.1	102.2	98.1	101.3	106.1	110.4
1964	100.5	94.3	101.0	101.2	101.2	96.7	92.5	100.6	104.6	97.1	99.0	102.8	102.9	98.5	101.5	107.4	109.2

TABLE 2.—*Prices received and paid by farmers*

Period	Prices received by farmers: All farm products	Prices received by farmers: Crops	Prices received by farmers: Livestock and products	Prices paid by farmers: All items, interest, taxes, and wage rates	Prices paid by farmers: Family living items	Prices paid by farmers: Production items	Parity ratio
	Index, 1957-59=100						
1955	96	104	90	94	95	96	84
1956	95	105	88	95	96	95	83
1957	97	101	94	98	99	98	82
1958	104	100	106	100	100	100	85
1959	99	99	100	102	101	102	81
1960	98	99	98	102	102	101	80
1961	99	102	98	103	102	101	79
1962	101	104	99	105	103	103	79
1963	100	106	95	106	104	104	78
1964	98	106	91	107	105	103	75

Senator JORDAN. Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Secretary, I would like to pursue the point raised by Senator Douglas and Mr. Ellsworth about France and our military presence there.

I note that the deficit caused by our military expenditures in Western Europe for the last fiscal year came to $1½ billion, which is certainly a large part of it, and of this, the Big Four, where we spent our money, was Germany, $707 million, France, $231 million, United Kingdom, $178 million, and Italy, $95 million.

As you pointed out, our balance of payments military deficits in three of those countries, Germany, the United Kingdom and Italy, are or are about to be completely or very substantially offset by agreements whereby they buy military equipment in this country. But this is not true of France where our quarter of a billion dollar a year is all deficit.

And when we run a deficit with France, as we now know, this tends to be a gold-grabbing deficit to a very large extent, so it is one that we have to give some attention to.

We are talking here not just balance-of-payments economics but foreign policy, military doctrine, and everything else.

As I recall, the reason why we spend a quarter of a billion dollars and have almost every year in France, was an early 1950's decision based largely on helping France with her balance-of-payments deficit. We wanted to put money into France, and so we set up a line of communications across France, from the Bay of Biscay, Orleans, Verdun, designed to get the petroleum and the hardware into West Germany, which is where our troops were, the hard way instead of what would have seemed a more direct and sensible way, bringing it in through Bremen, Hamburg, places where the Germany offset agreement could have wiped out this quater of a billion dollars annual military deficit.

I am wondering, therefore, in view of the French Government's belief that France apparently doesn't want American troops on their soil, and in view of the peculiarly damaging nature of a U.S. balance-of-payments deficit versus France, because of France's present policy of demanding gold, if it wouldn't be a good idea, while retaining, of course, our NATO installations, to put our line of communications in mothballs and to supply our forces in Germany, which I hasten to add should in no way be diminished, via Bremen, Hamburg, and possibly Rotterdam. Far from getting the Germans edgy, it seems to me this would be renewed assurance that the six American divisions intended to fight there if there is fighting to be done, rather than decamp. As I say, this involves diplomatic and military policy, but you are the representative of the executive branch here and I would like your comment.

Secretary DILLON. I would be glad to comment as much as I can. I have had something to do with those other fields at various times.

Certainly I agree with your fundamental question or fundamental thesis that we ought to do everything we can, and we ought to have a special effort to make sure we are doing everything we can to reduce to the minimum the dollar costs of our establishments that we are presently maintaining in France.

However, on the basis of overall policy and military strategy, our line of communications across France has a very real military value which I think was more the reason for putting it into effect than just dollar help to France.

The strategic importance of it is obvious, because Bremen and Hamburg, particularly Hamburg, are right up against the zone dividing line, with the Russians only a few miles away. Should there ever be a Soviet attack in Europe, and we did need to use our troops and fight there, it would be a matter essential to the safety not only of Europe but of our own American troops that were fighting there that there be a functioning line of communications across France, not simply one that could be cut by a very quick lunge by a powerful Soviet attack.

Now, I am not enough of a military expert to know or to be able to comment on the extent to which our present system can be put into mothballs and still have it available to be used rapidly at the time an attack might occur. We hope it never will, but we have to be prepared for the worst eventuality. I think that is the real question of the study that I would certainly hope that the military departments were undertaking, if they haven't already undertaken it, to see to what extent they can reduce our reliance on that line of communications and still maintain an effective military posture in Germany.

Representative REUSS. Yes. Well, Hamburg, of course, is a few miles from the Russian divisions. It would seem to me that Rotterdam, let's say, is about as safe a bet as Bordeaux. I wonder if this isn't just one of these cases where the military is living in the past once again, and hasn't wanted to review it. Who can ask them to? Can you ask them to?

Secretary DILLON. No. I think only the President can, and, of course, there are other considerations involved. If you took Rotterdam or Antwerp, which are, of course, further removed from the Soviets—although they are much nearer than Bordeaux—they would still require a very substantial building up of new facilities in the way of depots and dumps and things of that nature that don't now exist.

And so that would require a big outlay of funds both budgetwise and balance-of-paymentswise to construct these things.

While they don't advertise it, the Belgians and the Dutch operate on a gold basis similar to the French, and have for a very long time, a number of years. They have fixed amounts of dollars they hold. Whenever they gain more dollars they turn them into gold, and there have been recent gold purchases. It is a complex problem.

Representative REUSS. I certainly wish the military or somebody would tell me why we need to subsidize France to the extent of a quarter billion dollars a year on the line of communications.

Secretary DILLON. It is difficult for me to understand why that can't be somewhat reduced, but this is a military problem.

Representative REUSS. Let me ask one other question about our balance-of-payments effort.

I noticed in the newspapers over the weekend a report of the first round of the President's persuasive program in which Mr. Donner, the president of General Motors—the company that is going to build a $300 million or a $100 million plant in Belgium for the assembly of motor vehicles—promised 100-percent cooperation with the administration, but said he was going to go ahead and build this plant anyway because that constituted 100-percent cooperation. They had the money over there, and they were just not going to bring it home.

My reaction on reading it was that a few more cases of 100-percent cooperation like this and we really would be in trouble.

Why isn't it equally damaging to our net balance-of-payments effect if a country simply fails to repatriate oversea dollars? How does that differ from General Motors actually shipping dollars in this country overseas?

Secretary DILLON. It doesn't to the extent that they are oversea earnings and not just depreciation dollars or other funds of that nature. That has been made clear in what we spelled out to the businessmen at the meeting that we had this past week in Washington.

I think that what General Motors is suffering from in this case is in good part a case of unfortunate public relations. They could have done a much better job in making clear what the facts are. I don't know the complete facts, but I have been told by the Department of Commerce, which does have them, that General Motors Co. is raising a very substantial portion, I think something like half of the funds that are required for this $100 million investment—that is the size of it—by borrowing in Belgium, from the Belgians. The reason they are able to do this, among other things, is that Belgium has a rather unique system in Europe. Other countries had systems like this earlier, but don't generally have them any more, whereby they grant subsidies to companies that are going to make investments that they feel are desirable. In this case the Belgians apparently have granted a subsidy which takes the form of a direct government interest subsidy on the money that is borrowed. So actually General Motors has been able to borrow money in Belgium cheaper than they could borrow it in New York to build this factory.

Representative REUSS. That takes cares of part of it.

Secretary DILLON. That takes care of part of it.

Representative REUSS. What about the dollar part?

Secretary DILLON. The rest of it—it is just a question as to what the division is between moneys that are normally available through depreciation for reinvestment, and earnings normally retained and reinvested in a plant as compared with earnings normally repatriated. We wouldn't expect every company to repatriate 100 percent of their earnings, because then they wouldn't have normal growth. And I think that probably a large percentage of those other dollars are in that category. It probably is true that some portion of this General Motors investment does involve the retention in Europe of funds that might otherwise be repatriated, so that has an effect on our balance of payments. But I think it is a relatively small part—it is my understanding—of the whole $100 million. Certainly in their explanations of this to the public, they haven't made that clear. That is why I say that I don't think they probably have had as good press relations as possible, and I would think the ordinary average person reading the paper would come to the exact same conclusion that you came to. But I don't think that is in accordance with the actual facts in this case.

Representative REUSS. Then do I gather that the U.S. Government does not object to this General Motors plant?

Secretary DILLON. I think they have talked to the Department of Commerce and the general feeling is this will have a minimal adverse effect on our balance of payments, and, therefore, it is the way we would like other companies to finance foreign investment they feel is essential. If other companies did this same thing by borrowing abroad, they might not be able to get the subsidy. What we say is that if you are in a country where you don't get the subsidy, you ought to borrow abroad even if it costs you more than it costs you over here, and raise your funds that way. But if they did that, we certainly don't want to stop foreign investment. It is very useful in the long run, very profitable. If they can reduce the dollar outflow to a minimum by following the same sort of procedures as General Motors did in this one area, I think we would see a substantial decline in our outflow for new investment and probably an increase in our return.

Representative REUSS. Thank you.

Chairman PATMAN. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much.

It is very nice to see you, Mr. Secretary. I would like to point out that when I first went on Ways and Means, we were dealing with the trade bill, and then we struggled with the tax bill, the tax cut, and then the interest equalization tax. Now, in reality, the interest equalization tax did the exact opposite of that which was sought in the trade bill, didn't it?

Secretary DILLON. Well, they are two different things.

Representative GRIFFITHS. But it cut down on the trade.

Secretary DILLON. It didn't cut down on trade. It cut down on the flow of funds abroad, and capital certainly is a different area from trade in goods. I think it is fair to say that we are forced to have a different policy in the area of trade and goods than we do have in the area of capital. I think the reason for that is clear. Our idea on the trade of goods is that there will be a big two-way flow, and that this two-way flow is roughly balanced. We come out with a surplus, but it is a small surplus based on the volume of goods exchanged. I think that we feel our policy is that, even if that surplus doesn't gain, the more goods that are exchanged both ways is probably for the good of our economy and helpful for world trade.

In the capital area, the situation is quite different because the funds available in this country for long-term savings far exceed those abroad, for a variety of reasons. The whole structure of our pension system and insurance system is different from that abroad, ours being largely private, and theirs being entirely, or almost entirely government. We have these tremendous accumulations of funds in pension funds, in insurance companies that are available for long-term investment at home or abroad, and there is nothing comparable abroad. So you don't get this two-way flow, so we have to have a different policy.

Representative GRIFFITHS. To what extent did the tax cut increase savings in this country?

Secretary DILLON. I think the tax cut didn't increase savings except as the economy has grown, and it has increased savings that way. There was a jump for about the first quarter, but within 6 months after the tax cut was in effect, the rate of savings was back to a more or less normal rate where it presently is. Of course there are more savings because we are dividing a bigger piece of pie, and that 7 percent of income is bigger now than it was a year ago.

Representative GRIFFITHS. To what extent, if any, then, did the tax cut help generate the balance-of-payments problem?

Secretary DILLON. I don't think it really did. It might be one of the reasons that more funds were available and did flow abroad but it also did substantially increase investment and the competitiveness and the effectiveness of our whole American industrial complex, and I think that is a much more important element than the small amount of additional funds that were available for investment somewhere, of which some flowed abroad.

I think one thing is that these foreign loans, considering the point of view of the banks, as well as foreign investment, considering the point of view of companies, would probably have been made in large amounts anyway because they are more profitable.

The banks get 5¼ or 5½ percent, something like that on the average, on these loans they make to Europe, whereas their prime rate here is 4½ percent. So they do better and they are under pressure for their own reasons to make these sort of loans until they are asked not to. I think that is one of the reasons for this big increase.

Representative GRIFFITHS. To what extent would you say that the corporate tax cut and the increase in corporate profits generated developed the payments problem?

Secretary DILLON. I don't think that did in any way, because I think what we have done is really to increase the attractiveness and the competitiveness of investment in the United States as compared to investment abroad. But again in this case, there have been times when the company faced with a given amount of funds to invest has preferred to invest it abroad rather than here, because of the fact that profitability abroad seemed to be still higher, even though we have improved the profitability here at home. Also I think—looking ahead to the time of the Common Market coming into full effect, with 1 big market of nearly 200 or 175 or 180 million people—it has been a great attraction to many of our industries to move over and to establish themselves there so they would be there and ready to go when the Common Market became a complete reality. They felt that they could make more money there than they could by increasing their capacity here.

Representative GRIFFITHS. Of course, the Common Market made production line methods really usable.

Secretary DILLON. That is right.

Representative GRIFFITHS. In Europe.

Secretary DILLON. That is right.

Representative GRIFFITHS. And in addition to that, you had a great many more customers on a common ground, plus the fact that they were building up tariffs against us. Why don't we in addition to attempting to increase funds in the IMF, why couldn't we officially begin an attempt to create a Common Market of the Americas, and make an investment for our capital in the Americas?

Secretary DILLON. Well, obviously our market is so big it is still bigger than the Common Market in Europe, so it is large enough. The extra economies of scale we would gain here would probably not be enough to make much difference in cost of production and things of that nature. Obviously, the first place that this would work, if it were going to be done, would be with Canada, and there there are very important problems, psychological as well as real. The Canadians, for reasons of national sovereignty, think they would be the small parts of any such arrangement, and do not want it. If we did make it, it would have to apply to agriculture as well as industry, and certainly the competition of the tremendous surpluses in Canadian grain put on top of ours would be a very difficult thing to work out and to understand how that might be resolved.

I might say that in one area, a bill which will be before your committee very shortly, we are in effect in a limited area—that of automobile parts and new automobiles—moving in the direction of free trade with Canada, which is in that direction.

Representative GRIFFITHS. But why don't we work also with Mexico and with Latin America? Here is an enormous market.

Secretary DILLON. I think that they are trying with only average success so far to work out a common market of their own, and I think if that does develop successfully, then that will be something that is large and that we could negotiate with.

Mexico is part of this effort to develop this market called the Latin American Free Trade Area, the LAFTA, I think they are turned more in that direction than wanting to turn to the United States and turn their backs on the rest of Latin America. I think in the overall interests of Latin America, that is a good thing.

Now, there has been more progress in Central America where the common market is nearer a reality, but, of course, that is a very small area.

Basically, also, I think that we have felt that it is in our interests not to promote too many of these small trade areas, to try to join them, if it were going to be at the expense of our access to European markets and things of that nature, and I think there has been some fear that that might be the result if we tried to make a hemisphere market.

Representative GRIFFITHS. The European market is the thing that is causing the balance-of-payments problems?

Secretary DILLON. It is one of the things.

Representative GRIFFITHS. Right. So, if we developed someplace else that was equally desirable for an investment for capital, maybe in the two possibilities we would come out in better shape.

Secretary DILLON. At the moment, of course, as you know, because of various inherent dangers, the investment of capital in Latin America is not looked on as being quite as attractive by private industry as investment in Europe.

Representative GRIFFITHS. You can hardly get Congressmen down there.

Thank you, Mr. Chairman.

Chairman PATMAN. It is the consensus among the members I have just discussed it with that we conclude the hearings soon, but any member who desires to make a unanimous consent request will be recognized for that purpose now.

Representative CURTIS. Mr. Chairman, in behalf of Congressman Widnall who is sick, there is this question I would like to have submitted to the Secretary in writing and possibly there will be others, and then as I previously requested, I have a series of questions.

Chairman PATMAN. Without objection it is so ordered.

(Congressman Widnall's questions and Secretary Dillon's response were subsequently supplied for the record:)

Question. Last Friday, Mr. Ackley advised this committee that he estimated that approximately 2 percent of the economic growth last year was attributable to the stimulus provided by the tax reduction bill of 1964. He also testified that economic prospects are very good for the first 6 months of this year, but that continued high prosperity for the second half is relatively more uncertain.

With this in mind, I wonder if you could give this committee your views on the economic effect in consumer spending when the full impact of last year's underwithheld tax rates are translated to millions—perhaps tens of millions of households in unexpectedly high 1964 tax bills, all of which will have to be paid by April 15?

It has been estimated that the total, extra tax bill for those millions of American families—especially in the middle income brackets—will total more than $1 billion. Would your Department supply for the record of these hearings its own estimates of total amounts underwithheld for the tax year 1964, by income groups?

In view of the fact millions may have to borrow several hundred dollars on or before April 15, with the consequent economic drag in consumer spending primarily in the second half, would the administration support legislation aimed at spreading this unexpectedly high tax burden into two installments (April 15, 1965, and April 15, 1966) such as has been suggested by several Members of Congress? This, after all, would be but a bookkeeping change for the Treasury and IRS, and hardly more than the $700 million corporate tax break announced by President Johnson last week.

In this connection, I have in my hand a copy of a letter sent to you on February 10, 1965, by Congressman Wilbur Mills, chairman of the House Committee on Ways and Means, in which he asked for your opinion of such legislation "as soon as possible."

Answer. The combined effects of early adoption of the 14 percent withholding rate plus the structural changes in 1964 tax rates and the withholding rate under the Revenue Act of 1964 will result in about $500 million more of final payments due by April 15. An increase of this size added to the total final payments this year of over $5 billion is not likely to have any significant depressing effect on consumer spending. In fact, swings of final payments in earlier years have on occasion been about twice this size. Actually, the total final payments due this April are expected to be slightly smaller than those that were due in April 1964.

A distribution of the $500 million increased final payments due to the 1964 Revenue Act is shown below:

Adjusted gross income class:	*Increased final payments*
0 to $5,000	$40, 000, 000
$5,000 to $10,000	160, 000, 000
$10,000 and over	300, 000, 000
Total	500, 000, 000

The Treasury Department has been requested by Chairman Mills of the House Ways and Means Committee to report the administration position on H.R. 4607 which would permit a wage earner who has a Federal income tax balance due for 1964 to defer payment of one-half of that balance until April 15, 1966. This report will be submitted as promptly as feasible.

Chairman PATMAN. Any other questions?

Without objection we will stand in recess until tomorrow morning at 10 o'clock in the Banking and Currency Committee Room in the Longworth Building on the House side.

Mr. Gordon of the Bureau of the Budget, Director of the Bureau of the Budget, will be our witness.

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 23, 1965.)

THE PRESIDENT'S ECONOMIC REPORT

TUESDAY, FEBRUARY 23, 1965

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Joint Committee met at 10 a.m., pursuant to call, in room 1301, Longworth Building, Hon. Wright Patman (chairman) presiding.

Present: Senators Miller and Proxmire; Representatives Patman, Reuss, Griffiths, and Ellsworth.

Also present: James W. Knowles, executive director, John R. Stark, deputy director, Donald A. Webster, minority economist, and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order. This morning the committee moves in its hearings to consideration of the President's budget, which, along with monetary policy constitutes a most important weapon that the Government can use in the discharge of its responsibilities under the Employment Act of 1946.

Our witness this morning is Dr. Kermit Gordon, Director of the Bureau of the Budget. Dr. Gordon, we have had the pleasure of having you as a witness both as a member of the Council of Economic Advisers and as Director of the Bureau of the Budget.

It is a pleasure to welcome you back to discuss with us this morning the economic implications of the 1966 budget and how this budget may contribute to the fulfillment of the objectives of the Employment Act.

You may proceed with your statement, Dr. Gordon, in your own way. You have a written statement I assume.

STATEMENT OF KERMIT GORDON, DIRECTOR, BUREAU OF THE BUDGET; ACCOMPANIED BY ELMER STAATS, DEPUTY DIRECTOR; WILLIAM M. CAPRON, ASSISTANT DIRECTOR; HAROLD SEIDMAN, ASSISTANT DIRECTOR FOR MANAGEMENT AND ORGANIZATION; AND SAMUEL COHN, DEPUTY TO ASSISTANT DIRECTOR FOR BUDGET REVIEW

Mr. GORDON. Yes, I do, Mr. Chairman. I presume copies have been distributed to the committee.

Chairman PATMAN. Yes. You may present your associates for the record.

Mr. GORDON. Thank you very much.

To my right is Elmer Staats, Deputy Director of the Bureau of the Budget. To my left, Samuel Cohn, Deputy to Assistant Director for

Budget Review. I am mindful of your request that I limit my statement to 30 minutes or less. If I have to I will do so by not reading the last section of my statement.

Chairman PATMAN. We will leave it to you, Mr. Gordon.

Mr. GORDON. Mr. Chairman and members of the committee, review and evaluation of the President's budget is a central element in the discharge by this committee of its responsibilities under the Employment Act of 1946. I consider it an important obligation and privilege, therefore, to appear before the Joint Economic Committee to testify on the President's budget.

I shall organize my remarks under three headings:

(1) The fiscal implications of the 1966 budget.
(2) The program objectives of the budget.
(3) Cost reduction and better management in Federal activities.

