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# AUGUST REVIEW OF THE 1968 BUDGET

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HEARING  
BEFORE THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES  
NINETIETH CONGRESS  
FIRST SESSION

—————  
AUGUST 24, 1967  
—————

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## AUGUST REVIEW OF THE 1968 BUDGET

THURSDAY, AUGUST 24, 1967

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

The Joint Economic Committee met, pursuant to recess, at 10:05 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Sparkman, Javits, Miller, and Percy; and Representatives Widnall, Reuss, Moorhead, and Griffiths.

Also present: John R. Stark, executive director; George Iden, staff economist; Don Webster, minority staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

This morning's hearing marks a highly constructive step in the execution of the Employment Act. Federal budget expenditures on a cash basis are equal to approximately one-quarter of total national income. Obviously, the huge amount of funds expended by the Federal Government, as well as the manner of its expenditure, has a profound effect on the economy. Anything we can do to improve the accuracy of forecasting must contribute substantially to better conduct of public economic policy.

It was brought out sharply in our hearings last January that failure to project expenditures accurately handicapped the Congress severely last year. We are aware that the Vietnam estimate was 100 percent wrong in 1966. There were other serious errors in forecasting. We can understand the reason for them and they are certainly not, in my view, based on anything except developments which were unpredictable. But they were serious and they did handicap the Congress very substantially.

This year, we have established two safeguards against repetition. One is the monthly issuance by the Department of Defense of basic information on contract awards which I know to be a significant early indicator of economic direction. A second is the arrangement with the Bureau of the Budget to give the Joint Economic Committee a revised budget, both income and expenditures, early in the new fiscal year. A further review is to be presented to this committee when Congress has completed its action on the appropriation bills.

(The summer review of the 1968 budget follows:)

## EXECUTIVE OFFICE OF THE PRESIDENT

### BUREAU OF THE BUDGET

August 17, 1967

#### SUMMER REVIEW OF THE 1968 BUDGET

This report presents revised estimates of the Federal budget for the fiscal year beginning July 1, 1967, and ending June 30, 1968. These estimates must be considered tentative, since action by the Congress on the President's budget is far from complete. Subject to this and the various other limitations discussed below, the report takes account of the major changes now foreseeable from the budget estimates of last January which affect either revenues or expenditures.

*Basis for current estimates.*—The updated estimates are consistent with the continued resumption of economic growth, evidence of which has been seen in the latest economic statistics. This pattern of economic activity is the same as that which was the basis for last January's budget. Actual experience during the earlier months of the year, however, indicates the need for some relatively small revisions in the specific economic assumptions made at that time for calendar 1967.

#### ECONOMIC ASSUMPTIONS, CALENDAR YEAR 1967

[In billions]

	January projection <sup>1</sup>	Current projection
Gross national product.....	\$787	\$783
Personal income.....	624	625
Corporation profits before taxes.....	83	80

<sup>1</sup> As printed in the budget. Recent Commerce Department revisions of the national income and product estimates for 1964-66 would imply some adjustment in these levels to maintain comparability.

In addition, the estimates presented in this report take account of (1) latest actual experience with respect to agency workloads and various uncontrollable factors affecting the estimates; (2) amendments to the original budget and legislative proposals which the President has transmitted to the Congress; (3) congressional action where both the Senate and the House of Representatives have acted on a measure (where only one body or neither body has acted, the President's recommendation in the January budget is retained as the basis for the estimate); and (4) slippage of effective dates of legislation where it is no longer possible for a measure to be effective as of the date proposed or assumed by last January's budget.

For example, the revisions reflect such changes as—

the effect on income tax collections of the restoration of the investment tax credit and of a somewhat lower level of corporation profits;

the President's recent tax message, which revised the tax surcharge proposals made in January;

the actual experience of a higher rate of spending than had been anticipated for public assistance grants to States, especially medical assistance;

congressional action on veterans' benefits and on those appropriation bills which have thus far been enacted;

slippage from July 1 until October 1, 1967, of the recommended postal rate increase; and

slippage from July 1, 1967, to January 1, 1968, of the proposed social security benefit increases. (Although the House Ways and Means Committee has recommended certain changes in the administration's social security proposal, the estimates used here assume the benefit increases as originally proposed, except for the change in the effective date.)

#### CHANGES IN ADMINISTRATIVE BUDGET ESTIMATES

##### *Administrative budget receipts*

Total receipts in fiscal 1968 are estimated at \$122.5 billion, compared to the \$126.9 billion estimate of last January. This revised estimate includes the anticipated revenue yield from the tax measures proposed by the President in his tax message to the Congress of August 3. It also takes account of downward revisions in revenues attributable primarily to (1) a reestimate of the yield of the existing tax system, (2) a reduction in the anticipated level of corporate profits, and (3) the reinstatement of the investment tax credit.

As indicated in his tax message, the President's tax proposals include a temporary surcharge of 10 percent on individual and corporation income tax liabilities in lieu of the 6 percent surcharge recommended in the January budget. For individual income taxes, the effective date of the surcharge is now proposed to be October 1, 1967, rather than July 1, 1967, as assumed in the January figures; however, the surcharge on corporation income taxes would still be effective at the originally recommended July 1 date. The new surcharge proposals are estimated to yield \$6.3 billion in revenues in fiscal year 1968, compared with the \$4.7 billion estimated for the surcharge proposals presented in the January budget.

The President is also now proposing a temporary continuation at present rates of the excise taxes on automobiles and telephone service. Under present law, the automobile excise tax is scheduled to drop from 7 to 2 percent on April 1, 1968, and to 1 percent on January 1, 1969; the telephone tax is scheduled to fall from 10 to 1 percent on April 1, 1968, and to be eliminated entirely on January 1, 1969. The January budget estimate for fiscal 1968 was based on these provisions of existing law. The current proposal by the President calls for extending the present tax rates on both automobiles and telephone service until July 1, 1969, and sets January 1, 1970, as the date on which the automobile tax would drop to 1 percent and the telephone tax would be eliminated. The proposed extension of these excise taxes would add an estimated \$0.3 billion to fiscal 1968 receipts.

The President's current tax program includes the same recommendations as in January for accelerating certain corporate tax collections. This acceleration is now—as in January—expected to provide \$0.8 billion in additional revenues in fiscal 1968.

In total, the President's current income and excise tax proposals are estimated to increase revenues in fiscal year 1968 by \$7.4 billion compared with the \$5.5 billion anticipated for the income tax proposals in the January budget. The new estimate takes into account the revenue

loss resulting from the later effective date of the individual income tax surcharge. Reflecting the new tax proposal and revisions in revenue estimates, major changes from the January figures are as follows:

TABLE 1.—Major changes in 1968 administrative budget receipts

	[In billions]	
January budget estimate, total.....		\$126.9
Major changes:		
Reestimate of individual income tax receipts, based on actual experience with tax liabilities for calendar year 1966 and the effect of reduced personal income.....		-3.3
Reduction in corporation income tax receipts, based on a lower-than-anticipated level of corporate profits.....		-1.3
Reinstatement of the investment tax credit.....		-.8
Reestimates of customs and estate and gift tax receipts under existing laws.....		-.2
Decline in miscellaneous receipts, mainly due to a reduction in anticipated stockpile sales.....		-.6
Additional yield of new tax proposals above those in the January budget, including increases of \$2.7 from rate changes offset by reduction of \$0.8 from delay in effective date of individual income tax surcharge from July to October.....		+1.9
Total.....		122.5

### *Administrative budget expenditures*

The January budget estimated administrative budget expenditures for fiscal 1968 at \$135 billion. Since then, actions by the executive branch and the Congress plus certain changes in uncontrollable program workload have occurred which will raise expenditures by \$1.5 billion. In addition, a number of contingencies have appeared which could cause further substantial changes in expenditures.

#### *I. Actions and developments to date*

Changes in administrative budget expenditures from actions and developments since January are now estimated at \$1.5 billion (see table 2). These changes fall into four major categories:

1. *The effect of releases, earlier this year, of activities deferred in fiscal 1967.*—Last fall, as a means of fighting inflation, funds were withheld in a number of Federal programs. In late February, and again in March and April, with a lessening of inflationary pressure, and after extensive discussions with Members of Congress, some of these funds were released. These releases will add \$0.6 billion to fiscal 1968 expenditures, \$0.5 billion of which is accounted for by the purchase of low-cost housing mortgages, newly authorized last year by the Congress.

2. *Changes in workload or costs under relatively uncontrollable Federal programs.*—Under many Federal programs, payments to individuals or groups are set by provisions of law. The total of those payments in any fiscal year is determined by factors outside the control of the executive branch. Changes in weather and crop yields, for example, affect agricultural price support payments, and changes in State welfare laws or in the cost of furnishing medical assistance to the poor automatically lead to changes in Federal grants for public assistance. Revisions in fiscal 1968 expenditure estimates on account of such changes will amount to \$0.9 billion, on the basis of present information.

3. *Congressional action on the budget to date.*—Net congressional actions to date would raise fiscal 1968 expenditures by \$0.1 billion.

Five regular appropriation bills have passed both Houses of Congress. Reductions in appropriations in those five bills should lower fiscal 1968 expenditures by \$0.1 billion. Changes in appropriations for a given fiscal year do not usually affect expenditures by the same amount in that year. Some of the expenditure effect occurs in subsequent years, and some appropriation actions reflect purely accounting changes and have no impact on expenditures.

TABLE 2.—*Categories of major change in January estimates of 1968 administrative budget expenditures*

(In billions)

Effect of earlier release of some 1967 deferred activities.....	+\$0.6
Low-cost housing program.....	+0.5
Other, including construction by the Corps of Engineers and the Department of Health, Education, and Welfare.....	+0.1
Relatively uncontrollable changes under existing law.....	+0.9
Farm price supports.....	+0.4
Public assistance grants to States.....	+0.3
Medicare trust fund payments.....	+0.2
Effect of completed or almost completed congressional action.....	+0.1
Veterans' benefit legislation.....	+0.1
Slippage of postal rate increase by one quarter.....	+0.1
Appropriation actions completed.....	-0.1
Other.....	-0.1
Reestimates of rates of outlay in some programs, mainly loan activities of the Departments of Housing and Urban Development and Agriculture.....	+0.4
Reestimates of financial transactions for Export-Import Bank and international financial institutions.....	-0.5

The reduction in appropriation bills is more than offset by other congressional actions to date; these actions will add some \$0.2 billion to expenditures. The later effective date now assumed for postal rate legislation will raise estimated outlays by \$0.1 billion. In addition, both Houses of Congress have passed bills raising veterans' pensions and liberalizing the GI bill of rights by a larger amount than proposed by the President, adding another \$0.1 billion to fiscal 1968 expenditures.

4. *Changes in financial programs.*—Increased outlays for loan activities of various domestic programs will be more than offset by decreased expenditures for international financial programs, leading to a net reduction of \$0.1 billion.

Table 3 shows the \$1.5 billion increase as it affects the major departments and agencies of the Federal Government.

### II. Contingencies

In addition to the \$1.5 billion increase in expenditures arising from actions and developments to date, an appraisal of fiscal 1968 expenditures must take into account a number of contingencies whose precise outcome cannot be evaluated at this time.

1. *Defense expenditures.*—In a war situation military requirements tend to change, and prediction of those changes long in advance is virtually impossible. This has been true in World War II, in Korea, and in Vietnam. As a consequence, we must be prepared for additional



defense expenditures in support of our combat forces. For example, the President has recently authorized an increase in U.S. Armed Forces in Vietnam by at least 45,000 over the number on which the January budget estimates were based.

At the same time, the President has directed the Secretary of Defense to review all defense expenditures with the objective of reducing or deferring those not essential for our national security. The Secretary is now conducting this review.

Neither the magnitude of the increases for Vietnam requirements nor the amount of offsetting savings can be predicted with any accuracy at this time. The net result of these changes could, however, increase defense expenditures in fiscal 1968 by up to \$4 billion.

2. *Military and civilian pay raises.*—The administration has recommended to the Congress a 4½ percent military and civilian pay raise, effective October 1, 1967. The \$1 billion cost of this proposal was reflected in the January estimate of budget expenditures. Bills now being considered by the Post Office and Civil Service Committee of the House of Representatives would increase the size of the pay raise above the administration's recommendation, provide an earlier effective date, and make certain other liberalizing changes. Should the Congress enact such legislation, over the strong recommendation of the administration to the contrary, and should such legislation become effective, budget expenditures would, of course, be further increased by an additional \$1 billion.

3. *Participation certificates.*—The Congress, in the Participation Sales Act of 1966, authorized an expansion of the existing participation sales program to cover additional types of Federal programs. As part of that act, it was provided that the volume of participation sales made each year by the Federal National Mortgage Association would be authorized in appropriation acts. The January budget proposed total sales of \$5 billion of participation certificates and requested the necessary authorizations.

In appropriation actions to date by one of the other Houses of Congress, the requested authorizations for participation sales have been reduced. These reductions, if sustained by the actions of the full Congress, would result in some \$2 billion less participation sales during fiscal 1968 than estimated in the January budget document.

Proceeds from participation sales are credited to the revolving funds of various Federal credit programs, and reduce net budget expenditures for these programs. Consequently, if participation sales are \$2 billion below the January estimates because of failure to enact the needed authorizations, total budget expenditures will exceed the January budget by \$2 billion.

4. *Interest on the public debt.*—Expenditures for interest on the public debt will, of course, be determined by the level of interest rates and the amount of outstanding public debt. Expenditures at the higher end of the range possible under the various contingencies listed above, or the failure of Congress to enact the proposed tax increase, would tend to increase the January estimate of expenditures for interest on the public debt, both because of the additional debt outstanding and because of the impact of additional Federal borrowing on the general level of interest rates. Should all of the contingencies turn out unfavorably, interest costs could rise by perhaps \$700 million.

TABLE 3.—Major changes in 1968 administrative budget expenditures by agency

[In billions]	
January budget estimate, total.....	\$135.0
I. MAJOR CHANGES FROM ACTIONS AND DEVELOPMENTS TO DATE	
Housing and Urban Development—mainly effects of tightening money market on mortgage purchases, and earlier release of amounts deferred in fiscal 1967 for low-cost housing.....	+.7
Health, Education, and Welfare—mainly additional payments to Medicare trust funds and public assistance grants (cash payments and medical assistance).....	+.5
Agriculture—mainly Commodity Credit Corporation, caused by higher farm price support payments for feed grains and soybeans.....	+.4
Transportation—mainly for the supersonic transport (covered by contingency allowance in January).....	+.1
Veterans' Administration—mainly more liberal legislation for readjustment benefits, pensions, and death gratuity payments.....	+.1
Post Office—mainly slippage of effective date of proposed postal rate increase from July 1, 1967, to October 1, 1967.....	+.1
Office of Economic Opportunity—1967 budget amendment for expanded summer programs.....	+.1
Corps of Engineers—mainly effect of earlier resumption of work on construction deferred in fiscal 1967.....	+.1
International Financial Institutions—conversion of maturing IMF notes (which were recorded as expenditures when issued) to letters of credit (under which expenditures are recorded only when funds are actually paid out).....	-.4
Export-Import Bank—lower level of loan disbursements, net.....	-.1
All other.....	-.1
Subtotal.....	136.5
II. RANGE OF POSSIBLE CONTINGENCIES	
Defense expenditures.....	Increase up to..... \$4,000,000,000
Excess Federal pay raise.....	Increase up to..... 1,000,000,000
Participation sales.....	Increase up to..... 2,000,000,000
Interest on the public debt.....	Increase up to..... 700,000,000

5. *Reductions in Federal civilian expenditures.*—In his tax message of August 3, the President announced his intention of making every possible expenditure reduction short of jeopardizing the Nation's security and well-being. Only three of the 13 regular appropriation bills for fiscal 1968 have been enacted (two others—the Agriculture and Labor-Health, Education, and Welfare bills—have passed both Houses, but no conference agreement has been reached). We have set up machinery, so that as each appropriation is enacted, the administration will review it, item by item, to determine how much expenditure reduction or deferral can be accomplished. The budgets of the Treasury, Post Office, and Interior Departments—whose appropriations have been enacted—are already under intensive review with this purpose in mind.

Making reductions will not be easy. Table 4 classifies civilian expenditures in terms of their controllability in the fiscal year ahead. Of the \$61 billion revised estimate for civilian expenditures, about \$21 billion remains after excluding expenditures fixed by statute or made in payment of prior contracts. And of this \$21 billion, \$8 billion represents the pay of Federal employees in civilian agencies—outside the Post Office—which cannot be sharply reduced without impairing such vital public services as law enforcement, operation of the national air navigation system, the staffing of veterans' hospitals, and the like.

Another \$1 billion represents the cost of the civilian and military pay raise proposed by the President.

Nevertheless, expenditure reduction targets will be established and enforced by the executive branch for all civilian agencies. We have set a target of over \$2 billion in expenditures, which would require reductions of up to \$4 billion in program levels. Such an expenditure reduction would exceed the \$1.5 billion increase in civilian expenditures caused by the release of deferred funds and uncontrollable program items discussed earlier. In other words, assuming favorable congressional action on Federal pay and participation certificates, and taking into account congressional action on appropriations, we are setting our target to reduce civilian expenditures below the level estimated in January. To the extent that congressional appropriations result in lower 1968 expenditures this target will be easier to achieve. The precise outcome cannot be predicted at this time, but we are setting our sights high to insure significant reductions when the final results are all in.

TABLE 4.—1968 civilian administrative budget expenditures, based on actions and developments to date

[In billions]	
TYPE OF CONTROLLABILITY	
Relatively uncontrollable civilian expenditures:	
Major programs:	
Interest.....	\$14. 2
Veterans pensions, compensation and insurance.....	5. 0
Public assistance grants.....	4. 4
Farm price support (CCC).....	1. 9
Postal public service costs and revenue deficit (existing law)...	1. 0
Health insurance payments to trust funds.....	1. 1
Legislative and judiciary.....	0. 4
Other.....	2. 3
Total, major programs.....	(30. 2)
Payments on prior contracts and obligations.....	15. 3
Relatively controllable civilian expenditures:	
Sale of financial assets.....	- 5. 3
Proposed pay increases.....	1. 0
Personnel compensation.....	8. 0
Other.....	11. 7
Total.....	61. 0

#### *Administrative budget deficit*

The fiscal 1968 deficit will depend on the outcome of these contingencies. Changes in Federal expenditures directly affect the deficit, of course. But they also affect it indirectly—though to a much smaller degree—through their impact on the level of economic activity and thereby on the level of tax collections.

If, as one example, military expenditures should rise the full \$4 billion above the January budget level; if Congress enacts the pay bill and the participation certificates authorizations at the level recommended by the President; and if both the Congress and the executive branch are together successful in reducing civilian expenditures to the \$59.5 billion estimated in the January budget, the deficit would be approximately \$16 billion—\$139 billion of expenditures and \$123 billion of revenues.

As indicated earlier, we shall make every effort to reduce expenditures below this level. But we must also take into account the possi-

bility that they may exceed it. Considering the uncertainties involved, a reasonable range of possibilities for the deficit would be \$14 to \$18 billion. The lower end of that range would be difficult to achieve, in view of the relatively small percentage of civilian expenditures which are subject to immediate Presidential control, and the budgetary demands of the Vietnam war. But it is not outside the realm of possibility. At the other extreme, cooperation between the Congress and the executive branch in restraining expenditures should clearly make it possible to hold the deficit below the upper end of the range.

#### CHANGES IN CONSOLIDATED CASH ESTIMATES

On a consolidated cash basis (combining the administrative budget with transactions of trust funds, including Government-sponsored enterprises), receipts from the public in fiscal year 1968—consistent with the \$122.5 billion estimate of administrative budget receipts—are projected at \$164 billion, down \$4.1 billion from the January estimate. With administrative budget expenditures at \$136.5 billion, payments to the public would be \$175.5 billion—up \$3.1 billion from the estimate last January. The contingencies cited in the discussion of the administrative budget would generally affect the cash budget by roughly equal amounts.

Cash receipts are down mainly because of the estimated decline in administrative budget revenues. A relatively small offset to this decline is provided by receipts of the trust funds, which are now estimated at \$48.6 billion in 1968, \$0.4 billion higher than the January estimate. The principal increases are in the old-age and survivors insurance and hospital insurance trust funds.

Cash payments are estimated to be higher than in the January budget, partly because of the estimated increase in administrative budget expenditures, but mainly because of higher outlays now anticipated by trust funds, including Government-sponsored enterprises.

In total, trust fund expenditures are currently estimated at \$45.9 billion, up \$1.4 billion from the January estimate. The major changes are in—

*Federal home loan banks*, up \$1.9 billion, reflecting a resumption of net lending by these banks in fiscal year 1968, following a period of heavy repayments of earlier loans by Federal savings and loan associations late in fiscal 1967.

*Hospital and supplementary medical insurance* payments, up \$1.1 billion over the January estimate, largely attributable to higher daily costs of hospital service.

*Highway trust fund* payments, up by \$0.3 billion, due to the earlier-than-expected release of 1967 cutback funds.

*Old-age and survivors and disability insurance*, down \$2.0 billion because of the estimated slippage in the effective date of the pending benefit increases from July 1, 1967 to January 1, 1968.

