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THE 1969 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-FIRST CONGRESS

FIRST SESSION

PART 1

JANUARY 17, 1969

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THE 1969 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, JANUARY 17, 1969

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

The Joint Economic Committee met, pursuant to notice, at 10 a.m., in room S-407, the Capitol, Hon. Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Bolling, Griffiths, Moorhead, Widnall, and Rumsfeld; and Senators Proxmire, Javits, and Percy.

Also present: John R. Stark, executive director and Douglas C. Frechtling (minority).

Chairman PATMAN. The committee will please come to order.

Today the Joint Economic Committee begins its annual review of the state of the economy and the programs designed to achieve the objectives of the Employment Act of 1946.

We have just received from the outgoing administration their budget proposals for the coming fiscal year and their Economic Report. It is important that we take this opportunity to hear from them in regard to these and related matters.

In greeting you gentlemen this morning—the top three officials of the Government so far as public economic policy is concerned—I want to take the opportunity to commend you for your record in office. We have been fortunate to have men of your outstanding abilities and character in the key economic posts of the Government and I want you to know that we are most appreciative of your assistance on numerous occasions.

There is a great deal of material to cover and we are well aware that this is just about the last day we will have the opportunity to review it with you as representatives of the administration. For that reason it seems appropriate for the three of you to appear together so that we can more easily discuss question with you. After you have made your statements we will have questions from the members of the committee.

The Senator from New York, Mr. Javits, the Joint Economic Committee's ranking minority member, would like to make a statement.

Senator Javits, you may proceed.

STATEMENT OF HON. JACOB K. JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK, AND THE RANKING MINORITY MEMBER OF THE JOINT ECONOMIC COMMITTEE

Senator Javits. First, gentlemen—first, Mr. Chairman, may I thank the Chair for its indulgence in allowing me to make a brief statement.

Second, may I say to these three top officers of our Government that you represent in your own person here this morning the very embodiment of what gives our country such great stability, as you are in the economic field the expression of the smoothness of transition from the present to a new administration.

Our chairman has worked out the hearing question so that within a period of 30 days, roughly, the country will have the benefit of your views and your experience as well as the initial bow of the new administration through what it says about your Economic Report. Thus, the American people will have the best of both worlds in the whole fiscal field.

I think this is a tremendous tribute to you and to our Government and to what makes it go—which are people like yourself. I would like to express as an American and as a Senator my appreciation for that.

I have a few remarks on the Economic Report and the budget message. The outgoing Democratic administration in both these messages, recounts our economy's enviable record of achievement over the last 5 years. It is true that we are participating in the longest economic expansion in our Nation's history, that our growth in economic potential and production has been enormous and that overall unemployment has been pushed to record low levels. Although some may argue that the Vietnam war has helped fuel our prosperity and inflate our employment total, none will dispute the fact that we now have the means to insure balanced economic growth and prosperity, if only we will use them properly.

But we must not allow ourselves to become lulled into any idea that we are to have permanent prosperity by the euphoric enumeration of the economic milestones we have passed during the last several years, for there are grave dangers facing us now. I would like to refer briefly to them.

Overstimulated economic growth has produced a price inflation foreign to us for so many years. Over the 12 months of 1968, consumers have watched prices rise at a rate greater than 4½ percent—more than any year since the Korean war. Wage increases have become commonplace yet the average worker with three dependents finds his real spendable earnings reduced to levels below 1 year ago—while his dollar earnings have increased almost $4 a week, his real spendable earnings have declined 36 cents.

An overall unemployment rate at its post-Korean war low masks the fact that not all are participating equally in our high employment economy. Nonwhite workers and teenagers have consistently faced unemployment rates substantially higher than the total and the spiraling welfare rolls—and we can certainly testify to that in New York City—testify that economic growth has not reached the poor. Further, many of those who are employed receive an income less than adequate to take care of their families' needs, especially even their elementary education and health needs.

A grave problem that we must confront squarely is our country's balance-of-payments position. While it is true that we have achieved in 1968 an apparent balance for the first time in many years, this was achieved only by leaning on the crutch of capital controls and window dressing such as special official foreign purchases of U.S. Government securities. We cannot let this obscure the fact that our trade balance, for many years the source of strength in our international accounts, has deteriorated alarmingly. The longer we continue to prop up our balance-of-payments accounts with accounting gimmicks to provide an arithmetic balance, the more damaging will become the underlying weaknesses and the more difficult will be true improvement in our position.

While great strides have been made in improving the operation of the international monetary system, the three crises of 1968 are proof that we have a long way to go.

On the domestic front, it seems to me that we are fast approaching the end of an era. Solutions that may have been relevant to an earlier day are inappropriate to an incredibly changing world. Our neglected cities, deteriorating welfare system, the mounting financial problems of our State and local governments and obviously ineffective agricultural price policies are living testimonials to this. We have discovered that passing landmark economic and social legislation could be the relatively easier part of improving the quality of American life. Making the programs work—and avoiding harmful side effects that could nullify the benefits—is infinitely more difficult and calls for a strength of will and devotion to achieving success—and willingness to sacrifice, as in paying necessary taxes, we have not seen yet. New approaches are needed placing heavier reliance on the private sector, on States, and on local governments to utilize far more effectively the allocated Federal resources.

The 1970 budget is still woefully out of tune with the country's needs, and one of the greatest challenges of the new administration and the 91st Congress will be a reordering of our national priorities and enactment of legislation and appropriations based on agreed priorities. While proposed defense expenditures continue to rise, funds allocated for the crisis of the cities remain grossly inadequate. The fiscal year 1970 budget suggests that more than twice as much will be spent on farm price supports than on community development and housing; that more than twice as much will be spent on interstate highways than on urban mass transit, and that we are to spend no more in the coming year on water pollution than in the previous 2 years. The loan guarantee program to encourage the construction of academic facilities for higher education is proposed to be used as a replacement for, rather than as a supplement to, Federal grants and loans. While the President advocates higher education for all, the budget cuts back on National Defense Education Act loans for low income students. And I could go on and on.

The great failure of economic policy in the 1960's was the delayed implementation of a substantial measure of fiscal restraint—the failure to increase Federal income taxes in time to head off serious price inflation. The President's Economic Report blames the Congress for a tardy response to the administration's request for tax action, but I respectfully submit that no real administration muscle was used in the drive for it.

I would also remind the administration that long before it began to support a tax surcharge, the minority members of this committee warned that fiscal restraint was essential to maintain and moderate economic expansion. While the administration manipulated the time stream of Government revenues, pressured labor and business to comply with wage-price guidelines and secured the suspension of the 7 percent tax credit—a device to stimulate the expansion and growth of our productive capacity—we continued to point out that these makeshift measures merely postponed the day of judgment.

Further, had the administration vigorously campaigned for the tax surcharge it proposed and willingly considered the reservations we in Congress expressed, we could have avoided the terrible legacy of accelerated inflation left for the new administration.

But what remains unfinished by the old administration is a challenge to the new. Where the President's Economic Report looks longingly at past achievements—and that is their warranty—we must be concerned with the future. Where the old administration recites the successes of economic policy, we must examine and rectify its failures. For it is not in past achievement that the future can be secured, but only by what we do here and now and in the coming months and years.

Thank you so much, Mr. Chairman.

Chairman PATMAN. Mr. Barr, you are recognized. You may proceed, sir. Joseph W. Barr, Secretary of the Treasury. We are glad to have you.

STATEMENT OF HON. JOSEPH W. BARR, SECRETARY OF THE TREASURY

Secretary BARR. Thank you, Mr. Chairman.

With your indulgence, Mr. Chairman, I would like to say just a few personal words, sir.

Mr. Chairman, you have served in this Congress for many, many years and you have done many great things, but I cannot think that anything you have done in your career is as crucially important as your work with the late Senator Taft in establishing this committee and in establishing the Council of Economic Advisers to serve the President of the United States.

I have been an insider and outsider, Mr. Chairman, as you know. I have been on both ends of Pennsylvania Avenue. This is a prestigious committee that attracts some of the best minds in the Congress. The Council of Economic Advisers, almost since its inception, has attracted some of the best minds in this country. Mr. Burns, Mr. Saulnier, Mr. Heller, Mr. Ackley, and now my distinguished colleague, Mr. Okun. These men may disagree but their degree of professionalism, Mr. Chairman, is superb.

I will submit, sir, that in your long career there is nothing that you have done for this country that has had a more lasting benefit.

Now, Mr. Chairman, on a slightly more personal note, you may be dismayed to read in the papers this morning that I am going to leave the Treasury and move across the street and become a banker. [Laughter.]

Mr. Chairman, in my own defense—I served with you, sir, and I think you will admit the record shows that I am not a very good politician. I was promptly defeated after my first term in office and I go to banking secure in the knowledge, Mr. Chairman, that you are going to keep me honest. [Laughter.]

Senator JAVITS. Mr. Chairman, may I on behalf of the minority, welcome the chairman to his present post and join with Secretary Barr in the satisfaction we all derive from this great committee and what it is able to accomplish guiding our people and our Government, and express my personal thanks, and I know every member of the minority feels the same way, to Representative Patman for his unfailing courtesy.

Chairman PATMAN. Thank you, Senator.

Senator JAVITS. And also while I have got the floor, briefly I want to again thank our own colleague, Senator Proxmire, for his very gifted incumbency and the tact and kindness with which he conducted the chair during the past 2 years.

Senator PROXMIRE. Thank you very much.

Secretary BARR. Mr. Chairman, may I warn you that if this sounds a bit more like a stump speech than a statement by the Secretary of the Treasury, that is precisely what it is intended to be.

With that warning, let me plunge in.

First of all, Mr. Chairman, what I will say now is not in my formal statement. After I was defeated in the Congress and I joined the Treasury with Secretary Dillon under President Kennedy, there was one fire that really burned in my belly and that was to do something about the economic slack that prevaded this country. I thought we could do more in order to use our productive capacity, our labor, and our savings more efficiently.

Mr. Chairman, that agenda item is finished. We are doing all we can and probably more. Mr. Zwick and Mr. Okun later will inform you that we are perhaps trying to do too much today. So the agenda item on which I came in is behind us.

The new agenda item, the one in which I ask your support for the new Secretary-designate, is to help cool off this economy, to bring our prices back into a more adequate relationship without throwing the country into a tailspin.

Now, gentlemen and Mrs. Griffiths, this is a tricky business, and I do not want to sound too nonpartisan here today, but it is going to take the best judgment of all of you and the new administration to accomplish this extremely difficult task.

Now, what are the agenda items that I, after a decade of public service, would like to call to your attention—the unfinished items that I would like to call to your attention.

First of all, Mr. Chairman, I think the greatest unfinished agenda item is that we have not been able to do more on tax reform. Mr. Chairman and members of the Joint Economic Committee, I will hazard a guess that there is going to be a taxpayer revolt over the income taxes in this country unless we move in this area.

Now, the revolt is not going to come from the poor. They do not pay very much in taxes. The revolt is going to come from the middle class. It is going to come from those people with incomes from $7,000 to $20,000 who pay every nickel of taxes at the going rate. They do not have the loopholes and the gimmicks to resort to, Mr. Chairman.

However, when these people see, as I see, that in the year 1967, there were 155 tax returns in this country with incomes of over $200,000 a year and 21 returns with incomes of over a million dollars for the year on which the "taxpayers" paid the U.S. Government not 1 cent of income taxes, I think those people are going to say it is time to do something about it and I concur.

Now, we have tried for 8 years to reform the tax system and we have made some dent in the problem. May I encourage this committee to keep up the impetus that it has always had in this area of tax reform.

We have a good tax system. Economically it works as a countercyclical force. It is working that way right now. When the economy starts running stronger than it should, the tax system soaks up excess demand and tends to cool off the economy. It is a magnificent system that is producing in the income tax area alone $132 billion in this fiscal year.

Mr. Chairman, and members of the committee, this is a voluntary system. It will not work unless people support it. Mr. Chairman, I do not believe the problem is the level of taxation. I believe rather it is the equity of taxation. People want to feel they are not paying more than their share and that everyone should pay a fair share. This does not happen when you are running a corporation and you look at the international oil companies and see they pay little or no taxes. They pay huge taxes including royalties to other governments but not to this Government, Mr. Chairman.

You look around and you see many people with huge advantages. Now, these are difficult to terminate. These special tax provisions are controversial subjects, Mr. Chairman, but I submit that if we are going to mantain this magnificent tax system with its advantages for revenues, and provide the revenues that Senator Javits mentions that he wants to use in the cities and the rest of you want to use for various purposes, it must be a fair system.

Senator JAVITS. Mr. Chairman, I have one question that is so pertinent that I beg leave of the Chair to ask it.

Chairman PATMAN. You may proceed, Senator.

Senator JAVITS. It is a fact that the surcharge bill included a requirement for the President to submit a report on tax reform by December 31, 1968.

Secretary BARR. Right, sir.

Senator JAVITS. It is also a fact that on December 31, the President announced with the concurrence of Chairmen Mills and Long, that he will not submit such a report although the Treasury's recommendations would be available to Congress in confidence on request. I was talked to in advance of the date, and asked whether I would consent to its being submitted as a confidential document. I did not feel I was able to do that but I did not wish to embarrass the outgoing President and make him take responsibility for tax reform proposals which he could not carry on. I understood his desire, though I could not accord with it, and I have asked that at least the staff report be made public.

Now, is it a fact—and please do not answer, Mr. Secretary, unless you feel able to——

Secretary BARR. I am prepared to answer that. I knew you were going to ask it and I have the answer.

Senator JAVITS. I do not want to embarass you but can you tell us if the report has been requested by members of the proper committees of the Congress which I understand is the President's willingness? Will then, the report be made available generally?

Secretary BARR. Senator, in the past week I have had about as much pressure from the Congress for this data as I have ever had in my life, including a request from the vice chairman of this committee. The pressure was so great that I called the chairman of the Ways and Means Committee, who is now chairman of the Joint Committee on Internal Revenue Taxation, and said that I did not like to leave public office turning down requests from Members of Congress for data that should be available to them.

He convened a meeting of the Joint Committee on Internal Revenue Taxation. Secretary-designate Kennedy accompanied me to this meeting and it was agreed at this meeting that when the Ways and Means Committee is organized next week, Ways and Means will transmit a request to Secretary-designate Kennedy for the information. They will then publish it as a committee print. Secretary-designate Kennedy and I both agreed to this proposal.

Senator JAVITS. Thank you very much, Mr. Secretary. This is most reassuring.

Chairman PATMAN. Very well then—after the three of you finish your statements we will then ask you questions.

Secretary BARR. Now, may I move ahead, Mr. Chairman, to another subject. Over the past 8 years I have had a growing concern that in the area of trade, the United States is disadvantaged in exports because of our tax system compared with the tax systems of other nations. I have been concerned because I felt that an export, let us say a Caterpillar tractor, leaves the United States carrying all the burden of our tax load when it moves into export trade, while the same item of equipment as it leaves Germany or France is exempted from a large share of the tax load that is imposed in those nations. U.S. products such as automobile, cigarettes and alcoholic beverages, on which the Federal Government levies excise taxes, are exempt from the excises if exported.

Now, I can only confess that the academicians have not agreed with me in many instances but I do believe that the events of last November—when Germany reduced its border tax adjustments and France increased its border tax adjustments for the purpose of reducing trade imbalances would tend to lend credence to what I have thought, and

I may add that Secretary Dillon and Secretary Fowler have shared the opinion that we had to do something in this area.

Now, may I suggest, sir, that I do not believe you need to go to a value added tax or some other form of a national sales tax to achieve this objective. I do not think you need to do that. I do think this committee should consider carefully in conjunction with other committees whether or not this Nation should impose border tax adjustments whereby, as our exports leave, there will be a payment to the exporter and as imports come in, there will be a tax. This would tend to equalize our tax system with the systems of other nations relative to exports and imports.

Now, let me warn you, I do believe such border taxes must be under strict international control or you will end up with a protectionist device. On the other hand, may I say to the committee as bluntly as I can, that I think we are at a disadvantage in exports because of the way the present international rules apply to different tax systems and this should be corrected, sir.

Thirdly, we now have nearly completed the special drawing rights facility which your committee, the committee on which you and Mr. Widnall sit, the Banking and Currency Committee considered and the House and Senate approved last year. Not enough countries have ratified the agreement yet to bring this facility into force. May I urge you, sir, and this committee, to keep up an unrelenting pressure on the powers that be, to try to get this special drawing rights facility ratified so the world has an opportunity to create the reserves that it needs to keep international trade and finance and exports moving.

I think it is crucially important and I would hope that it would come into being soon.

Mr. Chairman, I also want to call to your attention the fact that the Congress has still not acted on the request for funds for the International Development Association. I have watched this arrangement since I was a member of Congress. I helped prepare the legislation that first created IDA. I have watched it for 8 years.

I think, Mr. Chairman, this is the way the American people want to move in assistance to developing nations. They want to share the burden with other industrial nations. I would urge the Congress to move as promptly as possible in this crucial area.

And lastly, Mr. Chairman, I want to submit for the analysis of this committee, and especially its staff, a study of tax expenditures which the Treasury has completed, presented in chart form, and called "Comparison of Budget Outlays and Tax Expenditures by Function," together with a supplementary statement entitled "Tax Expenditures: Government Expenditures Made Through the Income Tax System."

Now, I have not had an opportunity to go into this deeply, but the Treasury staff in this report, concludes that through the tax system, not by appropriations, but through special provisions in the tax system, similar in effect to appropriations, we are now making available huge sums of money to various functional sectors of the budget. You have the chart here in front of you. If you want to pick it up I will leaf through it very quickly.

Now, this is done on a functional basis the way the budget is established. You will see that for national defense chart 1, there is a little benefit under the tax code. You would ask where does that come from? Well, it comes from the fact that certain housing and other allowances for military personnel are nontaxable.