THE FISCAL IMPLICATIONS OF THE 1966 BUDGET

When the fiscal 1965 budget was presented a year ago, the American economy was about to enter its fourth year of steady expansion. Income, employment, and production were rising and had long since surpassed earlier peaks.

Despite this expansion, however, the economy was still suffering from excessive unemployment and idle capacity which had persisted since 1957. Economic expansion had not been sufficient to close the gap between the Nation's actual output and its rapidly growing potential.

A major reason for the persistent failure to achieve full employment was the "drag" of high tax rates—rates which absorbed too large a proportion of private purchasing power and impaired incentives to take risks. Calculated at full employment levels of personal income and corporate profits, the Federal tax system in calendar 1963 would have yielded revenues far in excess of expenditures—the "full employment surplus" was about $10½ billion.

This potential full employment surplus was so large as to constitute a major obstacle to the achievement of full employment.

In the light of this situation, the 1965 budget proposed a fiscal strategy based on four premises:

First, that the Federal Government need not and should not wait for a recession to occur before taking expansionary fiscal action;

Second, that with effective action to increase purchasing power and release economic incentives, the private economy—both consumers and investors—could readily generate and sustain a rapid economic expansion;

Third, that fiscal stimulus need not come through an increase in Federal expenditures, but could be achieved through tax reduction; and

Fourth, that steady progress toward a balanced budget could realistically be expected only in an expanding economy.

Accordingly, the 1965 budget called for a major reduction in personal and corporate taxes, amounting to over $11 billion. At the same time it provided for a modest overall reduction in administrative budget expenditures.

With congressional approval of the main elements of these proposals, the calendar 1963 "full employment surplus" of about $10½ billion was reduced to about $3 billion in 1964.

We are now witnessing the results of that choice:

(1) Reduced unemployment;
(2) Rising personal income and corporate profits; and
(3) Rapid expansion in output and living standards.

Meanwhile, we have added another year to our excellent record of price stability.

In the Economic Report and the testimony of the Council of Economic Advisers before this committee, the details of economic expansion during the past 12 months have been fully examined. I need not dwell upon them here. Rather, I would like to discuss the anticipated fiscal effects of the 1966 budget.

Whereas last year's budget injected a major stimulus into the economy and set in motion a rapid expansion of output and income, this year's budget provides less new stimulus. While we do not expect that it will speed up the rate of expansion as compared with last year's remarkable record, we do believe that it will help to keep the present healthy expansion going through a fifth consecutive year of prosperity.

As measured in the national income accounts, Federal expenditures will rise about $5 billion between calendar years 1964 and 1965. Only a small part of this increase represents a rise in administrative budget expenditures. The largest part of the growth of expenditures reflects increases in trust fund outlays, nearly $1½ billion of which flow from the proposed 7-percent increase in social security benefit payments.

The 1964 tax reduction did not have its full effect in that year. The lower withholding rates were in effect only for 10 months of the year; in 1965 they will be in effect for a full year. Moreover, the second stages of the cut in personal and corporate income taxes take effect in 1965. On the other hand, tax refunds this spring will be lower than last year. On balance, the impact of the tax cut in calendar 1965 is estimated to be about $2½ billion larger than in 1964.

The fiscal 1966 budget proposes a reduction in excise taxes, with a full year revenue loss of $1¾ billion. Reduction in excise taxes will serve a dual purpose. By spurring consumer outlays, they will help to maintain economic expansion. And by removing or reducing burdensome and unequal taxes, they will contribute to a simpler and more equitable tax system.

The budget also proposes increases in a number of user charges, primarily in the area of transportation. On a full-year basis, these user charge increases amount to about $400 million. Both the excise tax reductions and the user charge increases are proposed to become effective on July 1 of this year. The net reduction in Federal revenues during calendar 1965 arising from these proposals is slightly less than three-quarters of a billion dollars.

The total fiscal stimulus provided in calendar 1965, taking into account both expenditure increases and tax reduction, is about $8¼ billion. Against this must be set the approximately $6¼ billion increase in revenues which would be forthcoming in an economy advancing along a full employment growth path. For calendar 1965, therefore, this budget implies a net fiscal stimulus in the neighborhood of $2 billion.

Together with projected non-Federal sources of demand, we believe that this budget will help us to achieve yet another year of brisk economic expansion.

THE PROGRAM OBJECTIVES OF THE 1966 BUDGET

Overall fiscal impact is only one aspect of budgetary policy. At least as important is its program strategy. Federal expenditures are not undertaken primarily to furnish overall economic stimulus.

As last year's budget demonstrated, that stimulus can be provided by tax reduction. Rather, Federal expenditures are a response to important national needs and aspirations in the fields as varied as defense, education, health, and space.

Since needs and aspirations are virtually limitless, while resources to satisfy them are tightly limited, the budget must reflect hard choices among competing alternatives; and if these choices have been made wisely and consistently, the budget must embody a program strategy.

In his budget message, President Johnson declared that the Great Society must be bold, compassionate, and efficient. The basic program strategy of the 1966 budget reflects this pledge.

The budget proposes that we step up our efforts in education, the war on poverty, health, manpower training, and housing and urban development. Expenditure reductions are proposed in several other areas, and a steady drive for economies is being carried forward in all programs through management improvements, better manpower utilization, and a careful weighing of benefits against costs:

Table 1 illustrates the results of this policy. Between 1964 and 1966, administrative budget expenditures for education, housing and community development, and health, labor, and welfare programs, including the war on poverty, are estimated to rise by $4.3 billion. Interest charges on the Federal debt increase by $800 million. On the other hand, outlays for national defense and space, together, decline by $1.7 billion; and all other administrative budget expenditures are estimated to decrease by $1.4 billion, with the great bulk of the decrease anticipated from 1965 to 1966.

(The table referred to follows:)

TABLE 1.—*The changing Federal budget, fiscal years*

[In billions]

Description	1964 actual	Administrative budget expenditures			
		Change, 1964 to 1965	1965 estimate	Change, 1965 to 1966	1966 estimate
National defense and space	$58.4	−$1.3	$57.1	−$0.4	$56.7
Interest	10.8	+.5	11.3	+.3	11.6
Health, labor, education, housing and community development, economic opportunity program, and aid to the needy	6.7	+.7	7.4	+3.6	11.0
All other	21.8	−.1	21.7	−1.3	20.4
Total	97.7	−.2	97.5	+2.2	99.7

Mr. GORDON. I would like to examine briefly each of these major categories of expenditure.

NATIONAL DEFENSE, SPACE, AND INTEREST

As a striking illustration of changing trends in the budget, the anticipated decrease of $0.8 billion in expenditures for defense, space, and interest from 1964 to 1966 is in sharp contrast with the increase of $7.6 billion for these three categories of the budget between 1962 and 1964, and of $6.2 billion from 1960 to 1962.

Defense.—National defense outlays are estimated at $51.6 billion, a decline of $0.6 billion from 1965. Within this reduced amount, however, we shall continue to improve our military strength. This is possible for several reasons.

First, the great buildup of our forces which began in 1961 is now largely completed. Our Defense Establishment is now at a high state of power and readiness. Second, as more modern weapons come into the force, we are reducing or retiring promptly the early missiles and older manned bombers, such as the Atlas and the B–47. Third, the cost-reduction program of the Department of Defense is bearing fruit even beyond our optimistic expectations.

Although estimated expenditures in 1966 are somewhat below those for 1965, military strength will be further improved. Additional Polaris A–3 and Minuteman II missiles will become operational in 1966. Nine more Polaris submarines will be added to the fleet. We will continue to increase our Air Force tactical forces squadrons, our airlift and sealift capabilities, and our research and development efforts in such fields as antimissile defense and antisubmarine warfare.

Space.—As in the case of defense, there has been a very rapid expansion of our space effort in the last 4 years. Building on this broader base, we can now continue orderly progress toward our various objectives in space exploration with smaller annual expenditures increases than in the past.

The budget proposes expenditures of $5.1 billion for the National Aeronautics and Space Administration in 1966, $200 million more than in 1965. During the previous 4-year period the annual increases have averaged $1 billion. This investment has enabled us to develop a well-balanced space effort, pointed toward the achievement of a manned lunar landing within this decade, but also stressing scientific unmanned investigations, improved spacecraft technology for meteorology and communications, and the necessary supporting research and development.

Interest.—Interest charges on the public debt are expected to continue to rise in 1966, although the increase will be less than in the preceding year. It will stem partly from the larger outstanding public debt and partly from a higher level of short-term interest rates.

EDUCATION, HEALTH, WELFARE, AND RELATED PROGRAMS

The bulk of the expenditure increases proposed for fiscal 1966—in fact, considerably more than the net increase in total administrative budget expenditures—is for new or expanded activities whose common theme is the effort to improve the opportunities of our people for a fuller and more rewarding life.

Education.—Budget expenditures for education are estimated to increase by about $1.2 billion—or over 75 percent—in 1966. Over half of the increase is for the President's proposed new education program. This program provides for:

(1) Improvement of elementary and secondary education, especially for children in poor areas.

(2) Federal grants to assist in purchasing books for elementary and secondary school libraries.

(3) Expansion of research in education and establishment of supplementary education centers and services within communities.

(4) Aid to low-income college students through grants, loan guarantees, and expanded work-study programs.

(5) Assistance to small colleges to help improve their programs.

(6) Provision of university extension services in urban areas, support for college library resources, and help in overcoming the shortage of trained librarians and teachers of the handicapped.

About 30 percent of the estimated increase in expenditures for education in 1966 will be used to carry out new or enlarged programs enacted by the 88th Congress—for higher education academic facilities, expanded defense educational activities, a modernized vocational education program, and public library grants.

War on poverty.—The budget provides for an increase in expenditures from $0.3 billion in 1965 to $1.3 billion in 1966 to carry forward activities authorized by the Economic Opportunity Act of 1964.

These activities have three related objectives: to improve the education, skills, and health of the poor; to increase their employment opportunities; and to help them achieve a better homelife. Major elements of the economic opportunity program planned for 1966 are:

(1) Support for 300 community action programs in urban and rural areas, including preschool programs to help prepare culturally deprived children for regular schooling.

(2) Provision for work, education, and training programs for an estimated 600,000 persons through the Job Corps, the Neighborhood Youth Corps, and the college work-study program, and the work-experience and basic literacy programs for adults.

(3) Assistance for migrant workers, farmers, and other low-income rural families, and support for the Volunteers in Service to America (VISTA) who will devote a year to service to the poor.

Health.—Expenditures in the administrative budget for health services and research are estimated at $2.2 billion in 1966 compared with $1.8 billion in 1965. In addition, a program of hospital insurance for the aged is proposed to be financed by equal payroll contributions from employers and employees as part of the social security system.

An important element in the health proposals is the projected $114 million increase in research expenditures of the National Institutes of Health. The budget also proposes expansions of existing programs for (1) increasing the Nation's supply of doctors, dentists, nurses, and professional public health personnel; (2) carrying forward the Hill-Burton hospital construction program, with the shift in emphasis approved last year from general hospital construction to construction of long-term-care facilities and modernization of older hospitals; (3) attacking the problems of air and water pollution, and of contaminated foods and unsafe drugs; (4) promoting maternal and child health and welfare; and (5) enlarging efforts to deal with mental retardation and mental illness.

New legislative proposals, in addition to hospital insurance for the aged, include:

(1) Multipurpose regional centers to provide diagnosis and advanced treatment for heart disease, cancer, stroke, and other major diseases;

(2) Grants for operating expenses of medical and dental schools;

(3) Grants for initial staffing of community mental health centers;

(4) Improved diagnostic and treatment services for young children; and

(5) Increased aid to State and local governments to enable them to step up their efforts to reduce air and water pollution.

Manpower training.—The budget proposes improvements in the Manpower Development and Training Act of 1962, which has proved its effectiveness in aiding unemployed workers to develop the new skills which help them find jobs. We estimate that by the end of fiscal year 1966 about 700,000 unemployed or underemployed workers will have benefited from training provided by the Manpower Development and Training Act of which 260,000 will have been trained in 1966 alone.

Aid to the needy.—The budget includes various programs of aid to needy persons apart from those I have already mentioned. Expenditures for these programs are estimated to increase by $600 million from 1965 to 1966, mainly for public assistance grants to States for the aged, the blind, the disabled, and dependent children.

About $200 million of the increase will finance recommended legislation to increase the Federal share of assistance payments, to authorize payments for needy aged patients in tuberculosis and mental institutions, and to provide medical care to children in needy families similar to the care available for older persons under the Kerr-Mills program.

Substantial increases in expenditures are also provided in the budget for vocational rehabilitation services and the food stamp program; the latter program is expected to help more than 1 million people in 1966.

Housing and community development.—Administrative budget expenditures are not a very meaningful measure of activity or progress in the field of housing and community development. For one thing, there is a long leadtime between commitments and expenditures; thus, some of the proposals to improve our Nation's cities do not have a major budgetary impact initially. For another, successful Federal efforts to obtain private financing for Federal housing loan programs lower the budget expenditure figures below program levels. Nevertheless, budget expenditures for housing and community development rise $0.3 billion in 1966.

Increased outlays are anticipated for urban renewal grants, for public housing annual contributions, for urban mass transit loans and grants, for open space land grants, and for loans under the program enacted last year to encourage rehabilitation of properties in urban renewal areas.

In addition, the budget provides for new financial aids which will be outlined in a forthcoming special Presidential message.

Regional development.—A special program is proposed to promote the development of the economically depressed Appalachian region of 16 million people. The budget provides for a supplemental appropriation of $365 million this year to begin this effort, and for expenditures of $110 million in 1965 and 1966 together. In addition, budget provision is made for a new and strengthened Area Redevelopment Act to help other depressed areas to develop their economies.

EXPENDITURE REDUCTIONS

A dozen major agencies of the Federal Government will spend less in 1966 than in 1965. In some cases the reductions are small; in others, substantial. These and other reductions distributed widely through the budget result mainly from increasingly successful efforts to obtain maximum private participation in Federal credit programs; from cutbacks in the scope or level of existing programs; from proposed uniformity of budgetary treatment of business-type Government enterprises; from one-time 1965 expenditures which will not recur in 1966; and from many small savings realized throughout the Government by management improvement and cost reduction, including closing or consolidation of marginal Federal facilities.

In addition to the reduction in defense expenditures already discussed, budget expenditures for agriculture are expected to decline by about $500 million from 1965. Although a number of programs of the Department of Agriculture will expand in 1966, these increases are more than offset by a decline in projected expenditures under the Commodity Credit Corporation's farm income stabilization program. This reduction arises mainly from a change in the timing of acreage diversion payments in the feed grain program, reduced price-support loan levels for cotton, rice, and feed grains, and a smaller volume of tobacco production.

Substitution of private for public credit will realize major savings. During the fiscal year 1964 the net expenditures of Federal lending agencies were reduced by $1.1 billion through the sale of loans and mortgages from agency portfolios to private lenders and investors. In the current year 1965, these sales are expected to rise to $2.2 billion and in 1966 to $3.1 billion.

The increase from 1965 to 1966—and the corresponding reduction in administration budget outlays—is largely in the Veterans' Administration and the Small Business Administration. This expenditure reduction in the Small Business Administration is dependent on enactment of proposed legislation to authorize sales of participations in a pool of SBA loans, similar to authority granted the VA and the Federal National Mortgage Association last September.

COST REDUCTION AND BETTER MANAGEMENT

In response to President Johnson's unrelenting pressure for greater efficiency in Government operations, Federal managers are, I believe, more cost conscious today than at any time in recent memory.

The Defense Department continues to make a remarkable showing in its cost reduction program. When I was here a year ago, I reported that Defense had realized verified savings of $1.4 billion in 1963—almost twice the goal that had been set. Today I can report that the Defense Department achieved savings in 1964 of double the 1963 level—$2.8 billion.

Secretary McNamara continues to raise his sights. He announced recently a cost reduction goal of $4.1 billion for fiscal year 1966. The Defense Department is hopeful that the present goal of $4.8 billion in annual savings by fiscal year 1968 can be raised still further when the program is reviewed on July 1, 1965. It is hardly necessary to point out that these results could not have been achieved without hard decisions, such as the recently announced consolidation, reduction, or discontinuance of 95 defense installations.

The cost reduction spirit has caught on in the nondefense agencies. As their response to a Presidential directive of late 1963, the nondefense agencies have instituted and reported thousands of cost reduction actions which saved more than $500 million last year.

Under the President's direction, we are in the final stages of preparing instructions to all nondefense agencies which will require that the agency head himself take charge of cost reduction operations. He will be required to set specific dollar goals for cost reduction, reassess the priority and urgency of all programs and operations, find and remove any roadblocks standing in the way of improved efficiency, check and verify reported savings, indicate what he proposes to do with the money saved, and submit periodic progress reports to the President. This will install in every agency a cost reduction program modeled on the Defense Department program.

Productivity measurement.—When I testified last year, I said that the Bureau of the Budget was taking the lead in developing techniques to measure changes in productivity in Federal operations. We completed our pilot project last summer and released a report on the findings in September. We had set out to learn where productivity measurement might be feasible, how to measure it most practically, and how to make effective use of the resulting measures of productivity. The project has convinced us that it is feasible to develop valid productivity measures for a considerable portion of Government activities. In four of the five agencies we studied, it was possible to develop meaningful measurement systems.

We found that in two of the four organizations—Treasury's Disbursement Division and the VA Department of Insurance—productivity growth was unusually rapid. In fiscal year 1964, for example, Treasury's Division of Disbursement improved employee output by more than 14 percent over 1963, equivalent to the work of nearly 200 employees. The VA insurance program increased productivity by more than 24 percent over the previous year, equivalent to the work of about 600 employees.

But the real significance of this pilot project lies not in these findings, but in its potential for providing us with a useful new tool for better management. The budget is not yet ready to erupt with productivity indices and results for every agency. Gradually, however, we hope to be able to integrate productivity measurement techniques with the budget and management operations of many agencies, and thereby add more precision to our analysis of manpower and other requirements.

Civilian employment.—There is a temptation in Government for administrators to project employment needs on the basis of workload estimates alone, without taking into account the beneficial effects on productivity of systems and procedures improvements, including mechanization. Over the past year, we have made a strong point of pressing the agencies to overhaul their practices, simplify their procedures, and adopt better equipment for handling routine operations.

In cooperation with the Civil Service Commission, we have conducted intensive joint management-manpower reviews of 11 departments and agencies, and this program is continuing. We have, at the President's direction, applied limitations on employment for every agency, and we have made it clear that the President expects improvements in productivity from year to year.

All this has made it possible to head off increased total Federal civilian employment during the past year. It has not been a case of putting a freeze on employment. Some agencies have been permitted to put on more people, while others have been required to contract. Between June 1963 and June 1964, civilian employment dropped 21,000 to a total of 2,469,000. We expect to hold to about the same figure for June 1965.

In the 1966 budget, it has been necessary to allow a very small increase in employment—about 1 percent overall—above the fiscal 1965 totals. I consider this a very tight estimate in view of the workloads associated with the vitally needed new programs recommended by the President, and the higher workloads developing in the postal service, internal revenue service, public health, and other programs.

I might point out, as I have in the past, that Federal civilian employment over the past decade has not risen as much as might have been expected on the basis of other trends. In 1954 there were 14.6 Federal civilian employees for every 1,000 people in the Nation; in 1964 this was reduced to 12.9; and it is scheduled to drop to 12.6 in 1966.

In 1954, one out of every three public civilian employees worked for the Federal Government, and the other two for State or local governments. In 1964 this ratio was one out of four, and it will continue to drop.

Automatic data processing.—While the increased use of automatic-data-processing methods has been a significant factor in promoting higher productivity in Federal operations, it has not been an unmixed blessing in other respects. We find ourselves with a large and steadily growing inventory of ADP equipment, and this is giving rise to significant management problems. The Comptroller General has issued a number of reports indicating his concern on this score. Several congressional committees have also raised questions.

In 1963, under a directive from President Kennedy, the Bureau of the Budget launched a special study, using both Government and outside experts as advisers, to take a good look at these management problems and to determine what major steps might be indicated on a Governmentwide basis to insure maximum efficiency and economy in the procurement and utilization of these expensive machines.

Our study is now completed and I have it before me for final review before its transmission to the President and the Congress. Without going into detail, it is clear that we must enlarge the scope of our guidance to the Federal agencies. While we do not believe that it would be sound to place all computers under the control of one central agency for management purposes, there is no question of the need to strengthen the capabilities of the Bureau of the Budget, the General Services Administration, and the National Bureau of Standards to improve ADP management throughout the Government.