#### CHANGES IN NATIONAL INCOME ACCOUNTS ESTIMATES

Tentative revisions for the Federal sector of the national income accounts have been calculated consistent with the consolidated cash estimates presented above and the administrative budget expenditure

estimate of \$136.5 billion. These revisions are shown in the following table:

TABLE 5.—FEDERAL SECTOR, NATIONAL INCOME ACCOUNTS, FISCAL YEAR 1968

[In billions]			
Description	January estimate	Current estimate	Change
<b>Receipts:</b>			
Personal tax and nontax receipts.....	\$76.8	\$74.6	-\$2.2
Corporate profits tax accruals.....	35.3	33.9	-1.4
Indirect business tax and nontax accruals.....	16.9	17.1	+.2
Contributions for social insurance.....	38.1	38.4	+.3
Total receipts.....	167.1	164.0	-3.1
<b>Expenditures (before allowing for contingencies):</b>			
Purchase of goods and services.....	91.9	92.3	+.4
Transfer payments.....	46.6	46.1	-.5
Grants-in-aid to State and local governments.....	16.7	17.6	+.9
Net interest paid.....	10.5	10.5	-----
Subsidies less current surplus of Government enterprises.....	3.5	3.9	+.4
Total expenditures.....	169.2	170.4	+1.2

Most of the contingencies discussed in connection with the administrative budget would also affect the national income accounts budget—military expenditures, added pay increases, higher payments for interest on the public debt, and any reductions in civilian administrative budget expenditures which do not relate to Federal credit programs. Changes in participation sales, however, do not affect the national income accounts budget, since they are part of Federal loan programs which are excluded from the NIA budget.

[End of submission]

Chairman PROXMIRE. Mr. Schultze has been most cooperative in meeting the committee's needs. We appreciate it very much.

It is my understanding, Mr. Schultze, that you have already supplied the committee with a statement that is documented with regard to your estimates as you see it as of now, and that you are ready to submit to questioning by members of the committee.

**TESTIMONY OF CHARLES L. SCHULTZE, DIRECTOR, BUREAU OF THE BUDGET, ACCOMPANIED BY CHARLES J. ZWICK, ASSISTANT DIRECTOR, BUREAU OF THE BUDGET, AND DALE R. McOMBER, CHIEF, BUDGET PREPARATION, BUREAU OF THE BUDGET**

Mr. SCHULTZE. That is correct, Mr. Chairman. Last week I submitted to the Joint Economic Committee the documentation behind our estimates. I am sure the committee has also had a chance to review the testimony of Mr. Fowler, Mr. Ackley, and me before the Ways and Means Committee, which has the same numbers and perhaps some additional estimates in it. I am prepared now to answer your questions.

Chairman PROXMIRE. There will be other members of the committee, I understand, here a little later. But in view of the fact that you don't have an extensive statement—usually the statements take half an hour or an hour. I have talked with Senator Miller and it

seems to me it would be more efficient for us to conduct 15-minute-question periods instead of the usual 10 minutes apiece, and go back and forth on that basis.

You have many responsibilities, Mr. Schultze, as the Budget Director. A principal responsibility, certainly, is oversight—overseeing expenditures by the Executive. The Budget Director is often referred to as the President's "No" man—you have to say "No." You are in the strongest position, therefore, it would seem to me, to give us information on the proposed reduction in spending. You also can give us helpful information in the area of revenues, but the expenditures themselves are the ones that fall into your principal jurisdiction. As you have indicated, you think there will be what in reductions on the basis of the early 1968 estimates that we got last January?

Mr. SCHULTZE. Well, let me surround that question, perhaps.

First, looking at civilian expenditures, and for the time being, ignoring any potential increase in Federal pay above the President's recommendations and ignoring any change in our sales of participation certificates—ignoring those two items—you will recall that the information I submitted to your committee indicated that our estimates of civilian expenditures in fiscal 1968 have increased by one and a half billion dollars. You will recall also that there are two basic areas of increase: First, the \$600 million increase as the effect of the expenditure in fiscal 1968 of funds withheld last year and released this spring. Of that \$600 million—\$500 million in round numbers—represents purchases of low-income mortgages by FNMA, carrying out a program enacted by the Congress last year.

Chairman PROXMIRE. This, then, was an increase based on the decisions by the Executive to go ahead with spending which it late last fall, or December, had decided to withhold. In March, April, May, you have decided the situation has changed and you have included that increased spending?

Mr. SCHULTZE. That is right, particularly in the housing area. We did not go ahead with the full amount of the \$1 billion authorization for the low-rent-housing program. We went ahead with a majority—

Chairman PROXMIRE. \$600 million?

Mr. SCHULTZE. Well, a \$500 million expenditure effects for the release of \$750 million for the low-rent-housing program. For all the releases made there was some expenditure effect in fiscal 1967, \$500 million for the low-rent program in 1968, and another hundred million dollars scattered throughout the Government for other programs.

Second, there is \$900 million of increase in three basic areas: First, \$400 million of Commodity Credit Corporation, primarily on account of higher crop estimates for feed grains and lower consumption estimates for soybeans; second, \$250 million increase in public assistance payments, both cash and medical assistance, primarily medical assistance—because of rising medical costs and a larger entry into the program in terms of eligibility standards being changed by States.

Third, \$150 million of increase in general revenue payments to the medicare trust fund. You will recall that the general revenue makes two kinds of payments for the medicare trust fund: First, a payment of \$3 a month for supplementary medical insurance—if you will, the doctors' bills; and second, paying for the costs of certain beneficiaries not on social security rolls who are blanketed in the medicare system. Participation in medicare was somewhat higher than we had esti-

mated in January, it now appears, so we are up \$150 million. So that accounts for the \$900 million.

Second, we have also indicated that we are setting a target in the civilian area of some \$2 billion plus in terms of—

Chairman PROXMIRE. Wait a minute, the figures you gave me for the CCC, public assistance and medical trust fund, add up to \$800 million.

Mr. SCHULTZE. In addition, there are net increases of \$100 million across the board. There are some pluses and minuses. But \$100 million across the board net elsewhere.

Now, as against that, as I indicated in my statement, we are setting a target to attempt to save by reductions, deferrals, stretchouts, something more than \$2 billion in terms of expenditures. Let me make two or three points with respect to that.

First, this, of course, is a joint effort—and should be a joint effort with the Congress. You will note that several days ago, after the House Appropriations Committee reported out an appropriation bill, reducing NASA appropriations by \$517 million, the President issued a statement saying, in effect, that under normal circumstances, he might have opposed this reduction, but given the existing situation, he accepted the reduction.

Chairman PROXMIRE. That was an authorization?

Mr. SCHULTZE. No; the reduction was in the appropriation.

Chairman PROXMIRE. That was the appropriation by the House?

Mr. SCHULTZE. Let me clarify that if I may.

Chairman PROXMIRE. The authorization reduced the space figure?

Mr. SCHULTZE. By \$234 million. An additional \$282 million below the authorization was cut by the House Appropriations Committee. The two together, the total cut, is \$517 million. But as I said, the President indicated in his statement, a day or two after the House Appropriations Committee made its report, that given the circumstances facing us, he accepted that reduction.

Taking this into account and actions, perhaps future actions the Congress may take, and actions we will take, we are setting the target, as I indicated, at some \$2 billion-plus of expenditure reduction—

Chairman PROXMIRE. That seems to be a very, very small reduction. When you consider the enormous size of the budget and the fact that—I don't know how you classify foreign aid, whether you classify that as civilian or not.

Mr. SCHULTZE. Yes; I do.

Chairman PROXMIRE. Much of it is not military.

Mr. SCHULTZE. Economic aid is classified as civilian.

Chairman PROXMIRE. That has already been cut by the Senate from \$3.3 billion down to \$2.6 billion. The House may have restored that, but that was in an authorization, not an appropriation, and you certainly can't go higher than the authorization. It is my feeling, perhaps you share it, that the realistic view is it may well come closer to \$2.6 billion. It will be well below the \$3.3 billion.

Mr. SCHULTZE. We are talking about fiscal 1968 expenditures. If you cut the entire foreign aid bill to zero in terms of appropriations, both military and civilian, the expenditure in fiscal 1968 will still be somewhere between \$1.4 and \$1.6 billion. That is why the \$2 billion figure I gave you as our target, or \$2 billion-plus, depending on precisely where it is cut, means something like reductions of three and a half to \$4 billion in obligations or obligational authority.

Chairman PROXMIRE. Now, how about the spending reductions that were made by the President last December? As I recall, that was something like \$3 billion that were cut.

Mr. SCHULTZE. That is correct, last year's expenditure reductions were \$3 billion.

Chairman PROXMIRE. All of that, I take it, was not in fiscal 1968.

Mr. SCHULTZE. The cut was made in fiscal 1967.

Chairman PROXMIRE. In other words, there was a \$3 billion cut. Now we are talking about a \$2 billion overall cut. That is less, even, than the \$3 billion reduction that was made even in December. Why is it not possible for the President, in view of the feeling on the part of the administration that now we need a 10-percent surtax, not a 6-percent tax as they said late last fall, or early this year—under these circumstances it seems to me that you could make a case for a bigger cut. Certainly as big a cut as you had last time.

Mr. SCHULTZE. May I?

Chairman PROXMIRE. Yes.

Mr. SCHULTZE. There are at least three reasons.

Chairman PROXMIRE. Let me just interrupt before you respond to say that to the best of my knowledge, there has been no effort to cut back the road building fund; is that correct?

Mr. SCHULTZE. Not at this time; that is correct.

Chairman PROXMIRE. And there was last year?

Mr. SCHULTZE. There was.

Chairman PROXMIRE. This is a big item in public works, isn't it?

Mr. SCHULTZE. This is one of the points I wanted to make. Of the \$3 billion, \$400 million was for roads. We are talking at the moment of the administrative budget. I am talking of the \$2 billion-plus of the administrative budget. The \$3 comes down to \$2.6 for the administrative budget.

In addition, to give you a little history on this, that \$3 billion figure was in effect specified last year, although the details were not given out until later. It was specified last year at a time when Congress was adding substantially to authorizations. So as part of the cut, one of the items we indicated we could handle was not to send up appropriations to cover those authorization increases. That accounts for \$480 million of the cut. This year, we are not faced with that problem, at least up to date.

Next, a significant part of last year's cut, was a holdback—at least all during the fall and up through March—of the \$1 million FNMA mortgage purchase increase. So if you take the fact that last year, we were faced with substantial congressional additions to the President's budget and a large part—by no means all—a large part of the reduction was made simply by not appropriating for or by withholding appropriations, not spending them—and if you will recall, a part of it was highways—then in terms of the actual situation, the \$2 billion figure is much tougher to accomplish than the \$3 billion was last year, because you are dealing with a completely different situation.

That is point No. 1. Point No. 2, as I indicated in my statement, that \$2 billion, practically all of it is going to have to come out of a \$21 billion base, not out of a \$136 or \$137 billion base.

Chairman PROXMIRE. It has to come out of—we are just talking about the civilian part first. We have some questions also on the



defense part. The Senate has already cut the defense budget \$1.4 billion.

Mr. SCHULTZE. Correct. I am perfectly willing to discuss that. I will come back to that after covering the civilian side.

If you include the \$1.5 billion increase that I talked about earlier, civilian expenditures in fiscal 1968 would be \$61 billion. Of that \$61 billion, some \$30.2 billion is relatively uncontrollable. I say relatively. This does not mean you could not touch anything. But basically, these are locked in interest on the public debt, veterans' compensation, pensions and insurance, public assistance payments, payments to the Medicare trust fund, and CCC payments. You can change those programs, but not very much.

An additional \$15 billion comes in payments on prior contracts. If you then make the financial adjustments necessary with participation certificates, it leaves \$21 billion where we can really look for reductions. Of the \$21 billion, \$9 billion are for payrolls. I am not saying you cannot cut payrolls. You can. But that leaves \$12 billion of grants, new procurement—

Chairman PROXMIRE. If you cut back a program like the space program substantially, you cut back payroll to some extent?

Mr. SCHULTZE. That is correct.

Chairman PROXMIRE. If you cut back a public works program, you cut payroll.

Mr. SCHULTZE. If you cut back public works, primarily, you cut private payroll, not public payroll. Not all of it.

So you have \$21 billion to cut into, of which nine is payroll and 12 is other. The largest part of the \$2 billion has to come out of the \$12 billion. I am not saying all of it cannot come out of the nine. All I am saying is looking at where the cuts come, it is out of the \$21 billion and within the \$21 billion is—

Chairman PROXMIRE. What is the difference between the 21 and the 30?

Mr. SCHULTZE. You start with \$61 billion. You subtract out 30.3, which you are essentially fixed with by law.

Senator SPARKMAN. Thirty-three?

Mr. SCHULTZE. 30.3. You then take into account 15.3 which are payments of prior contract. That brings you to 45.6. Subtract the 45.6 from the 61 and you come out to 15.4. But that 15.4—I hate to be complicated in arithmetic, but it is complicated.

Senator MILLER. Will the chairman yield at that point?

Chairman PROXMIRE. Yes.

Senator MILLER. I want to ask him to go over these figures again starting with the 61. I am lost now.

Mr. SCHULTZE. Excuse me, sir. We start with \$61 billion of civilian expenditure. I am then going to make two major subtractions—one, \$30.3 billion, payments in programs where the payments are almost fixed by law.

If you will examine my statement, you will see that relatively uncontrollable civilian expenditures, for major programs, total \$30.2 billion. That was my error, I said 30.3. It is 30.2.

Payments on prior contracts and obligations is \$15.3 billion.

Chairman PROXMIRE. Let me interrupt at that point. Payments on prior contracts and obligations, is this really an element of commitment that is completely uncontrollable? Does it amount to \$15.3 billion for fiscal 1968, and is it not possible under some circumstances for the

President to reduce that? Was not part of the \$3 billion cut that was announced in December a matter of being able to reduce some of these contracts?

Mr. SCHULTZE. No, sir.

I do not mean that there may not be \$100 million or so. I do not want to be that firm about it.

You have to distinguish—let me see if I can say this as accurately as possible.

First, legally, yes, some reductions might be made. Most contracts have cancellation clauses and if you are willing to incur penalties, you can cancel them. So legally, I guess I would have to say it could be cut, so if you want to cancel the contract, you pay the penalty costs.

What we do in the public works area, however, when we stretch out public works, are two things. First, we do not inaugurate new starts. Secondly, these public works programs are done on contracts which tend to be renewed at periodic intervals. When a particular component is complete, you then renew the contract, or perhaps let it to a different bidder. In stretching out public works, we tend to slow down, delay the start of those new components. We do not, we generally try to avoid—I would not say in case of a full-scale war, you would not do this—but we generally try to avoid canceling contracts with a penalty clause.

Chairman PROXMIRE. What do the penalty clauses normally amount to?

Mr. SCHULTZE. That I could not tell you.

Chairman PROXMIRE. One, two percent?

Mr. SCHULTZE. I honestly do not know, sir.

Chairman PROXMIRE. Can you get us that for the record? Can you also get us for the record whether or not you did cancel such contracts in World War II and in the Korean war?

Mr. SCHULTZE. I am almost sure that in World War II, we did. I think in the Korean war, we did not. I will check that and get it for you for the record.

Chairman PROXMIRE. Will you get for the record also what are some of the penalty costs?

Mr. SCHULTZE. I don't think I can get it in exact figures.

Chairman PROXMIRE. Get us as much as you can.

(The information above referred to follows:)

The following information applies generally to contracts for construction and military procurement. However, most of the information is representative of contracts for other purposes as well:

Costs associated with the termination of contracts at the convenience of the Government are settled by negotiation or adjudication. Normally, there are no fixed penalty costs. Termination costs which are normally paid to the contractor by the Government include:

1. The cost of all work accomplished by the termination date together with a reasonable profit thereon.
2. The cost of special equipment and material ordered under the contract before termination which cannot be used elsewhere.
3. Costs of storage, installation of safety and other protection measures, transportation from the site, and other preparations of equipment and facilities for a closedown.
4. Other closing costs incidental to termination such as severance pay, leased equipment contracts, and clerical costs.
5. Any valid claims by the subcontractor on the prime contractor.

In addition, if work is resumed at a later date, costs associated with resumption are normally assumed by the Government. These include rehiring, new design work, movement back to the site and administrative costs.

Aside from the costs of completed work, the above factors result in costs which result in payments by the Government of the following percentages of original contract value:

- 8% to 20% for dredging projects.
- 25% to 35% for power and pumping facilities.
- 15% to 30% for other water resources construction including dams, locks, levees, channels, etc.
- 30% to 70% for military procurement (Termination costs are higher for this procurement than for water resources construction because lead times are longer and special equipment is often ordered at an early stage. Unlike most water resources construction contracts, there is normally only a single contract involved.)

It should be noted that costs increase original costs of the contract by the percentages noted above if work under the contract is subsequently resumed.

It should also be noted that expenditures in the immediate year would *increase* rather than decrease if contracts are terminated. This is true because spending from prior commitments will not be decreased but termination costs will often have an immediate effect.

During World War II, a number of contracts for water resources construction were terminated; however, only a portion of existing contracts were terminated. During Korean hostilities, widespread terminations did not occur although there was some deferral of scheduled completion dates.

Mr. SCHULTZE. Mr. Curtis and I have on other occasions had long colloquy on this. My answer has been "Yes," as a legal matter it is possible to cancel contracts. As a general matter of public policy, except in the case of World War II, we would not go into this, partly because all things considered, you do not want to leave a dam half-built. I will not say there are not any exceptions. Normally in terms of public policy, you do not want to leave a dam half built.

Chairman PROXMIER. I realize you were in the middle of an answer which was long and involved. But my time is up. I would like to yield to Senator Miller.

Perhaps we can come back on this a little later. I want to ask on the defense part, also, which I think is even more promising in terms of deductions.

Mr. SCHULTZE. Do you want me to finish this, Senator?

Senator MILLER. Please do.

Mr. SCHULTZE. So from the \$61 billion we deduct \$30.2 billion and \$15.3 billion. That leaves \$15.5 billion. That \$15.5 billion, however, is made up of items you see at the bottom of the page. In effect, \$20.7 billion of expenditures offset by \$5.3 billion for the sale of financial assets. So I am saying it is that \$20.7 billion, the sum of the three items on the bottom of the page, out of which practically all the deductions will have to be made. Of that \$20.7 billion, \$9 billion are payrolls, \$12 billion in round numbers are grants and contracts yet to be let; \$9 billion are payrolls.

Senator MILLER. Our figures, for example, used on the 1967 budget. Last year at our hearings, I asked Secretary Fowler whether or not the borrowing by the Federal Government to cover deficits was calculated on the basis of the administrative budget, and he replied that it was. That is your understanding, too, is it not?

In other words, if we have a deficit and the Federal Government has to go out and finance that deficit, that is generally measured against the administrative budget, is it not?

Mr. SCHULTZE. I will say "Yes," but I would like to give one qualification.

Senator MILLER. All right.

Mr. SCHULTZE. The Federal Government will have to borrow on an amount depending upon, (a) the deficit in the administrative

budget, offset by any drawdown of the cash balance that can be made. But let's assume that is going to be very small. So in effect, it is the deficit.

Senator MILLER. That is right, when we see an administrative budget deficit of a possible \$29 billion, that means that with perhaps a billion dollar or two difference due to these cash balances, the Federal Government is going to have to go out and borrow \$27, \$28, or \$29 billion to cover the deficit is that right?

Mr. SCHULTZE. There is one other point to take into account, that the trust funds of the Federal Government normally run surplus. They will this year have a surplus of about \$3 billion. Therefore, approximately that amount of the deficit will go into Treasury securities taken by the trust funds. It is the remaining amount which will have to be borrowed from the public.

Senator MILLER. Well, now, in the President's recent budget message, he mentioned a figure of \$29 billion.

Mr. SCHULTZE. In tax money, that is correct, sir.

Senator MILLER. How much of that, if we had the deficit of \$29 billion, approximately how much of that would have to be covered by Federal Government borrowing?

Mr. SCHULTZE. If you will give me a moment, I believe the Secretary covered that in his testimony before the Ways and Means Committee. I want to make sure I have the right number.

Well, he does not give that.

Senator MILLER. Can you supply it for the record?

Mr. SCHULTZE. I can give you a rough idea. On the one hand, you have to add to the \$29 billion \$5 billion of participation certificates, because those are participation certificates, they are not Treasury debt, but you have to get it from the market.

Conversely, you would have to subtract whatever is taken by the Federal Reserve and the trust funds together, which would reduce it. Now, I am not in a position, nor is anyone else, to indicate what Federal Reserve will necessarily take. But if you want to get a borrowing from the public, it would be well up into the 20's of billions of dollars if you had a \$29 billion deficit. Well up into the 20's would have to be borrowed from the public.

Senator MILLER. Did I understand you to say in response to a question from Senator Proxmire that your estimate of cutting the \$2 billion from the budget would really be a cut of around \$3.5 billion in obligational authority?

Mr. SCHULTZE. In obligations, I guess, is the best way to say that. That is correct, sir.

Senator MILLER. In obligations?

Mr. SCHULTZE. May I again—

Senator MILLER. Well, let me just make the point. Looking at it from the standpoint of what we have just been talking about—that is, the necessity to cover a deficit—it seems to me that that is what we in Congress are really much interested in, whether you call it obligational authority or obligations or anything else. The question is how much can you cut administratively, how much are you trying to cut administratively which will be reflected in a reduction in the deficit?