International affairs and finance, chart 2—you will find an explanation on the cover side as I flip through these charts—you will find that the Congress is appropriating $3.7 billion, and there is about a half billion dollars, running through the tax code.

Now, part of that arises from the fact that you can live overseas and the first $20,000 or $25,000 of your income is exempt from taxation. The other is various forms of corporate exemptions built into the code.

Agriculture and Agricultural Resources, which is chart 3. You will find that there are special provisions in the tax code that provide about a billion dollars in tax expenditures versus $5.2 billion in budgetary expenditures.

You will find under Natural Resources—chart 4—that the U.S. Government appropriates about $1.9 billion a year in the most recent years. The total that ran through the tax expenditure side was $1.7 billion.

In Commerce and Transportation—chart 5—you will find that the budget outlays which you voted are $9 billion. The tax expenditure item is $9.7 billion.

Community Development and Housing is chart 6. The budget outlays total about $2.8 billion a year, the tax expenditure item total $5.2 billion.

Health and Welfare, chart 7. Budget outlays are about $55 billion a year; tax expenditures are roughly $19.5 billion.

For education and Manpower, chart 8, the budget outlays are $7.9 billion, tax expenditures are $900 million.

Veterans Benefits and Services—chart 9.—Budget outlays are about $7.8 billion, tax expenditures are $700 million.

The study adds two other headings to cover tax expenditures which do not fit under functional headings in the Federal Budget:

Aid to State and Local Government. Financing involves tax expenditures of $4.6 billion.

Capital Gains—Individual Income Tax have a tax expenditure cost in the range of $5.5 to $8.5 billion.

Mr. Chairman, let me alert the committee to the fact that this is a highly controversial study. It is based on carefully drawn assumptions by the Treasury staff. I submit this not as the last word, but a carefully done staff study to provide additional information which I think this committee should have available to it. You can examine and discuss it as you see fit.

Chairman PATMAN. Without objection, they will be placed in the record at this point.

(The documents referred to follow:)

1. Comparison of Budget Outlays and Tax Expenditures by Function.
2. Supplementary Statement—Tax Expenditures—Government Expenditures Made Through the Income Tax System.

Comparison of Budget Outlays and Tax Expenditures by Function

Fiscal Year 1970

Table 1. National Defense

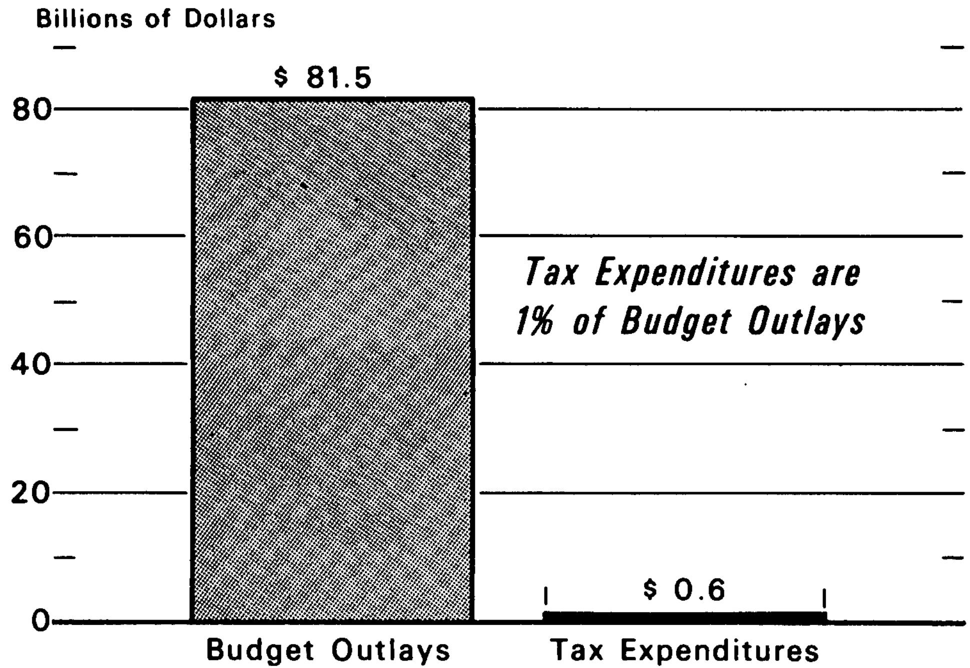
Tax expenditures (in millions of dollars)	1968
Exclusion of military benefits and allowances	500

Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	80.5	81.0	81.5
Net lending	-*	-*	-*
Total	80.5	81.0	81.5
Tax expenditures	0.5	0.6	0.6
Total budget outlays plus tax expenditures	81.0	81.6	82.1
Tax expenditures as percent of budget outlays	1%	1%	1%

*Less than $50 million.

National Defense, Fiscal 1970



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 1

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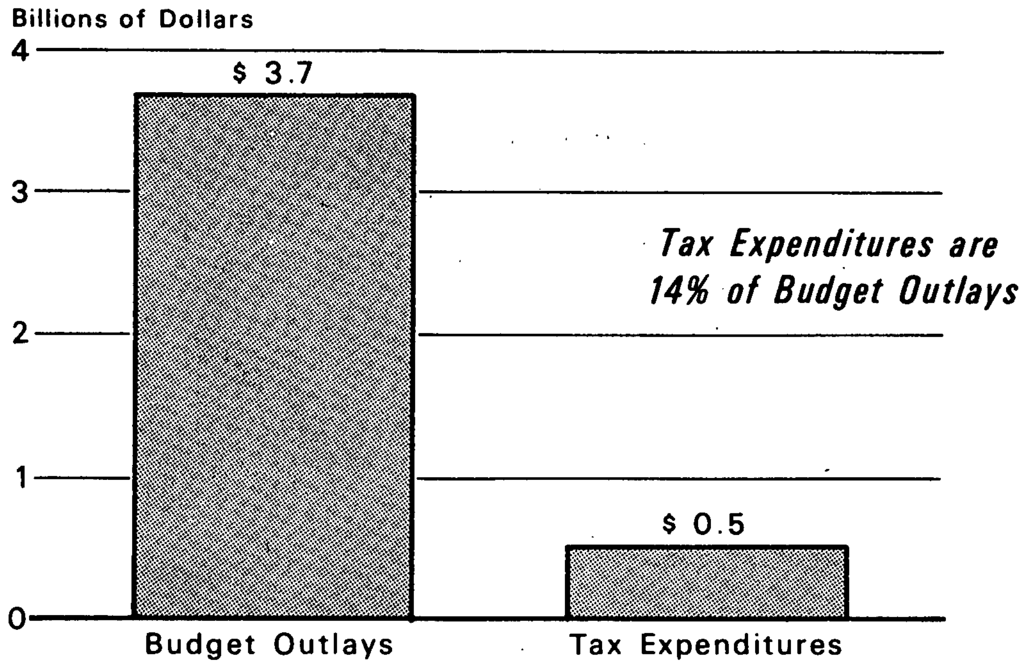
Table 2. International Affairs and Finance

Tax expenditures (in millions of dollars)	1968
Individual taxation:	
Exemption for certain income earned abroad by U. S. citizens	40
Exclusion of income earned in U. S. possessions	10
Corporate taxation:	
Western Hemisphere trade corporations	50
Exclusion of gross-up on dividends of less developed country corporations	50
Exclusion of controlled foreign subsidiaries	150
Exclusion of income earned in U. S. possessions	70
Total tax expenditures	370

Budget outlays plus tax expenditures (in billions of dollars)

Budget outlays:	1968	1969	1970
Expenditures	3.7	3.6	3.5
Net lending	0.9	0.3	0.2
Total	4.6	3.9	3.7
Tax expenditures	0.4	0.4	0.5
Total budget outlays plus tax expenditures	5.0	4.3	4.2
Tax expenditures as percent of budget outlays	9%	10%	14%

International Affairs and Finance, Fiscal 1970



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

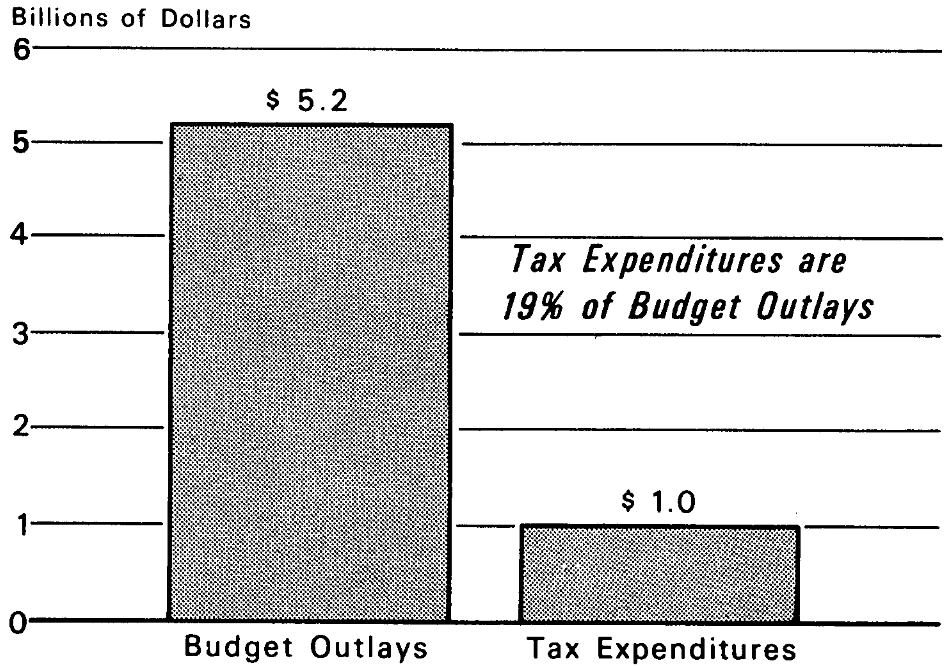
Chart 2

Table 3. Agriculture and Agricultural Resources

Tax expenditures (in millions of dollars)	1968
Farming: Expensing and capital gains treatment	800
Timber: Capital gains treatment for certain income	130
Total tax expenditures	930

Budget outlays plus tax expenditures (in billions of dollars)	1968	1969	1970
Budget outlays:			
Expenditures	4.8	5.3	5.1
Net lending	1.1	0.1	0.1
Total	5.9	5.4	5.2
Tax expenditures	0.9	1.0	1.0
Total budget outlays plus tax expenditures	6.8	6.4	6.2
Tax expenditures as percent of budget outlays	15%	19%	19%

Agriculture and Agricultural Resources, Fiscal 1970



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT,1970 AND
THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 3

Table 4. Natural Resources

Tax expenditures (in millions of dollars)	1968
Expensing of exploration and development costs	300 1/
Excess of percentage over cost depletion	1,300 1/
Capital gains treatment of royalties on coal and iron ore	5
Total	1,605

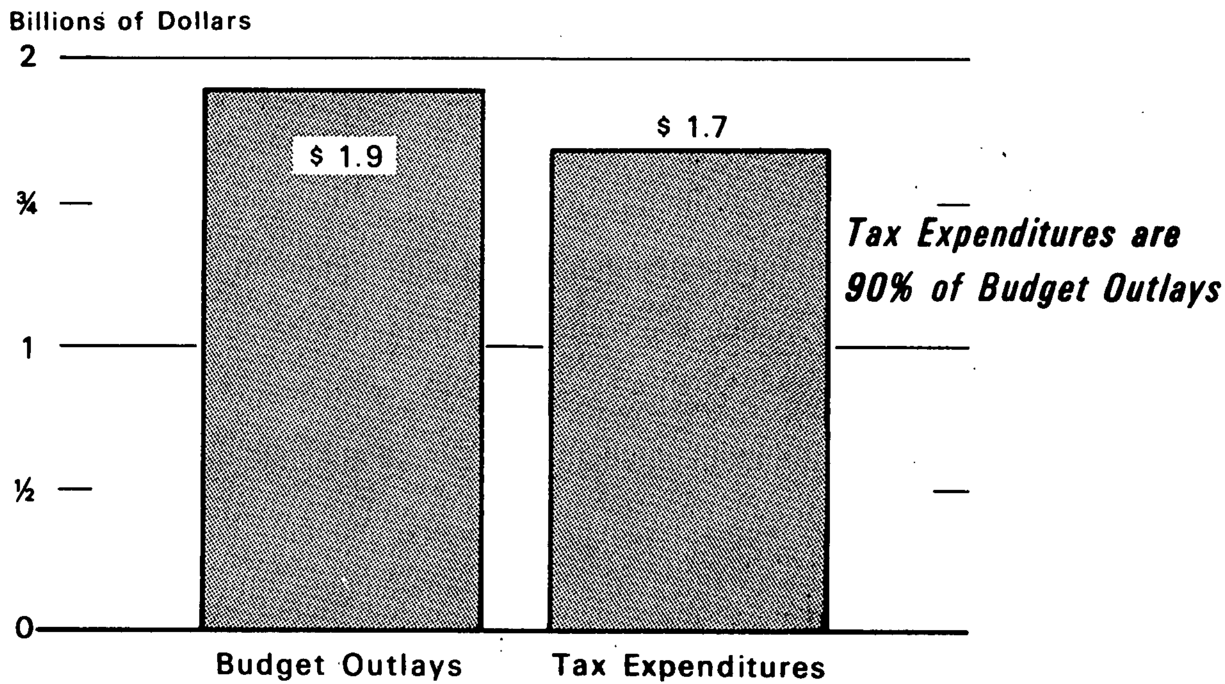
Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	1.7	1.9	1.9
Net lending	*	*	*
Total	1.7	1.9	1.9
Tax expenditures	1.6	1.7	1.7
Total budget outlays plus tax expenditures	3.3	3.6	3.6
Tax expenditures as percent of budget outlays	94%	90%	90%

1/ In the absence of the expensing of exploration and development costs and percentage depletion, the first year revenue effect would be $750 million and $1.5 billion, respectively. The difference from the estimates shown which are based on long-run effect is due to the fact that taxpayers with mineral properties would initially have little or no tax basis because of deductions in prior years.

*Less than $50 million.

Natural Resources



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 4

Table 5. Commerce and Transportation

Tax expenditures (in millions of dollars)	1968
Investment credit	2,300
Excess depreciation on buildings	500
Dividend exclusion	225
Capital gains: Corporations (other than Agricultural and Natural Resources)	500
Excess bad debt reserves of financial institutions	600
Exemption of credit unions	40
Deductibility of interest on consumer credit	1,300
Expensing of research and development expenditures	500
$25,000 surtax exemption	1,800
Deferral of tax on shipping companies	10
Total	7,775 1/

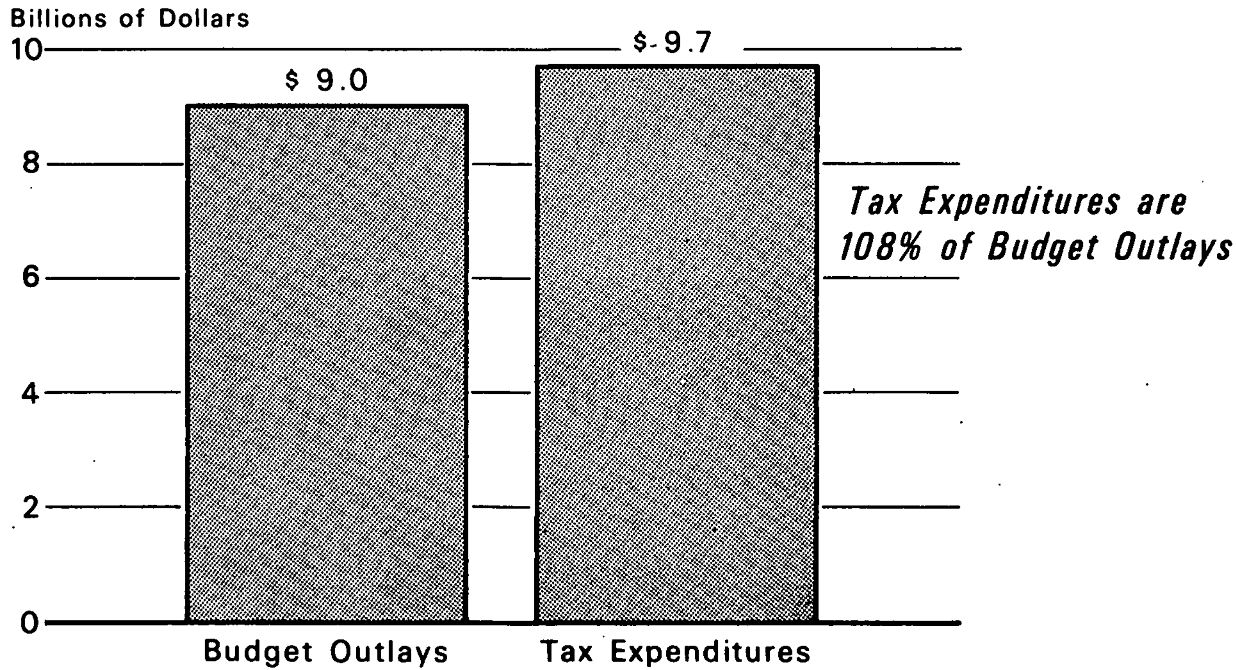
Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	7.8	8.1	8.9
Net lending	0.2	*	0.1
Total	8.0	8.1	9.0
Tax expenditures	7.8	9.2	9.7
Total budget outlays plus tax expenditures	15.8	17.3	18.7
Tax expenditures as percent of budget outlays	98%	114%	108%

1/ The revenue cost for 1968 under this category differs from that in Exhibit 29 of the Secretary's Annual Report due to the exclusion of capital gains - individual and its presentation as a separate item in this revised analysis.

*Less than $50 million.