While most of the actions that appear to be necessary can be accomplished under existing authority, I am inclined to believe that some broad expression of legislative policy would be helpful with regard to acquisition and use of this equipment. In addition, legislative authority will be needed to permit the establishment of a revolving fund to facilitate the establishment of computer service centers, equipment pools, and other time-sharing arrangements. Our study has proved to be timely, particularly in pointing up the most critical problems which need immediate and comprehensive attention.

The Bureau will be happy to work with the Congress in considering legislation dealing with this subject.

Government reports and publications.—We have been very much aware of the criticism in the Congress of the "paperwork" burden generated by Government questionnaires to the public. The President has been very explicit in instructing the agencies and the Bureau of the Budget to eliminate every unnecessary report and questionnaire, and I am glad to state that the public is now called upon to make 3,900,000 fewer responses than were required on March 10, 1964, the date of the President's instructions. In the intervening period, 870 reports have been dropped or simplified, representing 5,200,000 responses. During this same period, new and revised Federal programs called for the issuance of 237 new reports involving 1,300,000 responses, resulting in the net reduction of 3,900,000 responses annually. This effort will continue.

We are continuing the drive to eliminate marginal Government publications. The most recent figures that I have seen show that nearly 500 existing publications have been eliminated or marked for elimination, while 130 proposed new publications have been nipped in the bud.

Let me just add, Mr. Chairman, that under persistent pressure from the President, this drive for cost reduction and management improvement is not only continuing throughout the Federal Government, but I think accelerating in effort and effectiveness.

Thank you very much.

Chairman PATMAN. Thank you, Dr. Gordon. I am very much impressed with your statement. It certainly contains information on the general economy and on the programs that will be of help, if carried out, to the people of the entire Nation.

When I came to Congress, I advocated the payment of old-age pensions. I was the first candidate for Congress from the South or West that advocated such a farfetched proposal at the time. Of course, I was denounced as a Socialist and an IWW and everything else. This program has gone far beyond pensions for the aged for our senior citizens. It is a wonderful program. The administration is to be commended for it. The cost, I know, is great, but the return will be greater.

I am also impressed with the way you are cutting down costs in the national budget. I am not sure that I agree with you that it will cost less due to the private sector. I am rather impressed that it will probably cost a little more, but possibly the additional cost will be justified in view of its lack of impact on the Federal budget. The interest rates, I notice, have increased considerably. It is really disturbing to me that so little attention has been given to interest rates.

If we had maintained the same rates since 1952 that we had in 1952, and there is no question but what they could have been maintained, our debt today would be $40 billion less and our interest cost per annum would be $5,500 million instead of $11 billion-plus.

It also brings to mind your advocacy of this program which will cost several billion dollars. The cost of that interest increase alone on the national debt would have been sufficient, probably, to pay for this program. Of course, that is hindsight, but we can look forward to the future.

You agree, do you not, Dr. Gordon, that long-term interest rates, Government rates, must be kept down in order to insure proper economic growth and expansion?

Mr. GORDON. I would certainly agree, Mr. Chairman, that in the present state of the economy maintenance of stability in long-term interest rates would certainly encourage economic expansion as compared with any increase in interest rates. I look for no increase in long-term interest rates.

Chairman PATMAN. You look for no increase in long-term Government interest rates?

Mr. GORDON. That is correct.

Chairman PATMAN. I have not been favorably impressed with the upturn of short-term rates. If my memory serves me right, about 1961, I believe it was, we agreed on the average interest rate in such agencies of our Government as housing, commodity credit, and many others. That is correct, is it not, about 1961?

Mr. GORDON. I am not sure that I follow you completely, Mr. Chairman. Legislation provisions largely determine the rates of interest charged in various lending programs and the statutory formulas vary a good deal.

Chairman PATMAN. I know that, Dr. Gordon, but the main programs, about four or five, have the average interest rate and they are the most important insofar as the amount of money is concerned, including housing, commodity credit, and others. That is correct, is it not?

Mr. GORDON. There was major housing legislation in 1961 that is correct.

Chairman PATMAN. Yes; since that time they have been raising the short-term rate, and deliberately. I can't understand that, but the Federal Reserve and the Treasury have gone in together and they have the rate almost as high as this long-term rate. That disturbs me very much. Of course, that means that the average rate for these important programs has considerably increased during that time.

Mr. GORDON. That is substantially correct, Mr. Chairman. Since June 1961, on a market yield basis, the average rates have increased over seven-eighths of 1 percent; in terms of interest actually payable; that is, the coupon rates, they have increased about one-half percent.

Chairman PATMAN. During that same time, these refundings have been disturbing to me, too, when the Treasury Department just goes out and refunds bonds that are not due in the immediate future and agrees to pay much more interest. Add it up now and if my figures are correct, and I believe they are, these refunding issues of the last 4 years are costing us in increased interest rates every year $1,400 million a year. Now, that is enormous. I am greatly disturbed by the policy of doing that. I think there are other ways of doing it.

I know that the people who handle those matters have their problems, too. But it seems like an awful lot to pay in interest rates in addition to the rates we could have gotten.

Mr. GORDON. Mr. Chairman, I certainly share your interest and concern for the effect on the budget of trends in interest rates. I don't think that budgetary considerations can be decisive in determining monetary policy, because there obviously are many other consequences of monetary policy of great importance which have been discussed before this committee in the last few days. But insofar as the movements in interest rates affect the Federal budget, and this is a particularly parochial concern of mine, the relationship is quite important and quite substantial.

For example, we calculate that at the present time there is something between $80 and $100 billion of Federal debt maturing within a year.

Chairman PATMAN. Nothing unusual about that. That has been so for 30 years.

Mr. GORDON. That is correct. My point was that this would mean that an increase in short-term rates of as little as one-tenth of 1 percent means an added expenditure of about $100 million a year in the budget, just in this area.

Chairman PATMAN. Doctor, I will not take up any more time, but I want to read a question to you that I want you to answer when you look over your transcript. By the way, will it be all right for any member to submit questions to you in advance and will you answer them when you look over your transcript?

Mr. GORDON. I will be happy to do that.

Chairman PATMAN. Fine; without objection, that will be done.

I am going to recommend that, in the housing legislation, which the Committee on Banking and Currency will consider this year, that we save some money on programs for the shelter of the poor, the poverty stricken people, through saving in interest costs. Since the question will come up all the time in legislation, I expect to read this question to you and ask you to answer it:

Let me raise with you a question that we have already discussed with Dr. Ackley and his associates about a better approach to financing the requirements of the President's program for the Great Society, particularly education and antipoverty programs and general community rehabilitation. Attaining the President's objectives will mean increased requirements for investment in schools and other facilities needed in the fight against poverty. Let us set a figure, say $25 billion, as the requirement for the next several years.

Now, in the current financing practices, the communities of the Nation would have to go out and borrow most of this amount. Even though there is a tax-exempt advantage, they will have to pay interest on these borrowings and usually by the time the long-term bonds are paid there is as much paid on the interest as on the principal. This would mean they would have to pay back $50 billion in the next 25 years.

Moreover, the communities most in need, unfortunately, will have to pay the higher rate, and they, of course, are the ones least able to do it. May I invite your attention, too, that in these communities where they vote these bonds, most of the people are paying off mortgages on their homes and their farms and their ranches and their real property, property that they don't yet own. Many veterans owe as much as 90 percent on their homes, but they must pay taxes on it as though they owned it, which, of course, is a great burden; the hardest burden on earth is to pay taxes on what you owe. That is what they have to do under this system.

Under our monetary system, the commercial banks are the trustees of the sovereign power to create credit. Our Reserve System allows commercial banks to expand credit equal to many times our reserves. Actually, it comes to about $10 to $1. Furthermore, we know that the Reserve, Federal Reserve, creates a reserve in the banking system primarily through its open market operation without cost to the banks. It does not cost the banks a penny. The Federal Open Market Committee and the Federal Reserve Banks buy Government bonds; they are not out a penny.

We, in effect, pay for those bonds which I will not go into now. In my view, this is a very great privilege bestowed on the commercial banking system by the Congress of the United States. While I am not suggesting a general reform of this system, I do feel strongly that so far as these special needs of our society for education and rehabilitation are concerned, there is a doubt as to the wisdom or necessity of paying high interest rates to the banking system.

In other words, why should we have to pay the banks $1 million every time we build a $1 million schoolhouse? That is the part that is awfully hard to understand. Why should we pay the banks $1 million every time we pay $1 million for antipoverty drives? It seems to me we could develop special financing for these emergency needs. We could develop a special bond issue with very low rates of interest, as little as one-fourth of 1 percent, like we are dealing with some foreign countries right now.

These bonds could be issued directly through the Federal Reserve System and the funds would be available to the Federal Government for direct investment in needed community development or for relending to the communities themselves on a low rate of interest. Of course, critics will say this is inflationary. The answer is that "it need not be." Our Federal Reserve System can control the supply of money and credit very easily.

Moreover, our Economic Report indicates a persistent and chronic gap between existing gross national product and potential. So long as this gap exists, I think we ought to be concerned about reducing it. This is a deflationary gap. So long as it exists, we ought not to be worried about inflation, but the reverse. When we eliminate this gap and we are operating at full potential, then is the time to be concerned about inflation pressures, if they should exist.

Specifically, I would like your view on the feasibility of issuing $4 or $5 billion a year of these special, low-interest, special-purpose bonds under the conditions I have outlined for a limited period. It would be appreciated if you yould give me your view in writing. I know that the question involves some unusual features that make it difficult to give it full consideration on the spur of the moment.

Would you like to comment on it at this time, Dr. Gordon?

Mr. GORDON. I will be very happy to study the proposal, Mr. Chairman, and submit a statement for the record. As you say, it is a rather unusual proposal and I would be reluctant to try to evaluate it without careful thought. Obviously, there is a wide variety of ways in which the Federal Government could give financial assistance to States and localities for such activities as you describe.

I would think that your proposal would have to be evaluated in relation to the several other alternative ways of achieving the same effect. As you imply, this does have rather substantial and unusual implications for the use of the central bank to finance, directly, programs of the Federal Government, but we will be happy to study it, sir.

Chairman PATMAN. Of course, we do it now by selling the bonds to the banks. The banks have sold $36 billion worth of them to the Federal Reserve under the same kind of system I have proposed here.

Mr. GORDON. As you know, the commercial bank holdings of Federal securities have not been increasing.

Chairman PATMAN. I know, but the tax-exempt ones have been increasing.

Mr. GORDON. Yes.

Chairman PATMAN. They have been getting out of the ones they pay the taxes on and getting into those that don't pay taxes. Mr. Dillon brought that up yesterday. I asked him to file a statement. He did.

I will look forward to this, Mr. Gordon.

Mr. GORDON. Yes, indeed.

(Additional material supplied by Mr. Gordon follows:)

The chairman has asked for a statement on the merits and feasibility of financing the education and poverty programs through direct issuance of up to $4 billion to $5 billion a year in special-purpose low-interest securities by the Federal Government directly to the Federal Reserve System. The securities would carry a nominal interest rate, such as one-fourth of 1 percent, and their proceeds would be earmarked either for direct investment in needed community development or for relending to the communities at a low rate of interest.

Since the chairman raised the same question with the Council of Economic Advisers, I have consulted with the Chairman of the Council in evaluating the proposal. This statement incorporates our joint views.

If we understand the Chairman's approach correctly, adoption of this proposal is expected to (*a*) result in major savings to the Federal Government compared to alternative methods of financing the education and poverty programs and (b) avoid payment of interest to the commercial banks—payments which the Chairman considers to be unjustified. Also, in the Chairman's view, the proposed financing method would involve no real inflationary risks, since the expansionary effect on the monetary supply of direct Federal Reserve loans to the Government could be offset by the use of Federal Reserve credit control instruments, particularly the imposition of higher member bank reserve requirements.

Before discussing the essential issue, we should like first to dispose of two elements in the proposal which are not central to its evaluation.

First, the chairman's proposed innovation in Federal financing should be weighed separately from the intended use of the funds. The Federal Government now provides aid to local communities in a variety of forms—outright grants. tax concessions, and low-interest or interest-free loans. Whatever the type of Federal assistance provided, however, there is no necessary relationship between the way the Federal Government finances its own requirements and the form of assistance to local communities. Moreover, whatever the magnitude and type of Federal aids required for the education and poverty programs, a considerable part of the financing of local needs in these and other areas must continue to rely upon savings provided by the public through the securities markets. Banks as well as other private financial institutions can continue to perform important intermediary functions in channeling these savings into investments in municipal facilities.

Second, the choice of the rate of interest paid on Treasury securities sold to the Federal Reserve would have no effect on the Governments' budget surplus or deficit; hence, the proposed nominal rate of one-fourth percent, as compared with any higher rate, would not yield a saving to the Treasury. All Federal Reserve earnings, except for a relatively stable amount which the System retains mainly to cover its expenses and fixed dividends, are regularly returned to the Treasury. Thus, the saving to the Treasury which results when Treasury securities are acquired by the Federal Reserve rather than by other holders is the same whether these securities bear a market rate of interest or a below-market rate.

The central question, consequently, is whether it would be wise policy to finance a substantial amount of the budget each year by compulsory sales of Federal obligations directly to the Federal Reserve System—irrespective of the particular uses to which the proceeds might be applied or the rate of interest paid.

In our view, this policy would be unwise for two principal reasons.

First, the compulsory nature of the proposal means that the Treasury would bypass the test of the market in issuing securities. We see no gains from the proposal sufficient to justify departure from our recognized and long-standing policy to avoid direct access by the Treasury to the central bank except in carefully limited and temporary circumstances. It seems to us that this is a wise tradition and one to be preserved.

Second, the proposal would call for monetary control actions that could have seriously adverse effects on the functioning of our financial system.

As the chairman pointed out, his proposal would not necessarily exert an expansionary effect on the money supply beyond what would otherwise be thought desirable, since any initial expansionary stimulus could be fully offset by raising commercial bank reserve requirements. However, while this is technically correct, the proposed procedure would nevertheless raise serious problems.

The necessity for sharp increases in reserve requirements under the proposal must be regarded as a serious drawback. If the proposal were adopted and a total of approximately $4 billion in such securities were sold to the Federal Reserve each year, the increase in reserve requirements needed to prevent a net expansionary impact on the money supply would bring such requirements above the current statutory maximum in less than 2 years, assuming that only requirements against demand deposits are raised. (If increases in reserve requirements against time deposits were also utilized, there would arise particularly serious and immediate problems of equity in the relative treatment of commercial banks and of other types of financial institutions holding savings deposits.)

Furthermore, repeated and large increases in commercial bank reserve requirements against demand deposits would have major effects on the role and functioning of commercial banks in our financial system. They would tend to have an adverse effect on bank earnings and might thus in time threaten to impair the volume and quality of bank services. They would weaken the Federal Reserve System by encouraging banks to give up membership in the System, since with much higher reserve requirements, the burdens of membership would in many cases far outweigh the benefits. And by reducing the income available for paying interest to savings depositors, they would have a significant impact on the competitive position of commercial banks relative to other financial institutions.

These comments should not be taken to imply that upward revisions in reserve requirements have no further role to play within the spectrum of monetary control techniques. But they do imply that decisions regarding the use of credit control instruments should not be mechanically determined, but should be made on the basis of a wide range of considerations.

For these reasons, we cannot lend our support to the chairman's proposal.

Chairman PATMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Dr. Gordon, I wondered for some time why we could not have you people do some adjusting with the budget for the Agriculture Department to put into some of the other agencies some of the items which many people believe are more properly placed there than in the Agriculture budget.

I don't need to tell you, I am sure, that a good amount of the money appropriated for the Department of Agriculture never finds its way into the pockets of the farmers and yet there are some people who are a little superficially writing to the effect that the farmers are getting all kinds of money from the Department of Agriculture and getting very wealthy on these billions of dollars that are being appropriated.

Specifically why could not you come up with a budget to shift a good chunk of the food-for-peace program into the foreign aid program? The foreign aid budget, the school lunch program over into the Department of Health, Education, and Welfare, the storage of commodities, commercial storage costs into some other agency, the Department of Commerce, for example?

Wouldn't this be feasible and wouldn't it be a good idea to do so so that the taxpaying public would have a little more accurate idea of where this money is going?

Mr. GORDON. I think we have anticipated you there, Senator.

We have already done most of those things. In explaining, let me distinguish between the classification of appropriations to the Department of Agriculture—of course, Congress makes appropriations to the agency which administers the program—and a major classification we have in the budget, a functional classification, in which we try to classify appropriations and expenditures by their purposes.

Obviously if the Department of Agriculture administers the school lunch program you could not appropriate the funds to the Department of Health, Education, and Welfare. But what you can do is to classify the school lunch program not in the classification "Agriculture and agricultural resources" but in the classification "Health, labor, and welfare." That is the way it is classified in the budget.

The same is true of food for peace. You may have noticed this year, at the instruction of the Congress, we have changed the functional classification of the food-for-peace program. This program has been shifted from the classification "Agriculture and agricultural resources" to the classification "International affairs and finance."

Now in this case I confess I am a bit torn. You can have a lengthy and deeply philosophical argument about whether the food-for-peace program is more closely allied to "Agriculture and agricultural resources" or whether it is more closely allied to "International affairs and finance." Obviously it has very important implications in both areas. But as a simple statement of fact we are today classifying food for peace under "International affairs and finance."

Sentor MILLER. But in the Department of Agriculture budget, is that right?

Mr. GORDON. Yes, because the Department of Agriculture administers it, yes, sir.

Senator MILLER. What you are saying is that in order to get the food-for-peace part of this out of the USDA budget we have to have AID, for example, administer it rather than USDA, is that what you say?

Mr. GORDON. I am not sure that is the only way to accomplish it, Senator. But Congress specifically wants to appropriate funds to the agencies that administer the programs.

That is why we have sought to place increased emphasis on the functional classification of the budget, rather than only presenting the departmental and agency classification which does at times give the kind of misleading result to which you referred.

Senator MILLER. May I say that I compliment you on breaking this down into functions but on this to the uninitiated and there are a great many of them including some who write on this subject they just look at the overall budget figure for the agency without paying any attention to the functions that you have so carefully worked out.

Now I will grant you that the Congress does the appropriating and the Congress can appropriate just the way they want to. But I would think that the Congress would place great weight on a recommendation from your office.

Mr. GORDON. For example, Senator, in the 1966 budget, total estimated administrative budget expenditures of the Department of Agriculture are $6.4 billion. Total estimated expenditures in the function "Agriculture and agricultural resources" are $3.9 billion.

Now this I think draws clearly the distinction of the sort you are referring to.

Senator MILLER. Yes. You don't feel that you can go any further than you have now particularly in the food-for-peace program?

Mr. GORDON. As a matter of fact, Senator there is another area in which I am convinced that an activity now classified under the heading "Agriculture and agricultural resources" would be more appropriately classified elsewhere. However, I don't think I ought to go into detail because it is still under consideration.

Senator MILLER. Thank you.

Now in your statement you refer to yet another year of rising economic expansion. I presume you mean that we have just gone through or we are going through in the fiscal year 1965 a year of brisk economic expansion?

Is that right?

Mr. GORDON. That is correct.

Senator MILLER. Now what is the basis for your statement that we are enjoying a year of brisk economic expansion or have enjoyed one?

Mr. GORDON. You are referring to the last year, calendar year 1964?

Senator MILLER. Well, whichever one you are referring to.

Mr. GORDON. I was referring to both, you see.

Senator MILLER. Let us say calendar year 1964.

Mr. GORDON. Yes, sir.

Senator MILLER. What is the basis for your statement that we enjoyed a brisk year of economic expansion during calendar year 1964?

Mr. GORDON. I think that it would be very difficult to analyze the figures in the Economic Report on the performance of the American economy in 1964 and not reach some such conclusion. The gross national product showed a $38 billion increase, there was a substantial rise in industrial production, and continued growth in personal disposable income. Then if you look at the continued price stability we enjoyed in 1964, and the decline in unemployment I think that all of these things can fairly be summarized as indicating a year of brisk economic expansion.

Senator MILLER. I would agree if you would just look at those figures that you might arrive at that conclusion. What I would like to suggest is that we analyze, for example, the figure of the gross national product increase.

I have a feeling that a great many spokesmen for the administration are somehow or other equating an increase in gross national product with true economic growth and, of course, I am sure you recognize there can be considerable difference.

For example, this $38 billion of increased GNP on the surface looks fine but when you reduce it to real balance, to shrink the inflation out, you are down to $27 billion. Now measured against that ought to be also an increase in the national debt and an increase in State and local debt which helps finance the purchases that went into the GNP and those two figures come pretty close to $19 billion.

So, if you offset those you are down to about $8 billion.