Mr. SCHULTZE. My answer to that would be that together with congressional actions—we do not know how the appropriations process is going to come out, but we are aiming for something over \$2 billion

in expenditure reduction, because, of course, it is expenditures that go into the deficit.

In order to do that, in turn, we would have to, depending upon what items you cut, you would have to cut obligations—to get \$2 billion, you would have to cut obligations by \$3½ or \$4 billion.

Senator MILLER. Well, I am glad to get that explanation, but I must tell you that what I am interested in is how much are we going to be able to cut down and need for the Government to be able to go out and borrow money, which is causing you such difficulty in high interest rates?

Mr. SCHULTZE. On the obligations, my only point in bringing in \$3½ billion was simply to indicate that to get that \$2 billion cut in expenditures you have to make a larger cut in obligations.

Senator MILLER. Would that \$2 billion cut come in this category of “other” shown at the bottom of your table 4?

There are some of us who have the feeling that the cut ought to be larger than that, that it ought to be in the neighborhood of \$5 billion. Have you prepared any plans, such as one based on \$5 billion where expenditures could be cut, one based on \$2 billion, one based on \$3.5 billion, so that a decision can be made among the various plans for reduction?

Mr. SCHULTZE. Well, basically, I have to answer that “No”, for one very good reason. Obviously, we have looked at what cuts of \$1 billion, \$2 billion, \$3 billion, \$4 billion would mean in general terms, given the fact that we are going to have to make the cuts out of the \$21 billion controllable total. But in terms of making specific allocations to that cut, we would not be able to do that until we have some idea of what the Congress, is going to do on appropriations. Let me give you two examples.

As I indicated to Senator Proxmire, the House Appropriations Committee and the House has passed an appropriation cut of \$517 million for NASA. Now, our reduction—what we would have to do—would be a lot different if you assume we got from the Congress the full NASA authorization and appropriation that we originally recommended than if we are faced with a \$517 million cut. So in other words, we have not gone through this item by item yet until we see what we are faced with after Congress acts.

Senator MILLER. I recognize the practicality of your answer. But I wonder if it would be possible for you to furnish the committee with two plans.

Assume that regardless of what Congress does, the first plan would show where you believe it would be most feasible to cut expenditures within this bottom figure on that chart to arrive at a \$2 billion reduction in expenditures. And a second plan, doing the same thing, to arrive at an expenditure reduction of \$5 billion.

Mr. SCHULTZE. No, sir.

Senator MILLER. Could you furnish that for us?

Mr. SCHULTZE. No, sir, I am sorry I could not.

Senator MILLER. Why could you not do that?

Mr. SCHULTZE. For several reasons. First, the basic plan we are now following is that as each appropriation bill comes through, we examine it, and give the agency involved a reduction target. We then ask them to spread the reductions and then we go back and review their proposals and so on. We do not believe this is something that the budget director can order. This is a question of making recommendations to

the President; the President will then decide exactly where he is going to make reductions. We can make recommendations to him but the President is going to have to decide. Until he does, this is just an exercise.

Secondly, the Congress has already been in session over 7 months and we only have three appropriations bills enacted. I don't say this critically but to point out that if we were to send up to the Congress a specific list of reductions, I suspect that Congress would be here until at least December 31.

Finally, and quite frankly, our experience in the past has been, Senator, that we are going to be much more able to make these reductions if we wait until we get the appropriations bills and then go through them. Our experience in the past has been that we would not make the reductions—

Chairman PROXMIRE. Would the Senator yield at that point?

Senator MILLER. Yes, indeed.

Chairman PROXMIRE. And that is an extremely interesting observation. You mean that rather than recommend appropriations reductions to Congress this late in the session, you let the Congress appropriate and then you decide to withhold spending? That is what the Executive would do. You say we would not spend the money, right?

Mr. SCHULTZE. Right.

Chairman PROXMIRE. So it is possible you would have a much larger reduction in spending than \$2 billion?

Mr. SCHULTZE. What I am saying—

Chairman PROXMIRE. In response to Senator Miller's question?

Mr. SCHULTZE. In connection with what the Congress does and what we can do after that, we are aiming at withholding spending of about \$2 billion. What I am saying is this—if we are interested in getting the reductions, then sending a Presidentially approved set of recommendations to the Congress on revision of existing appropriations during the middle of an appropriation process, in which most bills have passed the House—some have come through the Senate committee, some have come through the Senate, some are in Congress—would mean we would be here through December, at least. I don't think we would get it passed.

Senator MILLER. Mr. Schultze, I don't think you are entirely responsive to my question. What I had in mind, and if it would make it any easier, would be for you to present these two plans with the caveat that the reductions indicated are not recommended, that they are merely examples of feasible reductions in arriving at the objective of the two plans—namely, a reduction of \$2 billion in expenditures in the one plan, a reduction of \$5 billion in expenditures in the other. Why could not you as a budget director provide that type of information to us?

Mr. SCHULTZE. Senator, I don't want to appear unresponsive, but I guess I am going to have to. As a practical matter, the budget director has no life of his own in the sense that the Budget Director speaks for the President. Practically speaking, it is not feasible for him to speak on his own, and I do not think I could, in all responsibility, send up a list of supposed examples of cuts. It just would not be good. The actions will have to be taken when the appropriations have been made. At this time, we are not quite sure what will come out of Congress, anyway.

Senator MILLER. Have you presented to the President recommendations for a budget reduction of more than \$2 billion?

Mr. SCHULTZE. Senator, my specific recommendations to the President on this, I think, are between the President and me.

Senator MILLER. Well, you can tell us yes or no, can't you? I am not asking you for specific recommendations. I have simply asked you a question, have you presented any recommendations to the President for expenditure reductions in excess of \$2 billion or along the line of a plan on how expenditures could be reduced by more than \$2 billion.

Mr. SCHULTZE. Essentially, Senator, the President has accepted this reduction of \$2 billion-plus—actually, we are aiming for a little more than \$2 billion to make sure we get the \$2 billion—based on the recommendations I made to him.

Senator MILLER. I understand that. I am, I think this committee is, entitled to know whether or not there are more than two or three, whether there is more than one plan of expenditure reductions being considered and whether you have been called upon to make a recommendation to the President for a program of expenditure reductions of \$2 billion, possibly another one for three, possibly another one for five.

Mr. SCHULTZE. No, sir; I have not prepared and given to the President, because I am not in a position to do it yet, any specific listing of alternative expenditure reductions in that sense.

Senator MILLER. Then how did you arrive at the \$2 billion?

Mr. SCHULTZE. By taking a look at the Government's activities and making a judgment in terms of the kind of programs that would be affected, of what looked feasible to do while still maintaining Government activities at a reasonable level. This review came out to something over \$2 billion. Now, I cannot sit here and say precisely we will come out \$300 or \$400 million one way or the other. I would not argue about it at this point.

Senator MILLER. You were requested to prepare a study and a recommendation in the neighborhood of \$2 billion, is that it?

Mr. SCHULTZE. Well, essentially, it never is quite that clear, Senator. It comes out of a long series of discussions among the President's advisers and with the President. It is not a question of getting an order to prepare a \$2 billion recommendation at 10 a.m. on a given day. It comes out of a longer series of discussions as to the size of the controllable part of the budget and what looks feasible. There is no specific plan A, plan B, or plan C. It just does not happen that way.

Senator MILLER. But you have to have the understanding from these discussions that something in the neighborhood of—

Mr. SCHULTZE. In the neighborhood of \$2 billion would be feasible, just as, quite frankly, we are reluctant to propose tax increases. Many of these programs, in fact all of them, would not have been offered in the first place, except that they are desirable programs and we are reluctant to cut them. But we will cut them just as we do when we develop a budget program.

Senator MILLER. Thank you. My time is up.

Chairman PROXMIRE. Senator Sparkman?

Senator SPARKMAN. Mr. Schultze, in your statement, under the section on administrative budget expenditures, you say:

Net congressional actions to date would raise fiscal 1968 expenditures by \$0.1 billion.

Mr. SCHULTZE. That is correct.

Senator SPARKMAN. In the next paragraph, you say that five regular appropriations bills have passed both Houses of Congress. "Reductions in appropriations in those five bills should lower fiscal 1968 expenditures by \$0.1 billion." Do they offset each other?

Mr. SCHULTZE. May I ask you, Senator, to turn to the paragraph following table 2:

The reduction of appropriations bills is more than offset by other congressional actions to date; these actions will add some \$0.2 billion of expenditures.

Now, this essentially is in two areas.

Senator SPARKMAN. One is appropriations, the other is legislation?

Mr. SCHULTZE. That is correct. The veterans' bill, for example—

Senator SPARKMAN. Well, I had not quite reached that paragraph. As a matter of fact, I was looking at this table at the time.

Mr. SCHULTZE. May I point out that the rules of the game that we have used in making our estimates is that we do not attempt to predict the outcome of congressional action which is not yet completed.

Senator SPARKMAN. I know that, you are dealing only with bills that have been acted on by both Houses?

Mr. SCHULTZE. That is correct.

Senator SPARKMAN. Otherwise, you let the President's proposal—

Mr. SCHULTZE. We let his proposal stand, except in a few obvious cases where we had proposed action by certain dates; for example, July 1 for the proposed date of the first-class postal rate increase. That cannot be put into effect. In many cases, we have slipped the date.

Senator SPARKMAN. The pay raise that you have mentioned, that becomes virtually a fixed charge, does it not?

Mr. SCHULTZE. To the extent that that pay raise will pass and become effective, that is right, sir, there is no option.

Senator SPARKMAN. The only way you could lessen it in any way would be a reduction in payrolls?

Mr. SCHULTZE. That is right, sir.

Senator SPARKMAN. And we don't make much headway in that, do we?

Mr. SCHULTZE. All I can say is it is quite difficult; that is correct.

Senator SPARKMAN. Let me ask you—you have answered this before, but just in order to reduce it to a very simple equation—the January estimate of the Federal budget for fiscal 1968 was what?

Mr. SCHULTZE. The administrative budget was \$135 billion.

Senator SPARKMAN. That is what we are dealing with, isn't it?

Mr. SCHULTZE. Right.

Senator SPARKMAN. And your estimate now is what?

Mr. SCHULTZE. I would love to give you a one-word answer and I cannot.

Senator SPARKMAN. Well, I thought you had been dealing with that earlier.



Mr. SCHULTZE. We start with \$136.5 billion. In other words, a billion and a half of known additions have occurred.

Senator SPARKMAN. A billion and a half. That makes \$136 billion?

Mr. SCHULTZE. \$136.5 billion.

Senator SPARKMAN. Well, I think I know the balance of it, because I came in at about that point.

Mr. SCHULTZE. There are a number of contingencies which we may very well face which I described which are not in the \$136.5 billion on the military side and on the civilian side. Conversely, we are aiming for a reduction of \$2 billion which is not within the \$136.5 billion.

Senator SPARKMAN. I am not quite sure I understood that. Would you repeat that again?

Mr. SCHULTZE. Please excuse me, Senator.

We start with \$136.5 billion.

Senator SPARKMAN. \$136.5 billion, yes.

Mr. SCHULTZE. There are two kinds of things to be taken into account—possible additions to that \$136.5 billion. Let me list three major ones.

Defense spending may very well increase by up to \$4 billion. We have also identified a billion dollars additional pay raise, though I would have to modify that possibility on the basis of recent action by the House Subcommittee on Post Office and Civil Service.

Senator SPARKMAN. Let me ask you, does that mean if the pay raise legislation exceeds the President's proposal by \$1 billion, that this will add \$1 billion to your present estimate?

Mr. SCHULTZE. That is correct.

Senator SPARKMAN. All right.

Mr. SCHULTZE. There is, at the risk of confusing us further—

Senator SPARKMAN. I realize, that it is a contingency.

Mr. SCHULTZE. That is correct.

Senator SPARKMAN. All right.

Mr. SCHULTZE. Thirdly, the \$135 billion and the \$136.5 billion both assume sales of \$5 billion of participation certificates. If the House action on participation certificates should stand—where the House has reduced the authorization to sell them—we would be able to sell \$2 billion less participation certificates. Our credit revolving funds would have higher net expenditures, so there is 2 more billion dollars.

Senator SPARKMAN. Yes.

Mr. SCHULTZE. So those are the major items on the increase side.

On the decrease side, there are two items of contingencies in the sense that I do not have them included in the \$136.5 billion. On the decrease side, there are two items. One, we are aiming at expenditure reductions of \$2 billion in the civilian sector. Two, Secretary McNamara has set up procedures to review his budget to determine how much of the increases on account of Vietnam he can offset with reductions elsewhere. On that, I cannot give you any number.

So I start with the \$136.5 billion. There are three items of possible increases, two areas of possible decreases.

Chairman PROXMIRE. Would the Senator yield at that point?

Senator SPARKMAN. Yes.

Chairman PROXMIRE. One of these contingents, however, is the \$4 billion increase for Vietnam, contingent, I take it, on the increase of troops to 45,000, which is more than a contingency; is that right or wrong?

Mr. SCHULTZE. It is partly right. Clearly the 45,000 troops to Vietnam in and of itself will not add \$4 billion to defense spending. The \$4 billion is a number which is, we think, a prudent measure of the kind of thing we ought to plan for in our fiscal policy, because it is entirely possible that defense expenditures may rise by \$4 billion. But it is not simply a pricing out of the 45,000 troops.

Senator SPARKMAN. Now, before my time expires, I have one other question. How do we get down to the \$61 billion figure you mentioned? It was \$61 billion?

Mr. SCHULTZE. Civilian expenditures.

Senator SPARKMAN. In other words, \$74.5 is accounted for by our defense expenditures.

Mr. SCHULTZE. National defense expenditures are subtracted out of the \$136.5 billion to get down to the \$61 billion of civilian.

Senator SPARKMAN. And the \$61 billion includes the interest on the national debt?

Mr. SCHULTZE. Correct, sir.

Senator SPARKMAN. And includes space programs?

Mr. SCHULTZE. Correct, sir. And veterans.

Senator SPARKMAN. And all of the other fixed items?

Mr. SCHULTZE. Correct; listed in table 4, sir.

Senator SPARKMAN. Yes; I know you have listed these items. The fixed expenditures pull down the figure over which we have much control—even though there could possibly be reductions. Subtracting these fixed items would leave \$30.2 billion. Then you have prior contracts, leaving existing contracts of \$15.3 billion?

Mr. SCHULTZE. That is correct, Senator. The remaining are the items where we would really have to cut.

Senator SPARKMAN. Well, thank you very much.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. Dr. Schultze, the housing industry has been particularly hard hit by the tight money situation in the past and you have referred to that in your report. The situation has been easing up a little bit in recent months. But the best estimates I can get are that conditions will tighten up again later this year. I wonder if you could give us an outlook for the year 1968 on the money market. Do you foresee further tightening up or easing of credit for the housing industry?

Mr. SCHULTZE. I am sure my answer is going to sound self-serving, and probably meant that way. But I think a large part of it is going to depend on what happens to the President's fiscal recommendations. Clearly I cannot give you a forecast of the absolute state of the money market. But it is clear that it will make a difference in the money market and in credit conditions (it will make a difference) as to whether or not the credit market has to finance a \$29 to \$30 billion deficit or a \$14 to \$18 billion deficit. I would be, I think, less than responsive if I really tried to forecast conditions. I will say, I believe, there is a very good chance that with actions to pull that deficit down—and we think it can be pulled down—to maintain those kinds of credit conditions which will enable the housing industry to continue its recovery. I don't think I really would want to try to make a prediction of precisely where it will come, but I think there is a very good chance that this will be done.

I would say on the other hand, the chances are very slim that it could be done if that deficit should range within the \$29 to \$30 billion.

Senator PERCY. If the President's tax proposals are enacted as he has requested, how much new financing would you have to do in the second half of 1967? Can you give us some idea of this total new debt, how much could be taken up by trust funds, public at large, commercial banks, and possibly the Federal Reserve?

Mr. SCHULTZE. Well, what I can give you is one figure on that. Then perhaps elaborate a little bit more for the record.

If the deficit should be held in this \$14 to \$18 billion range—say, for example, it could be held at \$14 billion. Let's assume that for the moment to discuss it. Then the net Federal credit demands on the private sector—in other words, the amount of Federal debt which would have to be floated outside the trust funds in the Federal sector—would be on the order of \$10 to \$12 billion for the fiscal year. At the moment, I am not in a position to tell you how those are split by half years, but as you know, the seasonal nature of the expenditures means that the largest bulk of our financing is in the first half of the fiscal year and the last half of the calendar year.

I cannot split it for you beyond that.

(Additional information was subsequently received and appears on p. 46.)

Senator PERCY. I would like to ask you this question on the way the budget operates and what can be done cooperatively between the executive and legislative branches. In your table 4, you list relatively uncontrollable civilian expenditures. There is a modest item in there of \$1.9 billion for farm price supports.

Mr. SCHULTZE. Yes, sir.

Senator PERCY. Now, this is always looked upon as something we cannot do anything about. And I realize you cannot do anything about it this year. But what needs to be done, what new legislation, what new attitude or policy or program of the Federal Government, to adjust itself to the present situation where we are not overburdened with surpluses and where there is a scarcity of food in the world. Can we not wean ourselves away from this multibillion-dollar uncontrollable expense every year in the budget? What program changes are needed in order to start now to begin to see some relief and move this from an uncontrollable to a controllable account by 1969 or so?

Mr. SCHULTZE. I am sure, I cannot answer that fully. I might point out two things: One, over the past 3 years, expenditures on Commodity Credit Corporation, even with the increase that we are facing this year because of the feed grains and soybeans, as I mentioned earlier, will still be down by some \$400 million from what it was three years ago. In large part, although I am not sure I can say solely, this is the result of new programs which have substantially pulled down our stocks. So we are supporting farm income much more heavily by direct payments rather than by the more expensive means simply of buying up the surpluses. This has only been possible because of legislation—legislation introduced, modified and accepted by the Congress. So I would not say, as you have indicated in your question, that over the longer run, these are uncontrollable.

On the other hand, I must confess, Senator, as between objectives relating to farm income on the one hand and budgetary restraint on the other, quite frankly, I have no magic solution to know how you can do one except at the expense of the other.

Now, people can quarrel, and quite legitimately quarrel about the level of farm income toward which these programs are aimed. I think they have been made more effective in the sense of getting more farm income support per dollar of expenditure and I do not want to say they could not be made more effective. But I think a lot of that has been squeezed out. I think you are really down to a conflict between objectives. And I must say at the moment that I am not prepared to start choosing among them right here and now.

Senator PERCY. One other area. Senator Ribicoff and I put our heads together after the crisis in the cities of this summer to see what could be done to provide a change in national priorities that was quite apparent was needed. We realize the difficulty of cutting budgets. We realize the irresponsibility of appropriating multimillion-dollar funds when you are adding to an already large deficit. The best that we could come up with was a suggestion that across the board in nondefense areas, the President be given the authority to reallocate 2 percent—we just picked an arbitrary figure—of funds out of other programs. This cut would not be deep enough to really injure those programs, for there ought to be 2 percent fat in every program, or the possibility of a shift in priorities or delay. Our proposal would give the President the authority to use those funds in an area of substantially higher national priority than when the budget was originally conceived. Might this not be a possibility or an approach that the Congress should give consideration to? Do you see any feasibility in this?

Mr. SCHULTZE. Let me arrange my answer to that in a kind of a technical part and a policy part. On the technical side, if you are talking of 2 percent, may I presume they are civilian expenditures? I should know that.

Senator PERCY. It would authorize the President to transfer 2 percent of all nondefense expenditures into the area of urban need as he saw fit.

Mr. SCHULTZE. Let me then point out the consequences of this just from the technical standpoint. Insofar as you are talking of the immediate fiscal year, of the \$61 billion of civilian expenditures, after making the appropriate accounting adjustments and so on, about \$40 billion of that—I won't say you cannot touch any of it, but can barely be touched. That 2 percent of \$61 billion is \$1.2 billion. You can't take the billion two out of the \$40 billion uncontrollable amount. You have to take almost all of that out of the remaining 21. In part, that 21 is itself concerned with the areas of education, housing, community development, water pollution—pretty high priority areas, from both your viewpoint and mine. At the moment, I cannot give you a number on that, but I am sure it would add up to \$8 or \$9 billion of the \$21 billion.

I don't want to be hung for that estimate. That is a very conservative quick estimate. If true, it means you are taking the one billion two out of the remaining \$12 billion, which is 10 percent. While one billion two does not sound very big against \$61 billion, it is a fairly sizable set of reductions against the remaining amount.

Then you have to remember that even here, you are dealing with things like Internal Revenue, tax collections, FBI, the Federal aviation aid to airports. So that technically, it is not as easy as it might sound at first blush.

When you get to the policy side, I almost plead separation of power here to say that I would not deny that flexibility would be useful, but it seems to me this is really a question for Congress to decide as to the amount of flexibility in this area it is willing to give up to the President. I would rather beg off on that, if you do not mind.

Senator PERCY. The last question. Last January, you told the committee that reductions and deferrals of spending in fiscal 1967 would reduce expenditures by about \$3 billion. This was a fine objective. Now that the fiscal year is completed, do you have a detailed report on these savings, and if not would you be able to make one available to this committee?

Mr. SCHULTZE. That is a tall order.

Let me point out what I did issue and try to think through what might be done with that.