Commerce and Transportation



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND
THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 5

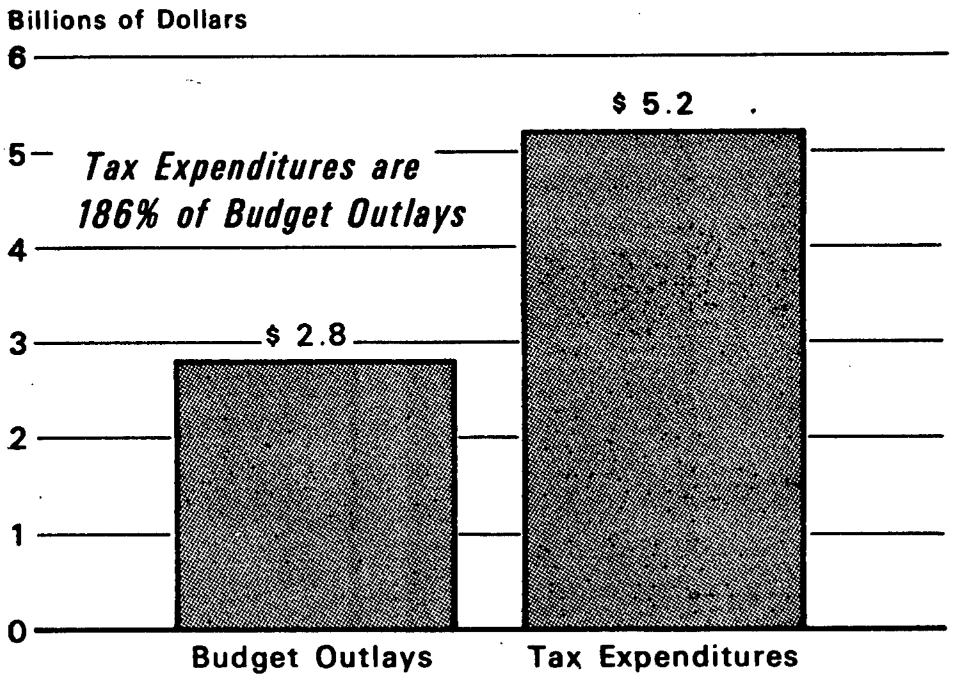
Table 6. Community Development and Housing

Tax expenditures (in millions of dollars)	1968
Owner-occupied homes, deductibility of:	
Interest on mortgages	1,900
Property taxes	1,800
Rental housing - excess depreciation	250
Total	3,950

Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	1.0	1.3	2.6
Net lending	3.1	1.0	0.2
Total	4.1	2.3	2.8
Tax expenditures	4.0	4.7	5.2
Total budget outlays plus tax expenditures	8.1	7.0	8.0
Tax expenditures as percent of budget outlays	98%	204%	186%

Community Development and Housing, Fiscal 1970



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 6

Table 7. Health and Welfare

Tax expenditures (in millions of dollars)	1968
Aged, blind, and disabled:	
Additional exemption, retirement income credit and exclusion of OASDHI for aged	2,300
Additional exemption for blind	10
Exclusion for "sick pay"	85
Exclusion of unemployment insurance benefits	300
Exclusion of workmen's compensation benefits	150
Exclusion of public assistance benefits	50
Exclusion for employee pensions	3,000
Deduction for self-employed retirement	60
Exclusion of other employee benefits:	
Premiums on group term life insurance	400
Accident and death benefits	25
Medical insurance premiums and medical care	1,100
Privately financed supplementary unemployment benefits	25
Meals and lodging	150
Exclusion of interest on life insurance savings	900
Deductibility by individuals of charitable contributions (other than education) including untaxed appreciation	2,200
Deductibility of medical expenses	1,500
Deductibility of child and dependent care expenses	25
Deductibility of casualty losses	70
Standard deduction	3,200 1/
Total	15,550

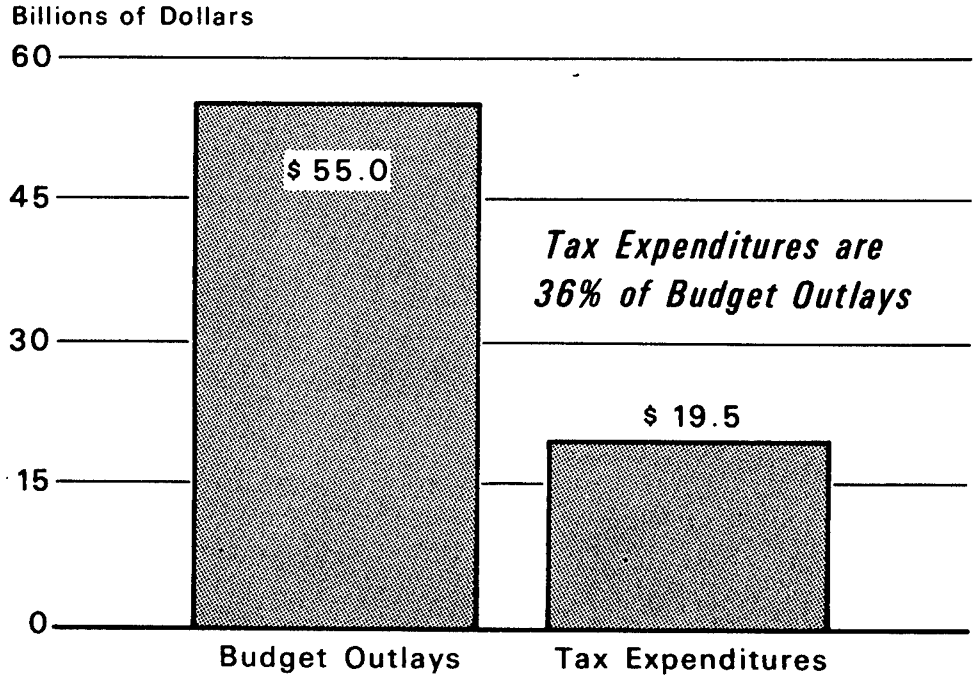
Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	43.4	49.5	55.0
Net lending	0.1	-0.6	*
Total	43.5	48.9	55.0
Tax expenditures	15.6	18.0	19.5
Total budget outlays plus tax expenditures	59.1	66.9	74.5
Tax expenditures as percent of budget outlays	36%	37%	36%

1/ In the absence of the 10 percent standard deduction and most itemized non-business deductions, the minimum standard deduction as presently structured would be taken by all taxpayers and its revenue cost would be relatively large. Under present treatment, the minimum standard deduction, in keeping with its objectives, is claimed almost entirely by low-income taxpayers and its revenue cost is $300 million. The revenue estimate assumes the minimum standard deduction is designed to assist only low-income taxpayers. The minimum standard deduction is regarded in this analysis as related to the system of personal exemptions and thus a part of the structure of an income tax system based on ability to pay, rather than as a tax expenditure.

*Less than $50 million.

Health and Welfare, Fiscal 1970



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 7

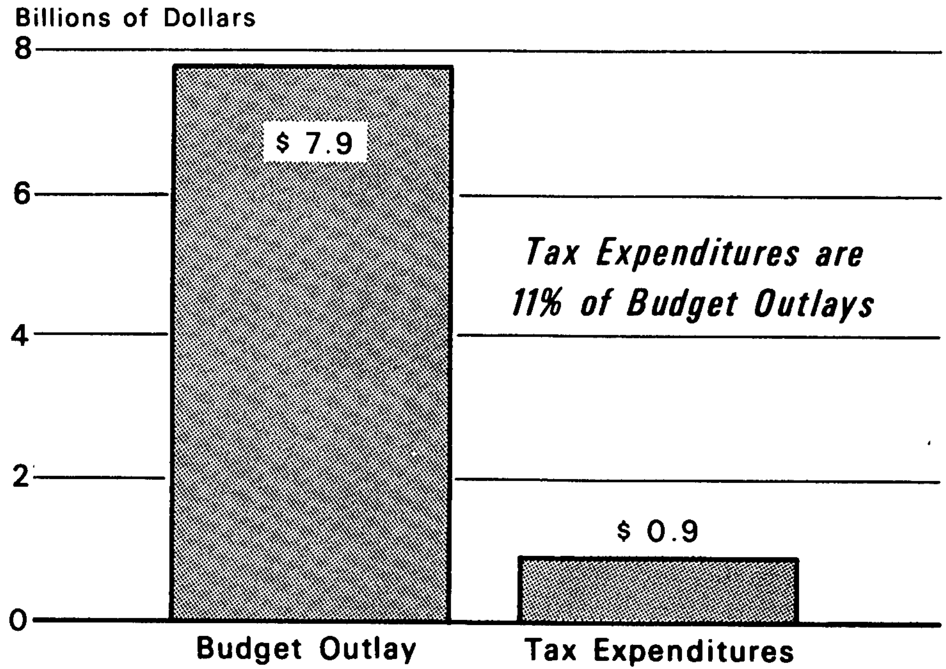
Table 8. Education and Manpower

Tax expenditures (in millions of dollars)	1968
Additional personal exemption for students	500
Deductibility of contributions by individuals to educational institutions	170
Exclusion of scholarships and fellowships	50
Total	720

Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	6.6	6.9	7.6
Net lending	0.4	0.3	0.3
Total	7.0	7.2	7.9
Tax expenditures	0.7	0.8	0.9
Total budget outlays plus tax expenditures	7.7	8.0	8.8
Tax expenditures as percent of budget outlays	10%	11%	11%

Education and Manpower



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 8

Table 9. Veterans Benefits and Services

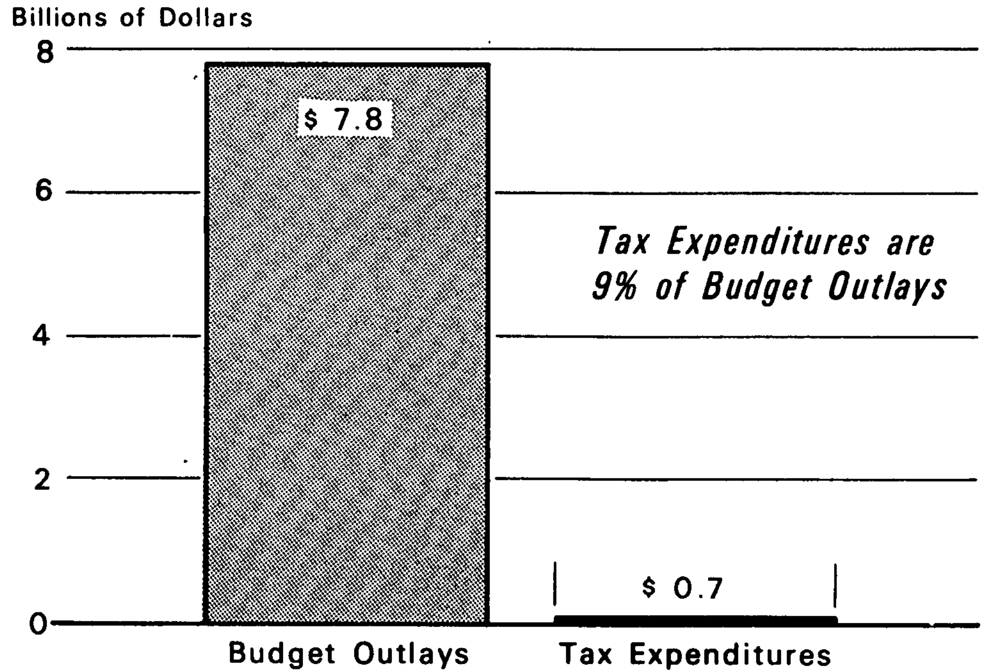
Tax expenditures (in millions of dollars)	1968
Exclusion of certain benefits	550

Budget outlays plus tax expenditures (in billions of dollars)

	1968	1969	1970
Budget outlays:			
Expenditures	6.7	7.4	7.8
Net lending	0.1	0.3	*
Total	6.8	7.7	7.8
Tax expenditures	0.6	0.6	0.7
Total budget outlays plus tax expenditures	7.4	8.3	8.5
Tax expenditures as percent of budget outlays	9%	8%	9%

*Less than $50 million.

Veterans Benefits and Services



SOURCE: DATA FROM THE BUDGET OF THE U.S. GOVERNMENT, 1970 AND THE DEPARTMENT OF THE TREASURY ESTIMATES.

Chart 9

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Table 10. Aid to State and Local Government Financing

Tax expenditures (in millions of dollars)	1968
Exemption of interest on State and local debt obligations	1,800
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes): 1/	
Individual income tax	1,350
General sales taxes	775
Gasoline taxes	400
Personal property taxes	150
Other taxes	125
Total	2,800
Property taxes on owner-occupied homes (included under Community Development and Housing)	1,800
Total - All State and local nonbusiness taxes	4,600

1/ For businesses owned by individuals, taxes other than income taxes are considered a cost of doing business and thus deductible in arriving at a net income figure.

AID TO STATE AND LOCAL GOVERNMENT FINANCING

The Federal Government aids State and local government financing through certain tax provisions. These take two forms: (1) the itemized deductions for nonbusiness State and local taxes; (2) the exemption from Federal income tax of interest on State and local government obligations. The revenue costs to the Federal Government of these special tax provisions are shown in Table 10. There is no single functional category in the present Federal budget for aid to State and local government financing, and thus there is no chart for this item.

CAPITAL GAINS - INDIVIDUAL INCOME TAX

The tax expenditures involved in the present treatment of capital gains of individuals are placed in the range of $5.5 to $8.5 billion. This revenue cost includes the exclusion from income tax of appreciation on assets transferred at death, the exclusion of half the gains from the sale of capital assets held more than six months, and the maximum rate of 25 percent. No table or chart is shown for this heading, because these tax expenditures would fall under a variety of functions in the Federal budget, including commerce and transportation, agriculture and agricultural resources, community development and housing, and health and welfare. Available data, however, do not provide a basis for accurate distribution among these functions. Thus, to avoid having to choose any single predominant category but to identify the importance of this special provision, a new heading outside any budget classification is included for this item.

Separation of this item from the budget classifications leads to an understatement of the amounts of tax expenditures for the functional categories affected.

SUPPLEMENTARY STATEMENT OF JOSEPH W. BARR

Tax Expenditures: Government Expenditures Made Through the Income Tax System

The Annual Report of the Secretary of the Treasury for fiscal year 1968 includes an exhibit which presents Government expenditures for 1968 made through the income tax system (Exhibit 29). The availability of the budget for fiscal year 1970 enables us to present an updating of tax expenditures to cover the fiscal years 1968, 1969, and 1970 on a basis consistent with the 1970 budget data and classifications. The following statement is a condensed and revised version of the exhibit in the Secretary's 1968 Annual Report with the updated figures.

PURPOSE OF ANALYSIS

This analysis extends the budget to include Government expenditures made through the income tax system. The present Federal income tax structure contains a large number of special deductions, credits, exclusions, exemptions, and preferential rates designed to achieve various social and economic objectives. Most of these special provisions serve ends similar in nature to those served by direct Government expenditures or loan programs, and they affect the private economy in the same way. In a specific functional area the Government may have direct expenditures, direct Federal loans, Federal insurance or guarantees of private loans, and interest subsidies which represent alternative methods of accomplishing the purpose which the special tax provision seeks to achieve or encourage. This analysis, together with the fuller presentation in the Secretary's Annual Report, will permit a better understanding of the amount and allocation of resources on both the outlay and revenue side of the 1970 budget.

A tax expenditure has the same impact on the budget surplus or deficit as a direct increase in expenditures. The tax revenues which the Government does not collect because of these special tax provisions, however, are not reported in the budget as presently constituted. The absence of line items—either on the receipts or outlays side of the budget—for these revenue losses thus results in an understatement of the role of Federal Government financial influence on the behavior of individuals and businesses and on income distribution. In many areas the magitude of tax expenditures approaches and, in some instances, approximates direct outlays having the same objective.

Tax expenditures are not disclosed in the budget and therefore are not subject to careful annual scrutiny in the budget and appropriation process. Budget outlay decisions, on the other hand, involve the departments and agencies, the Bureau of the Budget, the House and Senate program committees which are competent and experienced in their specialized fields, and the appropriation committees. Tax expenditures are not generally considered by the program departments and congressional committees concerned, and are not reviewed annually or periodically to measure the benefits they achieve against the amounts expended.

The purpose of this analysis is to present information which compares tax expenditures with direct expenditures or loan programs in various functional areas and thus to clarify and present more fully the role of the Federal Government in these areas Such a comparison should be helpful in the allocation of public resources.

A few illustrations will indicate how tax expenditures are alternatives to direct expenditures or Government lending programs. Under the functional category of health and welfare, the budget lists large direct expenditures which benefit the aged. In addition, $2.3 billion was expended in 1968 through the tax system to aid the elderly.

Direct expenditures for natural resources are itemized in the budget. To these should be added the $1.6 billion assistance the tax system provides these industries by permitting the expensing of certain capital costs, the use of percentage depletion in excess of cost depletion, and special capital gains treatment for iron ore and coal royalties.

In the field of housing the Government now provides direct subsidies to lower the interest rates on mortgages paid by buyers of certain homes. Homeownership is also subsidized through the tax deductions for interest paid on home mortgages and for property taxes on homes which now cost the Government annually about $1.9 billion and $1.8 billion, respectively.

SCOPE OF TAX EXPENDITURES

Some of the special tax provisions cause revenue to be lost to the Government forever because the current tax base or the tax rates are reduced without any offsetting increase later. Such tax expenditures correspond closely to direct expenditures.

Other special tax provisions serve to defer the time when the taxes will be paid. For a particular taxpayer, transaction, or asset, the special provision may really represent a deferral of tax. However, for stable or growing businesses with an indefinite life, for the Government, and for the entire economy, the deferral of taxes continues forever under most of these provisions; furthermore, in an expanding economy the aggregate amount of deferred taxes tends to grow year after year. Examples of special tax provisions which cause deferral of taxes include: Deduction of employer and self-employed contributions to private pension plans and exemption of investment income of such plans; accelerated depreciation deductions on buildings; net income reinvested in ship construction and renovation by certain shipping companies; expensing of capital costs in agriculture and natural resource industries; and exclusion of nonrepatriated earnings of foreign subsidiaries.