Mr. GORDON. I don't think I can accept that stage in the calculations, Senator. Of course you are quite right in drawing the distinction between the money increase in the gross national product and the real increase. But I think there is no better measure of the performance of an economy than the change in the real output of useful goods and services generated in the course of the year.

That is represented by the figure showing the increase in the real gross national product. Now, the increase in debt of the Federal Government and of State and local governments is a matter of considerable importance, but I think on a different level of discourse. That relates to financing, not to production of real goods and services.

I don't think you can deduct a financing magnitude from a production magnitude.

Senator MILLER. May I suggest that you can? Here is the way I look at it. If you went over to the bank and borrowed $3,000 and then you bought a $3,000 automobile, your individual GNP would have gone up $3,000 but you would not try to fool anybody by suggesting that you had economic expansion of $3,000 because you would be on dead center with a $3,000 asset and $3,000 liability.

Now, unless the Federal Government had gone about $9 billion deeper into debt last year and State and local governments had gone $10 billion deeper into debt last year they could not possibly have made some of these purchases that are reflected in the total GNP.

That is why I suggest that if you refine this down you—there may be different conclusions as to how brisk this economic expansion was. I am not suggesting that it is all bad but I do think that we ought to be very careful not to convey to the general public and especially to some of the writers on this subject that just because we had an increase in GNP of $38 billion, which includes about $11 billion of inflation, that we have had a brisk economic expansion.

I would hope that in future statements on this that we might refine these figures some more, because I think what we really want to know in this country is how is our true economic growth and that means more than just purchases.

Now one more question, if I may.

I don't want to continue to beat a dead horse, Doctor, but I happen to come from an agricultural State and naturally I am seeing many people out there who are deeply concerned about your article, I think it was in the Saturday Review, and also a statement that appeared in the Budget.

The statement I recall went something like this, that with the outlook for foreign markets and domestic markets we could look forward to about a million farmers having a decent income even with continued Government programs.

I now—I am sure you recognize that some of the consumption of agricultural products lies in the area of industrial use; we have had considerable development in that respect during the last few years. Is it not possible that if we had a real crash program of research to develop new industrial use of agricultural products that that statement which you made might have to be revised upward?

When we talk about domestic and foreign markets we are talking about not only human consumption, we are talking about industrial use as well, sir.

Mr. GORDON. We are indeed, Senator. As you know, the Department of Agriculture, for a number of years, has been heavily engaged in utilization research.

As a matter of fact, some quite important discoveries and advances have emerged from this utilization research program.

Senator MILLER. I am well aware of it. But the difficulty I have is that the great emphasis of the research activities of the USDA has been on the production side, more efficient production as distinguished from the consumption side and particularly in industrial use.

Mr. GORDON. My impression is that some of the work they have done in the field of cotton has related quite directly to the utilization side and some of it has been remarkably successful.

Senator MILLER. I recognize that some of it has. I am suggesting to you that if we emphasized the consumption side, particularly in a crash program that perhaps we might find a decent living for farmers. Is this not a possibility?

Mr. GORDON. Indeed this is a possibility, Senator, although I wonder whether we can count on this very happy outcome emerging in view of the heavy emphasis that has in fact been put on utilization research in the research program of the Department of Agriculture. The fact is that they have made a number of major advances, but certainly so far I think you will agree this has not drastically affected the total demand for agricultural commodities.

Senator MILLER. I agree because I don't believe we have emphasized that side of it. As long as we have the possibility which you and I think many others would recognize and as long as we have a severe social problem here, don't then you think that we ought to try——

Chairman PATMAN. Would you be willing to pursue that when we get back to you according to the time arrangement?

Senator MILLER. Yes, sir.

Chairman PATMAN. Thank you, sir.

Senator PROXMIRE. This is an excellent statement. It is most impressive and encouraging. I particularly like its emphasis on the

Gordon thesis of economy—that true economy is the efficient allocation of resources and not scrimping.

Mr. GORDON. I think that is the Johnson thesis.

Senator PROXMIRE. Let's say the Johnson-Gordon thesis. The fact that you are expanding sharply your expenditures in education, health, and antipoverty and so forth, at the same time emphasizing efficiency in government is sensible and consistent. I think this productivity measurement you discuss has exciting possibilities. I had previously read your pilot study.

In your last paragraph do I detect a feeling that you are not going to trespass very hard? It seems to me it will be hard to find an area in which the Government could do more to improve government.

Mr. GORDON. I fully agree. I think what I was trying to do there was simply to avoid raising expectations that next year we could put the whole budget on a basis involving close productivity analysis.

It will take more time than that. I do regard it as a very high priority activity. We are pressing ahead with this vigorously. This question, however, relates to something that Senator Miller was just saying. It has to do with the very tangled and complex question as to how much of what you reasonably might call inflation there is in the $38 billion increase in gross national product which occurred last year?

Obviously there have been price rises. But when you get indexes showing the range of price increases as between 1½ and 1¾ percent, it is not easy to conclude with confidence that what is occurring is in fact a genuine increase in the price level as opposed to statistical weakness that may exist in your price measurement system.

This relates to the point you were just making, Senator. The productivity studies we have done indicate that productivity in the Federal Government—certain parts of it—is going up rapidly but in the estimate of gross national product this has been ignored. The result shows up statistically as inflation. If our statistic could be made more accurate the apparent price rise might be offset in large part by productivity improvement.

Senator PROXMIRE. That might be a fallout benefit from these studies. Possibly in the future you can adjust the Government GNP to reflect the efficiency increase.

If not, it will be more and more distorted as time goes on, as you effect economics which you will effect eventually.

Mr. GORDON. Exactly.

Senator PROXMIRE. As you are aware Senator Miller and I and many other Members of the Congress were concerned about your article in the Saturday Review. I thought much of your article was excellent.

Your emphasis, as I said before, on the real nature of the economy, your highlighting the fact that reclamation projects are certainly questionable economy measures in view of the fact they increase the agricultural surplus land brought into production. On the other hand, on one point I stressed in my letter to you, I do not disagree. Isn't it true that we have had this diminution in farm population in the last 12 years?

In 1952–64 there was a drop from 21,800,000 people living on farms to 12,900,000, a fantastic drop really when you consider all that I think is involved in pulling up roots and leaving a big investment and so forth.

In spite of that fact, farm income, per capita income, has remained very low. It has remained far lower than this should be in terms of the hours worked, the efficiency increase, the risk, the investment, and is most unfair.

Now it seems to me if we are going to simply rely in the future on a somewhat more humane and more efficient movement of people off the farm—they will go off the farm all right whether we do anything or not, they have in the past and they will in the future—it seems to me this is wholly inadequate.

If we can so expect 10 or 15 years from now there will be a million farms, it would not follow at all that those who are left will be close to income parity, it would seem on the basis of history we can't trust this.

The distribution system is such that they lose the benefits of their efficiency. What will happen is that the farm income will continue to be very low and the rest of the country will get enormous benefit from this efficiency increase on the farms with great injustice to our farmers.

For this reason I wondered if you would not consider the possibility of some measures to strengthen the bargaining power of the farmers. To encourage farmers in someway to organize to work with Government in such a way that they can get a fairer price.

Mr. GORDON. I would be happy to comment on what you have said, Senator. I certainly agree with most of it. As I said in my letter to you, at the very heart of our present agricultural problem has been the absolutely spectacular increase which has taken place in agricultural productivity.

While most observers have been looking at the factories for examples of enormous technological advance, behind their backs such advances have been going on in agriculture at a rate which has eclipsed much of the technological breakthrough in industry.

Senator PROXMIRE. About three times as fast?

Mr. GORDON. I happened the other night to see some figures which drives this point home as well as anything I have ever seen, Senator. In the year 1820 it took one farmer to supply four persons with farm products. It took a century to double that. From 1820 to 1920 that number increased from four to eight—in other words, we went from the point where one farmer could supply four people with farm products to the point where one farmer could supply eight. Compared with that doubling in a century, there has been another doubling in the last 13 years—from 15 people supplied by one farmer in 1950 to 31 people in 1963.

This, of course, is at the source of much of the income pressure that exists in agriculture—the enormous improvement in the productivity of the individual producer. This is the reason—again alluding to something that Senator Miller said—the reason that the Department of Agriculture has said on a number of occasions, that today with this enormous increase in productivity, our total farm needs could be met by the 1 million largest farms.

I am looking at an excerpt from a speech that I referred to in my letter to you, Senator. This is a speech that Under Secretary Murphy gave back in November in which he was referring to these 1 million largest farms and said:

> They have the capacity to produce all of the Nation's need for agricultural products in the foreseeable future.

Now it seems very important to distinguish the problems of the larger farmers from the other two and a half million. I think here you have to distinguish further between smaller farmers who are in different circumstances of greater or less opportunity to improve their economic position.

One of the things that I find quite reassuring, for example, is that in this group of two and a half million smaller farmers there are nearly a million part-time farmers and among these million farmers, on the average, the family earns about four or five times as much from off-farm income as from farming.

Now this is a very large proportion of the total of two and a half million smaller farmers. This underlines the point that when you emphasize the need for making available more nonfarm jobs for smaller farmers, you are not necessarily talking about their leaving the farm. We already have a million farmers who are essentially dependent on nonfarm jobs and who are doing much better from their nonfarm income than they are from their farming income, but who nevertheless still remain part-time farmers.

That constitutes almost a million of the two and a half million smaller farms. Furthermore, another encouraging element in the picture—and I think this can be expected to continue—is the growth in the number of the relatively successful farmers, the million farmers that we referred to; for example, for the group at the top, the farmers with gross sales of $20,000 a year or more, there are today about 384,000 farmers.

Senator PROXMIRE. Gross sales of $20,000 a year or more, that is not the million farmers?

Mr. GORDON. No. I will give you the number. That is about 384,000 currently. But as recently as 1959 there were only 325,000 in that category. In other words, in this 4-year period, 1959–63, the number of farmers in the over $20,000 class, the top class, has increased from 325,000 to 384,000.

Senator PROXMIRE. Their net income would be around $7,000 for the whole family?

Mr. GORDON. No, sir. In that group, sir, the number is a good deal higher.

Senator PROXMIRE. Yes, but I am talking about the $20,000 level. If you make that as break even, it is not high.

Mr. GORDON. For the group as a whole, for that 384,000, the average net income from farming is a little over $10,000 and from nonfarming a little over $2,000.

In the next group, the $10,000 to $20,000 group, you have almost 600,000 farmers today; these are farmers with $10,000 to $20,000 in gross sales annually. The number in this group has increased by over 90,000 in 4 years. In 1959, there were 503,000 in that class. In 1963, there were 594,000 in that class.

Thus, another thing has been happening in addition to the fact that part-time farming has provided more substantial incomes for some of the smaller farmers. There has been a steady upward flow of some of the middle group farmers into the top class where, according to the calculations of the Department of Agriculture, average incomes are roughly comparable, roughly at parity, with nonfarm income today.

Senator PROXMIRE. My time is up. Let me just say that the net income figure in this latter category, you give me the $10,000 to $20,000, I suspect is fairly low. No. 2, the point I made and you conceded in your response to my letter, that whereas you can take the farmers in the top 5, 10, or 20 percent and say that they are close, they are below but they are close to parity income, how unfair this is. After all, the comparison should be with the wage earners or the small businessmen who are in the top 10 or 20 percent.

When you make that comparison the disparity is likely to be as great.

Here we have the farming industry, the most efficient in the Nation, with the longest hours, the greatest work, the greatest contributions to our well-being, yet regardless of how you rationalize or define the figures it seems to me the results are most discouraging.

Mr. GORDON. I would agree, Senator. As you know, it has often been stated that a proper goal of commodity policy is the achievement of parity income for efficient commercial farmers. As I said to you in my letter, on the basis of the figures I have just given you, the Department of Agriculture concludes, and I quote, "That a substantial part of the efficient family farms are now receiving returns roughly near 'income parity'."

This is spelled out in that quotation from Under Secretary Murphy's speech of last November.

Chairman PATMAN. Mr. Ellsworth.

Representative ELLSWORTH. Dr. Gordon, in your statement you refer to the fact that the calendar year 1964 full employment surplus of $10½ billion was reduced to $3 billion in 1964.

In the Council of Economic Advisers' report, on page 100, they say that the full employment budget surplus will shrink in 1965 but rise again in the first half of 1966. Do you have any figures for us on what those two figures might be at this time?

Mr. GORDON. I think, Mr. Ellsworth, I can give you the figure for calendar 1965 but we have not projected these figures into calendar 1966.

Representative ELLSWORTH. 1965 I mean, not 1966. Can you give me the one for 1965?

Mr. GORDON. Yes, sir. Our very rough projection would indicate a full employment surplus in calendar year 1965 somewhere between $1 billion and $2 billion. It will be lower than the 1964 figure.

As you know, there are some changes in the fiscal effect of the trust funds in 1966 which will tend somewhat to raise this figure in 1966, but I am afraid I am not in a position to give you any more precise estimate than that.

Representative ELLSWORTH. Thank you very much. I was going to ask about what effect you thought the trust fund changes would have on the 1966 figures.

Now, I want to ask, also, with respect to this discussion of full employment surplus, with respect to any discussion of the full employment surplus would you say that there are some underlying assumptions about monetary policy when you are discussing full employment surplus and the effect on employment expansion and so forth and if so, what are they?

Mr. GORDON. Let me think about that for a minute, Mr. Ellsworth.

Representative ELLSWORTH. I am not a professional economist by any means, but it seems to me if you have a very high full employment surplus figure that you are going to have to trend in the direction of easy money policy and you are going to have——

Mr. GORDON. I see your point. I think I basically agree with it, Mr. Ellsworth, in this sense: that the full employment surplus is the best device we have for indicating the extent to which the budget, the fiscal policy of the Federal Government, is either aiding or retarding a movement to full employment. However, that measure can be influenced in either direction by the state of monetary policy.

A large and restrictive full employment surplus could be offset to some extent by easy monetary policy; an expansionary full employment surplus could be offset to some extent by restrictive monetary policy. On that point I agree with you.

Representative ELLSWORTH. What happened to the matter that was bruited around in the press at the beginning of the year about the Federal Government sharing so-called Federal fiscal dividends with State and local governments? What are your thoughts on that at this time?

Mr. GORDON. There was, as you know, a group that studied this problem and made such a proposal. It is still under consideration. It has neither been accepted nor rejected, and it is still being studied. I am not able at this time to state firmly what my views on the matter are.

In a sense, the whole question of unrestricted grants to State and local governments will have to be regarded—to some extent, at least—as a substitute for future categorical grants.

One of the remarkable things about recent trends in the budget—I have a chart which shows this and I will be happy to put it in the record—is the increase both in the dollar amount of budget expenditures and the percentage of total administrative budget expenditures which have been going for aid to State and local governments. I can read off the numbers for the decade 1957 to 1966.

In 1957, total administrative budget grants to State and local governments were $3.2 billion. In 1966, they will be $9.3 billion. There has been almost a tripling of Federal aid to State and local governments in this period.

If you look at it not in dollar terms, but as a percentage of the total administrative budget, there has been a doubling since 1957. In 1957 about 4.6 percent of our total budget expenditures went for aid to State and local governments. In 1966 it will be 9.3 percent, just about a doubling.

There has, in other words, been a very, very substantial increase in Federal aid to State and local governments; I think this is in recognition of what everyone is aware of—the enormous increase in public demand for services of the kind that State and local governments provide and the limitations and restrictions on the fiscal capacities of State and local governments.

Representative ELLSWORTH. This proposal for unrestricted grants is still alive somewhere in the administration.

Mr. GORDON. It has not been rejected.

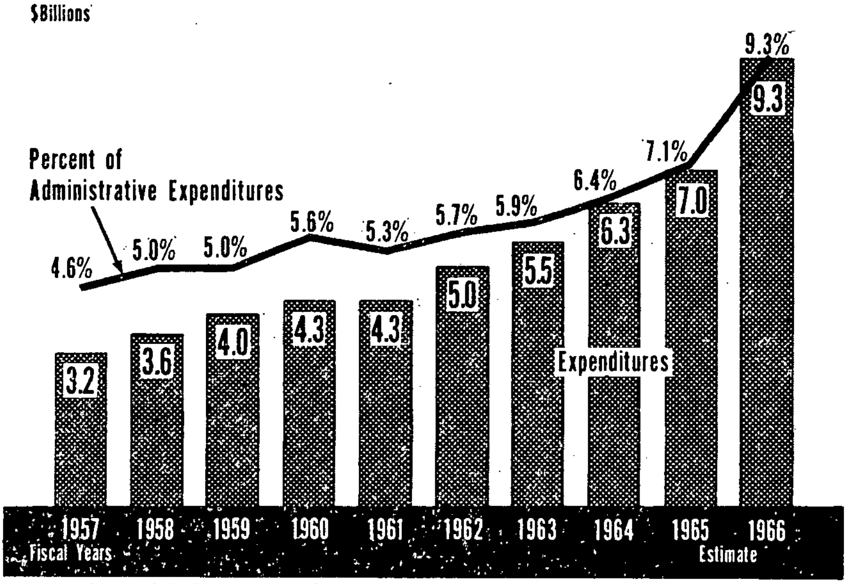
Representative ELLSWORTH. Thank you very much. I didn't mean to interrupt you. If you did not get all that table in——

Mr. GORDON. I will be happy to submit the chart for the record.

Chairman PATMAN. Without objection, it may be inserted.

(The chart referred to follows:)

Budget Expenditures for Aid to State and Local Governments



Executive Office of the President . Bureau of the Budget

Representative ELLSWORTH. Has the Budget Bureau made any projection of the likely cost of the Great Society programs for 1967, 1970, or beyond?

Mr. GORDON. In most cases, Mr. Ellsworth, the agencies themselves make estimates as best they can of the future year cost of new legislative proposals, and these are discussed and checked with the Bureau of the Budget.

As you are well aware, there are serious difficulties in making dependable projections 5 years ahead or even for a shorter period because of the enormous number of uncertainties which surround these matters. Some of these new programs are highly experimental, for example.

I can say, very flatly, that the future year recommendations for these programs are going to depend a good deal on how successful they are. When you are starting a pilot operation and hoping that in 5 years it may mature into a very, very useful addition to public services, I think it is very risky, almost reckless, to project what you expect to be spending 5 years hence until you have some better basis for judging its effectiveness.

There is not only the test of the effectiveness of the program itself, but there are also the annual judgments that the President must make, and must be free to make on competing claims for budget dollars. Then there are the other restraints imposed by the general fiscal situation which will exist in the future.

So I think any effort, in good faith, to project new program expenditures several years ahead ought to be taken in the light of these limitations on the possibility of accuracy in such projections.

Representative ELLSWORTH. Thank you very much.

Now, Dr. Gordon, as to these regulatory agencies that are not exactly part of the executive branch of the Government, is there any policy directive out from any agency of the executive branch that you know of that directs them to carry out their activities with due concern to the mandate of the Employment Act of 1946 or is there any surveillance of their activities to see that they are being carried out with due regard for the mandate of the Employment Act of 1946?

Mr. GORDON. I would think, Mr. Ellsworth, that the Employment Act of 1946 is so fundamental a part of the structure of thinking in the Federal Government that every agency would consider it to the extent the agency's policies had a bearing on the achievement of the goals of the Employment Act. They would seek to adapt their policy in order to realize these goals.

Now, I can remember when I was in the Council of Economic Advisers, there were a few occasions when there were discussions with regulatory agencies about relationships between their policies and the objectives of the Employment Act. These discussions were on an ad hoc basis as problems arose.

Representative ELLSWORTH. My time is up, but in other words, there is no directive and there is no overall surveillance to see about that; is that correct?

Mr. GORDON. Certainly I am not aware of any formal directive. That is correct.

Representative ELLSWORTH. I have a couple more questions I would like to submit in writing if I may have that permission.

Chairman PATMAN. That is satisfactory. You have that permission. Mr. Reuss?

Representative REUSS. Thank you, Mr. Chairman.

On the subject which Mr. Ellsworth just brought up, I gather that while there is no formal surveillance on the economy and efficiency of the so-called regulatory agencies, there is an informal surveillance?

Mr. GORDON. We are in continuing touch with all these regulatory agencies, through the budgetary process. They are subject to budgetary review by the President. Budgetary decisions must be made in the light of their programs and program objectives, and their programs are studied by the Budget Bureau in relation to other programs.

All I meant to say in answering Mr. Ellsworth is that I know of no specific directive addressed specially to the regulatory agencies which says they shall conduct their policies consistent with the objectives of the Employment Act.

Representative REUSS. But as to a regulatory agency, an independent regulatory agency such as the Federal Reserve System, which is outside the budgetary process of Government, there I take it you have absolutely no control, either formal or informal, over their expenditures.