We did issue in February—I can make that available. I can make copies available in detail. The list covered 18 pages and identified where we were taking those cuts. That was in February. It turned out as of the end of the year that civilian expenditures were 1 billion below what we had estimated in January and February. At the moment, I must confess I cannot guarantee that every single one of those items came out exactly as we forecast, but we did issue a detailed forecast in February and between February and the end of the year, about a billion some in the Federal budget. It was lower than the forecast, so I think clearly, as a general proposition, those cuts were accomplished, although I am not precisely sure I can guarantee in that whole list of 18 pages, every single one of them came out exactly as we predicted.

I would be glad to send you a detailed listing of exactly where they were.

Senator PERCY. I would appreciate it very much, because I appreciate there is a certain amount of discipline in these things, if the Department knows it is going to be followed up to see they actually were going to be put into effect.

(The following material was subsequently received from the Bureau of the Budget:)

#### SUMMARY ANALYSIS OF 1967 BUDGET REDUCTIONS AND DEFERRALS

Attached are summary tabulations and a detailed table on the 1967 budget deferrals, postponements and reductions.

There are several factors which should be kept in mind in reviewing these actions.

*First*, the President in his September 8 economic message, and the Budget Director in his subsequent testimony before the Ways and Means Committee, stated that the program deferrals and reductions would be accomplished in three areas:

By requesting appropriations for Federal programs at levels below those authorized by the Congress;

By withholding appropriations provided above the President's budget recommendations; and

By reductions or delays in programs requested by the President in his 1967 budget.

As the attached tables indicate, reductions were made in each of these areas.

*Second*, the Budget Director's statement before the Ways and Means Committee last September referred to a determination to reduce Federal *programs* by at least \$3 billion. Because of lags in expenditures, such a reduction in *program levels* would have produced expenditure reductions of about \$1½ to \$2 billion. The total delays, postponements, and reductions outlined in the attached papers actually total \$5.2 billion in program levels, significantly higher than the amounts

indicated in the September statement before the Ways and Means Committee. The expenditure effect of these program actions is estimated at \$3 billion, rather than \$1½ to \$2 billion.

*Third*, as both the President and the Budget Director stated last fall, a very large part of the reductions stems from delays, postponements, and stretchouts in contract awards and program commitments. These contracts will, in most cases, eventually be let. But the delay and deferral of awards has helped and will help to moderate inflationary pressures.

*Fourth*, the Administration is continuing to review 1967 programs with an eye to finding additional areas where stretchouts or postponements can be made. At the same time the delays and reductions already ordered are also being reviewed. If economic conditions should require, some funds that are now being withheld may have to be released. Consequently, the composition of the attached list may change as the year progresses.

## 1967 BUDGET REDUCTIONS

Attached is the listing of 1967 cutbacks and deferrals. As shown in the following summary (Table 1), they amount to reductions of \$5.2 billion in program levels and \$3.0 billion in expenditures. The detail supporting the second line (b) of that table is shown in Table 2 attached. The remaining details are shown in the attached Table 3. The cutbacks and deferrals are shown in the last two columns of Table 3 and do not include reestimates resulting from actions other than those taken specifically to reduce the budget. These reestimates, expenditures estimated in the January 1966 budget, and the expenditure effects of Congressional action are shown in separate columns of the table.

TABLE 1.—SUMMARY 1967 BUDGET REDUCTIONS

[In billions]

	Program level	Expenditures
Administrative budget:		
(a) From funds provided by the Congress.....	\$3.3	\$2.1
(b) Increased congressional authorizations for which we do not plan to request appropriations.....	.8	.5
Trust funds (nearly all Highway Trust Fund).....	1.1	1.4
Total reductions.....	5.2	3.0

† Expenditures effect is for the year beginning Oct. 31 1966.

TABLE 2.—INCREASED CONGRESSIONAL AUTHORIZATIONS FOR WHICH WE DO NOT PLAN TO REQUEST 1967 APPROPRIATIONS

[In millions of dollars]

	Program level	Expenditures
Agriculture: Food for freedom—farmer to farmer program.....	33	17
DOD: Military construction, procurement, and research and development.....	84	24
HEW:		
Comprehensive health planning.....	4	1
Elementary and secondary education.....	584	410
Higher education.....	22	3
Library services.....	12	8
Rehabilitation of narcotic addicts.....	13	4
Subtotal, HEW.....	635	426
Transportation:		
Chamizal highway.....	8	2
Coast Guard.....	23	3
Highway and auto safety.....	13	5
Subtotal, transportation.....	44	10
Other independent agencies:		
Smithsonian: National Air Museum.....	11	2
National Science Foundation: Sea Grant Colleges.....	4	1
District of Columbia: Higher education facilities.....	40	3
Total.....	851	483

TABLE 3.—1967 BUDGET REDUCTIONS

(In millions of dollars)

Agency, item, and description of deferral or cutback	Estimated 1967 expenditures			Deferral or cutback	
	January 1966 budget	Effect of		Expenditures	Program level <sup>2</sup>
		Congressional action	Revision in workload and other re-estimates <sup>1</sup>		
<b>Agriculture:</b>					
Agricultural Research Service and Library:					
Slowdown on research construction.....	12.6	1.8	7.4	-10.9	-11.8
Reduction in fire ant eradication program.....		4.2		-1.7	-2.0
Cooperative State Research Service: Construction grants, delay allocation of grants for facilities requiring provision of matching funds.....	47.7	13.2		-3.6	
Soil Conservation Service:					
Watershed protection, flood prevention, and resource conservation and development programs, slowdown rate of construction.....	102.9	1.3	-1.3	-4.1	-1.1
Great Plains conservation program: Hold program to 1966 level.....	15.0	.9		-.4	-2.3
Consumer and Marketing Service: Sec. 32, reduction in purchases of surplus commodities.....	185.9			-40.0	-40.0
Commodity Credit Corporation: Public Law 480—Food for freedom, reduction in shipments for 1967.....	3,755.0		-140.0	-100.0	-100.0
Rural Electrification Administration: Loans, electric and telephone—Hold down loans to minimum essential needs.....	184.0	89.5		-27.0	-125.6
Farmers Home Administration: Direct loan account, operating loans—Reduction in farm operating loans.....	300.0	50.0		-75.0	-75.0
Agricultural credit insurance fund: Action to speed up sale of loans, including changing discount.....	-102.6		122.9	-86.0	
Rural housing insurance fund, *above moderate income loans <sup>3</sup> : Reduction in relatively low priority loans made to persons with adequate incomes.....					-25.0
Additional items reduced or deferred since the 1968 budget estimates were prepared:					
Special milk and food stamp programs:					
Stop reallocation of special milk grants.....				-3.5	-3.5
Delay inception of food stamp programs in new areas.....	169.6	73.0	-1.0	-8.6	-8.6
Farm labor housing grants: Reduce 1967 program by postponing grants.....	3.0		3.0	-1.0	-1.0
Commodity Credit Corporation: Cut back shipments further under food-for-freedom program. (See above).....				-25.0	-25.0
Rural Electrification Administration: Further postpone advances on prior loan commitments. (See above).....				-10.0	
Soil Conservation Service: Further deferral of contracts and loans. (See above).....				-3.3	-3.3
Forest Service: Postpone planned land acquisition under land and water conservation fund.....	11.7	4.5	10.2	-5.0	
Commerce: Ship construction subsidy: Deferment of contract awards for approximately 4 ships until fiscal year 1968.....	91.5		-19.5		-47.2
<b>Corps of Engineers:</b>					
Construction:					
New starts: Delay initiation by 3 to 6 months of 56 projects; land acquisition would proceed as originally scheduled.....				-8.8	<sup>6</sup> -161.3
Continuing construction: Defer award of contracts by 1 to 12 months on 67 projects initiated prior to 1967; slow down, where possible, other continuing contracts.....	1,046.0	26.0	-6.1	-50.2	<sup>6</sup> -275.0
General Investigations:					
Transportation studies: Defer studies and await action by new Department of Transportation.....				-.2	-.2
Texas water plan and gulf pollution study: Portion of funds withheld pending clarification of study purposes and requirements.....	31.9	.2		-.3	-.3
Great Lakes delcing study: Study deferred because of low priority.....				-.1	-.1
Small equipment replacements: \$400,000 cutback reflects a 5-percent reduction from normal small equipment replacement expenditures of \$8,000,000 spread over 37 corps districts. Reductions will take place averaging \$50,000 per month for 8 months beginning November 1966 through June 1967.....				-.4	-.4

Footnotes at end of table.

TABLE 3.—1967 BUDGET REDUCTIONS—Continued

[In millions of dollars]

Agency, item, and description of deferral or cutback	Estimated 1967 expenditures			Deferral or cutback	
	January 1966 budget	Effect of		Expenditures	Program level <sup>2</sup>
		Congressional action	Revision in workload and other re-estimates <sup>1</sup>		
<b>Health, Education, and Welfare:</b>					
<b>Food and Drug Administration:</b>					
Defer procurement, supplies, travel, and printing and reproduction.....	64.9	-4.1	-3.0	-0.1	(-1.2)
Defer construction starts.....				-2.0	
<b>Education:</b>					
Higher education loan fund: Program level reduced from \$300,000,000 to \$200,000,000. \$100,000,000 is carried over for use in 1968 program.....	4.0		-20.2	-30.8	-100.0
Academic facilities construction, research construction, and research and training project grants: Defer construction and new project grants.....	365.2	-5.0	-40.9	-61.7	-94.3
Libraries, handicapped, and salaries and expenses: Stop reallocation of formula grants for libraries, defer new projects for handicapped research, and defer purchases, travel, etc.....	95.9	-2.2		-1.3	-2.2
Work study, educational opportunity grants, university community services:					
Limit continuation grants.....	195.4	-8.0		-1.4	-1.8
Limit reallocation of formula grants.....				-8.6	-14.2
Student loan program: Stop reallocation of formula loans.....	30.0	160.8		-2.0	-5.0
<b>Elementary and secondary education activities:</b>					
Title 1, education of disadvantaged: Stop reallocation of formula grants.....	970.0	-12.0	119.0	-34.0	-55.0
Title 3, supplementary centers and services: Defer new project grants until later in year.....	110.0	-7.0	-19.8	-18.2	(-22.7)
Titles 2, 4, and 5: Stop reallocation of formula grants.....	120.0	21.3	-3.7	-1.3	-3.5
Federally impacted areas: Defer new projects.....	267.0	167.8		-13.2	-17.4
Vocational education: Defer Appalachia vocational school construction, defer new project grants for research, limit continuation costs, and stop reallocation of formula grants.....	214.7	15.2		-8.6	-10.2
Vocational rehabilitation—research and training and project grants other than State formula support: Defer initiation of new projects within year and limit cost of continuations.....	42.0			-2.0	{ -.8 (-1.8)
<b>Public Health Service—Hospital construction activities:</b>					
Defer construction starts.....	240.0		43.4	-55.9	(-107.0)
Defer Appalachian health grants.....				-2.3	
Defer procurement of equipment, supplies, travel, and reproduction within the year.....					
<b>Public Health Service—Construction of health education facilities and NIH grants for construction of health research facilities:</b>					
Defer \$15,000,000 for obligations in 1968.....	86.8	5.0		-2.0	-15.0
Defer construction starts within the year.....				-6.8	(-10.0)
<b>NIH—Regional medical program:</b>					
Slow down planning and operating regional medical program.....	35.0		-16.0	-10.0	-30.0
Defer funding projects within the year.....				-1.4	(-1.8)
<b>NIH—Other:</b>					
Hold back continuation grants.....	852.9	27.7	-.2	-3.7	-5.5
Restrict procurement of equipment, supplies, travel, and reproduction for internal use.....				-1.1	-1.5
Defer major expansion on the artificial heart program until late in 1967.....				-2.0	(-10.0)
Defer procurement of equipment, supplies, travel, and reproduction within the year.....				-1.1	(-4.3)
Defer start of new research projects until later in the year.....				-5.2	(-6.6)
Defer start of new research projects until later in the year.....					
<b>NIHM (exclusive of construction):</b>					
Defer procurement of equipment, supplies, etc.....	195.3	9.0	-6.7	-1	-5
Defer new projects starts.....				-2.4	-3.0
Restrict procurement.....				-1	-2
Stop reallocation of formula grants.....				-1	-2

Footnotes at end of table.



TABLE 3.—1967 BUDGET REDUCTIONS—Continued

[In millions of dollars]

Agency, item, and description of deferral or cutback	Estimated 1967 expenditures			Deferral or cutback	
	January 1966 budget	Effect of		Expenditures	Program level <sup>2</sup>
		Congressional action	Revision in workload and other re-estimates <sup>1</sup>		
<b>Health Education, and Welfare:—Continued</b>					
<b>National Library of Medicine:</b>					
Defer until 1968 grants for the construction of medical libraries.....				-.5	-7.5
Restrict procurement of equipment, supplies, travel, and reproduction.....	.6				-.1
Defer procurement of equipment, supplies, travel, and reproduction.....				-.1	(-.2)
Construction of community mental health centers, Public Health Service: Defer construction starts.....	25.0		-7.0	-15.2	(-18.0)
<b>Public Health Service—Other public health:</b>					
Defer procurement equipment, supplies, travel, and reproduction.....				-1.2	(-4.9)
Stop reallocation of formula grants.....				-1.4	-2.3
Defer new project starts.....				-3.0	(-3.7)
Limit cost of continuation grants.....	584.7	28.9	-3.4	-1.1	-1.5
Restrict procurement, equipment, supplies, travel, and reproduction.....				-1.3	-1.8
Other.....				-2.9	-3.0
<b>St. Elizabeths Hospital:</b>					
Defer procurement of equipment, travel, supplies, and reproduction.....	10.5	1.1	.2	-.1	-.7
Defer construction starts.....				-.8	(-.8)
<b>Social Security Administration: Defer construction starts (trust funds).....</b>					
	(11.4)		(.4)	(-3.3)	(-3.9)
<b>Welfare Administration (except public assistance):</b>					
Defer initiation of new project grants and contracts.....	281.1			-5.3	-7.5
Coordination and development of programs for the aging: Stop reallocation of formula grants.....	8.5		-.6	-.4	-.6
Special institutions: Howard University: Defer construction starts.....	26.8			-.9	
<b>Housing and Urban Development:</b>					
<b>Low rent public housing (loans for new units): Reduction in new annual contributions contracts by 8,000 units below the budgeted level. This reduces loan obligations in the 1st year by \$1,333 per unit: (January 1966 estimate for 1967—60,000 units) (January 1967 estimate for 1967—52,000 units).....</b>					
	(*)			-.2	-10.7
Open space land programs: Reduction in grant approvals.....	30.0	-.1	-.6		-2.5
Neighborhood facility grants: Reduce grant reservations.....	12.5		-9.5		-3.6
Grants to aid advance acquisition of land for public facilities: Reduce grant approvals.....	.4		-.4		-4.0
Urban mass transportation: Only \$5,800,000 is now estimated for the new authorities. Use of remaining authority has been deferred until 1968.....	68.0	.1	-11.9		-13.2
FNMA construction financing of certain multifamily housing: The new authority is not to be used.....		75.0		-75.0	
Urban renewal program (reestimate results from tight money market):					
Reduction in commitments to be made in 1967 for grants for demolition of condemned structures.....	412.5	-.2	12.0	-2.0	-5.0
Reduction in grant and loan disbursements resulting from holding local public agency working balances to very low level.....				-10.0	
FNMA—Low cost housing mortgages: Only \$250,000,000 of the authority is now being used for mortgage purchases. The remainder is reserved for use if it should prove necessary.....		350.0		-280.0	-750.0
FNMA—Preferred stock purchase (net): Restrictions on FNMA secondary market mortgage purchases have been maintained to avoid the necessity of any net purchase of preferred stock this year.....	35.8	140.2		-176.0	-176.0
Rehabilitation loans: Reduce loan reservations.....	17.1	.2	-5.5		-34.2
<b>Interior:</b>					
Appalachian region mining area restoration: Defer programs to 1968.....	13.0	-1.3		-9.5	-10.0
Solid waste disposal: Slow down grant program; limit junk auto disposal demonstration to 1 site.....	3.2		-1.3	-.5	-.6

Footnotes at end of table.

TABLE 3.—1967 BUDGET REDUCTIONS—Continued

[In millions of dollars]

Agency, item, and description of deferral or cutback	Estimated 1967 expenditures			Deferral or cutback	
	January 1966 budget	Effect of		Expenditures	Program level <sup>2</sup>
		Congressional action	Revision in workload and other re-estimates <sup>1</sup>		
<b>Bureau of Indian Affairs:</b>					
Buildings, utilities, and road construction: Defer some starts and slow down construction rate	236.1	5.3	-1.0	-9.8	-13.5
Irrigation: Slow down Navajo project construction				-1.6	-1.6
Loans: Reduce commitments				-4	-4
<b>National Park Service:</b>					
Buildings and utilities: Slow down construction projects	28.8		9.8	-8.8	-8.8
Roads and trails: Defer construction projects	22.5		1.3		-6.7
Parkways: Defer construction projects	7.5		.6		-2.5
<b>Federal Water Pollution Control Administration:</b>					
Grants for waste treatment works: Defer to 1968 grants for demonstration of alternatives to separating combined sewers	98.0		-11.0	-1.0	-10.0
Water supply and water pollution control: Defer some program increase	50.0		-11.7	-2.4	-2.4
<b>Bureau of Outdoor Recreation: Land and water conservation fund (State grants): Cutback in the State grant program</b>					
	43.9	1.0		-20.0	-21.5
<b>Office of Saline Water: Slow pace of research and development</b>					
	19.2	-6	-3.3	-3.0	-3.5
<b>Bureau of Commercial Fisheries:</b>					
Anadromous and Great Lakes fish conservation: Reduce grants to States for conservation projects		2.0		-1.5	-1.5
Fisheries loan fund: Slow down rate of loan approvals	.2		4.1	-2.5	-2.5
<b>Bureau of Sports Fisheries and Wildlife:</b>					
Sport fish construction: Delay on starting construction of District of Columbia Aquarium	10.0	4.0		-5.0	-8.7
Federal aid in fish restoration: Slow down approvals of proposed State development projects	5.0		<sup>10</sup> 2.8	-1.3	-1.3
Federal aid in wildlife restoration: Slow down approvals of proposed State development projects	15.0		<sup>10</sup> 10.7	-7.1	-7.1
Anadromous fish: Establish reserve of \$1,500,000 against 1967 appropriation		2.0		-1.5	-1.5
<b>Bonneville Power Administration: Defer contracts for continuing work in construction of Northwest power grid</b>					
	103.0		-5	-2.5	-2.2
<b>Bureau of Reclamation:</b>					
Construction and rehabilitation: Defer contracts on continuing construction	176.3	18.8	-1.6	-4.5	-57.1
Upper Colorado River storage project (including recreation and fish and wildlife facilities): Defer contracts on continuing construction	45.4	10.7	-9	-4.9	-28.7
Loan program: Defer loans on continuing projects	14.0	1.4		-8	
<b>Bureau of Land Management:</b>					
Construction and maintenance: Defer maintenance items	2.0	.1		-1	-1
Public lands, roads, and trails: Defer construction of roads of lower priority	2.0		.2	-5	-5
Oregon and California grant lands fund: Defer part of roads program to 1968	7.0		2.8	-8	-8
<b>Transportation:</b>					
Federal aid to highways (trust fund): Reduction in program level during 1967	(3,970.0)	(166.0)	(-10.0)	<sup>11</sup> (-420.0)	(-1,100.0)
State and community highway safety programs: Hold obligations to \$50,000,000 in 1967	12.0	10.0	-3.0	-12.0	-17.0
<b>Federal Aviation Administration:</b>					
Defer SST long leadtime items	960.0	-3.0	-60.0	-16.0	-20.0
Defer facilities and equipment and R. & D.				-14.0	-30.0
Defer grants-in-aid for airports				-5.0	-21.0
Coast Guard: Construction, stretchout and deferral of Coast Guard construction	70.0			-2.6	-10.8
<b>Treasury:</b>					
Mint, salaries and expenses (coinage program): Reduction in level of coinage production	31.6	-5.0		-5.0	-5.0
Mint construction	16.4			-3.4	-5.0
<b>Atomic Energy Commission:</b>					
Nuclear safety test facility: Cancel scheduled construction of facility for reactor safety program, Idaho	.9			-9	-1.8
Project Rover facilities: Defer miscellaneous plant construction projects for Project Rover (nuclear rocket) program	.5			-5	-2.0

Footnotes at end of table.