Special tax provisions, which serve to defer but not forgive tax payments, might be compared to net lending in budget terminology. These special tax provisions are generally open-ended, with the extent and duration of their use largely at the taxpayers' option. For these reasons, the tax expenditure classifications in this analysis do not separate the special provisions which reduce taxes from those which defer taxes.

This analysis does not attempt a complete listing of all the special tax provisions. Various items have been excluded for one or more of several reasons:

(*a*) Some items were excluded because there is insufficient information available on which to base a sound estimate. For example, in the case of depreciation on machinery and equipment, accelerated tax methods may provide an allowance beyond that appropriate to the measurement of net income but it is difficult to measure that difference because the true economic deterioration or obsolescence factor cannot be readily determined.

(*b*) Some items were excluded where the case for their inclusion in the income base stands on relatively technical or theoretical tax arguments. The imputed rent on owner-occupied homes, for example, involves not only a conceptual problem but difficult practical problems of measurement.

(*c*) Some items were omitted because of their relatively small quantitative importance.

Other features of our income tax system are considered not as variations from the generally accepted measure of net income or as tax preferences but as a part of the structure of an income tax system based on ability to pay. Such features include personal exemptions and the rate schedules under the individual income tax.

It must be recognized that the exclusions from the listing are to some extent arbitrary. The objective of this analysis is to provide a list of items that would be generally recognized as an intended use of the tax system to achieve results which are now, or could be, achieved through direct Government expenditures. The design of this list seems best served by constructing a minimum list rather than including highly complicated or controversial items that would becloud the utility of this analysis.

TAX EXPENDITURES BY FUNCTIONAL CATEGORY

The tax expenditures resulting from the various special tax provisions are classified under the functional categories used in the budget. In most cases, particular special tax provisions which affect more than one budget category have been classified in the one where the effect is most important. In a few cases where the amount is large and the allocation relatively clear, the tax expenditures are divided between two functions.

No significant tax expenditures are made in three budget categories, space, interest, and general government and others. Two classes of tax expenditures (aid to State and local governments and capital gains—individual) which involve large amounts have not been assigned to specific functional categories for the reasons given in those sections of the analysis.

All estimates of tax expenditures resulting from special tax provisions represent revenues lost on an annual basis. The estimates of revenue foregone are, in general, based on the assumption that such provisions never existed, or, alternatively, that such provisions have been withdrawn sufficiently long ago that we are now beyond the period needed to permit an equitable transition to a new tax situation.

The revenue cost estimated for these special provisions is not in many cases the revenue change which would result in the first full year if these provisions were withdrawn. Replacement of some or all of these provisions by direct expenditures or lending programs might change the level and composition of economic activity. The revenue cost of each special tax provision presented for 1968 would, of course, generally vary over time with growth in the economy and changes in various parts of the tax base. Also, a realistic approach to any change in these provisions would provide in many situations transition arrangements which would effect the revenue change gradually over a period of years.

Another key assumption is that economic activity for the year would not have been affected by the absence of these special provisions. This, of course, is a simplifying assumption for tax expenditures undoubtedly have significant effects on the composition and perhaps the level of economic activity. Also, in the absence of these tax benefits, there would doubtless have been changes in Government direct spending and net lending to accomplish some of the objectives of the existing provisions. No attempt has been made to speculate how the budget and the economy might differ if none of these provisions were in the law.

No account is taken here of other taxes, such as payroll taxes, estate and gift taxes, excises, or tariffs. The assumption inherent in current law, that corporations are separate entities and subject to income taxation independently from their shareholders, is adhered to in this analysis.

The tax expenditures shown here for the three fiscal years 1968, 1969, and 1970 are figured at the tax rate which affect the revenues in these years.

A brief description of each of the special tax provisions for which a tax expenditure estimate is shown accompanies the estimates.

National Defense

The supplements to salaries of military personnel by provision of quarters and meals on military bases and off-base quarters allowances for military families, and virtually all salary payments and reenlistment bonuses to military personnel serving in combat zones are excluded from tax.

TABLE 1.—NATIONAL DEFENSE

Tax expenditures, 1968

[In millions of dollars]

Exclusion of military benefits and allowances	500

Budget Outlays Plus Tax Expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	80.5	81.0	81.5
Net lending	(1)	(1)	(1)
Total	80.5	81.0	81.5
Tax expenditures	.5	.6	.6
Total budget outlays plus tax expenditures	81.0	81.6	82.1
Tax expenditures as percent of budget outlays	1	1	1

[1] Less than $50,000,000.

International Affairs and Finance

Individual taxation.—For citizens of the United States, income earned abroad up to $20,000 for each complete tax year is exempted from taxation if the taxpayer is a bona fide resident of a foreign country for an uninterrupted period that includes 1 full tax year or, if he is present there 510 days during a period of 18 consecutive months. After 3 years, foreign resident taxpayers can exclude up to $25,000 a tax year.

United States citizens receiving from sources in a U. S. possession may, under certain conditions, exclude such income from tax.

Corporate taxation.—Domestic corporations which qualify as Western Hemisphere Trade Corporations are entitled to a special deduction which reduces their tax rate by 14 percentage points.

Income of foreign branches and subsidiaries of U. S. corporations is subject to taxation abroad and in the United States. A credit is allowed against U. S. income tax for the foreign income taxes paid, up to the amount of U. S. tax liability. U. S. corporations deriving income from foreign subsidiaries may claim a credit for foreign corporate profits tax deemed paid on that income, as well as for foreign taxes imposed directly on that income. If the subsidiary is in a developed country, the parent corporation must include both creditable foreign taxes in its U. S. taxable income; if the subsidiary is in a less developed country, the corporation need not "gross-up" its income to include the creditable portion of foreign profits tax.

United States corporations are not required currently to file consolidated returns which include the unrepatriated earnings of controlled foreign subsidiaries.

Domestic corporations deriving the bulk of their income in U. S. possessions may, under certain conditions, exclude such income from tax.

TABLE 2.—INTERNATIONAL AFFAIRS AND FINANCE

Tax expenditures, 1968

[In millions of dollars]

Individual taxation:	
Exemption for certain income earned abroad by U.S. citizens	40
Exclusion of income earned in U.S. possessions	10
Corporate taxation:	
Western Hemisphere trade corporations	50
Exclusion of gross-up on dividends of less developed country corporations	50
Exclusion of controlled foreign subsidiaries	150
Exclusion of income earned in U.S. possessions	70
Total tax expenditures	370

Budget outlays plus tax expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	3.7	3.6	3.5
Net lending	.9	.3	.2
Total	4.6	3.9	3.9
Tax expenditures	.4	.4	.5
Total budget outlays plus tax expenditures	5.0	4.3	4.2
Tax expenditures as percent of budget outlays	9	10	14

Agriculture and Agricultural Resources

Farmers, including corporations, may deduct certain costs as current expenses even though these costs represent inventories on hand at the end of the year or capital improvements.

Capital gains treatment also extends to the sale of livestock, orchards, vineyards, and comparable agricultural activities.

The gain on the cutting of timber is taxed at the rates applicable to long-term capital gains, rather than at ordinary income rate.

TABLE 3.—AGRICULTURE AND AGRICULTURAL RESOURCES

Tax expenditures, 1968

[In millions of dollars]

Farming: Expensing and capital gains treatment	800
Timber: Capital gains treatment for certain income	130
Total tax expenditures	930

Budget outlays plus tax expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	4.8	5.3	5.1
Net lending	1.1	.1	.1
Total	5.9	5.4	5.2
Tax expenditures	.9	1.0	1.0
Total budget outlays plus tax expenditures	6.8	6.4	6.2
Tax expenditures as percent of budget outlays	15	19	19

Natural Resources

Certain capital costs necessary to bring a mineral deposit into production may be deducted as current expenses rather than spread over the useful life of the property. Included in this category are the intangible drilling costs of oil and gas wells and the cost of developing other mineral deposits, such as mine shafts, tunnels, and stripping.

Extractive industries may choose between two methods of recovering capital costs invested in the development of natural resources. Under one method, actual outlays to the extent not immediately expensible may be deducted as "cost depletion" over the productive life of the property, much as other businesses may take deductions for the depreciation of capital goods. Alternatively, businesses in the extractive industries may deduct a prescribed percentage of gross income (at rates ranging from 27.5 percent for oil and gas to 5 percent for certain minerals, but not more than 50 percent of net income) where such "percentage depletion" exceeds "cost depletion." Percentage depletion is not limited to the cost of the investment as is cost depletion. The basis for "cost depletion" is reduced to the extent certain costs are recovered through expensing of exploration and discovery costs and intangible drilling costs. There is no comparable reduction in "percentage depletion" to allow for costs which are allowed as expenses.

Royalties from coal or iron ore deposits are treated as capital gains.

TABLE 4.—NATURAL RESOURCES

Tax Expenditures, 1968

[In millions of dollars]

Expensing of exploration and development costs	[1] 300
Excess of percentage over cost depletion	[1] 1,300
Capital gains treatment of royalties on coal and iron ore	5
Total	1,605

Budget Outlays Plus Tax Expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	1.7	1.9	1.9
Net lending	(2)	(2)	(2)
Total	1.7	1.9	1.9
Tax expenditures	1.6	1.7	1.7
Total budget outlays plus tax expenditures	3.3	3.6	3.6
Tax expenditures as percent of budget outlays	94	90	90

[1] In the absence of the expensing of exploration and development costs and percentage depletion, the 1st year revenue effect would be $750,000,000 and $1,500,000,000 respectively. The difference from the estimates shown which are based on longrun effect is due to the fact that taxpayers with mineral properties would initially have little or no tax basis because of deductions in prior years.

[2] Less than $50,000,000.

Commerce and Transportation

Investment credit.—Most businesses may take a tax credit equal to 7 percent of the cost of investments in new machinery and equipment made during the year. This credit does not lower the basis of the property for calculating the deduction for depreciation.

Excess depreciation on buildings.—To the extent that allowable depreciation for tax purposes exceeds the rate at which assets actually depreciate, business tax liabilities are deferred. Businesses may employ a variety of depreciation schedules for tax purposes, some of which cause a much larger part of asset values to be written off in early years of the asset's useful life than do others. The revenue cost of allowing for buildings depreciation methods for tax purposes that reduce asset value more rapidly than straight-line depreciation (the method typically used in financial statements) is shown below. The part based on rental housing is listed under community development and housing. The tax depreciation allowed for machinery and equipment is closer to actual depreciation than that allowed on buildings. In addition, the code permits full recapture as ordinary income of profits resulting from excess depreciation on machinery and equipment, but recapture of only a declining and then disappearing proportion of such profits on buildings. In view of this and the difficulty of estimating the divergence, if any, between depreciation allowed for tax purposes and actual depreciation, depreciation for machinery and equipment is not included here as a tax expenditure.

Dividend exclusion.—Individual income taxpayers may exclude $100 of dividends from income subject to tax.

Capital gains—Corporation income tax.—Capital gains of corporations are subject to a tax of 25 percent while the rate applicable to other corporate income above $25,000 is 48 percent (excluding the temporary surcharge).

Bad debt reserves of banks and other financial institutions—Commercial banks, mutual savings banks, building and loan associations, and cooperative banks are permitted to set aside bad debt reserves based on stipulated fractions of deposits, of loans outstanding, or of taxable income before computation for bad debts. The amounts set aside typically greatly exceed actual loss experience and reasonable expectations as to future losses.

Credit unions.—Credit unions are exempt from Federal income tax.

Deduction of interest on consumer credit.—Interest paid on consumer credit is allowed as an itemized nonbusiness deduction for individuals.

Expensing of research and development expenditures.—Expeditures by businesses for research and development (R&D) are carried out to find new products or processes, to reduce costs, or for other purposes. In nearly all cases, benefits from such expenditures will accrue for well over 1 year. For tax purposes business may deduct all R&D expenditures in the year during which they are incurred, or they may amortize them over not less than 5 years.

Surtax exemption ($25,000).—Corporations pay income tax at the rate of 22 percent on all taxable income plus a surtax of 26 percent on taxable income in excess of $25,000 (excluding the temporary surcharge). Each corporation therefore enjoys a surtax exemption of $25,000. This exemption is intended to encourage small or new businesses.

Deferral of tax on shipping companies.—Certain companies which operate U.S. flag vessel on foreign trade routes receive an indefinite deferral of income taxes on that portion of their net income which is used for shipping purposes, primarily construction, modernization, and major repairs of ships.

TABLE 5—COMMERCE AND TRANSPORTATION

Tax Expenditures, 1968

[In millions of dollars]

Investment credit	2,300
Excess depreciation on buildings	500
Dividend exclusion	225
Capital gains: Corporations (other than agricultural and natural resources)	500
Excess bad debt reserves of financial institutions	600
Exemption of credit unions	40
Deductibility of interest on consumer credit	1,300
Expensing of research and development expenditures	500
$25,000 surtax exemption	1,800
Deferral of tax on shipping companies	10
Total	[1] 7,775

Budget Outlays Plus Tax Expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	7.8	8.1	8.9
Net lending	.2	(2)	.1
Total	8.0	8.1	9.0
Tax expenditures	7.8	9.2	9.7
Total budget outlays plus tax expenditures	15.8	17.3	18.7
Tax expenditures as percent of budget outlays	98	114	108

[1] The revenue cost for 1968 under this category differs from that in exhibit 29 of the Secretary's annual report due to the exclusion of capital gains—individual and its presentation as a separate item in this revised analysis.
[2] Less than $50,000,000.

Community Development and Housing

Owner-occupants of homes may deduct mortgage interest and property taxes (but not maintenance outlays or depreciation) as itemized nonbusiness deductions. The owners of rental housing may claim in early years depreciation in excess of straight-line depreciation. (See Table 5.)

TABLE 6.—COMMUNITY DEVELOPMENT AND HOUSING

Tax Expenditures, 1968

[In millions of dollars]

Owner-occupied homes, deductibility of:	
Interest on mortgages	1,900
Property taxes	1,800
Rental housing, excess depreciation	250
Total	3,950

Budget Outlays Plus Tax Expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	1.0	1.3	2.6
Net lending	3.1	1.0	.2
Total	4.1	2.3	2.8
Tax expenditures	4.0	4.7	5.2
Total budget outlays plus tax expenditures	8.1	7.0	8.0
Tax expenditures as percent of budget outlays	98	204	186

Health and Welfare

A large variety of direct expenditures and transfer payments contribute to health and welfare of families and individuals, both currently and in later years. A considerable number of special tax provisions serve related ends.

Provisions relating to the aged, blind, and disabled.—Individual taxpayers age 65 and over may claim two personal exemptions of $600 and a second $100 minimum standard deduction (while persons under age 65 may claim only one of each). The revenue cost of these additional items is $500 million.

Aged recipients of old age, survivors, and health benefits under the OASDHI program and of railroad retirement benefits are not required to include such benefits in computing tax liability. This revenue cost is $525 million.[1]

Individuals over age 65 may claim a tax credit of up to $228.60 (15 percent of $1,524) for a single person or $342.90 (15 percent of $2,286) for a married couple based on retirement income from all sources except social security, railroad retirement, or other tax-exempt benefits. In effect, the provision permits taxpayers with taxable retirement income a tax benefit approximately comparable to that accorded recipients of social security and similar tax-exempt benefit payments. The revenue cost is $200 million.

The combined revenue cost of these three provisions is $2.3 billion. Because of the effect of the interrelationship of the three provisions on the tax base, the combined cost exceeds the sum of the three provisions taken separately, since the absence of one provision would increase the residual significance of the others.

The blind qualify for two $600 personal exemptions and an extra $100 minimum standard deduction.

"Sick pay" exclusions.—Certain payments financed by an employer in lieu of wages during periods of employee injury or sickness are excluded from the employee's income.

Exclusion of unemployment insurance benefits.—Benefits paid by State unemployment insurance plans are financed by a tax on wages paid by the employer and deductible by him, but these benefits are excluded from the employee's income.

Exclusion of workmen's compensation benefits.—Benefits paid under workmen's compensation are excluded from employee's income. These payments are primarily intended to replace earnings lost due to a work-related injury or illness, although some small part of the total payments is compensation for physical loss, such as an eye or an arm. As in the case of unemployment insurance, the benefits are financed by the employer's contributions and are deductible by him.

Exclusion of public assistance.—Public assistance payments are excluded from taxable income.

Exclusion for employee pensions.—Employer contributions to qualified employee pension and annuity plans are deductible by the employer. Income earned by these plans on their investments is not taxable. When an employee retires and is paid a pension or annuity, only part of the amount received is taxable to the employee. He does not pay taxes on the percentage of the benefit purchased by his contributions excluding from the percentage income earned on his contributions.

The revenue cost of the exclusion of investment income earned by all private pension funds, based on the corporate tax rate is $1.9 billion. The revenue cost of deduction of the total amount contributed by employers to these qualified plans, based on the corporate tax rate, is $3.4 billion.

The revenue cost, based on the individual income tax rates applicable to employees, is $0.7 billion as respects the investment income and $1.4 billion as respects the employers' contributions.

The greater the extent to which the benefits are vested, the more relevant is the use of the individual tax rate in estimating the revenue cost. Taking this vesting into account, the revenue cost of the treatment of pension plans can be put at $3 billion.

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[1] This revenue estimate is based on treatment comparable to other pensions and regards one quarter of the benefits as approximately the cost of employee contribution.

Deduction for self-employed retirement.—Self-employed individuals are permitted a deduction from taxable income for funds they set aside currently in qualified retirement plans.