Mr. GORDON. That is correct. We do not exercise budget control over the Federal Reserve Board.

Representative REUSS. I would like to raise a question which I have raised with the Secretary of the Treasury and with the Council of Economic Advisers, among others. It concerns the increasing use by municipalities and their subsidiaries of so-called industrial bonds whereby a locality will erect a plant for a factory, frequently one pirated from another area, and pass on the benefits of the tax-exempt status of these bonds to the private firm.

These bonds are very salable because they yield an aftertax income that is very favorable. The effect of all this, and some 27 States have adopted this method, is to markedly diminish the revenues of the Federal Government. This is where you came in, because if, as I am told, there have been issued more than a billion dollars worth of these bonds in the last few years, the Federal Government is foregoing the revenue which it would have received had the regular method of taxable corporate bonds been used.

Both Secretary Dillon and Chairman Ackley of the Council of Economic Advisers agree with me that it would be a good idea if, by legislation, the federally tax-exempt features of these industrial bonds were withdrawn while, of course, retaining the traditional tax exemption for ordinary municipal bonds.

I wonder what you, as one who has to worry about the Federal revenues, have to say about this?

Mr. GORDON. I am familiar, Mr. Reuss, with your discussion with Mr. Ackley and Secretary Dillon. I was not hitherto aware of the magnitude of the problem. I must confess I have not had an opportunity to study it with any care.

I must say that it strikes me as an individual that this may well be a quite questionable use of the tax-exempt authority. I question whether the whole purpose of tax exemption was meant to extend to this kind of borrowing.

I would certainly agree, however, that the problem does deserve study. On the basis of the little I have learned about it in the last few days, it is quite an important one.

Representative REUSS. Thank you.

In discussing the improvement in the Nation's economy in the last year, you say, and I quote:

> A major reason for the persistent failure to achieve full employment was the drag of high tax rates.

Aren't we still failing to achieve full employment, and isn't the reason still, in part at least, the drag of high tax rates? If not, what is it?

Mr. GORDON. Of course, it is a matter of degree, Mr. Reuss. We do not yet have full employment, although we are a good deal closer to it than we were a year ago. The improvement which has occurred in the labor market since the recession in 1961 has been a very remarkable improvement.

As I say in my statement, we do look for another strong year of economic expansion. The budgetary stimulus, of course, is not as strong as the stimulus last year. But the projections of gross national product for this year, $660 billion, plus or minus $5 billion, if borne out as last year's forecast was borne out, heralds a fifth consecutive strong year of economic growth.

Representative REUSS. With a lesser budgetary stimulus than last year and with a greater number, as I believe to be the case, of young people entering the labor market, we are going to stagnate as far as reducing unemployment is concerned.

Mr. GORDON. Mr. Reuss, we do look for a reduction in the unemployment rate this year below last year. Now, I cannot say, of course, that we look this year for a decline in this unemployment rate to 4 percent, or even for a very substantial decline. But in relation to the point you have just made, we do expect new job opportunities to be created this year to exceed the new accessions to the labor force and consequently to reduce the unemployment rate below last year.

Representative REUSS. In your presentation this morning you discussed the extent of interest charges on the national debt, and indeed, you have to do that every year. This involves, I am sure, a prediction as to monetary policy. I am interested in knowing just what your prediction was. You have to have one or you can't make your guess.

Mr. GORDON. We obviously can't predict monetary policy, Mr. Reuss, because, as you know, decisions as to monetary policy are not in the hands of the administration. So the ground rule continues to be what I think the ground rule has always been: we assume that the level of interest rate prevailing prior to the formulation of the budget will continue to prevail throughout the budget year. That is the assumption that has been made this year.

Representative REUSS. Thus, when you say on page 10 that interest charges in the upcoming year "will stem partly from the larger outstanding public debt and partly from a higher level of short-term interest rates," you refer to the increase in short-term rates which occurred during the last fiscal year——

Mr. GORDON. During the fiscal year we are in now, fiscal 1965. Consequently, we assume that interest rates throughout fiscal 1966 will be at the level which prevailed just before we submitted the budget, so that the average level for fiscal 1966 will be slightly in excess of the average level for fiscal 1965.

Representative REUSS. Your projections based upon what you guess the independent Federal Reserve is going to do has already been thrown out of kilter a bit, has it not?

Mr. GORDON. We don't guess, Mr. Reuss. We don't try to project the monetary policy of the Federal Reserve. We think the only defensible assumption is that the level of rates that prevail prior to the formulation of the budget will continue to prevail during the coming year.

This is not a forecast or prediction. It is the only plausible ground rule under which we can operate.

Representative REUSS. Since your prebudget formulation prediction was based, I assume, on last November and since, by the deliberate action of the Federal Reserve, short-term interest rates have been increased subsequently—and I think there have even been some increases in long-term interest rates—your budgetary formulations are already, due to no fault of yours, I hasten to add, been knocked off the tracks. Because interest rates are higher, there will be less economic activity, hence less Federal revenues, and you will have to recrank the whole process.

Mr. GORDON. I believe, Mr. Reuss, the estimate of 1966 interest costs in the Federal budget was made after the increase in the discount rate which occurred in November. I agree there has been some further increase in bill rates since then. I am sure that that could not have been taken account of in our projection of interest costs. To the extent that that is the only factor affecting our projection, these costs will probably be somewhat higher than our projection to the budget.

Representative REUSS. Based upon the activity of the Federal Reserve System in the last 10 years, would it be a safer assumption for planning that they always increase interest rates? Isn't that the fact?

Mr. GORDON. No, sir. There have been rather substantial declines in short-term rates. You remember that the peak of short-term rates was reached around the very end of calendar 1959, when the bill rate was about 4½ percent. It did fall in 1960, and 1961 to a little under 2½ percent, so there have been fluctuations both ways.

Representative REUSS. Due to depressions. But the Fed then speedily repaired the ravages of nature and raised them again.

Mr. GORDON. The bill rate is, according to the last issue of the Economic Indicators, close to 4 percent, but still substantially below the peak reached in that extremely tight money period at the end of calendar 1959.

Representative REUSS. I will leave with you the thought that a study of interest rate performance by the monetary authorities in the last 10 years shows consistently higher interest rates. In order to prevent budgetary self-deception I wonder if it would not be well to take that into account in the projections.

But my time is up.

Chairman PATMAN. Mrs. Griffiths.

Mrs. GRIFFITHS. Thank you. I would like to ask, Mr. Chairman, which of the fiscal measures of the last 4 years, Mr. Gordon, do you feel have poured money into the economy the fastest?

Mr. GORDON. By which of the fiscal measures?

Mrs. GRIFFITHS. Yes.

Mr. GORDON. You mean tax reduction or expenditure increase?

Mrs. GRIFFITHS. Yes.

Mr. GORDON. I am not sure that I would have chosen the phrase, "poured money into the economy." If the question is, Where has the greater economic stimulus come from over the whole 4-year period, it has probably come from the expenditure side, although, of course, in the last year, it has come predominantly on the tax rate side.

Mrs. GRIFFITHS. What measure do you think would be required now to lower the unemployment rate by 1 percent?

Mr. GORDON. Lowering the unemployment rate by 1 percent would reduce it to 3.8 percent, Mrs. Griffiths, from the last figure. This could come about, it seems to me, as a result of a wide range of possible developments. It could come from an upsurge in particular types of spending in the private economy.

As you know, one of the things we have most difficulty with in projecting 2 or 3 years ahead is the rate of business expenditures for plant and equipment.

Now, over the last 10 or 15 years, business expenditures for research and development have increased enormously. It does not seem to me wholly out of the question that this great growth in research and development could produce over the years ahead on increasing rate of modernizing-type investment which would help achieve the objective of reducing unemployment.

So it could very well come from investment in the private sector and it could also come from other elements of private demand. For example, as you know, in the area of consumption spending, the personal saving rate tends to vary within quite narrow limits, between 6 and 8 percent of disposable income. But even that narrow spread between 6 and 8 percent can be quite substantial because it is applied to a very high volume of consumption expenditures. A drop of 1 percent in the savings rate might account initially for something like an additional $3 or $4 billion of annual expenditures, just from a change that small.

So, there are various changes in the private sector which could move us to lower unemployment. As you know, the President has proposed a reduction in excise taxes to take effect on July 1, so that clearly this movement could be stimulated from the tax side and, of course, by simple logic it could also be stimulated from the expenditure side. I think all of these are possibilities.

I find it difficult to point to any one factor and say that it is the most effective or the most likely way to accomplish the objective.

Mrs. GRIFFITHS. Do you think that to lower the unemployment rate 1 percent would be inflationary?

Mr. GORDON. Well, you are getting very close to a margin where I have some uneasiness, Mrs. Griffiths. We have said, and I see no reason to change our views, that we can achieve a 4-percent unemployment rate without generating significant or dangerous inflationary pressures.

Now you are going below 4 percent. Well, maybe you can go to 3.9, 3.8, 3.5, or somewhere around that level, but I am just not sure, until we are closer to the facts of the situation, at what point we begin to run into bottlenecks. This is because the stage at which you run into the bottlenecks depends so much on how good a match you have between the skills of your labor force and the demands of employers for particular skills.

The better the match the lower you can go in the unemployment rate without generating inflationary pressures. So that as between 3.8 and 4 percent I am afraid I just don't know. We are not close enough to it for me to have a firm enough feel to answer.

Mrs. GRIFFITHS. If it were inflationary would this endanger the balance of payments further?

Mr. GORDON. I think without question, Mrs. Griffiths, that one of the things working for us, and working very effectively for us, has been our relative price stability over the last 6 or 7 years.

I think this is our secret weapon in our longer run balance-of-payments outlook. I would be most disturbed by any development which would upset this record. It seems to me so clear that we have slowly been improving our competitive position because of the better price record we have as compared to most of the other industrial nations in the world.

Mrs. GRIFFITHS. Since I am one of the people who think that we in Congress should learn when to lower the tax rate, may I ask what you would think would be one of those indicators or some of those indicators when we should begin to take action to lower the tax rate?

Mr. GORDON. We studied this in the Council of Economic Advisers, with some care, Mrs. Griffiths, back in 1961–62. I can't, offhand, reproduce all of the analyses we went through. My recollection is that we concluded that if one has to focus on a single magnitude as a basis for deciding the best timing of cyclical tax action, then that magnitude is probably the seasonally adjusted unemployment rate.

Obviously the more economic series you look at, the better feel you can get for the situation. In addition to unemployment, you can look at the quarterly behavior of the gross national product, industrial production, statistics on orders, and all the other indicators which give you some feel for how strong—or how weak—the economic climate is. This enables you to be better equipped to make a judgment. But if there were a single index I had to point to, if it were necessary to rely on a single one, it would be the seasonally adjusted unemployment rate.

Mrs. GRIFFITHS. Did you think that we could get the figures closely enough so that we know by what percentage exactly and in which area to lower the tax?

Mr. GORDON. I happen to feel, Mrs. Griffiths, that the attainment of a high degree of flexibility in the use of tax rates is a major objective in improving our tools of fiscal policy.

I think this is the most important objective. So I am extremely interested in it. It would seem to me that one of the things that would greatly facilitate prompt action would be for the Congress, and after all it is a congressional judgment, to reach some consensus on what form the tax change should take before it is necessary to take the action.

The simpler the form of the change the better and less controversial. I am not prepared to recommend any particular form, but it does seem to me that if there could be agreement reached that a particular pattern of reduction in the bracket rates of the personal income tax was the way to handle a weakness in the economy and a particular pattern of increase was the way to handle inflationary pressures, and if a consensus in advance could be reached on this, a great deal of debate and discussion on the equity considerations and appropriate form of the reduction could be avoided.

Mrs. GRIFFITHS. Thank you very much.

Chairman PATMAN. I would like to comment. Senator Miller did not finish a while ago. I am anxious for him to finish questioning you, Dr. Gordon, but I want to comment on some of the matters coming before this Joint Economic Committee; namely, payments in gold. I believe that the Members of Congress and the people of the country are very much disturbed and cannot understand certain things that are going on about the gold.

You take, for example, the fact that France is demanding gold and we are the only country that is paying gold. All the other countries are refusing to pay gold. Our country is the only one, is it not?

Mr. GORDON. I am afraid I don't know whether that is correct or not. I am not questioning what you have said.

Chairman PATMAN. I am sure it is correct. So, considering the fact that France is acting up on this when we have helped France substantially over the years, particularly after the war, and we are keeping a lot of troops in France and the payments, I understand, the expenditures involved, will amount to $200 million or $300 million a year, it occurs to me that if France persists in demanding gold under the circumstances, that we are justified as regarding it as unfair. In view of what has happened in the past, maybe we should consider pulling those troops out of there and putting them in another place and that would certainly help to relieve the gold situation.

I am mentioning this so that you will keep it in mind when these matters are considered by the administration in the future. Now, I will yield to Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Mr. Gordon, as I was suggesting, granted that we can't count on this because nobody knows when they undertake a program of research that it is going to be successful or how far it will be successful but, even granted we can't count on it, as long as there is a possibility, don't you think that, in view of the social problem involved in the continued decline of the farm population, particularly when we are not in a full employment position, that we ought to emphasize the consumption side of agriculture—agricultural research, particularly with industrial use?

Mr. GORDON. I would certainly agree, Senator, in view of the situation which has been created by agricultural productivity advancing at a rate far in excess of the growth in demand, and in view of the critical problem that this creates for the farm population and for farm income, that all promising opportunities for expanding utilization of farm commodities ought to be pursued.

I am looking at the budget on the matter. There is about a 20-percent increase in expenditures for utilization research and development by the Agricultural Research Service between 1964 and 1966, from about $24½ to $29 million.

Senator MILLER. How much is the whole agricultural research program?

Mr. GORDON. I am not sure I have it all consolidated here in one place, Senator, but the total obligations for research in the Agricultural Research Service are $137 million in 1966, of which a little less than $30 million represents utilization research, and other $4 million is for nutrition and consumer use research. There is another almost $8 million on marketing research.

Many of these types of research, I think, relate to the whole question of expanding demand for farm commodities.

Senator MILLER. I would agree with you. My point, however, is that I do believe we have been placing the emphasis on the production side. For example, in this budget in brief on page 33, under research and other agricultural services, the statement is made that special emphasis will be given to research in regulatory programs of the Department of Agriculture in 1966, particular stress will be placed on research on environmental problems such as pesticides and toxic molds. This is what I am wondering about, whether or not we should not place more emphasis on the consumption side to develop more industrial use, at least we may hope, there is a possibility, I think mostly everybody admits there is a possibility.

That is the point I am getting at. I am pleased that you have indicated that you agree.

Mr. GORDON. I think your factual statement is quite correct. Of the total of $137 million for research in the Agricultural Research Service in 1966, $87 million represents farm research which, I think, is predominantly production research.

Senator MILLER. Thank you.

With the chairman's permission I would like to ask that you include in the record an answer to some questions that I will submit separately.

Mr. GORDON. I will be happy to.

(Questions submitted by Senator Miller and answers subsequently supplied appear on p. 157.)

Chairman PATMAN. As I understand it, any member of our committee, whether here or not, may submit questions to you, Mr. Gordon. When you receive your transcript you will, of course, answer those questions for the record.

Mr. GORDON. I will be happy to.

Chairman PATMAN. That is all members, whether here or not. Senator Proxmire.

Senator PROXMIRE. I would like to follow up something Congresswoman Griffiths asked which I think is very significant. You say we can probably go to 4-percent unemployment, maybe to 3.8, without inflation.

Mr. GORDON. I prefer to say that I feel quite confident, based on earlier studies that I did of this problem, that 4 percent is a safe objective. I am not saying that less than 4 percent is unsafe.

Senator PROXMIRE. I understand. But you seem to imply at least a fair degree of assurance that if we get much below, to 3.5, to 3.3 percent, that we are going to have inflation.

Now, as I understand it, this is based on the fact that we have a very heavy unemployment of unskilled workers and what would happen under these circumstances is that the demand for skilled workers would exceed the supply and, therefore, wages would increase and there would be a cost-push inflation. Therefore it is very interesting that you, who were a member of the Heller-Gordon-Tobin Council which objected quite strenuously, as I recall, to some economists who argued that we were mainly plagued with a structural unemployment, and I think you were correct at that time, now on the basis of your analysis it would seem that you would feel that if we are going to get full employment in the area of 3.5 percent or less, our problem is primarily a structural one, that we have all the tools and we have the assurance now that we can move ahead to take care of the demand side through tax cuts and through expenditure policy and through monetary policy.

But as far as the solution below the 3.5 level, what we are going to do is to have to step up the antipoverty program, manpower training, education, and so forth; is that right?

Mr. GORDON. That is essentially correct. I am not aware of any fundamental change in this approach since 1961. I think when I was a member of the Council the problem was framed in terms of the question: "Can we get from 7-percent to 4-percent unemployment without creating bottlenecks of inflationary pressure?"

Senator PROXMIRE. That is correct.

Mr. GORDON. We argued, "Yes", we thought we could. At the same time, we have conceded, on a number of occasions, that there are structural problems in the economy, but that the structural problems relate principally to the question of the shrinkage of unemployment below something like 4 percent.

I would make one more point. I think we have made considerable progress in the last 4 years in evolving methods of getting a better fit between productive skills in the labor force and the demand for skills on the part of employers. As I said in my statement, we will have put something like 700,000 unemployed or underemployed workers through the manpower development and training program by the end of fiscal 1966—700,000 is a very substantial element in the total unemployment picture.

So I think at the same time that while we have been confident of the ability of increased aggregate demand to shrink unemployment, we have not neglected the necessity of improving the efficiency of the labor market through special programs such as manpower development and training.

Senator PROXMIRE. If the manpower training is a way of preventing inflation, which it is, it means that we can have this increased production and growth in our economy and prosperity without inflation as we train our people so that they can do a job.

The last question I have is this: You summarize your analysis of the impact of this budget on the economy by saying that the net effect, including the effect of the stimulation of tax cuts and of spending on increasing revenues, the net effect is $2 billion. How does this square with your cash budget deficit which it seems to me should reflect something in the same neighborhood, and your income accounts budget deficit?

Mr. GORDON. There is a different concept there. This $2 billion measures roughly what we estimate as the decline in the full employment surplus. Now, this is a hypothetical figure, not an actual figure.

As you know, it does not necessarily relate to the actual change in the deficit in the cash budget or in the national income accounts. Actually, there is an estimated increase in the deficit in the national income accounts of from $5.3 billion in calendar year 1964 to $6.4 billion in calendar 1965, an increase of a little over $1 billion. But that assumes a change in the level of economic activity which will generate greater increase in revenues than would be generated at a rate of——

Senator PROXMIRE. Are you talking about the net increase in stimulus or are you talking about the net stimulus? It seems to me the deficit in the national income budget should measure the total stimulus.

Mr. GORDON. I don't think it does for this reason: The deficit in any budget, whether administrative budget, cash budget, or income accounts budget, is affected by changes in the level of economic activity. For example, to take a simple and hypothetical case, suppose you had simply a sharp drop in economic activity. This would generate a deficit or an increase in the deficit in the national income accounts, but you could not infer from that fact that this was stimulating the economy. It came about because of a decline in the economy.

So the function of the full employment surplus idea is to eliminate the effect of changes in the level of economic activity in measuring the impact of changes in the budget from one year to the next. The way that is done is to assume full employment and say: "What would happen to this budget if we had full employment?"

Now, for such measurement purposes you could also stabilize the level of economic activity by having a 5-percent "full employment" surplus or a 6-percent "full employment" surplus, and each would eliminate as a variable in the picture the effect of changes in the level of economic activity on revenue.

I think perhaps the best insight into it is to see that when you get—for example, in 1958—a sharp decline in economic activity, it will generate a deficit even if the Government does little or nothing to counteract the decline.

So you can't point to the actual realized deficit as measuring the stimulus or restraint which is implied in the budget. I am not sure I made myself clear.

Senator PROXMIRE. My time is up. I will have to check this out. It seems to me you have to make different assumptions if you are going to have a $2 billion stimulus here but a $4 billion deficit in your cash budget account. I am sure you are right. I will just have to find out why I am wrong.

Chairman PATMAN. Thank you very much, Dr. Gordon. We appreciate your testimony. It will be very helpful to our considerations.

We will continue hearings all this week, including Saturday. Tomorrow we will have Dr. Galbraith and Dr. Seymour Harris. Our meeting place will be on the third floor of the Capitol at the Atomic Energy Committee room at 10 o'clock.

The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12 noon the committee recessed, to reconvene at 10 a.m. Wednesday, February 24, 1965, in room AE-1, the Capitol.)

(The following was subsequently submitted for the record in accord with the committee's continuing interest in Federal statistical programs.)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 29, 1965.