TABLE 3.—1967 BUDGET REDUCTIONS—Continued

[In millions of dollars]

Agency, item, and description of deferral or cutback	Estimated 1967 expenditures			Deferral or cutback	
	January 1966 budget	Effect of		Expenditures	Program level <sup>2</sup>
		Congressional action	Revision in workload and other re-estimates <sup>1</sup>		
<b>Atomic Energy Commission:—Continued</b>					
Weapons miscellaneous plant construction: Deferral of a portion of a project under the weapons program . . .	2.5	-----	-----	-1.0	-2.2
Alpha fuels facility: Defer construction of isotopic fuels development facility, Mound Lab, Ohio . . . . .	.3	-----	-----	-.2	-2.3
Fast reactor core test facility: Terminate construction project, Los Alamos: Program is being reoriented to more promising R. & D. . . . .	1.3	-----	-----	-1.3	-2.7
Environmental test facility: Deferral of construction of weapons development facility, Livermore, Calif. . .	1.4	-----	-----	-1.2	-1.9
General equipment purchases: Deferral of purchases for 6 months within fiscal year 1967 . . . . .	141.4	-----	-----	-6.4	(-7.6)
MIT linear accelerator: Defer construction of the housing for the MIT medium energy physics accelerator . . . . .	.9	-----	-----	-.5	-2.9
Sodium pump test facility: Defer construction of facility for fast breeder reactor development program, California . . . . .	1.2	-----	-----	-1.0	-6.2
Naval reactor facility mods: Defer construction (funds retained for design), Idaho . . . . .	1.5	-----	-----	-1.0	-8.5
Argonne advanced research center: Defer construction until fiscal year 1968 . . . . .	2.5	-----	-----	-2.5	-21.8
Plowshare excavation program: Defer part of program (principally cratering excavation experiments) . . . . .	8.2	-----	-----	-3.2	-3.2
New biology lab, Hanford, Wash.: Defer construction of facility . . . . .	.5	-----	-----	-.5	-4.5
Computer for Stanford accelerator: Deferral of procurement . . . . .	2.4	-----	-----	-2.4	-4.5
<b>Other:</b>					
Deferral of headquarters computer . . . . .				-1.0	-1.5
Deferral of university accelerator . . . . .				-.6	-1.5
Deferral of moderator purification improvements at Savannah River, S.C. . . . .				-.4	-1.2
Deferral of miscellaneous modifications to reactors . . . . .				-.5	-.8
Reduction of construction funds for Tandem Van de Graaff, Brookhaven National Laboratory, New York . . . . .	13.5	-----	-----	-1.0	-1.0
Deferral of construction planning and design funds . . . . .				-.7	-3.7
Deferral of modifications to Elk River reactor, Minnesota . . . . .				-.2	-.5
Deferral of portion of the construction of the thorium-uranium fuel cycle development facility, Oak Ridge, Tenn. . . . .				-.5	-.6
Deferral of a community disposal project . . . . .				-.5	-.5
Deferral of equipment procurement . . . . .				-3.0	-3.0
<b>General Services Administration:</b>					
General supply fund, motor vehicle procurement: Deferral of replacement of sedans and station wagons with new vehicles originally scheduled for 1967 . . . . .	12.8	-----	-----	-7.8	-7.8
Sites and expenses, public buildings projects: "Stretch-out" of site acquisition and building design program . . . . .	23.0	1.3	1.9	-2.2	-6.2
Construction, public buildings projects: Deferral of new starts until 1968 . . . . .	165.0	-9.0	<sup>12</sup> 15.0	-21.0	-87.0
<b>National Aeronautics and Space Administration:</b>					
Administrative operations: Elimination of 613 positions planned for in 1967 budget, plus reductions in overtime and other economies . . . . .	660.0	-23.0	<sup>13</sup> 9.2	-7.0	-8.0
Provision for extended lunar exploration: Development activity delayed . . . . .	137.0	-----	-----	-7.0	-17.3
Sustaining university program: Reduction in predoctoral training and facility grants . . . . .	50.0	-----	-----	-4.0	-10.0
Voyager: Funds reduced to allow proceeding at pace originally planned in budget for 1967 . . . . .	10.0	8.0	-3.5	-4.5	-8.0
Orbiting solar observatory: Deferral of experiment development . . . . .	11.0	-----	-----	-.5	-1.0
Lunar orbiter: Reduction in planned test and checkout activity at launch site . . . . .	33.0	-----	3.0	-1.0	-1.2
Launch vehicle procurement: Rephase production orders to shorten launch vehicle delivery leadtimes . . . . .	173.0	-----	-20.0	-3.0	-4.7

Footnotes at end of table.

TABLE 3.—1967 BUDGET REDUCTIONS—Continued  
[In millions of dollars]

Agency, item, and description of deferral or cutback	Estimated 1967 expenditures			Deferral or cutback	
	January 1966 budget	Effect of		Expenditures	Program level <sup>2</sup>
		Congressional action	Revision in workload and other re-estimates <sup>1</sup>		
<b>National Aeronautics and Space Administration—Continued</b>					
Selected supporting research programs: General reduction of the level of effort in space-related supporting research.....	203.0	-----	-1.0	-2.0	-8.0
Advanced mission studies (manned space flight): Reduced study effort on future manned space flight programs.....	8.0	-----	-----	-1.0	-1.8
<b>Veterans' Administration:</b>					
Construction of hospital and domiciliary facilities: Construction slowdown.....	73.0	-----	-7.5	-----	-10.0
Medical care: Reduction in medical equipment procurement and in staffing for their operation.....	1,245.0	-----	-8.2	-13.0	-13.0
General operating expenses: Employment restriction.....	158.7	13.4	-----	-1.1	-1.1
<b>National Science Foundation:</b>					
Construction of mounting and housing for 150 inch telescope: Defer second-stage funding until 1968....	2.0	-----	-----	-2.0	-6.5
Graduate research facilities: Defer obligations for graduate research facilities until 1968.....	26.5	-2.0	-----	-3.0	-5.5
<b>Small Business Administration: Hold down business and investment loans.....</b>	250.0	-----	-10.0	-33.0	-54.0
<b>Tennessee Valley Authority: Defer ongoing projects: Tims Ford, Tellico, Nickajack, Bear Creek, Land Between the Lakes, and related reductions in support.....</b>	69.0	-----	-----	-5.5	-6.0
<b>Economic Assistance:</b>					
Contingency fund:					
Reserve of \$25,000,000 has been placed against 1967 enacted appropriation.....	56.0	-----	14 40.0	-10.0	-25.0
Defer loan commitments and grant projects, and delay contract awards.....	-----	-----	-----	-14.0	(-260.0)
<b>Office of Economic Opportunity:</b>					
Limit advance payments:					
Neighborhood Youth Corps, administered by Department of Labor.....	1,600.0	-64.0	13 185.0	-21.6	-32.0
Headstart program.....				-60.0	
Defer initiation of new programs:				-6.5	
Work experience, administered by Department of Health, Education, and Welfare.....				-27.6	
Neighborhood Youth Corps, administered by Department of Labor.....	-----	-----	-----	-25.3	-----
Community action programs.....	-----	-----	-----	-----	-----
<b>Pay increases:</b>					
Civilian.....	(16)	300.0	-----	17 -240.0	17 -240.0
Military.....	(16)	200.0	-----	17 -45.0	17 -45.0
<b>Grand total, 1967 reductions:</b>					
Administrative budget.....				-2,069.3	-3,273.4
Trust funds.....				-423.3	(-590.2)
					-1,103.9

<sup>1</sup> Effect of expenditure slippages from 1966 into 1967, tight money conditions, workload changes and other expenditure reestimates. The effects of the 1966 Pay Act are excluded.

<sup>2</sup> Amounts in parentheses are for contracts and related items which are being deferred without effect on the obligations for 1967 as a whole. These items are primarily deferrals within the fiscal year 1967 which do reduce expenditures for the year as a whole.

<sup>3</sup> Results from money market conditions which cause private investors to redeem low interest rate loans.

<sup>4</sup> Unanticipated delays in getting this program underway in 1966 resulted in all \$3,000,000 of expenditures estimated a year ago for 1966 falling into 1967.

<sup>5</sup> Commitments for land purchases made later in 1966 than anticipated result in expenditures of \$10,200,000 falling in 1967 rather than in 1966.

<sup>6</sup> Face value of contracts scheduled to be awarded in 1967.

<sup>7</sup> Reflects State approvals of local school district projects imposing mandatory Federal expenditures.

<sup>8</sup> Reflects deferral of obligations and contract awards originally scheduled for 1966, and revised estimate of progress on construction already underway by grant recipients.

<sup>9</sup> Less than \$50,000.

<sup>10</sup> Increase due to higher receipts which led to a higher spending rate for these earmarked (dedicated) funds prior to the 1967 cutbacks.

<sup>11</sup> Expenditure effect is for the year beginning Oct. 31, 1966.

<sup>12</sup> Results from higher rate for ongoing construction initiated in prior years.

<sup>13</sup> Results from transfer of funds into administrative operations.

<sup>14</sup> Increase reflects faster spending rate in Vietnam.

<sup>15</sup> Results from slippage of 1966 expenditures into 1967; 1966 actual expenditures were \$200,000,000 less than estimated in the 1967 budget.

<sup>16</sup> Recommendations for pay raise effective Jan. 1, 1967, covered by allowance for contingencies.

<sup>17</sup> Approximate, pending analysis of details now underway. Pay raise was enacted effective July 1, 1966, with a somewhat different structure than recommended.

Senator PERCY. Mr. Chairman, do I have time for one more question?

Chairman PROXMIRE. Yes, indeed.

Senator PERCY. In fiscal 1968, it is estimated that the tax proposals of the President would yield about \$6.3 billion in revenue but all of those tax increases will not have been fully in effect for the full fiscal year. Can you give us an estimate as to what the President's tax proposal really will be in terms of a full annual increase?

Mr. SCHULTZE. Yes, sir; the answer is \$9.3 billion for the surtax. That is the calendar year 1968 liability increase. Now, that will be collected at varying intervals, but the full calendar year liability is \$9.3 billion for the surtax.

Senator PERCY. Thank you.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

First, Mr. Chairman, I think that this meeting of the committee today is a very good indication of the importance attached to your suggestions to have these meetings. I commend both you and Mr. Schultze for bringing us up to date. I think it is extremely important to have another look at the budget instead of just one for an 18-month projection. I commend you, sir.

Chairman PROXMIRE. Thank you very much, Mr. Moorhead. I am sure that Budget Director Schultze is cooperating as fully as he can. But I must say I feel kind of paralyzed. I frankly do not think we are getting a comprehensive, up-to-date picture of the real kind of changes in the budget that I had anticipated we would get by the middle of the year. But I will pursue that a little later.

Representative MOORHEAD. I might say I feel we need a subsequent hearing a few months hence concerning the military side.

Chairman PROXMIRE. We do indeed, and this is the area where we have a contingency of \$4 billion.

Representative MOORHEAD. A \$4 billion swing.

Chairman PROXMIRE. This was the particular area that we have been so disappointed in in the past and has so inhibited Congress in any kind of sensible, logical response to the real facts of the economy. So if we could have a fiscal policy that was tailored to meet the demands of the economy. But I understand there are a lot of problems in connection with it. But I don't want to take your time.

Representative MOORHEAD. Mr. Chairman, perhaps it would be well to say that before adjourning, if there is to be an adjournment this year, that it would be desirable to have another meeting.

Chairman PROXMIRE. Well, as you know, we did provide for two reports, as I recall. There was one in January, one in the middle of the year, and one when the appropriations were in, and we hope we will be here long enough to get something in.

Mr. SCHULTZE. This will be our normal fall review which used to be a midyear report. For 2 years, because Congress was in session so late, we did not get out a review at all.

I realize that colloquy was not between you and me, but I would like an opportunity to make just one point on the question of insufficient information. I would like to just remind the committee of one thing, that during the Korean war, there were \$45 billion of supplementals. Of course, in World War II, it was dramatically higher than that,

clearly. In my view, quite frankly, I think you are really asking for the impossible.

Chairman PROXMIRE. Quite frankly what?

Mr. SCHULTZ. You are asking for the impossible in terms of a precise, firm forecast that anybody can put their mind to and say this is it, when you are fighting a war. I don't say this in disrespect, but I remind you that the history of fighting wars is that you cannot predict well in advance exactly what the financial requirements are going to be.

Chairman PROXMIRE. We are 8 months closer to it than we were before and it seems to me we could get a more reasonable accurate estimate of what it is going to cost. The President has asked for more troops, to say there is a contingency of \$4 billion, you know—

Mr. SCHULTZE. I would be glad to run down some of the items in that contingency.

Chairman PROXMIRE. I don't want to impose on the Congressman's time.

Representative MOORHEAD. I suggest we keep coming back to this, Mr. Chairman, because I recognize the problem you have with Mr. Schultze.

Senator MILLER. The Director suggested that he would be glad to give us some kind of a breakdown of that \$4 billion. I would like to suggest that the chairman's request be answered and put in the record.

Representative MOORHEAD. I accede to that suggestion if you can answer that for the record, Mr. Schultze.

Chairman PROXMIRE. In just as much detail and specificity as possible.

Mr. SCHULTZE. What I can give you is not a detailed breakdown of the \$4 billion because, again, I stress that \$4 billion is an attempt on our part to tell the Congress to the best of our knowledge of the kind of increase in expenditures we may be facing. It does not mean we have any pricing out of the \$4 billion. What I can give you are some of the elements, both up and down, which were involved in our making that judgment—and it is a judgment. This I can give you. I would be glad to right now. It is up to the committee, of course.

Senator PROXMIRE. Why don't you go ahead? We can do that later.

Representative MOORHEAD. I would like to have it submitted for the record, because I have a few other questions.

(Additional material was subsequently filed. See pp. 49, 50.)

Chairman PROXMIRE. Let Congressman Moorhead's time run from now.

Representative MOORHEAD. Thank you, Mr. Chairman. I will try not to impose on that.

I would like to shift this discussion to the unpleasant subject of a tax increase, Mr. Schultze. On a 12-month basis, what is the total amount of the present proposal pending before Congress?

Mr. SCHULTZE. The increase in taxpayer liability in a full calendar year would be slightly over \$9 billion for the surtax proposal.

Representative MOORHEAD. Now, there are some Members of Congress who believe that a mix of some degree of tax reform in this proposal would actually make the tax increase more politically market-

able. I am not asking you to make the political judgment. But if you had your druthers and we could put some increases by tax reform into the mix, would you want that in addition to the \$9 billion, or do you think that \$9 billion is the right figure? And if you put in a mix of tax reform measures, should the proposal be adjusted so as to come out to approximately a \$9 billion figure?

In other words, I suspect that politics set the figure—it certainly did not mean that you really wanted less, but you thought it was political marketable to have more. So what I am trying to do is separate the politics from what is the correct figure? Is \$9 billion the minimum we should get, or should we be asking for more or—

Mr. SCHULTZE. Let me go at that in order. The surtax method for raising funds, in a situation where the need is for a temporary tax increase, follows precisely along the lines of the recommendations of the subcommittee on fiscal policy and this committee in the spring of 1966. The subcommittee had fairly extensive hearings on the kind of tax increase one should ask for; that is, the kind of changes which are best when a temporary increase is needed. So we are following recommendations of this committee. We agree with those recommendations, particularly from the point of view of the fact that this is a temporary tax increase rather than a fundamental change in the structure. We do not believe those two should be mixed up.

You will also recall that the President and the Secretary of the Treasury have indicated that a tax reform proposal will be placed before the Congress in this session.

Representative MOORHEAD. Do you know or can you reveal to us whether that will be a tax reform which will have a tax increase effect or a tax decrease effect, or a neutral effect?

Mr. SCHULTZE. At this stage, I cannot tell you that. The basic point is that it would not be a tax reform measure aimed primarily at getting revenue. That is my understanding. Now, this is something the Secretary of the Treasury or the Assistant Secretary, of course, are much closer to than I am. But I think the basic point is that for the fiscal needs of the country, we need a temporary tax increase during the period in which Vietnam is going on. We believe that the revenue for that purpose should be raised by a temporary surcharge and that discussions of the surcharge should not be involved with discussions of fundamental longrun reform of the tax structure. That does not mean that reform is not necessary. It is necessary. But we think the temporary increase and the reform should be kept apart, both from a fiscal standpoint and a political standpoint in the broadest sense. We do not want to mix the two up.

Representative MOORHEAD. Are you familiar with the proposal to include as part of the package a 10-percent tax on income that is not now includable for tax purposes, just as though it were included, for the 10-percent increase?

Mr. SCHULTZE. Yes, I have heard of that and I understand, if I read the paper correctly this morning, that Mr. Meany made such a suggestion yesterday. I have not had a chance to react. Again, our proposition, I think, would be basically that a straight surtax on existing taxes is the neatest, cleanest way to get at this problem and to try to get at it speedily. We should make sure this is a temporary tax increase and not mix it up with tax reform proposals. But I have not really had a chance to study the other proposal you mention.

**Representative MOORHEAD.** Mr. Schultze, why was October 1 selected as the effective date for the proposed surcharge on individuals and why was July 1 selected for the increase on corporate taxes? Is that still your proposal? If not, why not?

**Mr. SCHULTZE.** That was our proposal, and still is our proposal. I am not sure I can give you a full rundown of the reasons, but I think one of the key reasons is the fact that this year, when the investment credit was reinstated, it was made significantly more liberal than we had proposed. We felt that, therefore, there was a legitimate reason in terms of the income taxes for an earlier effective date for corporations than for individuals. If I am correct, and I think I am roughly correct, they will offset each other, the liberalization on the proposed investment credit and the fact of having a July 1 date on corporations instead of an October date.

**Representative MOORHEAD.** If the Congress goes along with this proposal, with the October and July dates, what do you estimate will be the effect on aggregate demand for the rest of 1967?

**Mr. SCHULTZE.** Well, maybe the best way to answer that is to say that our view of the economic situation is such that we felt that rather than wait until inflationary pressures really get underway, we thought it better—I hope we are right—to meet those pressures by having a tax imposed as soon as possible. This is the reason we did not propose a later effective date.

In other words, what I am saying is that we think economic conditions are such as to require the imposition of that tax. We think the money markets are such as to require and warrant bringing into the Treasury as much revenue as possible in order to try to maintain reasonable conditions in the monetary market. Those two reasons together dictated to us, at least, asking for the effective dates we did rather than later dates.

The converse of that, therefore, is that we felt that money market conditions would be made worse if we did not have that revenue. Further, we would be taking too big a chance on inflationary pressures if we waited until later.

**Representative MOORHEAD.** Do you think that there would be a significantly adverse effect on the money markets if, for instance, we make the corporate tax effective October 1 and the individual tax effective January 1?

**Mr. SCHULTZE.** I would have to try to go through the calculations of what that would mean in revenues. Just doing it in quick numbers, it would mean about a billion and a half dollars loss on personal taxes and about a half billion dollars loss on the corporate taxes. That is an extra \$2 billion that would have to be floated in the market. We think that this is, while not overwhelming, still fairly significant and that there is no reason to have to burden the market with that additional amount.

**Representative MOORHEAD.** I think in your statement, you have a budgetary change of \$1 billion based on a pay increase for Government employees. I believe that this is based on a 4.5-percent increase. Is this correct?

**Mr. SCHULTZE.** Not exactly, sir. We proposed in January a 4.5-percent increase for military and civilian employees to be effective October 1, 1967. That would cost a billion dollars—and this amount was included in the January budget. As of the time the tax message was written and I testified before the Ways and Means Committee,



the House Post Office and Civil Service Committee was considering a bill which would have added approximately an additional billion dollars, when the military pay implications are taken into account.

It was my understanding that the House Post Office and Civil Service Committee is now considering a different bill, which I have not had a chance to analyze, which would still add to the budget but perhaps not by that amount—it does not look like that amount, but I have not really had a chance to analyze it.

Representative MOORHEAD. It is my understanding that instead of the 4.5 percent, the House Post Office and Civil Service Committee has come up with a 6-percent increase. I think it would be helpful if you could obtain for the record what this difference would be, and how that would change your statement if this increase were enacted.

Mr. SCHULTZE. As soon as we can get a chance to analyze it. It is a fairly complicated bill, but as soon as we get a chance to analyze it; yes, sir.

Representative MOORHEAD. I am requesting this because I have a delegation of postal employees waiting for me in my office now.

Mr. SCHULTZE. I am not sure my answer will be that soon. I might say the bill gives the postal employees a different raise this year than other employees.

(The following was subsequently filed for the record:)

Information available at this time indicates that the subcommittee on compensation of the Post Office and Civil Service Committee of the House of Representatives has approved for consideration of the full committee a civilian pay raise bill. Based on known data, the subcommittee bill apparently would cost approximately \$50 million more in fiscal year 1968 than the Administration's bill. This increase is due to higher pay increases for postal service employees than proposed by the Administration.

As stated in the Summer Review of the 1968 Budget, enactment of earlier bills considered by the Post Office and Civil Service Committee would have further increased budget expenditures by an additional \$1 billion. The current subcommittee version apparently avoids most of the increases contemplated in the earlier bills.

Representative MOORHEAD. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Mr. Schultz, the House is currently debating the Foreign Assistance Act. In that act, there is a new proposal of the administration with respect to the sale of arms with credit involved, the sale to be made by private suppliers, and it does not say whether domestic or foreign, through international organizations. They do not describe the international organizations. But the people who sell these arms would receive notes in payment and those notes would be hawked with the United States through the President and a payment then made that way. With this arrangement in armed sales over a period of time, you could absolutely do away with the present procedure through the Export-Import Bank. As a matter of fact, the Pentagon could unload all of these promissory notes on the Export-Import Bank and they in turn could pool them and sell sales participation certificates in order to pick up the money for them. It would completely preclude any need for appropriations and at the same time, completely conceal the level of such activities from both the Congress and the people.

Now, I presume that you are familiar with the proposal. I would like to know, if possible, how much you estimate it will be necessary

for the Export-Import Bank to sell participation certificates in order to cover the traffic in arms?

Mr. SCHULTZE. I must admit I am embarrassed. I normally will be prepared to answer any question that I think will come up. This one I confess I am flatly unprepared to answer. I do not know. I would be glad to look it up for the record. I simply do not know, Mr. Widnall.