Exclusion of other employee benefits.—In addition to the benefits already enumerated, a number of other employee benefits (shown in Table 7), the cost of which is paid at least in part by the employer, are also excluded from income subject to tax. The cost to the employer is deductible, and the benefit to the employee not taxable, in all of these cases.

Exclusion of interest on life insurance savings.—Life insurance policies other than term policies, generally have a savings element in them. Savings in the form of policyholders' reserves are accumulated from the premium payment, and interest is earned on these policyholders' reserves. Such interest income is neither taxable as it accrues nor as an element of death benefits.

Deductibility of contributions for other than education.—Contributions to charitable, religious, or certain other nonprofit organizations are allowed as an itemized deduction for individuals generally up to 30 percent of adjusted gross income. Unlimited contributions, however, may be deducted by those taxpayers (a relatively small number) whose contributions plus income taxes equal 90 percent of taxable income in 8 out of the preceding 10 years.

Taxpayers whose contributions to charitable or educational organizations are in the form of capital assets, usually securities, which have appreciated in value above their cost, obtain a deduction for the contribution at the appreciated value of the asset without taxation on the appreciation in value.

Deductibility of medical expenses.—Medical expenses in excess of 3 percent of adjusted gross income and expenditures for prescribed drugs and medicines in excess of 1 percent of adjusted gross income may be deducted by individuals as itemized nonbusiness deductions. Individuals may also deduct half of the premiums paid for medical care insurance up to a maximum deduction of $150 per year, without regard to the 3 percent limitation.

Deductibility of child and dependent care expenses.—Deductions for a limited amount of expenditures for the care of children under 13 or incapacitated dependents to enable the taxpayer to work are permitted under certain circumstances.

Deductibility of casualty losses.—Taxpayers may deduct as an itemized nonbusiness deduction the amount in excess of $100 for each loss due to fire, theft, or other casualty to the extent not compensated by insurance.

Standard deduction.—Individuals may itemize deductions for certain personal nonbusiness expenditures, including charitable contributions, interest payments, and medical and drug expenses above a stated percent of income, and certain other items referred to earlier. The taxpayer is also given the option of deducting—instead of this itemization—standard deduction of 10 percent of adjusted gross income or $1,000 ($500 if married and filing separately), whichever is less.

TABLE 7.—HEALTH AND WELFARE

Tax Expenditures, 1968

[In millions of dollars]

Aged, blind, and disabled:	
Additional exemption, retirement income credit and exclusion of OASDHI for aged	2,300
Additional exemption for blind	10
Exclusion for sick pay	85
Exclusion of unemployment insurance benefits	300
Exclusion of unemployment insurance benefits	300
Exclusion of workmen's compensation benefits	150
Exclusion of public assistance benefits	50
Exclusion for employee pensions	3,000
Deduction for self-employed retirement	60
Exclusion of other employee benefits:	
Premiums on group term life insurance	400
Accident and death benefits	25
Medical insurance premiums and medical care	1,100
Privately financed supplementary unemployment benefits	25
Meals and lodging	150
Exclusion of interest on life insurance savings	900
Deductibility by individuals of charitable contributions (other than education) including untaxed appreciation	2,200
Deductibility of medical expenses	1,500
Deductibility of child and dependent care expenses	25
Deductibility of casualty losses	70
Standard deduction	[1] 3,200
Total	15,550

Budget Outlays Plus Tax Expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	43.4	49.5	55.0
Net lending	.1	-.6	(2)
Total	43.5	48.9	55.0
Tax expenditures	15.6	18.0	19.5
Total budget outlays plus tax expenditures	59.1	66.9	74.5
Tax expenditures as percent of budget outlays	36	37	36

[1] In the absence of the 10 percent standard deduction and most itemized nonbusiness deductions, the minimum standard deduction as presently structured would be taken by all taxpayers and its revenue cost would be relatively large. Under present treatment, the minimum standard deduction, in keeping with its objectives, is claimed almost entirely by low-income taxpayers and its revenue cost is $300,000,000. The revenue estimate assumes the minimum standard deduction is designed to assist only low-income taxpayers. The minimum standard deduction is regarded in this analysis as related to the system of personal exemptions and thus a part of the structure of an income tax system based on ability to pay, rather than as a tax expenditure.

[2] Less than $50,000,000.

Education and Manpower

Additional personal exemption for students.—Taxpayers may claim personal exemptions for dependent children over 18 who receive $600 or more of income per year only if they are full-time students. The student may also claim an exemption on his own tax return, in effect providing a double exemption, one on the parents' tax return and one on the student's.

Deductibility of contributions to educational institutions.—Contributions to nonprofit educational institutions are allowed as an itemized nonbusiness deduction for individuals.

Exclusion of scholarships and fellowships.—Recipients of scholarships and fellowships may exclude such amounts from taxable income, subject to certain limitations.

TABLE 8.—EDUCATION AND MANPOWER

Tax expenditures

[In millions of dollars]

Additional personal exemption for students	500
Deductibility of contributions by individuals to educational institutions	170
Exclusion of scholarships and fellowships	50
Total	720

Budget outlays plus tax expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	6.6	6.9	7.6
Net lending	.4	.3	.3
Total	7.0	7.2	7.9
Tax expenditures	.7	.8	.9
Total budget outlays plus tax expenditures	7.7	8.0	8.8
Tax expenditures as percent of budget outlays	10	11	11

Veterans Benefits and Services

All veterans pensions due to disability and those paid by the Veterans Administration due to age (over 65) are excluded from taxable income.

TABLE 9.—VETERANS BENEFITS AND SERVICES

Tax expenditures, 1968

[In millions of dollars]

Exclusion of certain benefits	550

Budget outlays plus tax expenditures

[In billions of dollars]

	1968	1969	1970
Budget outlays:			
Expenditures	6.7	7.4	7.8
Net lending	.1	.3	(1)
Total	6.8	7.7	7.8
Tax expenditures	.6	.6	.7
Total budget outlays plus tax expenditures	7.4	8.3	8.5
Tax expenditures as percent of budget outlays	9	8	9

1 Less than $50,000,000.

Aid to State and Local Government Financing

The Federal Government through certain tax provisions provides indirect assistance to State and local governments. The deductibility of property taxes on owner-occupied homes involving a revenue cost of $1.8 billion is listed above under community development and housing as an element of the tax system which provides support to promote housing. This deduction also aids States and, particularly, local governments, by providing more flexibility in financing their expenditure programs.

Two other special tax provisions also aid State and local governments, but unlike the deductibility of property taxes on homes, they do not fit clearly within any of the functional categories now used in the budget. They are, therefore, shown as a separate budgetary heading, aid to State and local government financing.

In calculating income subject to tax, individuals may take as itemized nonbusiness deductions State and local personal income, gasoline, sales, property, and other taxes. The deductibility of all these State and local taxes (with the exception of taxes on owner-occupied homes) on nonbusiness returns is classified as support for the finances of State and local governments, rather than listed under any of the functional categories in the current budget.

As a result of the exclusion from tax of State and local bond interest, these governments are able to sell debt obligations at a lower interest cost than would be possible if such interest were subject to tax.

The relative importance of indirect assistance to State and local governments through these provisions as compared with direct aid is not shown because the present budget does not show in a single functional category the aid given to State and local governments. The amounts of direct Federal aid by function, however, are brought together in *Special Analysis O* of the Budget for fiscal year 1970.

TABLE 10.—AID TO STATE AND LOCAL GOVERNMENT FINANCING

Tax expenditures, 1968

[In millions of dollars]

Exemption of interest on State and local debt obligations	1,800
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes):[1]	
Individual income tax	1,350
General sales taxes	775
Gasoline taxes	400
Personal property taxes	150
Other taxes	125
Total	2,800
Property taxes on owner-occupied homes (included under community development and housing)	1,800
Total, all State and local nonbusiness taxes	4,600

[1] For businesses owned by individuals, taxes other than income taxes are considered a cost of doing business and thus deductible in arriving at a net income figure.

Capital Gains—Individual Income Tax

The tax treatment of capital gains of individuals involves a large amount of tax expenditures. These expenditures would fall under a variety of functions in the Federal budget, including commerce and transportation, agriculture and agricultural resources, natural resources, community development and housing, and health and welfare. Available sources, however, do not provide a basis for accurate distribution among these functions. Thus, to avoid distorting any single category but to identify the importance of this special provision under the individual income tax, a new heading outside the budget classification is included for this item. Omission of this item leads to an understatement of the amounts of tax expenditures for the functional categories affected.

The types of special treatment accorded capital gains and the resulting tax expenditures are as follows:

If the owner of appreciated capital assets dies, the capital gains tax is not applied to appreciation which would have been taxable had he sold the assets just before death. Heirs who receive appreciated property from the decedent and who subsequently sell the property are subject to capital gains tax only on appreciation occurring after they acquired the property. Thus the appreciation on assets held until death is never taxed under the income tax. The revenue cost of this treatment is $2.5 billion at present capital gains rates. (If taxed at full ordinary rates, the cost is $4 billion.)

As to realized gains, half of the gains from the sale of capital assets held more than 6 months is excluded from income, and in no case is the tax rate applicable to such capital gains allowed to exceed 25 percent. The revenue cost of this treatment is $4.5 billion. The revenue cost of this treatment at ordinary rates for both realized gains and gains untaxed at death is $8.5 billion (including the $4 billion mentioned above).

The cost of capital gains treatment under present law is complex for a number of reason. It could be contended that:

1. Full taxation of realized capital gains, even with full taxation at death, could result in greater postponement of lifetime gains;

2. With a different treatment of capital gains another approach to the corporation tax might provide for some integration of corporate and individual taxes by giving taxpayers who sell corporate shares some credit for taxes paid by the corporation on retained income which is reflected in share values; and

3. Averaging of capital gains would lower the indicated revenue costs. In recognition of the complex issues involved, the tax expenditures involved in the present treatment of capital gains of individuals are placed in a range of $5.5 to 8.5 billion. (No table is shown for this heading.)

IMPORTANCE OF TAX EXPENDITURES

The above analysis indicates that tax provisions control a large fraction of budget resources employed in several functional categories. With respect to commerce and transportation, for example, the volume of budget resources allocated by current special tax provisions is approximately the equivalent of budget outlays. In certain other functional categories, such as natural resources, community development and housing, and health and welfare, tax provisions constitute a major component of total Government activities.

Many reasons for the enactment of these tax provisions may be found other than the promotion of the functional activity under which they are listed, just as a multitude of forces affect the approval of direct Government expenditures which are nonetheless summarized under specific functional headings. This analysis in no way reflects on the wisdom of such reasons.

More efficient use of resources by the Federal Government is advanced, however, if explicit account is taken of all calls upon budget resources, including tax expenditures. The relative importance of different budgetary objectives can be more carefully weighed against all the budget resources used for this objective. Also, the effectiveness of alternative methods of achieving these objectives, whether through direct outlays, loan subsidies, or tax expenditures, can be fully understood, examined, and reevaluated periodically.

Secretary BARR. That concludes my testimony, Mr. Chairman, and I thank you.

Chairman PATMAN. Thank you very much, Mr. Secretary.

(Secretary Barr's prepared statement follows):

PREPARED STATEMENT OF SECRETARY OF THE TREASURY JOSEPH W. BARR

Mr. Chairman and Members of the Joint Economic Committee, I appreciate the opportunity to meet with this distinguished Committee. I think it extremely important that the members have the economic rationale for the financial plan President Johnson has recommended to the Congress—a plan that is responsible and realistic in terms of the country's needs and resources, and that is consistent with our responsibilities to keep the dollar strong and respected.

Before getting into the body of my remarks, I want to take a moment to pay tribute to you, Mr. Chairman, to the Vice Chairman, Mr. Patman, and to the members of the Committee. Under your leadership, the work of this Committee has contributed greatly to the tremendous growth of public interest in economic issues, to better informed public attitudes on economic policy, and to the record economic progress the United States has achieved.

The economy is now in the 95th month of the most sustained and vigorous period of economic expansion in our country's entire history. There is no need for me to enumerate here the many economic records established during this period of unprecedented prosperity. I believe that in his State of the Union Message and in his Economic Report to the Congress the President clearly established that the economy is now stronger and more vigorous than ever before, with production, employment, and after-tax income, including both wages and profits, all at record highs, far above the levels of a decade ago.

And I want to emphasize that this isn't just a dollar prosperity. The purchasing power of the average American—the real goods he can buy with his dollar income after taxes—has actually increased by 31 percent between 1960 and 1968. This, gentlemen, is the basic definition of economic progress.

Perhaps an even more significant aspect of our economic well-being is that it is probably being shared by a broader segment of our population than during any previous time of great prosperity. Not only have business profits soared to record highs but the unemployment rate has been sharply reduced—particularly among minority groups who have not adequately shared in economic gains of the past. Much remains to be done in this key area of national policy, but it is clear that significant progress has been made in removing barriers and expanding job opportunities for our under-privileged citizens.

However, we must recognize that serious economic problems must still be overcome. The increase in consumer prices in the past year of nearly 4 percent is certainly larger than we can tolerate for very long. Although a small balance of payments surplus was achieved in 1968, vigorous efforts must continue to maintain this record in the current year.

Today I want to go beyond the over-all indicators of a prosperous economy and in a sense see whether the financial underpinning of our economy will support continued sound expansion in the years to come. I also want to review briefly a few items of major, unfinished business that will bear heavily on our future economic growth and, in some instances, that of the entire Free World.

Probably the most important single component of this financial underpinning of our economy is the Federal budget. A properly designed budget should reflect what the country needs, what it can afford and what the Congress can be expected to do. In my judgment President Johnson has presented to the Congress a budget that fully meets this standard. In fiscal 1969 the budget is expected to be strongly in the black, with outlays of $183.7 billion, revenues of $186.1 billion and a surplus of $2.4 billion. For fiscal 1970 we have projected an even larger surplus of $3.4 billion.

In fiscal 1970 budget receipts are estimated at $198.7 billion, an increase of $12.6 billion over the estimate for fiscal 1969. Outlays in fiscal 1970 are projected at $195.3 billion. The estimated increase in fiscal 1970 Federal revenue is due almost entirely to anticipated economic growth. For calender 1969 we have projected a gross national product of $921 billion, personal income of $736 billion and corporate profits of $96 billion.

Now there is nothing inherently good or bad in itself about a budget surplus or deficit. The test is whether it contributes to the economic strength of our country. And a budget does this only when it is consistent with current and prospective economic realities.

In the context of the economy as we see it, a Federal budget surplus for fiscal years 1969 and 1970 is necessary for several important reasons.

First, a budget surplus will tend to restrain over-all demand during a time when our productive capacity is straining hard to meet the demands thrust upon it. Second, a budget surplus means that during this period the Treasury will not on balance be competing for funds in our already hard-pressed credit markets. In fact, in fiscal 1969 and 1970 taken as a whole, the Treasury will actually be adding funds to the private credit markets in contrast to the situation in 1969 when $23.1 billion had to be drawn from private investors. This healthy situation means greater freedom for the Federal Reserve to establish effective monetary policies, and more ready access to private savings by private users of credit and state and local governments—borrowers who have had a rough time in past tight money periods. In this context the home-building industry in particular should greatly benefit.

A third important reason for maintaining a Federal budget surplus at this time is that it will strengthen the hand of our negotiators during the critical period in which we will be working to improve and modernize the international monetary structure.

The Federal Government influences economic activity and the distribution of income not only through direct expenditures and loan programs but also through special tax provisions. A dollar foregone through a special tax provision is no different than a dollar spent through a budget outlay. In other words, these tax expenditures use budget resources in the same way that direct expenditures or net lending do. In most cases, the special tax provisions are alternatives to direct expenditures or net lending to achieve the same purpose.

The Annual report of the Secretary of the Treasury for fiscal year 1968. which was issued this week, contains for the first time a detailed description and discussion of these tax expenditures and estimates of the amounts involved. To bring this material up to date, the Treasury staff has prepared an analysis of tax expenditures related to the budget for fiscal year 1970 which I am submitting as a supplement to my statement. The revenue costs of the special tax provisions are presented alongside the budget outlays. This makes it possible to get a more complete picture of total government expenditures for various functions. You may be surprised to find that tax expenditures approach or even surpass the budget outlay for certain functions.

The purpose of this special analysis is to present information which will help us to use budget resources most effectively. We can obtain more efficient use of resources by the Federal Government if explicit account is taken of all calls upon budget resources. In this way the importance of different budgetary objectives and the effectiveness of alternative uses, whether through direct expenditures, loan subsidies, or tax expenditures, may be fully understood, examined, and re-evaluated periodically.

I should inject a note of warning at this point. As the Committee knows, the whole subject of tax expenditures is highly controversial and the figures presented in this Treasury report are themselves certain to be controversial. The figures may vary depending on the assumptions used, and we do not claim that our figures and assumptions are the last word. Perhaps the Committee might want to have its staff analyze this document—perhaps in conjunction with the staffs of the Joint Committee on Internal Revenue Taxation and the Appropriations Committees. The staff of the Treasury will be pleased to cooperate. Many of the provisions in the Tax Code are virtually the same as appropriations and should be considered by the Congress as they review the various Federal programs.

Let me turn now to four areas where I believe there is urgent need for action by the United States or by those nations whose economic future is closely linked with our own.

THE NEED FOR TAX REFORM

We have an income tax system which has demonstrated its strength—$128.3 billion of revenues expected in fiscal year 1970—and its flexibility. The income tax is one of our country's strongest assets; and we must strive to improve it and perfect it.

Our income tax system needs major reforms now, as a matter of importance and urgency. That system essentially depends on an accurate self-assessment by taxpayers. This, in turn, depends on widespread confidence that the tax laws and the tax administration are equitable, and that everyone is paying according to his ability to pay.