PRINCIPAL FEDERAL STATISTICAL PROGRAMS IN THE 1966 BUDGET

This statement describes the subject matter content of the new projects summarized in "Principal Federal Statistical Programs," Special Analysis J of the 1966 Budget of the United States.

The 1966 budget recommends the expenditure of $126.3 million to produce the principal statistics used by business, Government, and the public at large. Of the total amount recommended, $106.5 million is for the current programs of Federal statistics and $19.8 million for periodic programs.

A description of the new projects included in the principal current statistical programs and the activities proposed under the periodic programs in 1966 is attached.

RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards.

SUPPLEMENT TO SPECIAL ANALYSIS J OF THE 1966 BUDGET OF THE UNITED STATES

PRINCIPAL FEDERAL STATISTICAL PROGRAMS IN THE 1966 BUDGET

Special Analysis J of the budget summarizes the principal statistical programs of the Federal Government for 1966. This supplement provides greater detail for those who have particular interest in these activities.

Objectives of the Federal statistical programs are to provide accurate, comprehensive, and timely data that are required for operations and policy decisions of the Government, and that furnish the public with information about the functioning of the economy and the welfare of people. This program is under constant review to assure that it reflects only the more pressing needs for data and that it is accomplished with a minimum burden on respondents.

Formulation of the Government's statistical program begins with the identification of problem areas and consideration of the data needed for measurement and for policy guidance. Some of the statistical series developed in response to these needs, such as the national economic accounts and the Consumer Price Index, are now recognized as significant current indicators of economic activity and must be maintained. New statistical data have to be developed in response to problems as they arise and to new programs of the Government. For example, the current emphasis on balance of payments led to establishment of a Review Committee for Balance of Payment Statistics; the 1966 budget provides for funds to effectuate some of the recommendations of this committee. Similarly, the budget for 1966 extends the statistical program proposed by the President's Committee To Appraise Employment and Unemployment Statistics. A new program, required by the Civil Rights Act of 1964, involves the compilation of registration and voting statistics.

In this presentation statistical programs are divided into two major categories—current and periodic. The former provides statistics which are produced from single time surveys or from monthly, quarterly, or annual series while the latter relates to data derived from large-scale census-type surveys characteristically taken only once or twice a decade.

The principal current statistical programs are classified by six major subject areas for the purpose of this analysis. This is done for two reasons: First, as an aid in evaluating the Government's overall statistical program in terms of relative emphasis by subject; and second, to indicate the interrelationships of the statistical activities of the various agencies. The subject areas, the agencies, and the amounts involved are summarized in table 1.

Programs covered by this statement represent a substantial part of the data collection and processing activities of the Federal Government. Since it is not always possible to separate production or use of data from other aspects of agency administrative responsibility, some statistical activity is not included. Entire programs of the following major statistical agencies are covered: The Economic Research Service and the Statistical Reporting Service in Agriculture; the Bureau of the Census and the Office of Business Economics in Commerce; the Bureau of Labor Statistics in Labor; and the National Center for Health Statistics in the Department of Health, Education, and Welfare. In addition, the general-purpose statistical activities carried out as a part of the overall program of selected agencies are included: the Corps of Engineers (Defense); Social Security Administration, Welfare Administration, and Office of Education (HEW); Bureau of Mines (Interior); Bureau of Employment Security and the Office of Manpower, Automation, and Training (Labor); Internal Revenue Service (Treasury); Civil Aeronautics Board, Federal Trade Commission, Federal Home Loan Bank Board, Housing and Home Finance Agency, Interstate Commerce Commission, National Science Foundation, and the Securities and Exchange Commission.

The agencies and amounts involved in both the current and periodic statistical programs included in this analysis are shown in table 2.

TABLE 1.—*Obligations for principal current statistical programs, by broad subject areas*

[In millions of dollars]

Program	1964 actual	1965 estimate	1966 estimate
Labor statistics (Departments of Agriculture, Interior, and Labor; National Science Foundation)	21.4	23.9	29.1
Demographic and social statistics (Departments of Agriculture, Commerce, and HEW; National Science Foundation)	15.9	18.2	20.9
Prices and price indexes (Departments of Agriculture, Commerce, and Labor)	5.0	5.6	5.9
Production and distribution statistics (Departments of Agriculture, Commerce, Defense, and Interior; Civil Aeronautics Board; Interstate Commerce Commission)	31.5	36.0	36.7
Construction and housing statistics (Department of Commerce; Federal Home Loan Bank Board; Housing and Home Finance Agency)	3.1	3.2	4.6
National income and business financial accounts (Departments of Agriculture, Commerce, and Treasury; Securities and Exchange Commission; Federal Trade Commission)	8.2	8.7	9.3
Total, principal current programs	85.1	95.6	106.5

TABLE 2.—*Obligations for principal statistical programs by agency*

[In millions of dollars]

Agency	1964 actual	1965 estimate	1966 estimate
CURRENT PROGRAMS			
Department of Agriculture:			
Economic Research Service	9.2	10.9	11.4
Statistical Reporting Service	10.5	11.9	11.9
Department of Commerce:			
Bureau of the Census	13.6	15.2	15.6
Office of Business Economics	2.1	2.4	2.8
Department of Defense: Corps of Engineers—Domestic shipping statistics	1.0	1.1	1.1
Department of Health, Education, and Welfare:			
Office of Education—Educational statistics	1.5	1.9	2.6
National Center for Health Statistics	5.8	6.3	7.3
Social Security Administration—Statistical and research activities	4.3	4.8	5.3
Welfare Administration—Statistical and research activities	1.2	1.7	1.7
Department of the Interior: Bureau of Mines—Statistical activities	2.4	2.4	2.7
Department of Labor:			
Bureau of Employment Security—Statistical activities	1.7	2.5	5.6
Bureau of Labor Statistics	16.3	18.5	20.6
Office of Manpower, Automation, and Training—Statistical activities	4.2	3.8	3.8
Treasury Department: Internal Revenue Service—Statistical reporting	4.6	4.8	5.0
Civil Aeronautics Board: Statistical and research activities	.4	.5	.5
Federal Home Loan Bank Board: Statistical activities	.9	.8	.9
Federal Trade Commission: Financial statistics	.3	.4	.4
Housing and Home Finance Agency: Urban studies and housing research	.4	.4	1.5
Interstate Commerce Commission: Transport economics and statistics	1.4	1.5	1.5
National Science Foundation: Statistics and research	3.0	3.6	4.0
Securities and Exchange Commission: Operational and business statistics	.3	.4	.4
Total, current programs	85.1	95.6	106.5
PERIODIC PROGRAMS			
Department of Commerce: Bureau of the Census—			
1962 Census of Governments	.6		
Modernization of computing equipment	4.5		
1963 economic censuses	7.1	7.1	1.5
1964 Census of Agriculture	1.5	16.2	5.6
1967 economic censuses			1.2
1967 Census of Governments			.2
Preparatory work for nineteenth Decennial Census	.5	1.3	2.4
Compilation of registration and voting statistics		.8	6.5
Department of Agriculture: Statistical Reporting Service—Computer			2.5
Department of Labor: Bureau of Labor Statistics—Revision of Consumer Price Index	1.4		
Total, periodic programs	15.6	25.5	19.8
Total, principal statistical programs	100.7	121.1	126.3

CURRENT PROGRAMS

LABOR STATISTICS

This area includes statistics on employment, hours, and earnings; number and characteristics of persons in the labor force, whether employed or unemployed; labor turnover, wage rates, industrial relations, industrial hazards, foreign labor conditions and productivity. Programs of the Bureau of Labor Statistics in these areas and statistical programs of the Bureau of Employment Security and the Bureau of Mines are included, as well as the estimates of the use of farm labor prepared by the Department of Agriculture and research on scientific manpower resources carried on by the National Science Foundation. Statistical and general research activities of the Office of Manpower, Automation, and Training, of the Department of Labor, are also covered.

Manpower and employment data

Increases in the manpower and employment statistics field result primarily from recommendations of the President's Committee to Appraise Employment and Unemployment Statistics (Gordon committee). Late in fiscal year 1964 a supplementary panel of households was established for the purpose of testing new concepts and procedures. A number of experimental approaches are being tried during fiscal 1965. This panel will be increased to 17,500 households, or about half the size of the regular CPS sample, during fiscal 1966 and improvements in definitions and procedures which may be decided upon as a result of the experimental program will be thoroughly tested in the framework of a regular monthly collection program operated parallel with the present survey. Thus, during fiscal 1966 there will be an overlap period to permit an orderly transition from the old to the new definitions and procedures ($699,500 BLS).

A long-range effort to test and improve the reliability of State and local estimates of unemployment, now based only in part on current data, was begun this year. This effort will be extended in 1966 to provide additional household interviews to supplement the records of State unemployment insurance programs. Particular attention will be paid to unemployment among groups excluded from current counts of the insured unemployed, such as persons entering or reentering the labor force and persons who have exhausted their unemployment insurance benefits ($347,000 BES).

Another step in the longrun program to improve the current monthly estimates of employment for States and other major areas will be taken in fiscal 1966. These series are developed cooperatively by BES, BLS, and State agencies, based on reports from employers of employment, hours, and earnings in their establishments. An additional 10,000 reports will be added to the sample to strengthen trade and service estimates and to add 33 more areas to the 159 for which estimates will be prepared by the end of fiscal 1965 ($137,400 BES; $129,000 BLS).

The Labor Department has recently initiated an experimental program to collect statistics on job vacancies in local areas. Surveys are being made in 16 areas, testing a variety of procedures and questionnaires. In addition to testing the feasibility of collecting such data from all types of employers showing the occupations and other characteristics of the vacancies, a followup survey is being made with a subsample of respondents to evaluate the accuracy of the responses and the burden on respondents. Funds are included in the 1966 budget request to initiate a series of such surveys in 150 metropolitan areas, should the experiments prove successful ($2,675,000 BES; $330,000 BLS).

The National Science Foundation will conduct analytical studies of the National Register of Scientific and Technical Personnel in order to appraise its coverage and effectiveness in measuring the supply of scientific manpower. It will also undertake studies of the demand for scientific manpower of various types ($150,000).

Wage and industrial relations statistics

Funds are recommended to expand and improve the BLS survey of professional, administrative, technical, and clerical salaries which is used by the Federal Government in determining salary levels for its classified employees as well as by private employers in salary administration. Changes include addition of smaller establishments, extension of geographic coverage, inclusion of more occupations, beginning revision of the sample, and other changes to improve the quality of the survey. In addition, exploratory work would be undertaken on a survey of salaries of State and local government employees ($332,000 BLS).

Studies of employer expenditures for supplementary employee remuneration ("fringe benefits") would be expanded and accelerated. More information would also be obtained in connection with the BLS series on current wage developments ($150,000 BLS).

DEMOGRAPHIC AND SOCIAL STATISTICS

Demographic statistics measure the population growth of the Nation and its political subdivisions and provide basic information on characteristics of individuals and families; included is the body of data generally referred to as "vital statistics"; i.e., births, deaths, marriages, and divorces. Social statistics are concerned primarily with data on the well-being of people, their health, education, and welfare.

Principal statistical programs included here are those relating to the above activities in the Bureau of the Census, the National Center for Health Statistics, the Office of Education, the National Science Foundation, the Social Security Administration, and the Welfare Administration.

Much of the information in this category, particularly with respect to population statistics, is obtained through periodic census programs covered later in this statement.

Population statistics

An expanded program of population estimates for local areas between decennial censuses is recommended for the Bureau of the Census. This program began in 1964 and, by the end of 1965, will cover 38 standard metropolitan statistical areas; funds for 1966 will permit extension to 30 more.

There is also provision of funds for consultation and advice to local groups and individuals on appropriate techniques for estimating the population of areas not covered by the above. The program of the Census Bureau already contains funds for annual estimates of State populations and for periodic projections of their future population changes.

Proposed funds also cover special tabulations and analyses of current trends in the population; for example, changes in the sources and the amounts of family income, children in low-income and broken families, migration and changes in occupations. In order to provide this information, the Bureau of the Census would make full use of its existing sample survey program and organization ($218,000).

Health and vital statistics

Increased funds in the amount of $1 million are recommended in the 1966 budget for the National Center for Health Statistics. These funds will permit full-scale operation of the hospital discharge survey, initiated in 1965. This survey is designed to collect data about patients discharged from a nationwide sample of short-stay hospitals, including information on diagnoses and success or failure with various treatments and operations, length of stay and types of services rendered and their costs, methods and sources of payment, and selected social and economic characteristics of the discharged patients.

The recommended increase also provides funds for initiating a series of special annual surveys and analyses of recurring data for a continuing statistical appraisal of the relationship of smoking to health. These studies are designed for the particular purpose of evaluating the effectiveness of programs initiated to influence smoking habits. Funds are also included for continuing research and development leading to new and more efficient techniques and procedures for processing the huge volume of medical and vital statistics records now handled by the center.

Education statistics

During 1965, the educational statistics functions of the Office of Education have been consolidated in a National Center for Educational Statistics, and all of the funds for this organizational unit are contained in the 1966 summary of principal statistical programs. A major component of the 1966 recommendations for funds provides for beginning the preparation of an analytical model of the educational system in the United States. This model will describe the educational system and the flows of students, staff, physical facilities, and funds through it; when completed, it will provide the basis for preparation of an updated, comprehensive, and interrelated program of educational statistics ($700,000).

Social Security statistics

An enlarged program for 1966 is recommended in the budget request of the Social Security Administration for the purpose of conducting depth studies of the social security problems of special groups in the population. The 1966 program includes a national study of the disabled, which will consist of a sample of 6,000 to 10,000 disabled persons, both beneficiaries and nonbeneficiaries of the social security system, to examine the effect of incapacity on the social and economic circumstances of adult disabled persons and their families ($100,000).

In addition, a retirement history will begin as part of the regular survey program; this study will follow a sample of 6,000 to 7,500 persons (beginning age 60 to 65) through a series of periodic interviews for at least 10 years ($275,000).

Increased staff is recommended for long-range research, economic and social surveys, and for the evaluation and measurement system which provides a validation of claims application decisions through a continuing monthly sample ($100,000).

Statistics on research, development, and related activities

Recommendations for the National Science Foundation in 1966 are directed, primarily, at greater emphasis on planning, particuarly in the area of developing a system to measure the social and economic impact of research and development activity, scientific advances, and improved technology ($250,000).

PRICES AND PRICE INDEXES

This program area includes the collection and processing of data for four major price index series. The Bureau of Labor Statistics prepares the Consumer Price Index and the Wholesale Price Index. The Statistical Reporting Service, Department of Agriculture, compiles the indexes of prices paid and of prices received by farmers. A recommended increase in this area of $257,000, all to the Bureau of Labor Statistics, is contained in the 1966 budget.

Funds will permit the expansion of price indexes for manufacturing industries based on the Standard Industrial Classification so that comparisons can be made with other major economic data that are presented on an industry basis, such as production, employment, hours, and productivity. These indexes will supplement the wholesale price indexes which are prepared on the basis of a commodity rather than an industrial grouping. Recommendations also include funds to start work on the preparation of price indexes of goods purchased by the Federal Government.

The program of presenting prices of goods imported and exported will be strengthened. At present, these prices are largely compiled from unit-value figures derived from export and import transactions; these unit values are recognized to be weak measures of actual prices. In the light of the intense interest in balance of payments, a more accurate measure of the relationship of U.S. prices to those of competing countries is essential. During 1966, techniques will be developed for more valid international price comparisons, beginning with metals and machinery products.

Current data on standard budgets are needed in connection with the anti-poverty program. Recommendations for 1966 include funds to do the preparatory work for updating the standard budgets for city workers' families and for elderly couples. These budgets will be based largely on data from the 1960–61 consumer expenditure surveys with current pricing.

PRODUCTION AND DISTRIBUTION STATISTICS

The principal programs included in this area are those involving the collection and analysis of data on agricultural production, marketing, and distribution in the Statistical Reporting Service and Economic Research Service of the Department of Agriculture; the statistical activities relating to industrial production, domestic and foreign trade and transportation of the Bureau of the Census in the Department of Commerce; and the statistical work of the Bureau of Mines in the Department of the Interior dealing with minerals and their products. Also included are transportation statistics activities of the Corps of Engineers in the Department of Defense, the Interstate Commerce Commission, and the Civil Aeronautics Board.

Except for minor changes elsewhere, the only program additions for which funds are requested in the 1966 budget are for the Economic Research Service and the Bureau of Mines.

Agriculture statistics

The final step is to be taken in 1966 to complete the long-range plan of the Statistical Reporting Service in the Department of Agriculture for improving crop and livestock estimates through the use of enumerative surveys and objective measurements of yields on a probability basis. The program, initiated in 11 Southern and 4 Midwestern States in 1961, is to be extended to the 3 Pacific Coast States and the 6 New England States, thus placing it on a full operating basis in all 48 contiguous States. This is to be accomplished at an estimated cost of $226,000 by eliminating or curtailing three other phases of crop and livestock estimates work: reducing the frequency of reports on cattle on feed in 6 States, eliminating surveys of cut flowers (11 States), and discontinuing estimating programs for 8 minor seed crops.

Additional funds are requested for data compilation and analysis by the Economic Research Service in several areas. Research in financial management of commercial family farms ($50,000) would emphasize studies of the problems of individual farmers, and an intensive appraisal of the effectiveness of credit institutions and programs in meeting emerging capital and credit needs in agriculture. Economic analyses of water management and use problems in agriculture ($104,000) will be undertaken in two major water problem areas in which Agriculture Research Service water management research is underway. National and regional analyses of the value of water in agriculture and competing uses will be expanded.

An increase of $90,000 is requested for establishing a program for the compilation and analysis of statistics on exports and imports of agricultural commodities by the major trading countries of the world and for outlook projections for U.S. exports. In addition, $200,000 is included as a nonrecurring item for a study and analysis of the away-from-home market for food. This would provide information on quantities and values of food used in away-from-home eating establishments, use of new foods, the policy on utilization of foods in temporary surplus supply, procurement practices and related activities.

Mineral statistics

An increase of $230,000 is recommended for the Bureau of Mines. These additional funds are for automating the processing of a number of regular statistical surveys in the expectation of longrun cost reduction and for increased support of cooperative work with State agencies.

CONSTRUCTION AND HOUSING STATISTICS

Basic construction and housing statistics are obtained through current programs in the Housing and Home Finance Agency, the Bureau of the Census, and the Federal Home Loan Bank Board. These statistics include data on housing starts; the value of construction, both residential and nonresidential, put in place; housing sales, vacancies and unsold inventory; and various aspects of housing transactions, such as foreclosures, mortgages recorded, financing, and mortgage interest rates. There are significant series affecting housing and construction in other areas: prices and production of construction materials, wages and employment of construction labor, and population growth and income.

An increase of $1.1 million is recommended for the urban studies and housing research activities of the Housing and Home Finance Agency. The principal part of this increase is for the extension and improvement of housing market data. These data are needed by business and by government, both national and local, in the decisionmaking and policy formulation process. They involve the provision of statistics on new rental housing to supplement the existing series on new housing for sale; extension of both bodies of data to encompass the characteristics of new occupants; and, the beginning of studies of the market for existing housing and the interaction between segments of the new and existing housing markets. Remainder of the funds is for studies of urban growth, development, renewal and organization, and of the problems involved in providing expanded and improved public facilities and services.

As part of its program to improve its estimates of the value of construction-put-in-place, the Bureau of the Census plans to design and initiate in 1966 a sample survey to measure private nonresidential value in place in the 13 Western States not now adequately covered. The recently established monthly progress reporting system for private nonresidential buildings is presently limited to the 37 Eastern States, since the reporting sample is drawn only from the individual project reports supplied by the F. W. Dodge Corp., which limits its collection of these data to this geographic area. To cover the entire United States, it is necessary to draw a sample of new private nonresidential building projects in the West and obtain reports on their construction progress. This sample will be drawn from lists of large projects provided by construction news sources and from building permits, supplemented by an area sample, particularly in the areas where building permits are not required.

NATIONAL INCOME AND BUSINESS FINANCIAL ACCOUNTS

This general category of statistics, includes the estimates for the national economic accounts—i.e., national income, gross national product, and interindustry purchases and sales—financial data for industry, and the measurement and analysis of business trends. The accounts provide summary analyses of economic changes for consumers, business, governmental units, and international transactions.

National economic accounts

The Review Committee for Balance of Payments Statistics, established in 1965, is making a number of recommendations for improvement of data in this area. To put some of these recommendations into effect additional funds are required; an additional $150,000 is requested in the 1966 budget of the Office of Business Economics for this purpose.