(The information which follows was later supplied:)

1. The authority to purchase promissory notes for military equipment which was proposed in the Foreign Assistance Act would have been exercised through the Foreign Military Sales Fund. Any purchase of such notes in Fiscal Year 1968 would not have required new obligatory authority in addition to the \$60 million requested in the budget for the Fund, since any sales financed by this method would have been within the total sales estimate on which the budget was based.
2. In the past, only very minor amounts of evidences of indebtedness from Defense (so-called "Country X" loans) have been used to support participation certificates of the Export-Import Bank. None will be used in the future.
3. As to total arms sales, the Export-Import Bank's cash requirements would be reduced by a reduction of disbursements on military credits just as would be the case if disbursements under other credits were reduced. The Fiscal Year 1968 budget estimated that Export-Import Bank's total disbursements for military credits would be \$780 million.

Representative WIDNALL. That is an honest answer.

The next thing is this: I notice some of the sales in the past have been made at interest rates lower than the cost of our obtaining money in order to help in the sale of these arms. Do you as the Budget Director think that this is a proper practice at this time, that we sell arms at lower than the cost of money to us at the current time? I believe the last sale to Great Britain was being made on a 4½-percent basis. I believe that current Government moneys run from 4.9 to 5.1.

Mr. SCHULTZE. Yes, Mr. Widnall. As you know, there are many, many credit programs in which the rate charged to the borrower is substantially lower than the rate the Government pays itself. You have, I am sure, dealt with a number of these programs yourself.

Secondly, there are a number of programs where the rate is based on a formula relating the rate to the Treasury rate, but the formula by necessity must cover a period of 6 months or a year of experience to get the formula. Hence, in a rising market, you may find the actual rate charged the borrower slightly below the Treasury rate, even though the basic formula, over the long pull, keeps it together. It seems to me the specific judgment on this has to be made in terms of the judgment of the objectives you are after, not in terms of whether or not the rate itself is below the Treasury rate. In other words, is it a program in which you feel this is desirable?

I am not sure at the moment—again, I will be glad to supply it for the record—whether that rate is simply based on a lag in terms of collecting or calculating what the Treasury rate is or whether it is on some other basis. That particular sale, I just don't know.

(The following was subsequently furnished:)

The interest rate charged by the Export-Import Bank on loans for military equipment is set at a level sufficient to cover the cost of money to the Bank at the time the Bank first undertakes to enter into such financing. There is no deliberate subsidy. In the case of the so-called "Country X" loans, any interest subsidy is borne by the Military Sales Fund. The amount of subsidy is not the result of the application of a set formula, but rather is determined by foreign policy considerations and the economic condition of the country involved.

Representative WIDNALL. I am particularly interested from this standpoint, apart from the sale of arms. At this time, we are considering a very large increase, a substantial increase in taxes to the American people. It seems to me that in order to justify it, we certainly should be closing down every avenue of loss that we have. It certainly does not seem to mean we have to take a deliberate loss, particularly when we are dealing with hard currency countries. I do not think as far as that business is concerned that we ought to be doing anything for the underdeveloped countries at all. We ought to be out of it and let them devote their currencies to living conditions in the countries which so sorely need help.

In your summer budget review, you estimate that GNP in the current calendar year will be \$783 billion rather than the \$787 billion estimated last January. What do you now expect the real growth will be this year compared to the January budget estimate?

Mr. SCHULTZE. It will still be very close to 4 percent. It will be a shade lower than we had estimated in January, but it will still be very close to 4 percent. Specific differences in a fraction of a percent between then and now, I am not sure we can give you. But the growth we estimate will be very close to 4 percent.

Representative WIDNALL. It seems to me from reading news reports recently that inflation is as great a thing as it has been and caused a certain creeping up materially in many areas of the economy. Do you believe inflation will be greater than the 2.5 percent expected by the council early this year? Even with the tax increase.

Mr. SCHULTZE. I would hesitate to deal in fractions of a percent. I think with the tax increase, it can be held in that ballpark; yes, sir. As I say, dealing in fractions of a percent, I am not sure I would want to predict.

Representative WIDNALL. What would it be without the increase?

Mr. SCHULTZE. Again, Mr. Widnall, I cannot give you a prediction. I think it would be significantly higher. But exactly how much higher, I cannot tell you. I am not sure anyone has yet found a means of translating the specific budgetary and economic forecasts into a precise price prediction. I think the direction of the change is clear. It would be a higher and importantly higher amount, but I would not want to put a figure on it.

Representative WIDNALL. In preparing the 1968 estimates of budget receipts, a substantial error was made by overestimating the yield of the existing tax system or of increase in personal income. Can you tell us what the procedures which were used which resulted in this error so the same mistake can be avoided in the future?

Mr. SCHULTZE. Yes, sir. I can surely tell you what the procedures were and how they can avoid them in the future.

The basic mechanism, the revenue miscalculation that you are talking about, was in the personal income tax sector. The method used for arriving at a revenue estimate is as follows:

First, we estimate, project, and expect an increase in personal income, a projected increase in personal income; secondly, we apply to that increase a marginal rate, a rate of taxation—that is, how much of the additional income can you expect to turn into a revenue increase?

Now, for 3 years running, we substantially underestimated revenues. What had been happening was that the marginal rate, the amount of the increase in tax you should get from increase in income, had

been going up each year from an earlier figure of 12 or 13 percent, then to 14 percent, then to 17 percent. And every year for 3 years we were faced with a substantial underestimate of revenue—fiscal 1964 through fiscal 1966—3 years.

In preparing the budget this year, therefore, we put that marginal rate on a trend and said, each year it has been going up, because people were moving into higher income brackets the rates were going up from 12 to 13 to 14 to 17 percent. We assumed an even higher marginal rate for 1968; about 19.

When the 1966 tax figures were in this last April and May, it turned out that instead of the rate continuing up, it turned down. After 3 years of increasing, and for the first year when we tried to take that into account, it turned around and went down. As a consequence, we have reestimated a lower marginal rate back down to 15 percent instead of the 17 and 19. We are now using only 15 percent. That is the estimate—I think it is 15.5 percent actually. That is the estimate that is incorporated here.

Now, the Treasury has had any number of consultants in trying to figure out what happened. We do not yet know, quite frankly, why the taxes relative to income behave the way they did for 3 years and then the relationship suddenly changed. I think what it does illustrate is that even when your income estimates are good, and our projections have been fairly good on personal income—we are still not sure of the revenue in the way the revenues respond to income changes. I just do not know, we do not know. The Treasury is continuing to investigate this. As I say, they have hired a number of consultants, trying to pin down the cause. We do not know. We have a lot of alternative theories, but we are not yet quite sure.

Now, finally, Mr. Widnall, all of this was complicated by the fact that we can, during the year, usually check on the validity of these rates and estimates by looking at what was happening to withholdings month by month. But it turns out that the graduated withholding introduced last year reduced our ability to use the month by month figures to check on our original forecast. We had these two factors, combined, which gave us our overestimate in January, an overestimate which, at the time we thought was a conservative estimate taking into account what had happened prior to that.

Representative WIDNALL. Would there be a lag in the tax increase, or would it appear rapidly—

Mr. SCHULTZE. I would say as a general proposition that the personal income tax would operate fairly rapidly. The corporate income tax would operate fairly rapidly. The corporate income tax would operate perhaps with somewhat more of a lag. Corporations are a little more flexible in how they respond to tax changes than individuals are. As a general proposition, I think that would be a fair estimate.

Representative WIDNALL. As I end my questioning now, I would like to just tell you something that happened before the House Banking and Currency Committee recently. Under Secretary Barr was testifying before us, and I was saying that we did not get any kind of a real report from the Treasury. He said, "It is all there in the budget."

Well, I said to him that there are just a few people who can read and understand the budget and understand the fine print. As a matter of fact, millions more read the Peanuts cartoon than read the budget and they understand the Peanuts cartoon.

The following day, I received a little note from him saying, "I did not think to tell you on yesterday that both the Peanuts cartoon and the budget were prepared by Charlie Schultze."

So that begs credibility for the budget.

Mr. SCHULTZE. I do not know whether to thank you or what, on that one.

Representative WIDNALL. That is all, thank you.

Chairman PROXMIER. Congressman Reuss?

Representative Reuss. Thank you, Mr. Chairman.

Mr. Schultze, back in 1964, when this committee had before it the proposed tax decrease of around \$12 to \$14 billion a year, as I recall, we were told—and I went right along with it—that this really in the end would not hurt the revenues at all, because as a result of the accelerator and the multiplier, there would be enough additional economic activity so that the revenues could be recouped. That, in fact, has turned out to be the case, and I am glad that I voted for that tax bill back in 1964.

Now, we are confronted with a proposal to raise taxes on individuals, for instance, by more than \$5 billion a year. I am wondering how the accelerator and the multiplier are going to work there in very simplistic terms? I suppose, if you take \$5 billion from consumers' pockets, they do not buy that refrigerator they were otherwise going to buy. Then, at the refrigerator plant, somebody is likely to lose the job and the refrigerator plant is going to sell that many fewer refrigerators. Then you get the accelerator working because the management of that refrigerator plant is not going to make a capital outlay so that it can build more refrigerators which it can otherwise make.

My question is, do you not get a decelerator and a negative multiplier, and if so, how does that figure in your revenue estimates?

Mr. SCHULTZE. Yes, sir. In the first place, as you of course know, in an economy which has been running for some years at a relatively stagnant level, with high unemployment and relative to GNP, very low investment expenditure, a stimulus to the economy through a tax cut can give you the multiplier effect on consumption which will never, in and of itself, generate more revenue than you lose. But it can have a major impact on investment expenditures and, in turn, back through the multiplier, again on revenue. So in an economy with high unemployment, a history of stagnation, particularly an economy in which investment expenditures are running quite low in any historic relationship, quite low in relation to GNP, a major stimulus to the economy through a tax cut can generate significant enough economic activity because of the improvement in the whole climate for economic expansion—not just in the multiplier, but the whole climate for economic expansion—that you can end up generating so much extra income that when you apply the lower tax rate for additional income, you more than recoup your losses.

That cannot, however, be carried over into an economy which is running—with one exception which I will come to in a moment—running already at very high levels of employment, where the room for improvement is much less, and secondly an economy where investment is already up at a high level compared to any historical relationship to GNP. I realize that no one ratio is adequate.

Representative REUSS. Therefore, when in full employment, let us not have a tax cut. I will stipulate to that. But how about on the down-

side? How about right now, where at 85 percent of industrial capacity, we have almost 4 percent unemployment?

I put it to you, Mr. Schultze, that there is going to be a decelerator and a negative multiplier. I would like to know what its dimensions are and how those figure in your revenue today.

Mr. SCHULTZE. Mr. Reuss, clearly there is a decelerator, using the word in its broadest connotation. One of the two grounds for the tax increase is to hold down the rate of economic growth to a relatively reasonable level, and this is cranked into our revenue forecast; namely, an economic forecast which takes into account the fact that you have levied higher taxes. That is taken into account in the estimate of revenues that the Secretary has presented and I have presented here.

Representative REUSS. You are going to take out on an annual basis \$5-billion-plus from individuals. We leave corporations to one side, because that is a little trickier. How much less are consumers going to spend, do you figure? I would think they would spend close to \$5 billion less, and maybe they would get scared and spend more than \$5 billion less. Then what is the "pebble thrown into the pond" effect of that? What about the refrigerator plant with its orders diminished, which reduces its activity?

Then, what about the third process, whereby investment decisions are scaled down? Can you give me the arithmetic on all this?

Mr. SCHULTZE. I do not think I can give you the arithmetic quite that way, because the way our revenue estimate was done was to incorporate a model which included the tax increase. So, I do not precisely have the difference between no tax and a tax increase in that exact sense. But I think you could say from the terms of a revenue feedback on your normal conditions, maybe something like 30 or 40 percent would be reduced by feedback operations. By that I mean that if you look at the gross intake from additional revenues, then that intake related to a situation of no taxes would not permit collection of maybe 30 to 40 percent. In other words, by the time you take into account your multiplier and accelerator and crank that into your taxes, you may lose 30 to 40 percent under those conditions.

(The following was subsequently provided for the record:)

Computations indicate that the "negative multiplier" would amount to approximately 25% for fiscal year 1968.

Representative REUSS. So, if you levy a tax of \$5 billion a year on individuals, the Treasury each year is only about \$3 billion richer?

Mr. SCHULTZE. Then you have to take some additional calculations into account. One, the Treasury is only, let us say, \$3 to \$3.5 billion richer, depending on the way it comes out.

Conversely, to the extent that you avoid increases in debt, and more particularly, increases in interest rates, interest expenditures on the public debt are thereby affected, offsetting the offset to the offset. So the Treasury comes out more like 3.5 than 3 billion, although still below 5.

Still, of course, I never—I should not say this flatly, but I will put it personally. I would never want to get into a situation where the only reason you are maintaining a high gross in revenues was inflation; in other words, to the extent you get revenues as a result of inflation, while you do get the additional revenues out, you sure do not want them that way.

Representative REUSS. Could you break down that 30 or 40 percent feedback figure for the record—I do not mean today, but when you complete your odds and ends from this hearing—so that I can get some sense of how that is constructed, how much is the actual removal of spending money from people's pockets, how much is the depressing effect upon consumers' spending power over and above that, how much is in the second phase where factories supplying goods that would have been bought but are not because with the tax increase, people had to tighten their belts, and finally, what diminution of investment in the new plant and equipment you attributed to the tax increase? Because we had a very complete prospectus on this when we were trying to go up by reducing taxes. Now that we are trying to go down by raising taxes, I would like an equal piece of guidance.

Mr. SCHULTZE. We will supply what we can for the record. I would like to make it clear—I have said it, but I would like to make it clear for the record again—that the revenue estimates we have presented in conjunction with the tax proposal which is the \$122.5 billion, does take into account all of these reactions. So, in other words, you should not discount the \$122.5 billion on this account. That estimate already takes this factor into account.

(The Bureau of the Budget subsequently furnished the following for the record:)

It is true that when taxes are raised there is a feedback effect which reduces potential revenues to the Treasury. In our calculations concerning the 10% surcharge we estimated this "negative multiplier" at about 25% for fiscal year 1968. In other words, with no tax increase, profits and personal income would rise more rapidly and provide tax bases which would yield one-fourth more under a hypothetical surcharge.

However, I would like to point out two contingencies associated with this line of reasoning. First, in the absence of a tax increase we could expect a more stringent monetary policy which would tend to restrain the pace of economic activity and thereby reduce the feedback effect. This was not a factor in the 1964 tax reduction. Second, any further increases in personal income and profits which would result from a no-tax policy would be largely monetary rather than real. With the economy at full employment levels, any additional demand could result only in a rise in the price level. The key factor, therefore, in assessing the "feedback effect" of a tax action is whether or not the economy is operating at full employment.

Representative REUSS. What I am after is the same kind of detailed breakdown that we got on the up side in 1964.

On another subject, your budget analysis for last January, fiscal year 1968, lists expenditures for the Federal space program of \$7,229 billion. Do you not think that this represents a much more post-ponable category than, let us say, human resource development?

Mr. SCHULTZE. Two points in response to that. One, as you are aware, the \$7.2 billion is not just NASA.

Representative REUSS. Right, it includes Defense and seven or eight other industries.

Mr. SCHULTZE. It includes Defense—about \$2 billion is in the defense area.

Secondly, I am not sure you were here earlier when I pointed out that in a relatively, I think, unprecedented move, the President 3 days ago responded to the House Appropriations Committee action in reducing the NASA appropriation by \$517 million; the President responded by saying that under these circumstances he would accept that reduction; he would not oppose it.

Representative REUSS. As you know, that \$517 million referred just to postmoon projects. Unless I am mistaken, the House did keep the moon shot and expenditures on schedule.

Mr. SCHULTZE. Except for Apollo.

Representative REUSS. That is why I voted against it. Did I do wrong?

Mr. SCHULTZE. Mr. Reuss, do not pin me down.

Let me point out, I think to be as precise about this as I can, what the President was talking about was the total level of the appropriations, not necessarily particular choices within the House-approved amount.

Representative REUSS. A final question, an extension of the line of questioning of Mr. Moorhead. Can you tell us now, or in addition to your testimony, precisely what these Treasury borrowing dates are? I would like somehow to match these new revenue flows with them as best I can.

I say that because I have a hunch that much of the big borrowing crunch is upon us, and that even the enactment of the President's proposal as is would not help tremendously on the given dates when borrowing has to occur; and that if Congress does what is likely—advance those dates a bit if it passes a tax increase bill at all—it really will not help the Treasury very much in this dreadful second half of 1967.

Mr. SCHULTZE. Well, in the first place, as you know, most of the borrowing the Treasury has to do in any year comes in the second half of the calendar year. I think you have to bear in mind two things: One, the psychological impact on the business, and particularly the lending community, of knowing what the fiscal year borrowing is going to have to be can make a large impact on what happens in the first half of the fiscal year and the last half of the calendar year, even though the actual revenue receipts will not come in until later: (a) because the amount of total borrowing for the year makes a big difference to them what the total year is since in turn, it makes a big difference whether the Treasury is simply handling a temporary seasonal phenomena or not. In other words, that would be either a situation with a tax increase but with the revenues coming in primarily in the second half of the year or one with a long-term increase in debt, which is another matter completely.

So it seems to me it does make a major difference, even though the actual collections from the tax increase for the July 1 and October 1 dates in the second half of the year may not be a large one, the effect on the money markets will be much larger than that particular figure would cause you to expect.

Representative REUSS. Also, to go on to the second point, unless I am mistaken, hopes of people that the money market would have eased off a bit at the President's announcement have not been validated in the event. Interest rates and money are about as tight now as they were before the August 8 announcement.

Mr. SCHULTZE. It may, Mr. Reuss, be that the money markets are watching as carefully as we are what the Congress may do with that.

Representative REUSS. My time is up.

Mr. SCHULTZE. Well, I covered my second point together with the other; A, the psychological impact, and B, the fact that the nature of the Treasury borrowing would be different, depending on whether it



was borrowing simply against tax receipts to come in the second half of the fiscal year or just borrowing against deficits which would stay up there. I covered them in one point.

Representative REUSS. I see. Could you elaborate on that by giving me a couple of tables of when the borrowing needs are going to occur—they are certainly known now—and when the money starts rolling in if the tax measure is passed and how they match up?

Mr. SCHULTZE. Within some limits I can do this, I think.

(The following was subsequently furnished for the record:)

Treasury anticipates *net borrowing* in fiscal year 1968 of approximately \$15 billion. About half of this amount has already been financed and the remaining \$7½ billion will be carried out before the end of 1967. During the first half of calendar year 1968, Treasury needs will be just about offset by revenue collections. This is true for two reasons—the 10% surcharge will raise total revenues for fiscal year 1968 to \$122.5 billion and collections during the first half of calendar year 1968 will amount to about \$69 billion due to the seasonality of the income taxes.

Representative REUSS. Thank you.

Chairman PROXMIRE. Congressman Moorhead said earlier, Mr. Schultze, that he thought this midyear review was a real service, and I think that the idea is a service. As I was saying, you are co-operating as much as you can. But I am disappointed, because frankly, I had expected, in view of the attitudes expressed by the administration, that there would be some explicit recommendations for reduction in spending. What we have here is what you say is an almost unprecedented agreement by the administration to cut back their space program by \$5, \$6, \$700 million. But nothing else is explicit but that you are going to do your best.

You see, the trouble is the administration, it seems to me, has the Congress over a barrel on spending. And you know you have. The President initiates and approves about 98 percent of all the big programs, all the money that is involved. This is especially clear where he has us over a barrel on defense expenditures. The policies which the President decides he is going to support, both in Vietnam and in Europe, put the Congress in a position where it is difficult to cut defense spending very much.

Now, Senator Russell and his committee did a marvelous job, I thought, by recommending reduced expenditures of \$1.4 billion; the House reduced them by \$1.2 billion in the appropriation measure recommended for fiscal 1968. But even though you have a unanimous Democratic Policy Committee recommending withdrawal of four of the six divisions from Europe, even though you have almost a majority, close to a majority of Senators cosponsoring this measure, you still do not get any recommendations from the President in this area.

My point is if the President would recommend a change in policy in Europe, for example, if the President would recommend a much bigger cut in space—Gallup polls show that the majority of the American people favor a reduction below \$4 billion—if the President would recommend against a supersonic transport for this year, if the President would make recommendations in this area, you would have no trouble, in my view, in getting very, very large support in Congress. Now, the President does not do that. To expect the Congress to initiate cuts very much below the President's is expecting a lot, because he has this terrific power.

Mr. SCHULTZE. Senator, in the first place, you will recall, I am sure, that last year, fiscal 1967, the President did send to the Congress about seven or eight proposals for reducing specific reductions in programs. We did not get a one of them. Now, you know, one man's meat is another man's poison.

Chairman PROXMIRE. Well, I have suggested areas where he could get response.

Mr. SCHULTZE. We have suggested areas, also. As I said, one man's meat is another man's poison. People differ on the question of where the expenditure cuts are to be made.

Chairman PROXMIRE. Let me just interrupt at this point to say supposing the Congress, following Senator Miller's question, adopted this kind of an alternative to try to help the President in this area. Supposing we recognized the very great difficulty of our reducing expenditures under these circumstances without changing the policy on the part of the President, all the expertise he has, all the initiative he has with regard to policy. Suppose we authorized the President to cut spending 10 percent—10 percent; told him to go ahead, said this was the Congress's intent, we wanted him to do it.