We face now the possibility of a taxpayer revolt if we do not soon make major reforms in our income taxes. The revolt will come not from the poor but from the tens of millions of middle-class families and individuals with incomes of $7,000 to $20,000, whose tax payments now generally are based on the full ordinary rates and who pay over half of our individual income taxes.

The middle classes are likely to revolt against income taxes not because of the level or amount of the taxes they must pay but because certain provisions of the tax laws unfairly lighten the burdens of others who can afford to pay. People are concerned and indeed angered about the high-income recipients who pay little or no Federal income taxes. For example, the extreme cases are 155 tax returns in 1967 with adjusted gross incomes above $200,000 on which no Federal income taxes were paid, including 21 with incomes above $1,000,000.

Judging from taxpayers' letters to the Treasury, I would say that many people are upset and impatient over the need for correcting these and other situations which demand our attention. In this connection, I should point out that the 10 percent surcharge has made many taxpayers more aware of the inequities in our present tax system and more demanding that reforms be adopted.

I believe public confidence in our income tax system is threatened and that tax reform should be a top priority subject for the new Administration and the 91st Congress.

As you know, we at Treasury have been working on tax reform proposals for more than two years, and they are now ready. They will be turned over to Secretary-Designate Kennedy and, upon request, to the Congress.

I feel that the enactment of major reforms to substantially improve the fairness, simplicity, and neutrality of our income taxes are essential to continue and strengthen public confidence in our tax system.

THE NEED FOR RESTORING THE UNITED STATES TRADE POSITION

The international trade position of the United States is rapidly deteriorating. It is essential therefore that we make a forceful policy response to restore our trade account to a position of strength. Short of this, we will find a continuing upsurge apparent in the country.

The answer to our trade problem does not lie in an overhauling of our tax system through the introduction of a value-added tax either in addition to or in lieu of our present taxes. The adverse domestic effects of such a move would far outweigh any small trade advantage which we might gain.

What we might well consider instead is our own system of border adjustments, encompassing both a tax on imports and a payment to exporters. The level of these adjustments would be unrelated to our domestic tax system. The rates would be set at whatever level is necessary to achieve our objective—a healthy trade surplus. This system should be established under the strict control of the General Agreement on Tariffs and Trade or other appropriate international body.

THE NEED FOR ACTION ON THE SDR FACILITY

I would urge the member nations of the International Monetary Fund that have not yet completed action on the Special Drawing Rights Facility to do so promptly. Their ratification of the Proposed Amendment to the IMF Articles of Agreement establishing the SDR Facility will bring closer the day when the world will be assured of an adequate growth in monetary reserves.

The SDR Facility will be created when 67 member nations having 80 percent of the weighted votes in the Fund have ratified the Amendment, and when members having at least 75 percent of the quotas in the Fund have deposited with it an instrument of participation.

The United States completed action on the SDR Facility last July 15. However, as of January 10 of this year, only 29 members of the Fund having 47½ percent of the total votes had ratified the Proposed Amendment.

After years of intensive negotiations, nations have neared establishment of a method for creating the monetary reserves needed by a rapidly growing world economy. We are near the goal of the most important reform in the international monetary system since the Bretton Woods Agreement of 1944. I earnestly hope that other nations and their governments will make it possible for the world to reach that goal within a period of weeks or months.

THE NEED FOR SUPPORT TO MULTILATERAL DEVELOPMENT INSTITUTION

I am also deeply concerned about two items of unfinished business in the field of multilateral development finance. Both—the replenishment of the International Development Association and the provision of special funds for the Asian Bank—involve institutions that I have been intimately involved with over the years. What we in the United States do in regard to these two institutions can have a profound effect on the well-being and the very lives of millions among the two-thirds of the world's population that has little to possess and still less to hope for.

As a freshman Congressman, I helped write the legislation for our participation in IDA. I have seen it in action in the field, in Asia in 1963 and in Africa in 1967. I know it is capably guided by the World Bank under Robert MaNamara's sure hand.

IDA is, most importantly, serving in a growing way the primary function we had in mind in the late 1950's—it is mobilizing a greater share of development resources from the other advanced countries. It is putting these resources to work in an efficient and effective manner. Eighteen other countries put up a total substantially greater than our own. Our share in the effort has been reduced from 43 percent at the outset to 40 percent currently, meaning a cumulative transfer of the burden of about $150 million.

The contribution proposed for the United States—$160 million in each of three years—will have no adverse effect on the U.S. balance of payments, because we have obtained internationally agreed safegards to ensure this.

But the entire IDA replenishment package cannot become effective unless the U.S. makes its contribution. I consider it of the highest urgency for the Congress to demonstrate again its consistent attitude of bipartisanship toward IDA by acting on the legislation that has been re-introduced in recent days.

While IDA's operations are world wide, those of the Asian Bank are concentrated in the area of the world that has been torn by intense conflict and wracked by human misery for all too many years. In December 1965, I was privileged, along with Eugene Black, to sign the agreement establishing the Asian Development Bank, thus placing us firmly on the path of constructive multilateral development in Asia. Many members of the Congress and Congressional staff members participated actively in the events leading up to the creation of the Asian Bank. It is now in being, with a distinguished staff and with an effective loan and technical assistance program moving forward.

However, the Bank needs additional resources—beyond its regular funds for conventional lending—for special lending programs on favorable terms in fields such as agriculture and transportation. The new budget proposes a $25 million U.S. contribution to Asian Bank special funds in 1969 and 1970, and I consider this action, already long delayed, as crucial to Asia and our total interests there.

These funds will help to encourage regional cooperation and peaceful development in southeast Asia. Like our IDA contribution, we would be putting up only a monority share; Japan and other advanced countries will bear the major burden. And this contribution, too, will have no adverse balance of payments effect since it will finance U.S. goods and services.

I sincerely hope that both these vital programs will promptly receive the Congressional support they deserve.

I am submitting with my statement for the record a set of charts with the heading "The Fiscal Program for 1970 in Perspective." These charts set forth the economic rationale for the financial plan which President Johnson recommends to the 91st Congress, and I would like at this time to review them with you.

(The material referred to follows:)

the fiscal program for 1970 in perspective

Office of the Secretary of the Treasury

THE FISCAL PROGRAM FOR 1970 IN PERSPECTIVE

Current Fiscal Picture

Chart 1 - Budget Outlays and Receipts, Fiscal Year 1970

Chart 2 - Effect of Tax Action on Budget Deficit Fiscal Years 1969 and 1970

Chart 3 - Original Revenue Estimates Compared with Actuals

Burden of Federal Debt and Expenditures

Chart 4 - Budget Outlays as a Percent of Gross National Product

Chart 5 - Net Federal Borrowing From or Repayment to the Public

Chart 6 - Federal Debt Held by the Public as a Percent of Gross National Product

Performance of Economy in Recent Years

Chart 7 - GNP Growth and Price Comparisons

Chart 8 - Growth of Civilian Employment, 1962-'68

Chart 9 - Real Gross National Product After the Recession Troughs of 1954 and 1961

Chart 10- Annual Rate of Growth in Selected Countries

Chart 11- Annual Rate of Cost of Living Increase

Effects of New Tax Program on Taxpayers

Balance of Payments

Tables

Chart 1

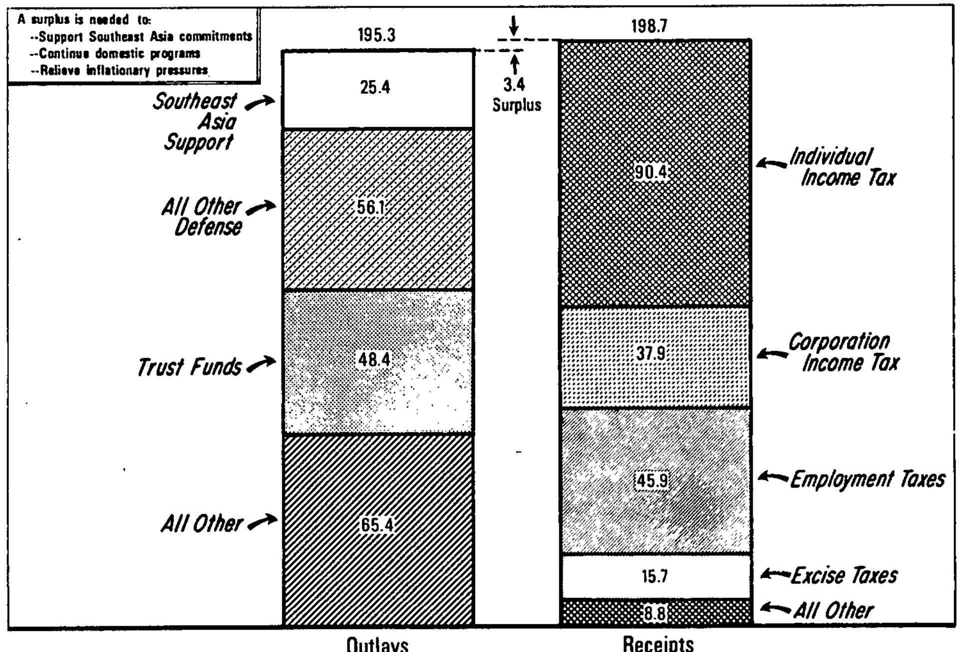
The budget in fiscal year 1970 should register a surplus if economic policy in the country is to be responsible and realistic. The estimate of $195.3 billion in total budget outlays represents our minimum requirements to meet the urgent domestic and international needs. An extension of the surcharge will make it possible to meet these requirements and to provide for a surplus which will be helpful in relieving inflationary pressures.

It is clear from the chart that if hopes for an early settlement of the Vietnam war are realized, military expenditures can be reduced and substantial savings made for other desirable purposes.

Chart 1

BUDGET OUTLAYS AND RECEIPTS, FISCAL YEAR 1970

Billion Dollars



Note: Figures are rounded

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Chart 2

Under existing legislation, a budget surplus is expected at $1.9 billion in fiscal year 1969 reflecting the surcharge, excise and other provisions enacted last June. The proposed surcharge extension would add another $0.5 billion, reflecting estimated corporate tax payments.

Under existing legislation for fiscal year 1970, the budget would register a deficit of $7.1 billion.

Under proposed legislation, revenue yield would increase $10.5 billion to yield a surplus of $3.4 billion.

NOTE: The $10.5 billion includes the net effect of increased social security contributions and benefit payments.

Chart 2

EFFECT OF PROPOSED TAX ACTION ON BUDGET FISCAL YEARS 1969 AND 1970

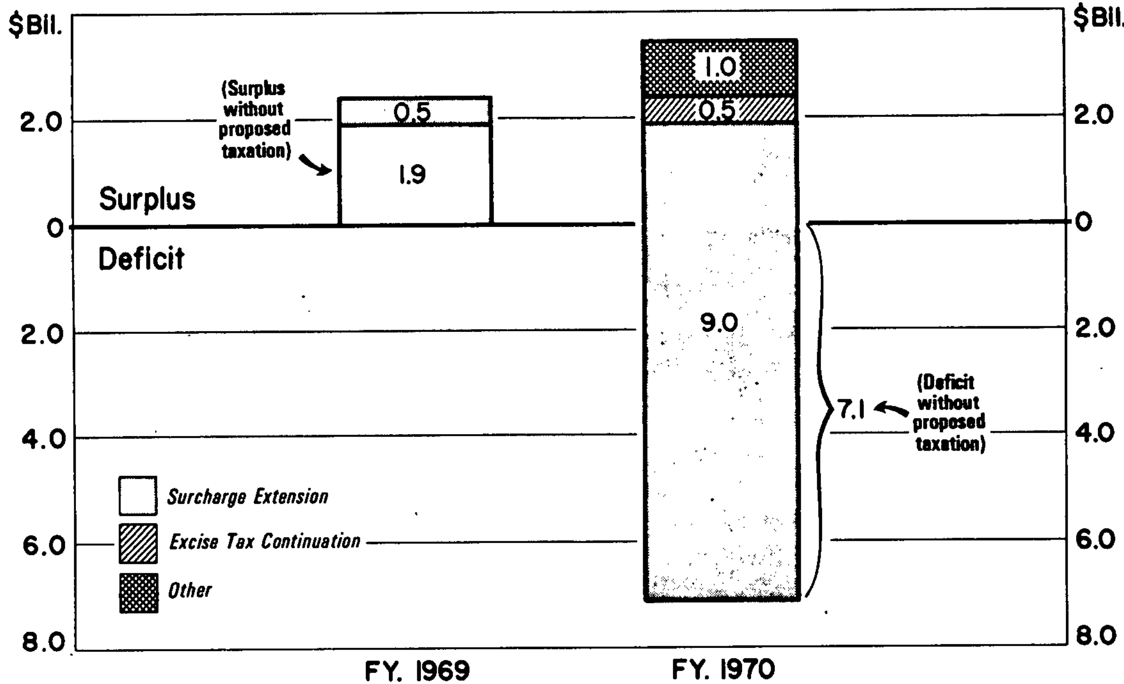

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Chart 3

The record shows that this Administration has not overestimated receipts in order to justify higher expenditures. Actual receipts have equaled or exceeded the original estimates in four of the last five years.

(In the chart, the original estimates for the fiscal years 1968 and 1969 have been adjusted to take account of legislation which was proposed but not enacted.)

Chart 3

ORIGINAL REVENUE ESTIMATES COMPARED WITH ACTUALS

Administrative Budget 1965-'68; Unified Budget 1969

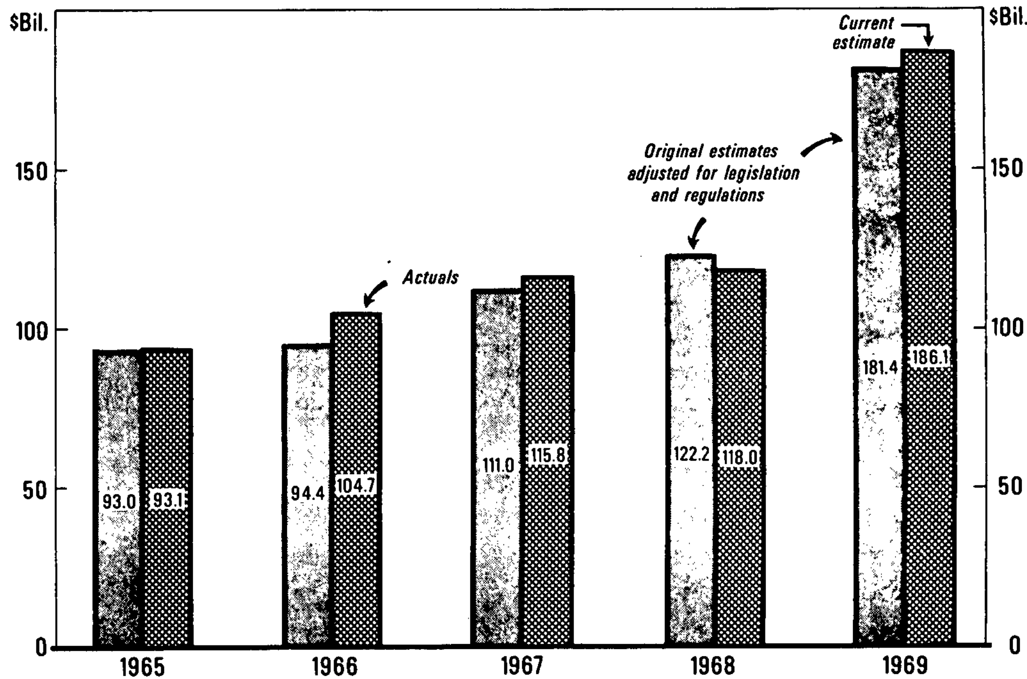

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Chart 4

Federal outlays as a proportion of gross national product have remained at about one-fifth for the past fifteen years. However, excluding special Viet Nam costs and the self-financed social insurance trust funds, outlays have been declining as a share of the Nation's product -- declining from an average of 15.9 percent during 1955-1960 to 14.2 percent in 1968. This share will decline further to 12.9 percent and 13.2 percent in fiscal years 1969 and 1970, respectively.

Chart 4

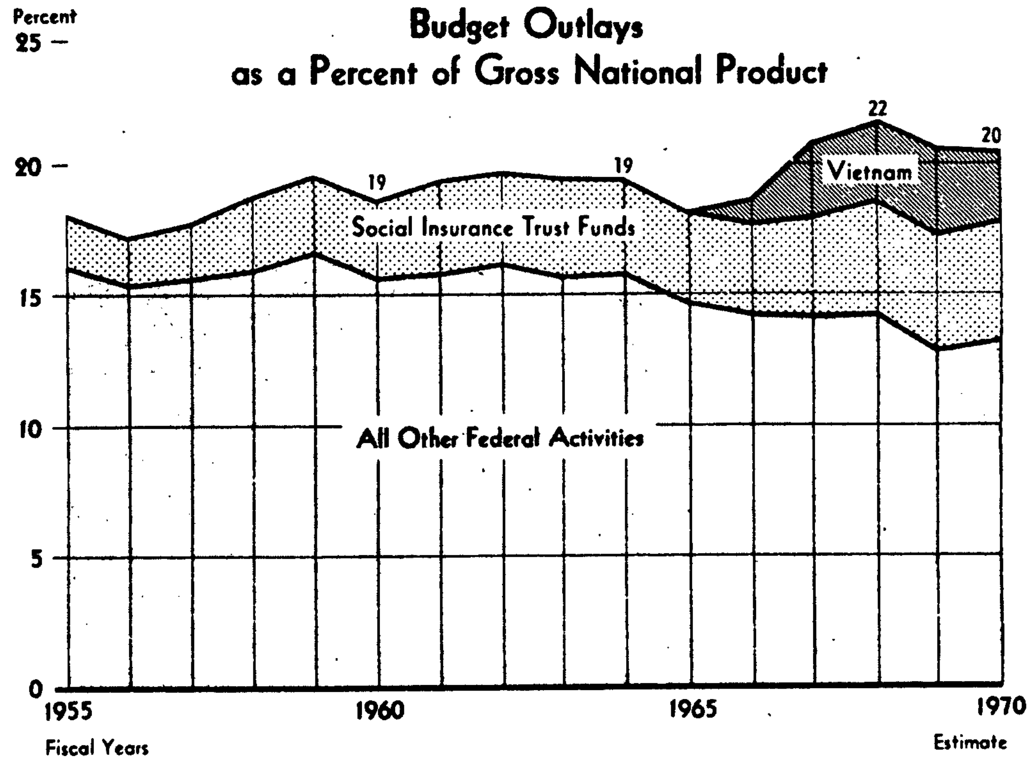
Budget Outlays
as a Percent of Gross National Product
Percent
25
20
15
10
5
0
19
19
22
20
Vietnam
Social Insurance Trust Funds
All Other Federal Activities
1955
1960
1965
1970
Fiscal Years
Estimate

Chart 5

The budget surpluses in fiscal years 1969 and 1970 will permit sizable repayment of debt to the public. This is in contrast with the huge Federal borrowing of $23 billion during fiscal year 1968. In the period ahead, the Federal Government would be providing funds to the private sector and contributing to easier money and capital markets, instead of exerting pressure on the supply of credit as it did in fiscal 1968.