Other recommendations for the Office of Business Economics involve the strengthening of basic estimates in the national accounts, mainly in the area of trade and services ($70,000) and the size distribution of personal incomes ($60,000).

Work on trade and service industries involve study of employment and payroll data derived from records of unemployment insurance compensation, old-age and survivors insurance, and census data. The detailed study is needed to reconcile sizable discrepancies in payroll statistics among these sources of employment data.

Funds for work on income distributions will be utilized for incorporating a large volume of new data available from the last decennial census of population and other sources into the structure of the national accounts. New information on income size distributions for entrepreneurial and wage earner families and on composition of total income by type of income such as wages, dividends, etc., will also be provided.

An increase of $90,000 is requested to extend the application of automatic data processing further into the operations of the Office of Business Economics and to cover administrative costs in the Office of the Director. Improvement in data processing will include, in particular, the development of programing capability to adapt ADP to projects such as employment growth by counties and special analyses of the economic accounts and related data.

Business financial accounts

An increase of $190,000 for the Statistics Division of the Internal Revenue Service provides for technical statistical assistance to other offices of IRS on the taxpayer compliance measurement program, the provision of statistical data required in the formulation of tax policy and for increased workload. A small increase of $40,000 is recommended for the Securities and Exchange Commission for assembling additional information on operations of the securities markets.

PERIODIC PROGRAMS

Periodic statistical programs include large-scale census-type surveys usually taken only once or twice during a decade. In this category are such items as: the decennial censuses of population, housing and unemployment, the quinquennial economic censuses and the census of agriculture. Budgets for the periodic program fluctuate widely from year to year depending on the timing of the censuses during the decade. Except for the compilation of voting and registration statistics required by the Civil Rights Act of 1964, there are no large-scale surveys to be conducted in 1966. Funds are requested primarily for the tabulation of data already collected and for preparatory work in connection with future censuses.

THE 1964 CENSUS OF AGRICULTURE

Funds requested for 1966 provide for more than four-fifths of the tabulations and for the publication of a major part of the data from the general census of agriculture taken in the fall of 1964. These tabulations will show data for the United States and for each State and county. In addition, the program for 1966 provides for a survey of a sample of approximately 12,000 farms to be taken in the fall of 1965. This sample survey will provide information not required for small geographic areas and therefore not included in the general census. Subjects to be covered pertain to changes arising from widespread uses of new technology and equipment on farms, expenditures for items from nonfarm sources used by farmers in producing crops and livestock, income of farm families, farm finance, and construction of farm buildings.

ECONOMIC CENSUSES OF 1963 AND 1967

These censuses cover business, manufactures and mineral industries, and transportation. They provide information on number of establishments, sales, product shipments, inventories, number of employees, man-hours worked, payrolls, operating costs, and quantities of materials used, and capital expenditures in manufacturing and mineral industries. This information is presented by kind of business, by geographic location (e.g., State, county, city, standard metropolitan statistical areas, central business district, etc.) and by various other classifications such as sales size, employment size, legal form of organization, degree of product specialization, and type of operation.

The economic censuses are required by statute at 5-year intervals. A change in the law places the next economic censuses in 1967 although the previous ones were taken in 1963. This change was made in order to distribute the workload of the Bureau of the Census more evenly over the decade. The 1966 budget reflects estimated obligations of $1.5 million to complete the 1963 censuses. This represents the unobligated portion of funds appropriated for 1965. Economies achieved by automation programs have made it possible to complete the censuses at a cost of about $2 million less than the adjusted cost of the preceding (1958) economic censuses. The 1966 budget also provides $1.2 million for preparation work for the 1967 Economic Censuses.

PREPARATION FOR 1967 CENSUS OF GOVERNMENTS

Taken at regular 5-year intervals as required by law, the census of governments collects data on taxes and tax valuations, other revenues, expenditures and indebtedness, and government employment. The data are published for States, counties, municipalities, townships, school districts, and special districts. Funds in the amount of $200,000 are requested for preparation for the 1967 Census of Governments.

PREPARATION FOR THE 19TH DECENNIAL CENSUS

In 1964 and 1965 the Census Bureau received funds for testing new procedures for taking the 1970 census. The primary objective of these tests is to develop a satisfactory address register so that in the great majority of cases questionnaires can be mailed to respondents and returned by mail. On the basis of experimental studies to date, it is believed that this procedure would be less costly and produce more accurate data than door-to-door canvassing which has been used in the past. A decision as to the feasibility of this approach must await evaluation of the tests conducted in 1964 and 1965. If an address register is used it is necessary to begin its preparation in 1966 and the budget request assumes this method will be employed. A decision to the contrary will result in a lower expenditure in 1966. The 1966 budget request is $2.4 million, primarily to begin preparation of an address register.

Other preparatory work for the 1970 census is also included in the budget request. This involves continuing research to develop better ways of taking the census in rooming houses, tenements, slums, and foreign language areas; to improve questionnaire design to make more effective use of self-enumeration and computer processing; to determine statistical measures relating to the condition of housing; and to improve geographic identification for small areas.

REGISTRATION AND VOTING STATISTICS

Title VIII of the Civil Rights Act of 1964 requires that the Secretary of Commerce shal promptly conduct a survey to compile registration and voting statistics in such geographic areas as may be recommended by the Commission on Civil Rights. Such a survey is limited to a count of persons of voting age registered and voting by race, color, and national origin. Funds for this survey will be requested in 1965, of which it is estimated that $6.5 million will be obligated in 1966. The Civil Rights Commission has recommended complete coverage of the States of Alabama, Louisiana, and Mississippi and will recommend selected counties in other States.

QUESTIONS AND ANSWERS

ANSWERS TO ADDITIONAL QUESTIONS SUBMITTED BY SENATOR MILLER

Question 1. How many of the estimated 260,000 who will have been trained in 1966 will be employed? What is the record for 1963 and 1964 on number of trained and number of those trained who are employed?

Answer. In each year since inception of the Manpower Development and Training Act training program, about 75 percent of those completing training have gotten jobs promptly. In 1963, about 38,000 workers completed training and about 29,000 had obtained employment within 2 months of completion of training. In 1964, over 53,000 workers completed training and over 39,000 were placed on jobs.

The estimate of 260,000 persons who will receive training in fiscal year 1966 represents the total number who will receive training at some time. Assuming continuation of the 30 percent dropout rate and the 75 percent placement rate generally experienced to date, it is reasonable to estimate that 182,000 will complete training and about 136,000 will be placed on jobs within 2 months after completion of training.

Several points should be kept in mind in using the above statistics:

(A) No information is currently available on the employment status of trainees who dropped out of training; a study is now being conducted to shed light on this aspect of the program.

(B) Information on placement of workers completing training currently extends only to 2 months after the end of the training project. Thus, information on job retention rates of those initially placed and extent of placements after the initial 2 months following training are not now available. However, the Department of Labor is now preparing to obtain information on the employment status of trainees up to 1 year after completion of training.

(C) The above estimate of persons trained in fiscal year 1966 who will be placed in jobs probably does not represent the number who will obtain employment in that year. Many training projects will extend into fiscal year 1967 and perhaps into 1968. Accordingly, many of the estimated 136,000 persons who are expected to obtain employment shortly after completion of training will do so after fiscal year 1966.

Question 2. How much (in dollars) is involved in the change in timing in acreage diversion payments and reduced price support loan levels (by commodity), and explain the mechanics of the change in timing.

Answer. The change in timing of feed grain acreage diversion payments will reduce 1966 expenditures by $379 million below 1965. Usually a payment equal to 50 percent of the total payment is made in the spring when a farmer signifies his intent to divert the required amount of acreage from feed grain production. For the 1966 crop program—assuming the program is extended by the Congress—it is anticipated that the participant will receive only one payment, a final one at about the time of harvest when compliance is established.

Because of reduced price support loan levels for feed grains, cotton, and rice, 1966 expenditures will be about $269 million less than they otherwise would have been. These reductions were announced prior to submission of the 1966 budget to the Congress.

Question 3. What is the increase in noncivilian employment between June 1963 and June 1964, and what is the estimate thereon for June 1965?

Answer. Summary data on total Federal Government personnel is presented in Special Analysis C: "Civilian Employment in the Executive Branch," of the 1966 budget document on page 378. Military personnel (noncivilian) declined by 12,816 between June 1963 and June 1964. Total military personnel as of June 30, 1965, is expected to decline a further 28,906 to a level of 2,689,614 persons.

Question 4. Does the estimated decline in DOD outlays recognize potential increases for South Vietnamese operations? Recognizing that the decline reflects retiring of older manned bombers, what is in the Defense budget to replace them with new manned bombers?

Answer. With respect to the first part of the question, the 1966 budget did not contemplate a substantial step-up in operations in South Vietnam. However, we do believe that the amounts in the 1966 Defense budget request could provide adequately for a range of possible conditions in southeast Asia in the coming year. Furthermore, recognizing that as the year unfolds, developments may occur which cannot now be estimated with any confidence, the budget includes a substantial allowance for contingencies, for defense as well as nondefense programs, totaling $650 million in new obligational authority and $400 million in expenditures. These amounts are larger than is customary. If, however, international conditions—in southeast Asia or elsewhere—did change to a degree that was not covered by the budget estimates, the necessary financial requirements would have to be sought from the Congress via a budget amendment or supplemental appropriation.

Nevertheless, a considerable range of activity can be accommodated within existing resources plus those requested for the Department of Defense for 1966. To illustrate, various fixed budget costs, such as military pay, must be met whether our forces are engaged in combat or not; the cost of ship steaming hours or aircraft flying hours must also be met, whether for training functions or combat operations. To some extent, additional funds needed to support emergency operations may be transferred from other segments of the Defense budget by the Secretary of Defense.

In response to that portion of the question dealing with manned bombers, I attach an extract from Secretary McNamara's recent statement before the House Armed Services Committee on the 1966–70 Defense program and the 1966 Defense budget.

As the Secretary notes, the 1966 program provides for (1) continuation of the substantial B–52 modification program to enable the B–52 fleet to operate safely and effectively into the 1970's, and (2) a four-part program of aircraft design, avionics, and propulsion system development, and development of a new short-range attack missile which will retain for us the option to develop and deploy a new manned bomber in time to replace the B–52 force if needed.

EXTRACT FROM STATEMENT OF THE SECRETARY OF DEFENSE BEFORE THE HOUSE ARMED SERVICES COMMITTEE, FEBRUARY 18, 1965

THE DEVELOPMENT AND DEPLOYMENT OF A NEW MANNED BOMBER

I believe our analysis of the general nuclear war problem in the early 1970's clearly demonstrates that the destructive potential of our missile force alone should provide a most persuasive deterrent to a deliberate attack on the United States. Nevertheless, for reasons which I have already discussed, it would seem wise to keep open the option of continuing at least some manned bombers in our strategic offensive forces indefinitely, if need be. This we propose to do.

With appropriate maintenance and modification, the current B–52's can be operated, safely and effectively, through the early- or mid-1970's. About $1.8 billion has already been programed for the strengthening of the fuselage and tail structure, the provision of structural wing fasteners, flight safety modifications, capability improvements such as new radars and ECM (electronic counter measures) equipment and depot maintenance. Another $339 million is included in our fiscal year 1966 budget request for these purposes.

Considering the present size of the B–52 force, 630 operational aircraft, and the continuing availability of two wings of B–58 medium bombers, we do not believe that the expenditure of about $70 million over the next few years to keep two B–52B squadrons (30 U.E. (unit equipment) aircraft) in safe operating condition would be justified. These are the oldest and least effective B–52's. The two squadrons have been reflexed to Guam to replace the B–47's. Eight other B–52B's are being used for training.

We now propose to phase out the latter in fiscal year 1965. Additional B–52 aircraft will be activated out of available resources to carry on the training function. Later, when we will have additional Polaris submarines deployed in the Pacific, the B–52's on Guam will no longer be required and will be phased out. The elimination of the B–52B's should save about $40 to $45 million a year in operating costs over and above the $70 million which would be required to keep them in a safe and effective condition and without any significant effect on our strategic offensive capability. We would still have a force of about 670 manned bombers in 1970, and the B–52's would continue to be equipped with Hound Dog air-launched missiles.

There are at least two other alternatives available to us, in addition to the immediate development of the AMSA (advanced manned strategic aircraft), which would preserve the manned-bomber option for the period following the retirement of the B–52 force. These are: (*a*) the procurement of a strategic version of the F–111 (i.e., a B–111), and (*b*) the initiation of advanced development work on long leadtime components which would be needed for the AMSA as well as for other new combat aircraft.

A strategic version of the F–111 could carry the SRAM (short range attack missile) or bombs, or a combination of both. Its speed over enemy territory would be supersonic at high altitudes and high subsonic at low altitudes. While a B–111 force would have to place greater reliance on tankers than an AMSA force, its range (considerably better than the B–58), its target coverage and its payload carrying capability would be sufficient to bring under attack a very large share of an aggressor's urban/industrial complex. Since the F–111 is already nearing production, and we plan to initiate development of the SRAM in the current fiscal year, a B–111 could be made available in the early 1970's at a much lower cost than the AMSA, even if the decision to commence production is postponed for another 2 or 3 years.

The AMSA, as presently envisioned by some of its proponents, would incorporate the payload capabilities of the B–52 and the speed/altitude characteristics of the F–111. Its takeoff gross weight would be in the 350.000 pound class and it would require the development of a new engine and new avionics, as well as the SRAM.

However, Secretary Zuckert, in his memorandum transmitting the AMSA proposals to me, noted that the Air Force intends:

"* * * to complete, prior to the initiation of the Project Definition Phase, a prerequisite phase which will further refine our systems evaluation. This phase will include further evaluation of * * * [several alternatives]. * * * Each system configuration will be assessed in terms of performance, cost, schedule, military effectiveness, complexity, and development risks."

Considering the other alternatives available, the high cost of an AMSA fleet ($8.9 to $11.5 billion for the one proposed), the need to develop a new engine and avionics, the still-existing uncertainties as to the kind of new bomber we would want by the mid-1970's, and the remaining B–52 life which exceeds the leadtime required for development of new aircraft, I do not believe we are ready to go ahead with a full AMSA development at this time. But I do believe it would be desirable to keep open the option for developing such an aircraft as a replacement for the B–52's when they have to be retired.

We therefore propose * * * [a program which] would permit full development and deployment of a new manned bomber in ample time to replace the B–52's, should that decision appear to be necessary or desirable within the next few years. Funding beyond that recommended for fiscal year 1965 and fiscal year 1966 is not required at this time to achieve that objective.

Question 5. Congress recently enacted a deficiency appropriation of $1.6 billion to enable the Commodity Credit Corporation to continue operations. Does this mean that the fiscal 1965 budget was understated by $1.6 billion? Could this not have been avoided by requesting an adequate amount for restoration of capital in the fiscal 1965 budget? Similarly, may we not expect a deficiency appropriation request early next year for around $900 million (see second paragraph of budget, p. 155)? And, in any event, should not the full $3,226.8 million be appropriated to preserve the capital structure of CCC?

Answer. The appropriations requested for CCC in the 1965 budget were believed to be adequate at the time the budget was submitted. In fact, a reserve of over $900 million was provided. Developments subsequent to submission of the 1965 budget, however, made it necessary to request additional funds. These developments included lower sales of feed grains and wheat, greater production of cotton and tobacco, and a reduction by the Congress in the amounts appropriated.

The amounts requested for CCC in the 1966 budget were intended to be sufficient to finance the Corporation's activities, including a reserve of $1,343 million. (This will be slightly less since supplemental funds appropriated recently by the Congress were $142 million less than requested.) Unless the CCC programs require extremely large additional expenditures, now unforeseen, or unless the funds appropriated are not at about the level requested, it will not be necessary to request a deficiency appropriation in 1966.

The $3,226.8 million referred to is the loss realized by the Corporation in the fiscal year 1964. It does not include $1,057 million in losses realized by a reevaluation of inventories in 1961.

It is only necessary to restore the Corporation's realized losses if the funds are needed for subsequent operations. Although it generally was the practice in the past to request an appropriation equal to the realized losses of the actual year in the budget, there have been years when such an amount was more than adequate and other years when it has been less than adequate. Of course, the larger the amount that is appropriated the greater the chances that it will be adequate; however, we believe that our general budgetary policy of requesting only what appears to be needed in the budget year should apply also to the Commodity Credit Corporation.

ANSWERS TO QUESTIONS SUBMITTED BY CONGRESSMAN BOGGS

Question 1. Would you provide for the record a table indicating—

(*a*) the national debt for each year since 1940?

(*b*) the national debt as a percentage of the gross national product for each year since 1940?

(*c*) the per capita national debt of every American citizen for each year since 1940?

(*d*) the percentage of governmental expenditures for defense purposes for each year since 1940?

(*e*) the percentage of governmental expenditures for nondefense programs exclusive of interest on the debt for each year since 1940?

Answer.

Fiscal year	Public debt [1] (billions)	Public debt as percent of GNP (percent)	Per capita public debt	Defense as percent of administrative budget (percent)	Nondefense less interest as percent of administrative budget (percent)
1940	$48.5	50.7	$367.08	16.5	71.8
1941	55.3	50.1	414.85	45.7	45.9
1942	77.0	54.8	571.02	70.4	25.8
1943	140.8	78.9	1,029.82	79.6	18.1
1944	202.6	99.9	1,464.17	80.8	16.4
1945	259.1	118.7	1,851.70	82.7	13.6
1946	269.9	133.1	1,908.79	71.7	20.4
1947	258.4	115.7	1,792.67	37.0	50.1
1948	252.4	102.3	1,721.21	35.7	48.3
1949	252.8	96.6	1,694.93	32.7	53.5
1950	257.4	97.5	1,696.74	32.9	52.4
1951	255.3	82.2	1,654.44	51.1	35.9
1952	259.2	76.5	1,651.20	67.4	23.5
1953	266.1	74.0	1,667.87	68.1	23.1
1954	271.3	75.0	1,670.94	69.6	20.8
1955	274.4	72.8	1,660.36	63.2	26.8
1956	272.8	66.8	1,621.78	61.5	28.2
1957	270.6	62.5	1,580.83	62.9	26.5
1958	276.4	62.8	1,587.36	62.0	27.2
1959	284.8	61.0	1,606.73	57.9	32.6
1960	286.5	57.9	1,585.55	59.7	28.2
1961	289.2	57.3	1,574.01	58.3	30.6
1962	298.6	55.4	1,600.53	58.2	31.3
1963	306.5	54.0	1,618.30	56.9	32.3
1964	312.5	51.7	1,627.16	55.5	33.5
1965 (estimate)	316.9	49.5	1,627.00	53.5	34.9
1966 (estimate)	322.5	(2)	(2)	51.7	36.6

[1] Includes Government enterprise debt guaranteed by the U.S. Treasury.
[2] Indicates that the estimate required is not available.

Question 2. In view of the Bureau of the Budget's current concern about both our farm policies and our international payments deficit, it would be most helpful if you would outline the administration's policy regarding cotton. As you know, traditionally, the United States has been the major supplier of cotton in world markets, yet since World War II our cotton exports have been running about 50 percent below the level of the 20-year period prior to the war. This is all the more surprising since our principal customers, including the Common Market, have no duties or other import restrictions on American-produced cotton. What are the primary reasons for the deterioration in our cotton export markets? Are there any policies being contemplated at the present time which would enable U.S. producers to recapture our traditional share of the world market?

Answer. The administration position on cotton legislation is currently under review. A decision is expected shortly which will be followed by the submission of proposed legislation to the Congress.

Although many general factors affecting our foreign trade are involved in our reduced share of total world exports of cotton as compared to pre-World War II, the fact that cotton production outside the United States has increased more rapidly since the end of World War II than has U.S. production doubtless is an important part of the explanation.

A second factor appears to be associated with the rapid expansion of the production of manmade fibers in several of the countries that had been major export markets for our cotton prior to World War II. The wartime destruction of their industrial plants facilitated the shift to manmade (i.e., synthetic) fibers when plants were rebuilt. This, along with the efforts of many countries to become self-sufficient with respect to cotton, tended to narrow our export market.

It should be noted that our exports have been substantially higher in most years since 1955 than in the earlier post-World War II years, mainly because of a change in our foreign sales program for cotton which enabled exporters to compete better in the world market. Also, the Department of Agriculture, working with the Cotton Council International, is engaged in the promotion of the use of U.S. cotton overseas.

Question 3(a). If the administration's health care program is enacted without major amendments, what is the estimated cost of the program for fiscal years 1966, 1967, 1968, 1969, and 1970?