Mr. SCHULTZE. Let me ask you one question: 10 percent of what amount?

Chairman PROXMIRE. Ten percent of the budget.

Mr. SCHULTZE. \$13.5 billion.

Chairman PROXMIRE. Up to \$13.5 billion. There would be areas where he could not do it—in defense; there are other areas you have indicated very well—in interest. But this would accomplish a substantial reduction above what I think is a pretty pitiful performance of \$2 billion.

Mr. SCHULTZE. I think this is where you and I disagree. I do not think \$2 billion in the context of the kind of budget we have submitted, in the context of the areas we think are controllable, is a pitiful performance; obviously you disagree.

In the second place, I think \$13.5 billion, quite frankly, would be irresponsible.

Chairman PROXMIRE. I recognize that you cannot cut it \$13.5 billion. But I think you can cut it.

Mr. SCHULTZE. Again, Senator—this is a personal opinion—I do not think in the long run that it is good responsible policy for the Congress to specify across-the-board percentage cuts without stipulating areas of cut.

Chairman PROXMIRE. How was it possible to cut the budget by \$12 billion in 1953 and cut the budget again in the following year by \$8 billion?

Mr. SCHULTZE. Very simple: Korea was over.

Chairman PROXMIRE. They cut the budget, they got the recommendations of the President.

Mr. SCHULTZE. Surely, because President Truman, in the last budget he submitted in January 1953 submitted a budget on the assumption that Korea was going to continue. That budget was cut substantially. In addition, there were some cuts from civilian expenditures. But the biggest cut was due to the fact that Korea was over.

Chairman PROXMIRE. That is true of both of those years?

Mr. SCHULTZE. I am not sure about 1954.

Chairman PROXMIRE. We had much smaller budget and a much higher percentage for that reason. You might be right for the first year; I am not sure about the second.

Mr. SCHULTZE. Two things happened that I do recall, because I was a staff member on the Council of Economic Advisers for part of the time. There were substantial cuts simply because Korea was over, and funds were not needed in the defense area. Secondly, in the first year in office, the Eisenhower administration did reduce—I do not know how much—the civilian area of the Government below the last budget President Truman had submitted. How much of that cut you are talking about was Korea and how much was civilian explicitly, I do not know, but Korea was by far the great bulk of it.

(The Bureau of the Budget later submitted the following for the record:)

Information available in the Bureau of the Budget indicates that the Administration did not reduce budget requests for fiscal year 1953. However, early in calendar year 1953, fiscal year 1954 requests were reduced over \$8.5 billion. Of this amount, nearly \$7.5 billion was for military requirements of the Department of Defense, the military assistance program, and the Atomic Energy Commission.

Chairman PROXMIRE. What concerns me and what really got us moving on this was the protest, especially in the press, over the very bad mis-estimates in 1966 over the cost of the Vietnam war. This was one of the reasons why we in Congress wanted to get another estimate this time.

Now, you are projecting an increase in expenditures of \$1.5 billion, which includes no increase over the January estimate for Vietnam, as I understand it.

Mr. SCHULTZE. That is part of it, that is correct.

Chairman PROXMIRE. Yet the President has indicated he is going to send or is interested in sending 45,000 more troops to Vietnam, is that not correct?

Mr. SCHULTZE. Oh, yes, sir, but putting those two statements back to back I think may give a misleading impression.

The President did not say, nor am I saying, that we are forecasting no increase in defense expenditures.

Chairman PROXMIRE. I understand that.

Mr. SCHULTZE. What I am saying is that in terms of specifics—

Chairman PROXMIRE. But it seems to me you can do better than saying that there are \$4 billion of contingency here, not included in your budget estimates at all. Certainly it would be more than \$1 or \$2 billion. I think it would be more than \$4 billion.

Mr. SCHULTZE. From anything that I know now, I do not think so. Do not get me wrong, Senator. In fighting a war, I cannot sit here and say there is absolutely no possibility that it would be more than \$4 billion.

Chairman PROXMIRE. Are you assuming that Secretary McNamara will be able to find other areas where he can cut enough to support the additional troops?

Senator Stennis, who is very, very competent in this area, as I am sure you will agree—everybody would agree—told us that if we send more troops, it will cost us \$4 to \$6 billion overall to do so, as I recall. In his testimony earlier this year, he said that. This was not challenged, to the best of my knowledge, by anybody in the administration. It seemed to me to be a pretty firm and competent estimate.

Mr. SCHULTZE. I am not at the moment trying to quarrel with Senator Stennis. He is, of course, very knowledgeable in these areas. I do not think you can relate the \$4 or \$5 billion to 45,000 troops.

Chairman PROXMIRE. What you are saying is, at least in the hard figures you give us, you are saying you cannot even add \$1 billion for it. You are not putting any estimate in here. But you are also adding to that the notion that it is going to cost more, we do not know how much. We knew that last January.

Mr. SCHULTZE. But we are trying to give you an appreciation of what we think the range is we are dealing with.

Remember, Senator, as I went through with you last February, there is a major difference in the way the budget was made up in 1968 as compared to 1967, for the 1967 budget in terms of financing in this budget the leadtime items for continuation of the war, if that should be necessary. This was not done in the prior budget. Hence, a very large part of the reason for the overrun last year is not present now. You may recall when we discussed this last February, so that the \$4 billion figure as a potential that we may be facing is not at all out of line with the kind of increase we had last year when you take account of the fact that last year, unlike this year, there was the problem of not having put into the budget the long leadtime items for contingencies.

Chairman PROXMIRE. Well, it is a 20-percent mistake instead of a 100-percent mistake.

Mr. SCHULTZE. Senator—

Chairman PROXMIRE. Maybe not that much.

Mr. SCHULTZE. It was the word "mistake."

Chairman PROXMIRE. Well, underestimate.

Mr. SCHULTZE. I insist that when you are fighting a war, if you want to put it that way, you cannot avoid a mistake. I have here for you—maybe I could put it in the record—some areas of plus and minus. I cannot put precise figures, maybe.

Chairman PROXMIRE. Put it in the record.

Mr. SCHULTZE. I can put it in the record for you to see the kind of items we are facing.

(The information referred to follows:)

#### ILLUSTRATIVE DETAILS OF POSSIBLE EXPENDITURE CHANGES

##### I. Possible increases

1. Contract payments are resulting in expenditures being made at a somewhat faster rate than prior experience would have dictated. For example, it appears that the second year rate of expenditures under research and development contracts and the first two year rate of expenditure under procurement contracts tend to be higher than we had anticipated. We do not yet have any precise fix on this, but it might result in some expenditure increase on this account.

2. 45,000 men will be deployed to Vietnam. The cost of this has not yet been worked out because the specifics of the deployment have not been fully developed.

3. On a related matter, we will, as you know, review with Asian allies the possibility of their increased participation in the Vietnam effort. Again, we do not know how these reviews will turn out. But additional participation on their part may well require some additional logistical and other support by the U.S.

4. Transportation costs related to southeast Asia have increased above the budgetary estimate. This could run up to \$400 million.

5. Aviation fuel prices have increased by 1.2¢ a gallon, and this could raise the aviation fuel budget by \$60 million, or perhaps more; other cost increases for petroleum products will probably result because of the blockage of the Suez Canal.

6. Refurbishing the battleship New Jersey will add almost \$40 million to defense costs.

7. Consumption and thereby requirements for some types of munitions are up substantially compared to our budgetary estimates, which will add significantly to budgetary costs for munitions.

8. A review of requirements has indicated a price increase in aircraft modifications.

## *II. Possible decreases*

1. Consumption of some items of munitions has decreased, which will result in an expenditure reduction about equivalent to the increases mentioned above.

2. Aircraft attrition in Vietnam is somewhat lower than assumed in the original 1968 budget plan. The aircraft procurement program has been reviewed to determine whether it would be possible to have a revision of procurement plans. Some production rates have been adjusted downward.

3. The Department is studying the possibility of reducing general supply inventories of consumables, spare parts, and support equipment.

4. The Department is also examining the time schedule now planned for a number of items of non-Vietnam procurement to see whether these schedules could be delayed consistent with maintaining an appropriate defense posture.

5. The Defense Appropriation Bill, as passed by the House differs somewhat from the bill as reported out of the Senate Appropriations Committee. However, as a general proposition, it would appear that appropriation action could reduce 1968 defense expenditures by about \$500 million.

Chairman PROXMIRE. I have read in columns in the press that the President has directed various agencies to recommend as much as 15 percent reduction in spending. Now, this may or may not be—

Mr. SCHULTZE. It is not accurate. I can tell you what that refers to. It is not an accurate statement.

Chairman PROXMIRE. What does it refer to?

Mr. SCHULTZE. In preparing for the tax message, the President, on several occasions—one particular one—told his Cabinet officers that we were going to have to reduce spending. He told them they had better get to work taking a look in their own programs to determine what they could—

Chairman PROXMIRE. Did he put any percentage on it?

Mr. SCHULTZE. He did not, but I did. I then told the Cabinet officers and other agency heads that one way to do this—I was suggesting—is just take your entire budget and rank it and look for the lowest 15 percent out of which you ought to be able to take some reduction.

Chairman PROXMIRE. Out of that, leaving aside for a moment, space, which is an accommodation of what the Congress has already done, you ended up with \$1.4 billion reduction that you think you can make out of this \$135 billion budget?

Mr. SCHULTZE. It is a little more than that, because—

Chairman PROXMIRE. A little better than 1 percent.

Mr. SCHULTZE. The \$500 million in space translates into \$300 million in expenditures. So it is there. As I said, we are shooting for a little more than that.

May I make one point to try to put this into a framework that I think is reasonable. In the late 1950's, the last half of the 1950's, the Federal expenditures, I think, took up 16.5 percent of our gross national income. So, 16.5 percent of our outgo and income ran through the Federal Government. In 1964, the figure was very close to that, about 16 percent. Excluding Vietnam, in 1968, even with the billion and a half I told you—

Chairman PROXMIRE. What are you talking about, the total budget?

Mr. SCHULTZE. The administrative budget outside of Vietnam.

Chairman PROXMIRE. Well, you left out all social security, all the road building, you left out a great deal of what the Federal Government is doing; rightly or wrongly.

Mr. SCHULTZE. I will come back to that. What I am saying is that in the areas that are not self-financing through exclusive earmarked taxes—put it that way—through payroll and gasoline taxes in areas of general fund, it has come down from 16.5 in the late 1950's to 14 percent in 1968. My point is that we have increased Federal spending in the non-Vietnam area, but we have taken a smaller and smaller share of the economy.

In other words, it is what I consider a reasonable increase, and there is no reason to think that Vietnam being over, this trend cannot continue to some extent. So it is not a question of Federal spending, outside of Vietnam, rising, and rising, taking a larger share of our economy, and now Vietnam on top of it; we are not doing that.

Now, if the trust funds are put in you will find that outside of Vietnam, the percentage of GNP has been about level.

Chairman PROXMIRE. As far as the relationship to GNP, which has been increasing at a tremendous rate, a lot more rapidly than it has in the past.

Mr. SCHULTZE. That is right. But what I am saying is that those are self-financed, and they are coming in a lot faster than the expenditures, if you come to that.

Chairman PROXMIRE. I want to ask if Senator Miller will permit me to press one other area that concerns me very much. That is the economic case for the timing of this tax increase. All the estimates have been that we are going to get an increase in the GNP in the third quarter and fourth quarter that is very substantial. I have not seen any very hard or very firm estimates of what is going to happen in the first and second quarter of 1968. Indeed, the Bureau of Economic Research indicates that these longer term forecasts are pretty bad, pretty inaccurate, we cannot rely on them very much and we do not know. But virtually the whole impact of tax increase is going to be next year. Even if we follow the President's recommendation, we are not going to get a tax increase through at the very most, before October 1, because you and I know we are not going to get it done because the Senate will not finish by then. So what is going to happen is you are going to have this so-called predicted increase in the GNP and the pressures—I do not think they will develop, but this is what the administration says—you get this big increase in the third quarter and the fourth quarter of the year. No tax policy to counteract it, and I know there is not much you can do about that. But then next year, when I think there is every reason to suspect that the economy may well be softer, you are going to hit us with a \$9 billion increase in taxes.

Mr. SCHULTZE. Conversely, Senator, I think there is every reason to suspect not that the economy will be softer, but that it will be stronger. Let me give you the basic thinking involved. I think it was pretty well laid out in Chairman Ackley's testimony before the House Ways and Means Committee.

The key fact to remember is that in the first half of this year, final sales, sales to ultimate users in our economy, rose by two quarters, by \$31 billion, at larger rates than almost any quarter that we have had. I think there are two exceptions to that.

Now, that was offset by inventory reduction coming down from \$18.5 billion, inventory investment coming down from \$18.5 billion at the end of last year to practically zero now. In other words, this

economy was so strong that it took in stride, only with a slight leveling off, an \$18—

Chairman PROXMIRE. That is exactly my point. We have such a productive economy now, I do not think we really appreciate what has happened in 1964, 1965, 1966. We can produce so much more than we have in the past, even with an increase as you have described in sales, even if we have a limited inventory situation, we still have not gotten much of an increase in utilization of our plant facilities.

The astonishing thing to me is here, when we are recommending a tax increase, we have precisely the same percentage of plant utilization of vacant plant capacity as we had in 1964, when we recommended a tax cut in order to utilize more of our plant.

Mr. SCHULTZE. Except, Senator, if you follow out my reasoning on this, you do not have to have a buildup on inventory. All you have to have is an inventory accumulation of zero, and you are facing a \$60-plus billion increase in GNP in 1 year, and you saw what that did to the economy in 1966.

Chairman PROXMIRE. I want to point out, as Fortune pointed out, which I think is a good economic analysis, that we have had a remarkable increase in capital investment in the past 3 years, a fantastic increase in investment in plant and equipment. In their view, and I think it is very sound, we are very unlikely to get an increase—in fact we are likely to get a decrease in this accelerator part of the economy in the foreseeable future. If you allow for that, it seems to me the case for an exuberant 1968 just is not very strong. While we can see that there are forces that are going to increase some pressures in the economy in this quarter and next quarter, it would seem that this is not significant, because you are not going to get a tax increase in this quarter or next quarter. You may get it next year, when we do not know what we are going to have.

Mr. SCHULTZE. May I respond to that just a moment?

Chairman PROXMIRE. Yes.

Mr. SCHULTZE. In the first place, the source that you quote on this is the same source which, in 1959 and 1960, was saying the economy was going to enter the 1960's with a roar, and we did not need a tax cut. That is point No. 1. Maybe you want to be a little careful about that particular source of citation as to what to do on fiscal policy. We would not have had a tax cut if that had been followed. I happen to think the tax cut was in the interest of everybody.

Chairman PROXMIRE. I am not so sure. I voted against it. Maybe that was a good decision.

Mr. SCHULTZE. Point No. 2—and I think you cannot get away from this, Senator—is that an economy which has continued to rise while still taking an \$18 billion reduction in inventory investment, which is now tapering off, is an economy which has tremendous strength.

Chairman PROXMIRE. It has not risen. We are producing substantially less this year than last year.

Mr. SCHULTZE. The total economy is not down. Industrial output is down this year and, as you will recall, the latest indicator—all the indicators are now starting to move that way. Personal income in 2 months alone, about a \$9 billion increase, 2 months alone in personal income. If you look at orders for machinery and equipment, which did go down, they have turned around sharply and dramatically.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Chairman, I am very sorry I was unable to be here through the hearing up to now. I was in a markup on the Independent Offices Appropriation. However, I do have questions I want to ask; I will take but a very few minutes.

I ask you this Mr. Schultze: As we calculate it, the net public and private debt of the United States equals something in the area of \$1,368 billion. Now, the whole question which involved this tax increase, the surcharge, is something in the order of magnitude of \$7 billion. We are bound to have material deficits anyhow, even if you have the income tax surcharge. Yet the President claims that unless we have this surcharge, we are likely to drive interest rates up so high as to seriously hurt the economy. What I would like to ask you is this: In view of the order of magnitude of public and private debt, the order of magnitude of the deficit anyhow, what basis is there for claiming that we have to have this tax surcharge to drive up interest rates?

Mr. SCHULTZE. I think the key point, of course, on that, Senator, is that relatively modest changes in terms of flotations in the capital markets can make major differences in the availability of credit on the margin. For example, last year the Treasury was a net supplier of funds to the market. Taking into account that it ran down cash balances, there were large amounts purchased by the Fed, and there were large amounts purchased by the trust funds, the net debt impact on the private sector was negative. In other words, we were reducing outstanding debt, whereas without the tax increase and without avoidance of the additional pay increase, without the expenditure reductions we are talking about, the net impact on the market of Treasury borrowing could jump to something over \$20 billion, from the minus to a plus 20.

Now, sure, you are dealing with a market at which debts outstanding are very high, the total amount of debt. But on the margin, the amount that the Treasury goes into this or is able to avoid that by taxes and expenditure reductions, that marginal difference can make a big swing in interest rates, as we saw last year.

Senator JAVITS. Is the administration really basing its surcharge request seriously upon the possible rise in interest rates as a major factor?

Mr. SCHULTZE. As a major factor, yes; not the only one.

Senator JAVITS. But it is basing it on it as a major factor. So if we knock that out, that would be taking, you say, a major prop out from under the administration?

Mr. SCHULTZE. I would not agree that prop should not be knocked out, but it is a major factor; yes, sir.

Senator JAVITS. Now, you gave us some figures on what the Treasury would lose if there was a deferral of corporate surcharge to October 1 and personal surcharge to January 1. Could you give us the figure on what the Treasury would lose if you deferred the whole business until January 1, 1968?

Well, your assistant can figure that out if he wishes, or perhaps you can give it to us later. You gave us a figure of \$500 million for corporations and \$1 billion for individuals.

Mr. SCHULTZE. It would be close to \$2 billion. Two billion dollars plus, probably.

Senator JAVITS. The total loss would be \$2 billion?

Mr. SCHULTZE. Plus.



Senator JAVITS. It may well be worth that in order to have a look at the whole economy to determine whether the tax surcharge might not have a seriously regressive effect, which worries many of us. All we have so far is a prediction—underlined—that the third and fourth quarters will bust out all over. That is yet to be realized, except as you testified in response to Senator Proxmire's questions on the very short information we have, 1 month.

Mr. SCHULTZE. Except, Senator, that the other side to that story is that once you get a wage-price situation going it is very difficult to reverse the fiscal policy. It is much easier to prevent than to reverse. I think we will be in a very difficult situation in terms of trying to do anything next year if we wait too late to get this thing moving.

Senator JAVITS. Many of us feel that in the wage-price field, you are not applying the maxims of determination, courage, will, that the President is asking us to apply on the Vietnam war. It is a war. We have never operated in a war without acting in response to it in terms of being much more forceful with the people of the country on stability than we are.

The question that is worrying me, and I would appreciate your comment, is whether what is bothering us is not more a guns-and-butter philosophy than the actual guns and butter themselves, and that the administration is responsible for that, because it has not made the American people face up to the consequences of a war while we have a war. It is trying to excuse us from the consequences, but carry on the war.

Mr. SCHULTZE. Senator, I respond to that by saying that if you mean that every other war in modern times has been fought with wage and price controls and rationing and materials allocations, and we are trying to avoid those now and take into account the entire situation, keep the economy moving healthily with monetary and fiscal policy, you are quite right. I happen to think that is a good policy. I think we can do that. I think that wage and price controls, rationing, are not needed. They are extremely detrimental to the economy in the long run. Under certain situations, they may have to be put in. We do not think this is the situation. We think it is a situation where such controls can be avoided with appropriate fiscal policies.

Senator JAVITS. So one of the elements is this surcharge.

Mr. SCHULTZE. Correct, sir.

Senator JAVITS. As a practical matter, however, you are not quite doing what you say. You have, for example, a voluntary credit restraint program in respect of investments overseas. You have an interest equalization tax to discourage utilization of American capital markets. You are not completely free of some effort to impose discipline on the—

Mr. SCHULTZE. That is correct.

Senator JAVITS. All I say is I agree with you about the wage and price controls, quote and unquote, rationing and so on, but there are measures short of that in terms of restraints which face realistically a war which we might apply. Has the administration considered that in lieu of a tax surcharge, or at least as a part of it so as to really do the complete job?

Mr. SCHULTZE. What kind of restraints, Senator?

Senator JAVITS. I say, for example, the administration has abandoned the guideposts.

Mr. SCHULTZE. No, sir.

Senator JAVITS. Which if it had, because they were unequal, because they restrained labor and did not restrain management in terms of prices. They abandoned them, jettisoned them completely. There has been no real effort to deal with the price equation, even on a patriotic basis.

I just asked you these questions as to whether the same argument would not justify the effort to orient the American economy through some forms of restraint, in addition to or in lieu of the tax surcharge in order to really do what you gentlemen feel must be done.

Mr. SCHULTZE. In the first place, let me answer those questions in reverse order. I do not believe that any kind of voluntary or moral suasion on the wage-price guidepost area can take the place of the surcharge. As a matter of fact, the wage-price guideposts work best precisely in a situation in which you do not have excessive aggregate demand. That is the whole point.