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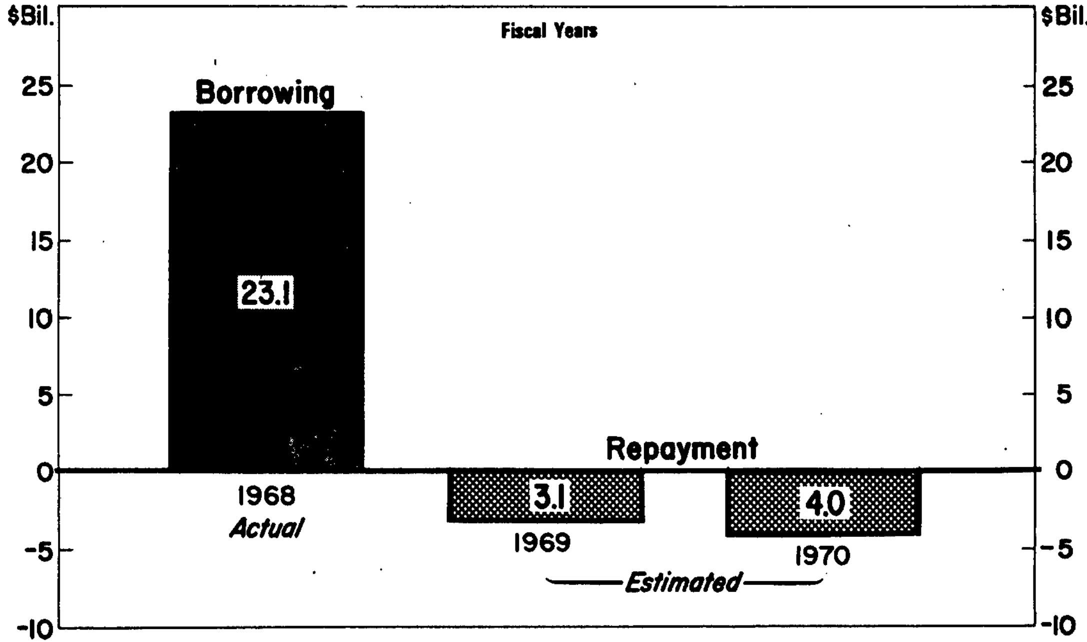
Chart 5

NET FEDERAL BORROWING FROM OR REPAYMENT TO THE PUBLIC



Source: 1970 Budget Document.

Office of the Secretary of the Treasury

Chart 6

Federal debt held by the public has grown at a much slower rate than the economy. Federal debt held by the public as a percent of gross national product has continued to decline in recent years. From the peak of almost $1\frac{1}{4}$ times the GNP in fiscal 1946, the Federal debt held by the public dropped to 48 percent in 1960 and 40 percent in 1965. The 1970 budget would bring down this percentage even further -- to 29 percent. By this measure, the size of the Federal debt would represent a steadily lessening burden on the economy.

Chart 6

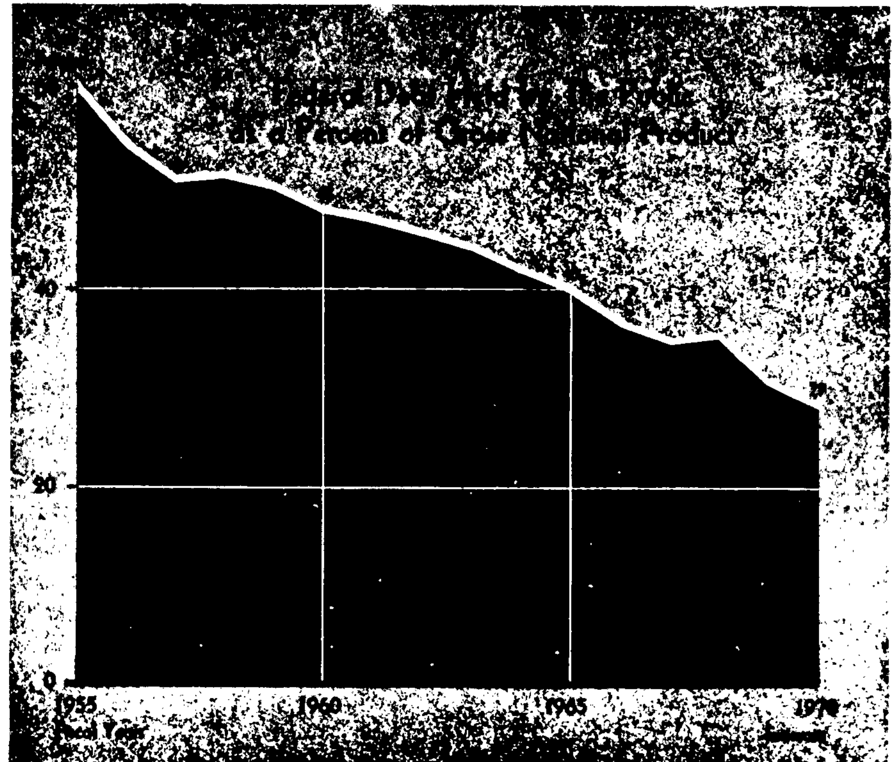


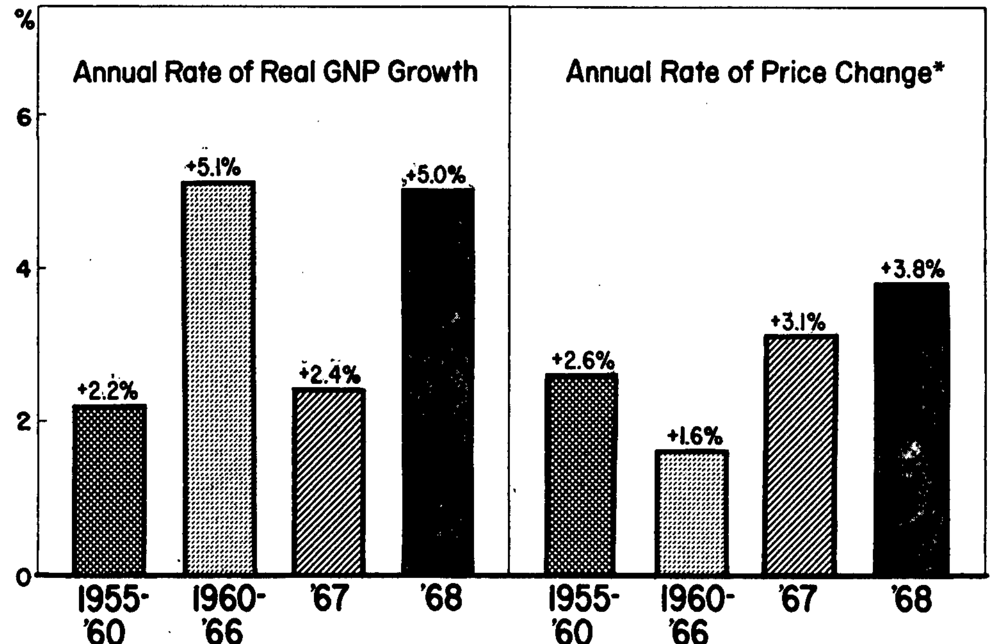
Chart 7

Between 1960 and 1966, real GNP was strong enough to attain more complete utilization of the Nation's resources than in former years. At the same time, prices remained relatively stable. In the last two years, however, strains on our economic resources have begun to develop and were reflected in an acceleration of price advances.

Chart 7

GNP GROWTH AND PRICE COMPARISONS

During 1960-'66 the economy greatly improved in both growth and price performance; however, prices accelerated rapidly in 1967 and 1968.



*GNP Price Deflator.

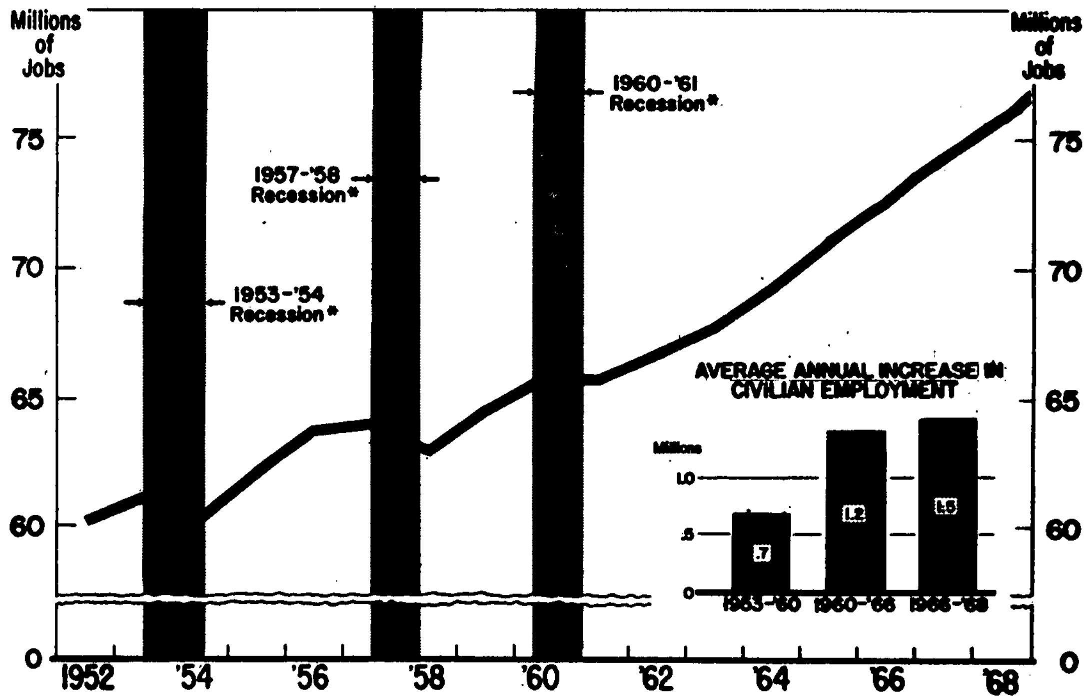
Chart 8

Sustained economic growth without recessions from 1960 to 1966 has generated large employment gains. The average annual increase in civilian employment amounted to 700,000 during 1953-60 as compared with 1.2 million between 1960 and 1966. In the last two years, gains mounted to 1.5 million per year.

Chart 8

GROWTH OF CIVILIAN EMPLOYMENT, 1952-'68

Economic Growth Means More Jobs; Slack Means Fewer Jobs



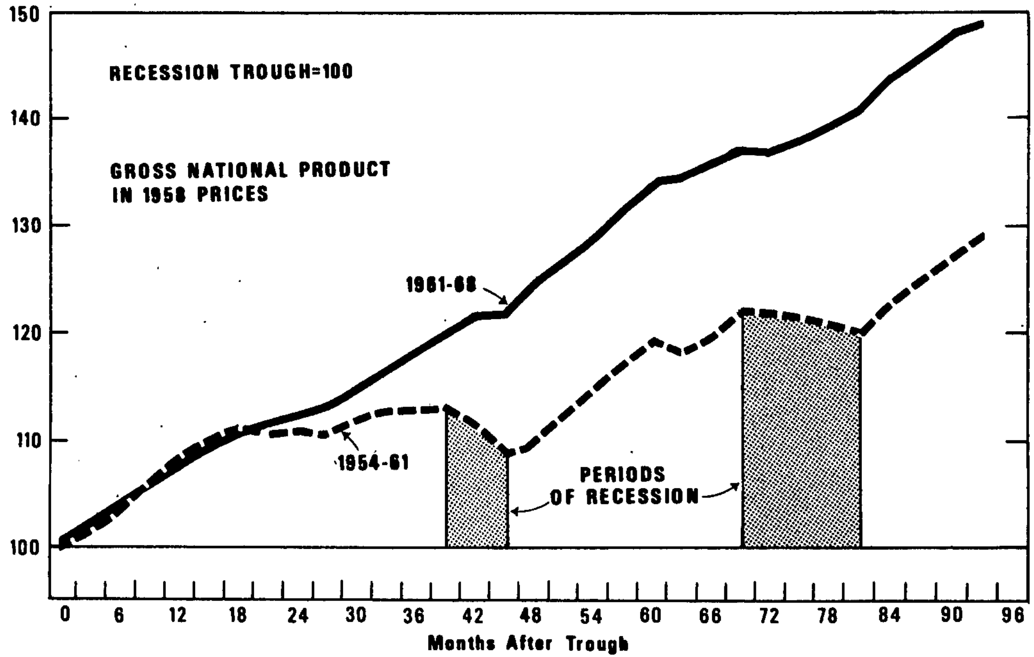
*Periods of recession as dated by National Bureau of Economic Research.

Chart 9

The accelerated rate of growth in GNP during 1961-68 has made available a considerably larger volume of goods and services each year to consumers, business and government. The chart shows a widening improvement in the more recent performance as compared with the earlier period. Since the early 1961 cyclical trough, GNP in 1958 prices has increased 49 percent, which compares with an increase of 29 percent for a comparable period of time since the 1954 recession trough.

Chart 9

REAL GROSS NATIONAL PRODUCT AFTER THE RECESSION TROUGHS OF 1954 and 1961



NOTE.–BASED ON SEASONALLY ADJUSTED QUARTERLY DATA.
SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

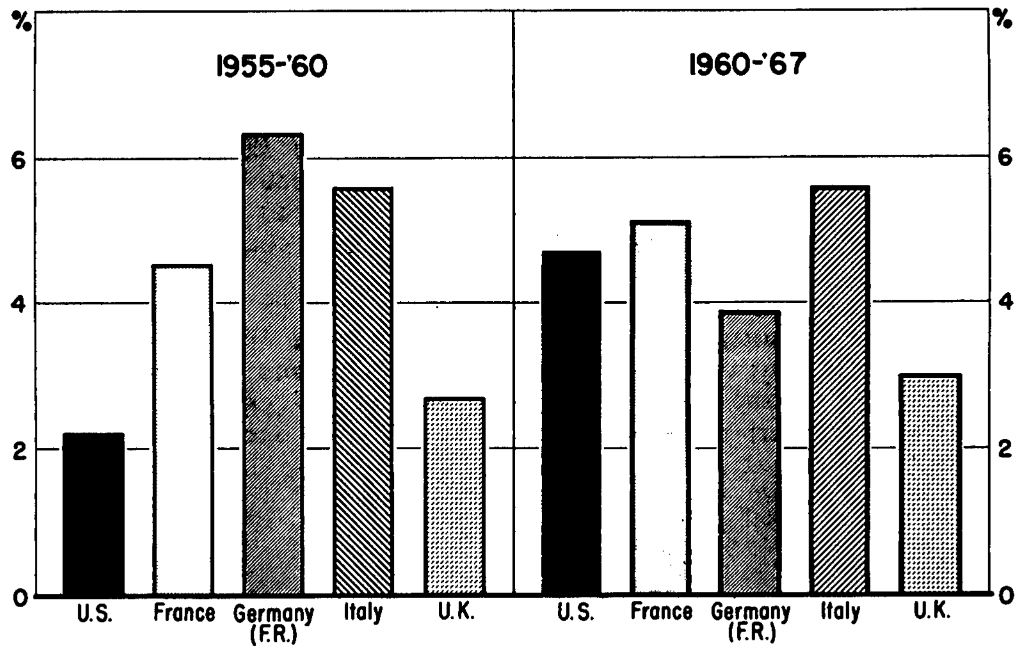
Chart 10

During the late 1950's, the growth rate of the U. S. economy fell below that of other major industrial countries. In the 1960's, the U. S. growth rate has risen appreciably and compares very favorably with growth rates abroad.