Answer. The Department of Health, Education, and Welfare's Actuarial Study No. 59 (January 1965), "Actuarial Cost Estimates for Hospital Insurance Act of 1965 and Social Security Amendments of 1965," presents estimates on a calendar-year basis. Adjusting these estimates to the fiscal-year basis indicates that estimated expenditures under the administration's hospital insurance for the aged proposal would be:

[Fiscal years, in millions]

	1966	1967	1968	1969	1970
Expenditures from the hospital insurance trust fund for those currently covered under social security and eligible for hospital insurance	$20	$1,720	$1,900	$2,110	$2,340

In addition to these trust fund expenditures, general fund financing is necessary to "blanket in" the uninsured aged. The gross costs of this provision are as follows:

[Fiscal years, in millions]

	1966	1967	1968	1969	1970
Gross costs of blanketing-in the noninsured aged	------------	$250	$250	$250	$250

It should be noted, however, that the costs will be substantially offset by savings in other programs such as old-age assistance and medical aid to the aged.

Question 3(b). If the current medical care program for the aged provided by the Kerr-Mills Act continues, what is the estimated cost to the Federal Government in fiscal years 1966, 1967, 1968, 1969, and 1970?

Answer. Expenditures for the Kerr-Mills program for 1966 are estimated at $613 million. Future trends would be strongly influenced by the enactment of the administration's hospital insurance for the aged proposal (H.R. 1). With enactment of H.R. 1, the future expenditures would be considerably lower, despite expected increases in the needy aged population.

Answers to Questions Submitted by Mr. Knowles on Behalf of Senator Proxmire and Others

Question 1. Would you indicate the relation between the $2 billion net stimulus of which you spoke and the deficit figures in the cash and national income accounts budgets for the fiscal years 1965 and 1966? That is, would you reconcile your $2 billion figure with the national income accounts budget deficit of $6 billion for 1966 and the cash budget deficit of $3.9 billion?

Answer. In my prepared statement to the Committee, I said that "For calendar 1965 * * *" the budget submitted to the Congress in January "* * * implies a net fiscal stimulus in the neighborhood of $2 billion." My estimate of about a $2 billion net fiscal stimulus referred to the estimated decrease in the full employment surplus between calendar 1964 and calendar 1965 on the basis of the proposals in the 1966 budget.

The estimated cash budget deficit of $3.9 billion and the national income account deficit of $6 billion for fiscal 1966, cited in the above question, differ from the $2 billion estimate of net fiscal stimulus for the following reasons:

(*a*) The cash and national income account deficits are for the fiscal year 1966 and not the calendar year 1965.

(*b*) My estimate of the net fiscal stimulus describes the change in the budget's fiscal impact on the economy between 2 years (calendar 1964 and 1965) while the deficits cited refer to the difference between receipts and expenditures in one specific fiscal year (1966). On the basis of estimated change from one fiscal year to the next, the consolidated cash deficit declines by $800 million in fiscal 1965 and by $100 million in fiscal 1966; the national accounts deficit rises by $1.1 billion in fiscal 1965 and by $1 billion in fiscal 1966.

(*c*) The receipts, expenditures, and deficits estimated for the cash budget and national accounts for fiscal 1966 are based on the continued economic growth projected in the budget (i.e., a range of GNP for calendar year 1965 centered on $660 billion). The estimate of net fiscal stimulus, however, is based on the assumption of uninterrupted full employment throughout the periods being considered. As I stated in response to Senator Proxmire's question, the change in full employment surplus (measured in terms of the national income accounts) is the most relevant measure of fiscal stimulus because it abstracts from other factors in the economy which could themselves bring about changes in the surplus or deficit. For example, a decrease in private economic activity could lower Federal revenues substantially. A larger Federal deficit would result, but it would come about as a consequence of declining private activity and not from any fiscal stimulus provided by the Government.

A more complete reconciliation of the national income account deficit with the cash budget deficit for fiscal 1966 is presented in table A–1 on page 357 of the 1966 budget. A copy of that table follows:

TABLE A-1.—*Relation of Federal receipts and expenditures in the administrative budget, consolidated cash statement, and national income accounts, 1964–66*

[In billions of dollars]

	1964 actual	1965 estimate	1966 estimate
RECEIPTS			
Administrative budget receipts	89.5	91.2	94.4
Plus trust fund receipts	30.3	30.5	33.6
Less:			
Intragovernmental transactions	4.2	4.2	4.4
Receipts from exercise of monetary authority	.1	.1	.1
Equals Federal receipts from the public	115.5	117.4	123.5
Adjustments for agency coverage less District of Columbia revenues	.3	.3	.3
Adjustments for netting and consolidation:			
Plus contributions to Federal employees' retirement funds, etc	2.0	2.1	2.2
Less interest, dividends, and other earnings	1.4	1.9	2.1
Adjustments for timing plus excess of corporate tax accruals over collections, personal taxes, social insurance contributions, etc	−.7	−.9	−1.8
Adjustments for capital transactions less realization upon loans and investments, sale of Government property, etc	.6	.4	.5
Equals receipts—national-income accounts	114.7	116.0	121.0
EXPENDITURES			
Administrative budget expenditures	97.7	97.5	99.7
Plus trust fund expenditures (including Government-sponsored enterprise expenditures, net)	28.9	29.0	32.9
Less:			
Intragovernmental transactions	4.2	4.2	4.4
Debt issuance in lieu of checks and other adjustments	2.0	.9	.8
Equals Federal payments to the public	120.3	121.4	127.4
Adjustments for agency coverage less: District of Columbia expenditures	.3	.4	.4
Adjustments for netting and consolidation:			
Plus contributions to Federal employees' retirment funds, etc	2.0	2.1	2.2
Less interest received and proceeds of Government sales	1.4	1.9	2.1
Adjustments for timing:			
Plus:			
Excess of interest accruals over interest payments	.9	.8	.6
Excess of deliveries over expenditures and other items	1.5	1.7	1.2
Less Commodity Credit Corporation foreign currency exchanges	.6	.8	.7
Adjustments for capital transactions:			
Less:			
Loans—including Federal National Mortgage Association, foreign economic assistance, redemption of International Monetary Fund notes, etc	3.4	1.4	.7
Purchase of land and existing assets and other items	.5	.5	.5
Equals expenditures—national-income accounts	118.5	121.0	127.0

Question 2. If, as I assume, your statement refers to the change in the full employment budget surplus, would you supply me with Bureau estimates of the full employment budget surplus during calendar 1965 and during the first half of calendar 1966? Semiannual estimates such as those presented on page 64 of the Economic Report of the President are sufficient.

Answer. Under conditions of full employment, the budget for fiscal 1966 would show a national income account surplus of about $2½ billion. This corresponds to the $6 billion national income account deficit estimated for fiscal 1966 at the levels of economic activity actually projected in the budget. The corresponding estimates are:

Fiscal Year 1966

[Billions of dollars]

	Budget estimate	Calculated at full employment
Receipts	121.0	128¾
Expenditures	127.0	126¼
Surplus (+) or deficit (−)	−6.0	+2½

The requested estimates of the full employment surplus by half years are presented below. These estimates are based on somewhat later information than those supplied to Senator Javits by Chairman Ackley of the Council of Economic Advisers on February 18. The differences, however, are relatively minor.

Estimated Federal receipts and expenditures assuming full employment conditions, by half years

[National accounts basis, seasonally adjusted annual rates, in billions of dollars]

Period	Receipts	Expenditures	Surplus (+) or deficit (−)
1964:			
January-June	122	118	+4
July-December	121	119	+2
1965:			
January-June	124	121½	+2½
July-December	125	125½	−½
1966: January-June	132½	127	+5½
Calendar year:			
1964	121½	118½	+3
1965	124½	123½	+1
Fiscal year:			
1965	122½	120¼	+2¼
1966	128¾	126¼	+2½

Answers to Additional Questions Submitted by Congressman Ellsworth

Question 1. I understand the Bureau of the Budget is pushing to get the steel industry capability made a matter of public record. Wouldn't it be far more useful, in analyzing steel industry pricing policies, to have some measure of production that shows the actual value of material flowing from a plant? This would show whether industry pricing were following costs of building and maintaining a plant and use of raw materials.

Answer. In April 1964 the Budget Bureau wrote to the American Iron and Steel Institute to propose that a joint effort be undertaken by the steel industry and the Government to develop a satisfactory measure of capacity for the steel industry. Our letter recognized that the construction of such a measure might present significant problems because of changing production techniques and improvements in steel products.

The institute responded promptly that one of their technical committees would review this suggestion. In the meantime work has been started by the institute on an exploratory basis with the cooperation of a selected number of companies. We have met with representatives of this group on several occasions and have discussed the progress of their work.

The thinking at the present time is directed toward development of a measure of capacity which will take into account the production pattern of the industry at all stages, from ingots (unless these are bypassed in newer techniques) to steel products (including the manifold shapes and forms and types of steel). Because it would encompass the full pattern of output, the measure we are presently seeking, together with industry, will not be dissimilar from what you are suggesting.

Such a measure is needed by all analysts who attempt to determine changes in the relationship between actual and potential production. We wish not only to measure how much our potential is growing, but also how much of our potential we are using. We need this especially for industry as a whole, and without a measure for the steel industry our overall measures are seriously deficient. Such a measure is also needed for analyzing changes in total potential output by tracing changes in the individual key industries.

It will differ from actual production, of course, in being a measure of capacity. We presently have a measure of production for the steel industry; what we lack is a measure of the extent to which actual production is pressing upon the capacity of existing facilities.

Question 2. If it is within the jurisdiction of the Bureau of the Budget, what is the Bureau doing to provide surveillance over Government agency buying policies and procedures from the standpoint of easing the payments imbalance? I understand the Defense Department, the Bureau of Reclamation, and other agencies are developing or have already put into practice stringent "Buy American" procedures and policies. What about the General Services Administration and other big Government spenders?

Answer. As part of a wide range of efforts to reduce the balance-of-payments deficit, the Bureau of the Budget has been carrying on a comprehensive program to reduce the adverse balance-of-payments effect of Federal programs.

The focal point of this program has been a system of Federal agency estimates and reports of international transactions. This system, informally known as the gold budget, was established at the request of the President by the Bureau of the Budget in August 1962. Currently, all agencies with substantial receipts or payments abroad prepare statistical estimates in March and September of their international transactions for the current and coming years. These estimates are reviewed by the Budget Bureau along with proposals for reducing the balance-of-payments impact of Federal programs. In addition, agencies prepare—and the Budget Bureau reviews—narrative statements on agency balance-of-payments projections each July and December.

Agency gold budget reports do not merely project current trends or programs, but rather reflect all possible efforts, consistent with the national interest, to minimize payments to and maximize receipts from, other countries.

It is now estimated that net Federal payments abroad will decline by $0.5 billion from fiscal year 1964 to fiscal year 1966. This figure excludes special transactions—receipts from military advances, prepayment of loans, and sales of medium-term, nonmarketable securities.

Receipts from abroad (excluding special transactions) are expected to increase steadily from $2.1 billion in 1964 to $2.6 billion in 1966. Payments are expected to decline slightly from the 1964 level of $4.5 billion.

In 1963 payments were about $5 billion; $0.5 billion higher than the current level.

Concerning purchasing policies overseas, the Bureau of the Budget does not have direct authority to set policies governing offshore procurement. However, it does participate in developing recommendations on such policies for the President's consideration.

In this area, two separate questions should be distinguished: (1) Procurement overseas for use in the United States. Such procurement is subject to the Buy-American Act as interpreted by Executive Order 10582. (2) Purchases overseas for use overseas. Such purchases are not subject to the Buy-American Act and policies regarding them may be determined administratively.

In the first case—procurement covered by the Buy-American Act—considerable information on agency practices has been gathered by the Joint Economic Committee; the most recent roundup can be found in the hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, 88th Congress, 2d session, April 16 and 21, 1964, appendix 3, pages 297–347. In general, as indicated in this material, procurement covered under the Buy-American Act is subject to a 6-percent differential in favor of domestic producers, with an additional 6 percent added if the domestic goods are offered by a small business or are produced in a labor surplus area within the United States. However, the Defense Department applies much greater differentials because its large volume of procurement has a significant impact on the balance of payments. The Defense Department may apply these differentials under section 3(a) of Executive Order 10582 which provides for exceptions to the normal rules for reasons of national interest.

In the case of procurement overseas for use overseas, all agencies currently apply a 50-percent differential to the delivered cost of the items involved; i.e., they procure domestic materials unless the delivered cost of these materials is estimated to be 50 percent greater than the cost of comparable materials of foreign origin. This procurement policy is not covered under the Buy-American Act or the Executive order. It was approved by the President upon the recommendation of the Cabinet Committee on the Balance of Payments.

Answers to Questions Submitted by Senator Javits

(Note.—The following answers were prepared from information supplied by the Department of Defense.)

Question 1. "What training and retraining programs, if any, does the Department of Defense maintain for Government employees displaced by base closings? Please indicate DOD funds expended for this purpose during fical year 1965 and the previous 3 fiscal years and the number of persons trained under this program by category of skill obtained."

Answer. The Department of Defense, in cooperation with other agencies, has developed certain training programs to assist in providing Government employees displaced by base closings with job opportunities. These programs are used, where feasible, to supplement efforts to place employees in other positions using their present skills. Extensive retraining has not been necessary to date, since most employees are placed in positions requiring their existing skills. The Department expects, moreover, that it will be possible to provide job opportunities for most displaced employees without the need for retraining.

There is no single or centralized retraining program; such retraining as is conducted is organized at the level of the installation or command with surplus employees. Maximum use is made of the authority to waive qualification requirements and to enter into training agreements with the Civil Service Commission. Where feasible, DOD activities also cooperate in retraining efforts with other government and nongovernment organizations.

The specific budgetary data and the information regarding the number of personnel trained by category of skill which were requested are not readily available, primarily because training and retraining functions are handled in the decentralized manner indicated above.

Question 2. "Does the Department of Defense maintain a program of assistance for relocating displaced employees of (*a*) Defense contractors and (*b*) DOD employees? What type of assistance is being extended? What has been the budgetary expense involved during fiscal year 1965 and the three previous fiscal years? How many people were involved in this period?"

Answer. The Department of Defense does not maintain a specific program of assistance for relocating displaced employees of Defense contractors. The Department does, however, allow separation or retirement expenses as part of regular contract termination costs as well as the costs of training and education related to new jobs with the same employer.

With respect to Defense employees, the Department has guaranteed another job opportunity to every career employee whose job has been abolished by a base closing or reduction.

To make certain that these job opportunities will be available, the closures and consolidations are being carried out on a phased basis. Most extend over periods up to 4 years in duration. Based on past turnover experience, an estimated 96,000 vacancies will develop annually in the Department of Defense to which displaced employees can be reassigned.

To the extent necessary to provide job opportunities to employees displaced by base closures, freezes on employment are imposed, and in some situations, freezes on internal actions such as promotions and reassignments also are invoked.

Employees are referred for placement in vacancies based upon their skills, their desires as to location and type of work, and the needs of the Department.

Displaced employees are being registered for referral to vacancies under the Department of Defense regional priority placement program. Under this program, the displaced employee's application is forwarded to other locations in the Civil Service region where he works in which he has expressed an interest and which offer some prospect for his placement. The receiving organization then is precluded from hiring from other sources for positions for which displaced career employees are available.

To broaden further the placement opportunities for employees, and to speed up and centralize the referral process, a nationwide computer program has been established to match the skills of displaced DOD employees with vacancies occurring anywhere in the DOD in the United States. Under this program all displaced DOD employees in the United States are registered at a single centralized referral activity located in Dayton, Ohio, for placement. Employees are registered for placement in jobs at grades and locations they indicate willingness to accept. This information, along with data on their qualifications and past experience, is fed into the computer at the centralized referral activity. Instructions to Defense installations having vacancies are automatically dispatched and employment orders from those installations are matched with the skills of displaced employees registered in the system.

If the job to which the employee is reassigned is at another DOD installation away from the employee's present residence, the Department pays the cost of transporting the employee, his family, and his household effects to the new location. Employees will also be given assistance in locating positions in other Federal agencies and in private industry. The Department is working closely with other Federal agencies, including the Departments of Labor and Commerce, the Civil Service Commission, State employment services, and industrial organizations to generate job opportunities for employees.

Because of the diversity of these activities, and because many costs cannot be separately identified, it is not possible to supply the budgetary data requested. With regard to the personnel aspect of the defense program, the Department reports that as a result of base closure announcements made since 1960, 61,927 civilian positions have been or will be eliminated. Civilian positions already eliminated by fiscal year are as follows:

Fiscal year:	*Civilian positions eliminated*
1962	3, 352
1963	3, 761
1964	7, 432
1965 (estimate)	12, 024

Although many of the announced closures are not yet in effect, the Department has recently surveyed the result of the job opportunity guarantee program as it applied to nine activities at which closure has been completed. All 2,681 career and career-conditional employees who were available to accept job offers have received offers and none was separated without having rejected an offer or having refused to be considered for available offers. Of the total, 2,039 were placed in other Federal jobs, 25 were placed in non-Federal jobs, 196 retired, 96 resigned, and only 324 were separated after declining an alternative job offer.

Question 3. "List number of instances the DOD's Office of Economic Adjustment assisted communities adversely affected by changes in defense and defense related programs during fiscal year 1965 and the three previous fiscal years? Provide amount of funds spent, budget and personnel of OEA during this period."

Answer. The Office of Economic Adjustment was established on May 3, 1961, by Secretary McNamara to assist in mitigating the economic impact of defense changes on individuals, business, and communities. The following table lists the number of instances in which that office has provided assistance to communities since that time. Most communities are counted in each of several fiscal years, reflecting the continuing contact provided by OEA over phase-out periods.

Fiscal year:	*Instances of community assistance*
1961	11
1962	14
1963	14
1964	21
1965 (estimate)	30

The staffing of the OEA for the fiscal years 1962 through 1965 is shown in the following table. Also shown are the expenses of the Office. Since it does not itself conduct programs of financial assistance, OEA expenses are mainly limited to salaries, travel, and per diem. Costs of travel on military aircraft are excluded, as are certain administrative expenses not readily attributable to that office.

Office of Economic Adjustment

Fiscal year	Staff (end of year)			Salaries, travel, and per diem
	Professional	Secretarial	Consultants	
1962	3	2	1	$73,965
1963	3	2	1	74,482
1964	3	2	1	80,644
1965 (estimate)	7	2	2	144,187

Although the Office has been expanded by Secretary McNamara in the past year, the size of its staff remains comparatively small. These personnel data are not, however, truly indicative of the scope of the Department's effort in this area. The OEA represents but the nucleus of DOD activity; the Office is actively supplemented and assisted as needed by personnel from the military departments, the Defense agencies, and the Office of the Secretary of Defense. Further, the Office seeks to play a catalytic role in its efforts to assist communities, providing ideas and advice, encouraging and assisting local governmental and business leadership to identify and exploit their own resources for economic recovery and growth, and to put communities in touch with other Federal agencies which operate programs applicable to local problems.

Question 4. "Does the Department of Defense provide any assistance to firms affected by changes in defense and defense related programs available to firms under the Trade Expansion Act of 1962? If the answer is in the affirmative, please indicate budgetary cost involved during fiscal year 1965 and the 3 previous fiscal years. If the answer is in the negative, please indicate why the principle embodied in the Trade Expansion Act, namely that the Government should accept responsibility for dislocations caused U.S. business as a direct result of Government action, is not applicable in this instance?"

Answer. The Department of Defense does not extend to individual firms affected by defense cutbacks the kinds of assistance available to firms adversely affected by tariff changes under the Trade Expansion Act of 1962.

Although, as noted in the Employment Act of 1946, the Federal Government has a major role in promoting "maximum employment, production, and purchasing power," there are limits on what can, or should, be done to assist individual firms in our competitive free enterprise economy. The first business of the Department of Defense is to provide and maintain forces in terms of strict standards of military need and operating efficiency. The Congress has recognized this fact by explicitly forbidding in the Department's annual appropriation act "the payment of a price differential on contracts * * * for the purpose of relieving economic dislocations."

There are, however, things which the Department can do to moderate the disruptive effects on firms of changes in the Defense program. As already noted, the Department permits contractors to include separation or retirement expenses as part of regular contract termination costs as well as the costs of training and education related to new jobs with the same employer. The Department of Defense also conducts several other programs to assist firms in adjusting to program changes. For example, a series of industry briefing sessions will be conducted this year to acquaint Defense contractors with future trends in the Defense program. The Department has also recently revised the Armed Services Procurement Regulations to allow under Defense contracts a portion of the "costs of generalized long-range management planning which is concerned with future overall development of the contractor's business and which may take into account the eventual possibility of economic dislocations or fundamental alterations in those markets in which the contractor currently does business."

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