Secondly, it is not that we have abandoned the wage-price guideposts; it is rather that the 3.2 percent, which was the criterion we were using, in view of what happened to consumer prices, which turned out to be primarily food and services, we felt we could not keep it at that 3.2 percent this year. It is not so much a matter of abandoning wage-price guideposts, it is a matter of abandoning that particular figure.

Senator JAVITS. I am reminded that we had a Voluntary Credit-Restraint Committee of the American lending institutions during the Korean war. We have not even that now. Do you not think that really we are not doing all we at least should do in the face of what the President calls the will, the courage, the resolution, the sacrifice to fight this war, except impose a 10-percent surcharge on taxes? Do you not think that we have a right to demand that the other things be done, too, if you really are worried about the economy, as obviously the administration is?

Mr. SCHULTZE. Senator, in the first place, we have been continually asking for that restraint. The one difference is we have abandoned the 3.2-percent figure on the wage side for reasons I have indicated.

Secondly, with respect to the voluntary credit restraint, you will remember that last year, during which period the Federal Reserve Board went through quite an exercise with its regional banks in terms of getting voluntary credit restraints with respect to the individual banks under those regional banks' supervision, that actually was done. I cannot testify to the specific effect, but it was done in a period when it was needed.

Senator JAVITS. Mr. Schultze, I most respectfully and strongly urge upon the administration a complete inventory of all of these questions of restraint in respect of a price system and the wage system, the credit system, contemporaneous with the request for a tax surcharge as really plain fear with the people and the fact that we are in a war, which is a costly war in money and a strain on the economy and in lives, and that the implementing action matched the will, the courage, the resolution for which the President calls. I respectfully feel that the only justification for this tax surcharge requires also that these other measures, in all fairness if we really are going to do the things in the economy which are claimed for the tax surcharge alone—in short, I just do not believe that the tax surcharge alone is going to do the things that need to be done and attain the objectives that need to be attained, as you gentlemen see them, in the economy. I just make that plea.

Mr. SCHULTZE. Senator, I respect your suggestions. I would like to point out that in each of these areas, we are urging restraint to the best of our ability. We have mounted, for example, a savings bond campaign with the new savings instrument, the equal of which, in a sense we have not had before. The wage-price guideposts have not been abandoned. We are still pushing them higher.

In the credit area, when credit did tighten up last year, we did go through a restraint exercise, a very substantial restraint exercise.

As I say, I respect your suggestions. I do not feel the 10 percent tax surcharge alone will do it. It is a key element, however, for economic stability.

Senator JAVITS. What is the question of priorities which the administration sets? We are told this is a war tax. On the other hand, the President sends special appeals to Congress that we have to do major things about the agony of the cities—that is what I call it. He did not call it that, but I think I know whereof I speak in that. Now, is there any sense of priorities in the administration? What are we going to give priority to?

Obviously, we are giving it to the war. What are we going to do about the cities' problem? Are we going to put that on equal priority; put the space program and public works and other things in lower priority?

Mr. SCHULTZE. In testifying to that, Senator, let me bring out two facts. The major social programs of the Federal Government—and I realize you cannot measure their effect simply by expenditures—but we were spending in 1963 some \$7 billion, this year some \$23 billion, which happens to be just about the same as Vietnam.

Secondly, with respect to priorities, you may, as I stated in earlier colloquy this morning, the President, in a fairly unprecedented action, announced that in view of the House Appropriations Committee's reduction of \$500 million in space appropriations, he accepted that reduction. Under normal conditions, presumably, he may have very well opposed it.

I think our priorities have been demonstrated. We will, of course, in the ensuing months and year, have to continue to reexamine those priorities. But I think our priorities have been shown and shown dramatically.

Senator JAVITS. If I may ask Senator Miller's indulgence for a minute, the priorities you give me are an equal priority for the Vietnam war and the cities, is that correct?

Mr. SCHULTZE. I do not want to be in a position, Senator, of saying one equals one and two equals two. What I am saying is in terms of expenditures, there have been priorities put on the substantial problems and major social agonies that we are facing. I cannot say one is equal to the other. I am merely saying that a very high priority has been put on it in terms of both expanding and existing programs and new legislation to attack it.

Senator JAVITS. My last question is this: Why has not the administration sent us proposals for tax reform, like closing the loophole for depletion and depreciation allowances? We understand, at least I do, that there is quite a report on somebody's desk which shows a great many tax loopholes that ought to be closed. Why are we not entitled as to taking our choice between putting on a surcharge or knocking out loopholes, or not doing both? Why are we faced with a surcharge?

Mr. SCHULTZE. First, we are following a major recommendation made by this committee last spring, that in terms of raising the needed revenue, the surcharge is the way to do it.

No. 2, the Secretary and the President have said they will send to this committee a proposal aimed at the fiscal problem.

Senator JAVITS. My own opinion is they ought to send us both at the same time.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Schultze, first, I want to associate myself with the remarks of the chairman, which is, in effect, a criticism of the unsatisfactorily low amount of the \$2 billion proposed cutback in expenditures and of the way the executive branch is dealing with the Congress on this matter. In your statement, you say:

We have set up machinery so that as each appropriation is enacted, the administration will review it item by item to determine how much expenditure reduction or deferral can be accomplished.

I find that an incredible statement, because it seems to me that the proper policy is for the executive branch to come over and give us recommendations to the Congress on the budget. Now, they did that last January.

Now, if there is a change in the rules of the game that has occurred in the meantime, it seems to me they ought to come over and ask for a reduction in some of these items. They make no bones about coming over and asking for a supplemental appropriation if there is a change in the rules. Why this approach?

In effect, it does this: It causes the Congress to say, well, the executive branch has asked for these budget items. They have assured us that they have run this through the wringer and these are the minimum amounts that they need in a prudent administration. If we appropriate these things, then the administration comes along and, item by item, determines how much they can be reduced, and the general public gets the idea that the Congress is irresponsible and that the administration is the one that is exercising the prudent reduction. Why is it not possible for the administration to come—not you, Mr. Schultze, because you cannot make that decision. You can merely serve us the vehicle from the White House to do this. But why cannot that be done so that we will know what these priorities in cutting expenditures are, what items should be cut?

Now, the Congress may disagree, but at least the administration, the executive branch, has fulfilled its responsibility. It seems to me your response is that it is not living up to its responsibility.

Mr. SCHULTZE. Senator, on this, one has to make a practical judgment. One factor is the status of appropriation action. The appropriations are in quite different stages of completion though almost all of them are through the House. It was our judgment that, quite literally, it will be physically impossible to send up appropriation reductions and expect completed actions. The Congress would be here through December. We cannot, given the fact that of appropriations sent up in January, only three are through the Congress. This would be in effect—a new budget and would put us in a situation where we would never get out until December.

Senator MILLER. Are you suggesting that these items for reduction would come out to such an extent that it would represent a new budget?

Mr. SCHULTZE. What I mean is you cannot do this by going through a very large number of items, affecting every agency, and a very large number of appropriations in each agency. So in that sense, yes, each appropriations committee would have to go through this. I am saying that between now and any kind of reasonable time when you want to start cutting, it could not be done. We would delay the process so long that either we would not get the cuts or Congress would not be out of here until the end of December.

Senator MILLER. It seems to me that if anything, it might save some time in doing it this way. It might speed up the action on the appropriations bill. And in any event, you would have upheld your responsibility for telling the Congress how much you really need. You would not have any hesitancy in coming over to the Congress on a supplemental item.

Mr. SCHULTZE. On a supplemental which broke the budget, we sure would, Senator. By breaking the budget, I mean a supplemental which was not already taken into account in the budget which we sent up in January, given the circumstances we are in this year. I do not mean there would not be a supplemental, but there are many items in the supplemental which are already contemplated in the budget.

Senator MILLER. I understand that, but it just seems to me that this is a shirking of the responsibility of the executive branch. I do want to associate my views with those of the chairman on this point.

Now, getting back to that other item of \$11.7 billion, could you furnish for the record a breakdown of that item, Mr. Schultze?

Mr. SCHULTZE. Yes, sir.

Senator MILLER. Do you have a full breakdown of that item? Do you have a breakdown to, say, items of \$20 or \$30 or \$40 or \$50 million and anything under that is lumped in another figure?

Mr. SCHULTZE. I can give you a breakdown which covers about \$10.5 billion of the \$11.7.

Senator MILLER. If you would furnish that for the record, I would appreciate it very much.

Mr. SCHULTZE. I will be very glad to.

(The information referred to follows:)

*1968 controllable expenditures, excluding personnel compensation*

	[In billions of dollars]	
Agriculture.....		2.5
Public Law 480.....		(1.8)
Food stamp, school lunch and special milk.....		(0.5)
Other.....		(0.2)
Corps of Engineers.....		0.4
Health, Education, and Welfare.....		3.0
Elementary and secondary education.....		(1.2)
Impacted areas.....		(0.3)
Higher education.....		(0.3)
National Institutes of Health.....		(0.5)
Other.....		(0.7)
Housing and Urban Development.....		0.8
Transportation.....		0.5
Civil supersonic aircraft development.....		(0.1)
Other.....		(0.4)

Agency for International Development.....	0.5
National Aeronautics and Space Administration.....	3.2
Research and development.....	(3.1)
Other.....	(0.1)
Veterans' Administration.....	0.6
All other (including Interior, Office of Economic Opportunity, General Services Administration, Justice, et al.).....	0.2
<b>Total.....</b>	<b>11.7</b>

Senator MILLER. Senator Percy focused our attention on another item in the same place—farm price support, CCC. Can you tell us how much of that \$1.9 billion is involved in financing the food for peace program?

Mr. SCHULTZE. None of it. We include that in the \$11.7. We only have the domestic farm price support operations, not purchases of commodities for Public Law 480. Those are in the \$11.7 billion at the bottom. We do not consider those uncontrollable.

Senator MILLER. Thank you.

You expressed some optimism to Senator Percy by saying that there is a good chance that the tight money market might improve in the near future, on the housing situation. But last year, it was very generally regarded as a very bad situation.

Mr. SCHULTZE. Yes, sir.

Senator MILLER. Last year, the budget deficit amounted to only around \$9 billion. Now, here we are faced with a budget deficit which, even with the tax increase and even with some of the budget reductions, amounts to \$18 billion. It looks to me like, if anything, the situation would get worse than last year. On what do you base your optimism by saying there is a good chance that it will improve?

Mr. SCHULTZE. Basically on the proposition, Senator, that obviously, what affects housing is not just the Federal financial situation, but the Federal financial situation in the context of what is going on in the private markets. You will recall that was true last year and the year before. But last year, plant and equipment expenditures in private business were rising in an almost unprecedented rate. Our expectations for those expenditures in the period ahead are roughly a leveling off.

So, you are quite right, you are faced on the one hand with a higher Federal deficit in the coming year, even with a tax increase, than you had in the prior year, but the deficit occurs when there is a change in a different sector of the private economy; namely, plant and equipment.

Senator MILLER. You had this problem also, that in the interim, inflation has continued on. Land prices, costs of building homes, have gone up, cost of real estate is apparently up considerably in the last year or two.

Mr. SCHULTZE. Costs are up; yes, sir.

Senator MILLER. So that is going to have a dampening effect.

Mr. SCHULTZE. It will have some, I agree.

I think the key point is that from its low point, the housing starts of 850,000 in October, housing starts have moved up to 1,350,000 at an annual rate, despite cost increases. I would agree that cost increases do place a dampening factor on it.

Senator MILLER. I hope you are right in your optimism.

Now, finally, did I understand you to make a comment—I think it was in response to a question by Congressman Moorhead—that you did not want to see a tax increase designed to curb inflation?

Mr. SCHULTZE. Oh, no. I clearly did not say that.

Senator MILLER. I did not hear exactly; that is why I am asking.

Mr. SCHULTZE. No, sir. I think it may have come from colloquy in which I said that an inflation would indeed bring in additional Government revenues, but we surely did not want additional Government revenues from that kind of source.

Senator MILLER. May I say I thoroughly agree with that?

Mr. SCHULTZE. Yes, sir.

Senator MILLER. I want to thank you, Dr. Schultze, for your very fine answers and your thoroughly honest answers on some very highly technical and tough questions.

Mr. SCHULTZE. Thank you.

Chairman PROXMIRE. That is a roll call vote. I apologize, Mr. Schultze. The hour is late, but I do have some more questions. If you would be patient, and you are a mighty patient man, I would appreciate it if I could run over and vote and come back. I will try to make it in 6 or 7 minutes.

I am very sorry, but I do want to ask these questions.

Mr. SCHULTZE. Of course, Mr. Chairman.

(Short recess.)

Chairman PROXMIRE. The committee will come to order, please.

When I was questioning you last, Dr. Schultze, we were talking about the economic case for the request for a tax increase, the fact that the tax increase will not take effect most of it, even on the President's timing, until 1968, primarily in the last quarter. There will be no effect, of course in this quarter. The economists I have talked to make a very strong case for the lag impact of any tax change. They point out that in 1964, when the tax reduction took place, there was a period of several months before consumers started to spend more. They saved most of what they got.

On the other hand, if they continue their spending with a tax increase, spending patterns will not change. There will be a lag of several months. So when you add that lag effect, the fact that you will not get the tax increase until next year you can see the tax increase will not affect the foreseeable boom.

Mr. SCHULTZE. I would agree with you on the last effect. Particularly with respect to money markets, there is a psychological effect. But presumably with business expenditures and so on, there is a lag effect.

If it is your feeling that we do have an inflation problem in the last quarter or so of this year, I would not disagree and say, as a matter of fact, the danger gets a little worse as you look further ahead, primarily looking at the inventory situation.

Chairman PROXMIRE. Now, you indicated also that you thought that there was a 30- to 40-percent erosion in tax revenues if you had the tax increase, as compared to not having it, because with the tax increase, you slow down the economy. You want to do it.

Now, we had an increase in 1964 and we had a very similar kind of rate of capacity utilization. It was 84 or 85 percent, then, is 84 or 85 percent now. At that time, the tax reduction on the basis of the claims by Garner Ackley, was more than compensated for. In other words, it was 100 percent.

Mr. SCHULTZE. Correct.

Chairman PROXMIRE. Now, I think you could make some case that you are being pretty modest and conservative when you say 30 or 40 percent, depending on the circumstances, psychological circumstances and others. You could lose all your additional revenue.

Mr. SCHULTZE. The only way you could lose all of it is if the economy went into a recession. That is the way you would lose all of it. It seems to me that just about everyone, every economist, every businessman, certainly that I have talked to, indicates that that is certainly no danger.

Chairman PROXMIRE. I am not sure. I would agree with you 100 percent that there is no danger that in this quarter or next quarter, or perhaps in the first quarter of next year, but it is hard to see beyond it, especially in view of the fact that we have had a tremendous increase in investment in plant and equipment, and such an increase that it is very likely to be on the basis of our experience in the 1950's, and on the basis of our experience for a slowdown there. In the past, it has led to business recession.

Mr. SCHULTZE. As a matter of fact, that is one of the reasons—I will not say a major reason, but certainly one of the reasons that fiscal policy must be taken into account is the fact that we do not want to get into a situation where plant and equipment spending gets so high as to be unsustainably high and throws us into a recession.

Now, I do not know exactly what will happen in plant and equipment spending without a tax increase, without a fiscal policy of some restraint. But I think it entirely possible, particularly in view of the fact that plant and equipment expenditure rising rapidly and not turning down, as is usually the case, but rather just leveling off—this is what we are facing. I think the possibility of getting into a substantial inflationary pressure, a new burst of plant expenditure and then a turndown, has to be taken into effect in our fiscal policy. I will not say it is a major factor, but it does have to be taken into account. A kind of steady growth is what we want, not a hectic advance and then a turndown.

Chairman PROXMIRE. But specifically, the elements that are likely to increase in overall price are, No. 1, an increase in food prices. We had a fortunate leveling off, even a drop in food prices over the past 7 or 8 months. That is not going to be affected by the tax increase very much. People are not going to eat less food; they are going to eat the same amount.

Then, the second area is in the area of services, much of which are considerably insulated from a tax increase, especially things like medical services and so forth. At any rate, services have been going up at a fairly steady, relentless, sharp and steep incline over the past 8, 9, or 10 years.

Mr. SCHULTZE. Since World War II.

Chairman PROXMIRE. Right. So, it would seem to me that the area where this is going to have its principal impact is in the consumer purchasing of hard and soft goods.

Now, look at that area. We find in that area a capacity on the part of the American industry to produce a great deal more without inflationary pressures being substantial; that is, 84 percent of capacity utilization, No. 1.



No. 2, you have the fact that our men are working the shortest work week now in 6 years—well, it was about the same in July as in June—40.3 hours per week.

When you put these two facts together, it seems you can stand a big increase in demand without much real inflationary pressure.

Mr. SCHULTZE. Senator, you have to remember you are dealing with an unemployment rate which is already down to 3.9 percent, even though hours are down some.

Secondly—

Chairman PROXMIRE. Well, over the last 6 or 7 months, not much increase in the work force. Last month some increase, but by and large, the work force has been fairly stable, so there is a resilience there. You can draw more people in.

Mr. SCHULTZE. No, sir; the work force over the last year has increased very substantially.

Chairman PROXMIRE. But it took place in the last part of the year.

Mr. SCHULTZE. The last 2 months.

What you had clearly was a leveling off of economic activity giving rise to lower capacity utilization; even with level activity, capacity was going up, giving rise to a lower work week. But the room that you have to move is so substantially less that you had in 1964, point No. 1.

No. 2, all you have to do is go back to last year and look at the impact if there is too rapid a rise. Now, it is true that a large part of the price increases we are now seeing are not coming from excessive demand. But the fact that you can have price increases coming from other than demand, does not mean that excessive demand will not accelerate those. That is clearly what will happen.

For example, when you look at the history of service prices, you will find that service prices have risen relentlessly since World War II, but they tend to rise somewhat faster in periods of excessive aggregate demand than they do in other periods.

You are quite right, they go up in any event, but they tend to go up a little more rapidly in times of excessive demand.

Chairman PROXMIRE. Unfortunately, that is another rollcall, so we are going to have to end the questioning, but you might respond for the record. I would appreciate it.

The lead article in the Wall Street Journal this morning indicated that many people in industry feel that a tax increase is going to be an occasion for increasing prices; it is going to be inflationary. I think there is sound understanding and analysis behind this conclusion. It is based on a notion that we are now in much more of a cost-push situation than a demand-pull situation as far as industrial production is concerned, for reasons that we have already discussed. Under these circumstances, the tax increase is much more likely to be added as a cost—corporation income tax increase—where it can be. In many oligopolistic situations in American industry, it can be and will be.

Then, I also wanted to ask you about the glaring fact, from the standpoint of this committee, that when the President delivered his economic message, he put terrific emphasis on the national income account budget and the cash budget. He pointed out that this is the way to judge the impact of a budget on the economy. Now he has forgotten it. There is almost nothing in his statement, and I have to go back to the very back of your analysis to find any reference to it. Even

then you do not tell us what the deficit is in the NIA budget, which includes the real impact of Government overall.

You and I know it is unwise to take only one part and not look at the other part of Federal spending when there are balancing factors in the trust funds that, to some extent, compensate or may compensate overall for the big deficit in the administrative budget.

Mr. SCHULTZE. Senator, I am glad you brought that up. I should have gotten around to it earlier.

Without the tax increase, the program the President proposed, the deficit in the NIA budget would range between \$15 and \$18 billion. At no time in the postwar period, a period of high employment, have there been really significant deficits in the NIA budget—at no time.

Chairman PROXMIRE. That is a lot less, \$15 to \$18 billion with a much bigger budget is a lot less than \$29 billion. I can see why he does not mention it. That is a very interesting statistic.

Mr. SCHULTZE. But it is \$10 to \$15 billion more than the deficits we were running at any high employment period in the postwar period.

Chairman PROXMIRE. But we have a much bigger economy now.

Mr. SCHULTZE. But the economy is running along at the level. Capacity and output are moving with it.

Chairman PROXMIRE. No, it is not a capacity.

Mr. SCHULTZE. On the manufacturing side, that is correct. But manufacturing, you must remember, is only about one-third of this economy.

Chairman PROXMIRE. Well, all right. But let me say the other point I wanted an explanation of is what I consider a very, very hard to appreciate revision of your estimate of personal income. You say there is a \$3.3 billion that you estimated in January which you would get from the 1968 fiscal year from personal income taxes.

Mr. SCHULTZE. Yes.

Chairman PROXMIRE. \$3.3 billion too high, that it should be reduced.

Mr. SCHULTZE. Right.

Chairman PROXMIRE. That is based on experience in fiscal 1966, when you had a falling stock market, a falling bond market, a loss in capital that was considerable, had a substantial effect in this area.

Mr. SCHULTZE. We cranked in a half billion dollars because of that.

Chairman PROXMIRE. It seems to me you could go as easily in the other direction, when you had in 1964 and 1965, you underestimated. It seems to me this could be giving us a notion of a much bigger administrative budget deficit than you have.

Mr. SCHULTZE. Do you want me to answer that now, or for the record? I do not know what your time commitment is.

Chairman PROXMIRE. For the record, please. I must leave now.

Mr. SCHULTZE. I answered this question earlier in a discussion with Senator Miller or someone else.

(See the statements of Budget Director Schultze on this point on pp. 40, 41.)

Chairman PROXMIRE. Thank you very, very much for an excellent job, as usual. I appreciate it a great deal.

The committee will stand adjourned.

(Whereupon, at 1:10 p.m., the Joint Economic Committee adjourned.)