Chart 10

ANNUAL RATE OF GROWTH IN SELECTED COUNTRIES*

In the 1960's U.S. growth compares favorably with that of other countries



*Percentage change in constant dollar GNP.
Source: OECD

Office of the Secretary of the Treasury

Chart 11

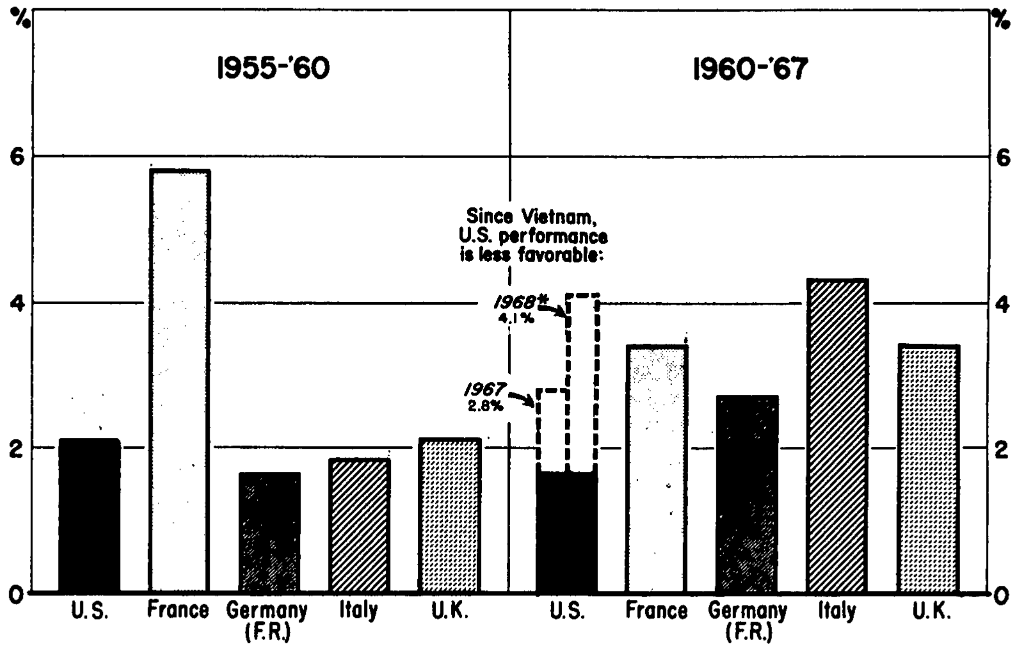
The U. S. cost of living record was generally in line with the experience of most major industrial nations in the 1955-60 period and it was considerably better than the major industrial countries during the 1960-66 period. After rising at about a 2 percent rate in the 1955-60 period, the U. S. cost of living advanced at the slower rate of approximately 1.6 percent in the 1960-66 period.

Since 1966, U.S. performance has been less favorable than earlier. The chart shows that 1967 and 1968 consumer prices rose 2.8 percent and 4.1 percent, respectively. These rates of advance are not less favorable than in some other industrialized countries. However, they do suggest the need for fiscal restraints.

Chart 11

ANNUAL RATE OF COST OF LIVING INCREASE

U.S. cost of living increases have been smaller than abroad



*First eleven months of 1968 over first eleven months of 1967.
Source: Labor Department and OECD.

Office of the Secretary of the Treasury

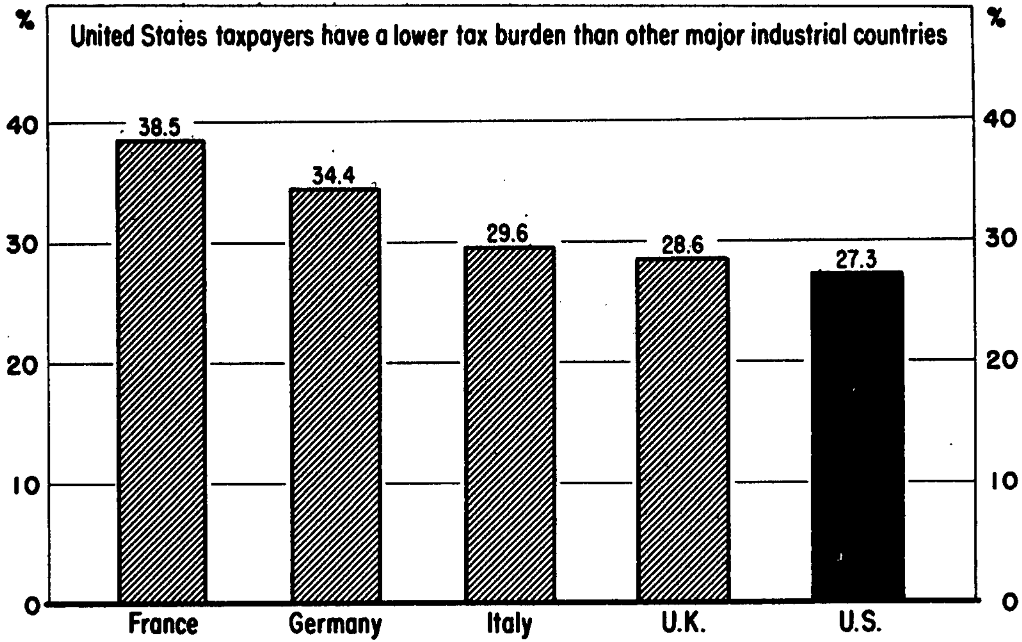
Chart 12

Americans enjoy a lower tax burden than any of the major industrial countries of Western Europe -- and this includes taxes levied at all levels of government -- Federal, state, and local. As shown in the chart, estimates based on data compiled by the Organization for Economic Cooperation and Development show that as a proportion of total national production, French citizens paid 38.5 percent in taxes; Germany, 34.4 percent; Italy, 29.6 percent; United Kingdom, 28.6 percent; and the U. S., 27.3 percent. The figures are based on data for 1966. Little change in these percents has occurred since then.

Chart 12

TAX BURDEN IN SELECTED COUNTRIES*

Total Federal, State and Local Taxes as % of GNP



*Based on OECD data for 1966.

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Chart 13

One factor in the proposed tax increase which should not be overlooked is the amount of tax savings which results from actions taken after 1963. These tax savings, which were over $8 billion in 1964, will rise to nearly $24 billion in 1969. Even after the increases passed in 1968 and assuming enactment of those proposed, the savings in 1969 would still come to over $12 billion. Thus, even with the proposed tax increase, American taxpayers are still far ahead of where they would have been were tax rates to have remained at pre-1964 levels.

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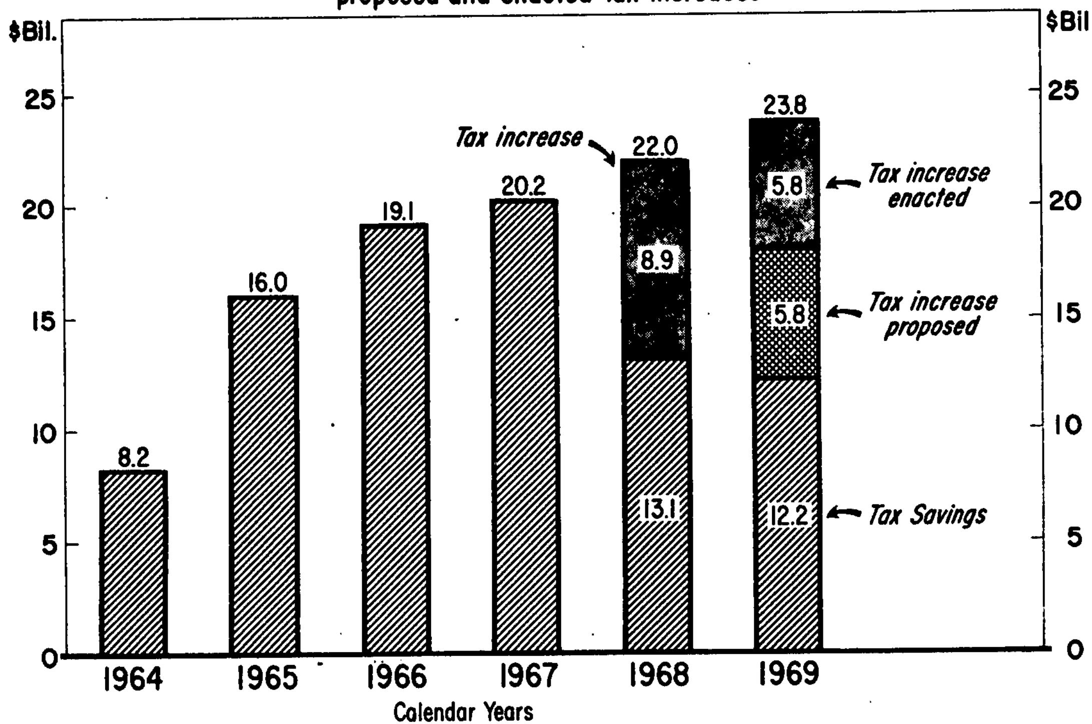
Chart 13

TAX SAVINGS FROM ACTIONS TAKEN AFTER 1963

Taxpayers will continue to benefit from huge tax savings after proposed and enacted tax increases*



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*Tax increases exclude amounts from continuation of excise tax rates.

Chart 14

The proposed continuation of the surcharge at 10 percent for the full calendar year 1969 would still leave individual taxpayers paying much less income tax than they did in 1963. For example, a married couple with two dependents and a wage and salary income of $7,500 would have a 1969 tax liability of $755 instead of $877 at 1963 rates -- a saving of $122. Savings at other income levels are shown in the chart.

Chart 14

TAX SAVINGS AT 1969 PROPOSED RATES COMPARED WITH 1963 RATES

Wage or Salary Income, Married Couple, Two Dependents

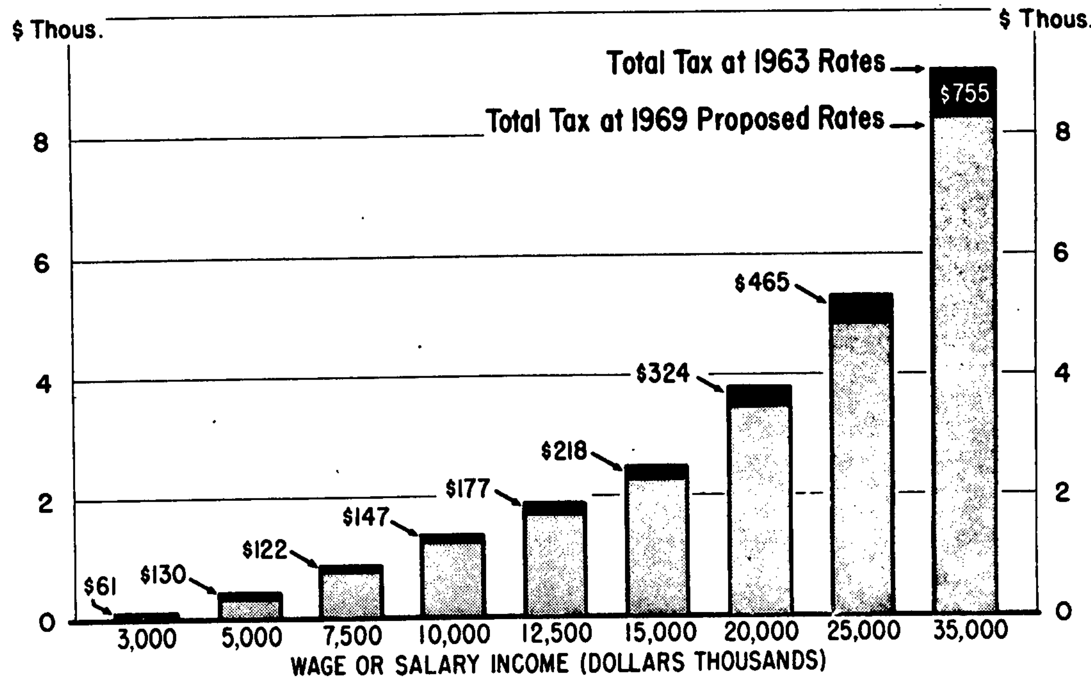

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Chart 15

The tax savings at 1969 proposed rates are <u>relatively</u> greatest at lower wage and salary levels, as shown in the chart. For example, at 1969 rates, a married couple with two dependents and wage and salary income of $3,000 would still save about 94 percent of their total 1963 tax liability. (There would be no increase in 1970 tax for a married couple whose tax at 1967 rates was $290 or less.)

Chart 15

TAX SAVINGS AS A PERCENT OF 1963 TAX: AT 1969 PROPOSED RATES COMPARED WITH 1963 RATES

Wage or Salary Income, Married Couple, Two Dependents

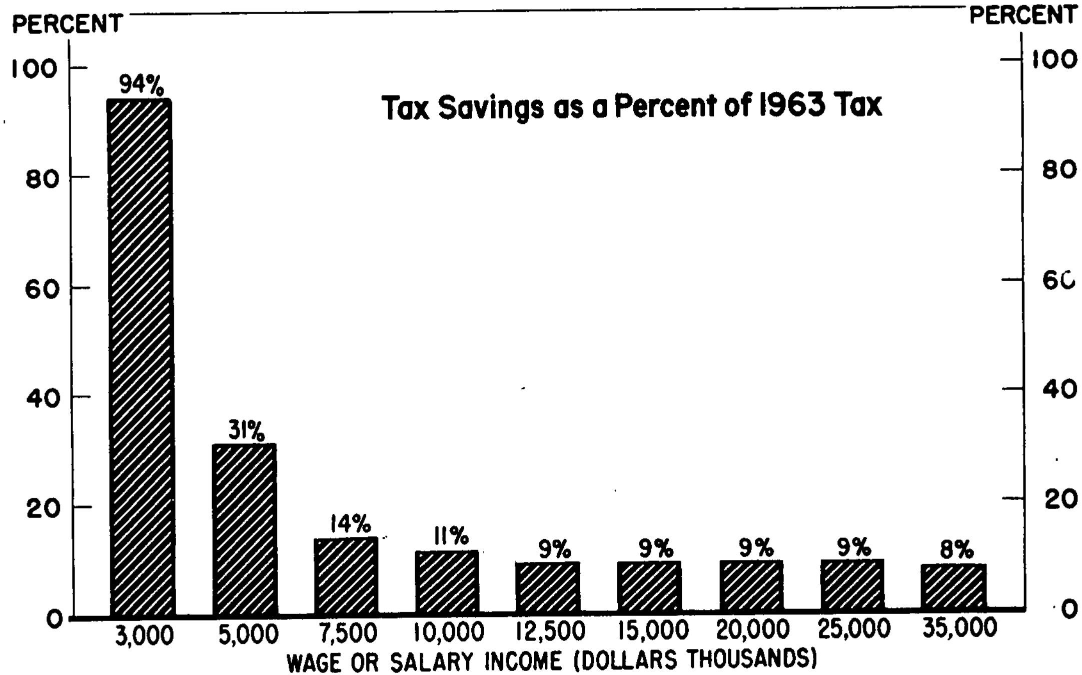

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Chart 16

The liquidity deficit was between $1.3 billion and $1.4 billion in each of the years 1965 and 1966--only a third as large as the 1959-1960 average.

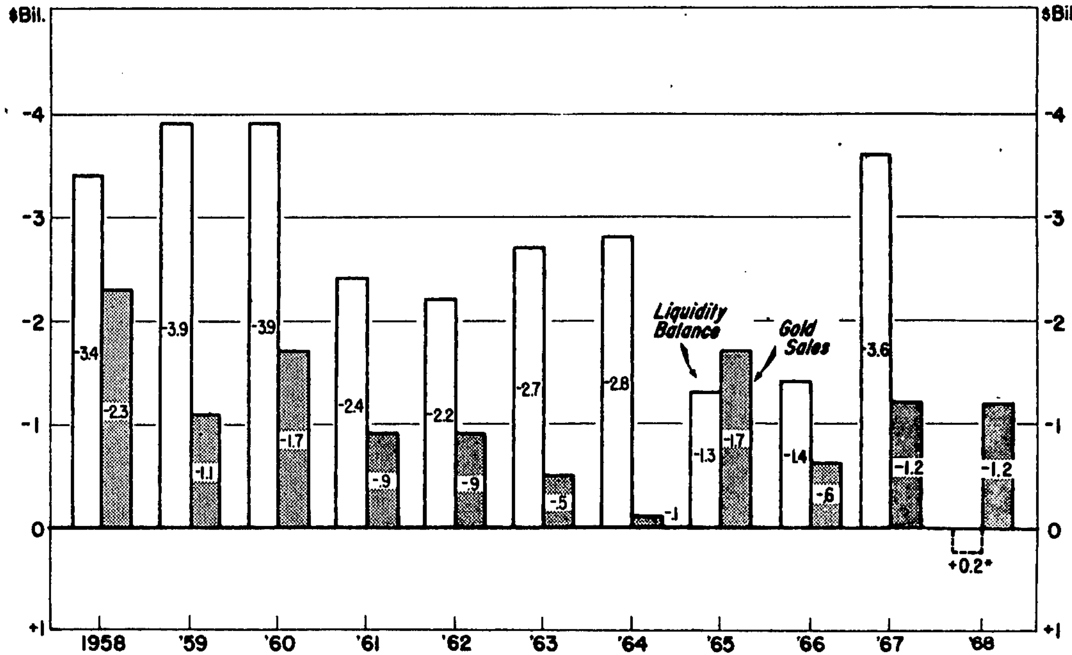
In 1967, our attempts to restore balance in our international accounts received a severe setback and the deficit rose sharply to $3.6 billion. The uncertainties and unrest which accompanied the sterling devaluation in November, 1967, accentuated our problems. However, this deterioration also reflected the effects of higher costs in Vietnam, heavy unilateral transfers, a disappointing trade surplus, and increased outlays by U. S. citizens traveling abroad.

In 1968, despite a strong upward surge of imports stimulated by domestic inflation, a strong rate of real GNP growth and various strike situations, the liquidity deficit disappeared and a small balance-of-payments surplus emerged. The improvement, however, was not well balanced as among various accounts.

The trade surplus fell well below $1 billion and the tourist deficit continued at a high level. Also, some of the sharp improvement in the capital accounts was the result of restraint programs which are not permanent features of our system. The over-all results, however, are encouraging and have been reflected, in part, in a net increase in our gold stock during the second half of last year.

Chart 16

U.S. BALANCE OF PAYMENTS ON "LIQUIDITY" BASIS AND GOLD SALES



*Rounded preliminary figure.

Note: *Includes sales for domestic industrial and artistic purposes. Also includes acquisitions from IMF of $300 million of gold in 1960 and $150 million in 1961 and a payment of $259 million of gold for quota increases in 1965.*

Office of the Secretary of the Treasury

Chart 17

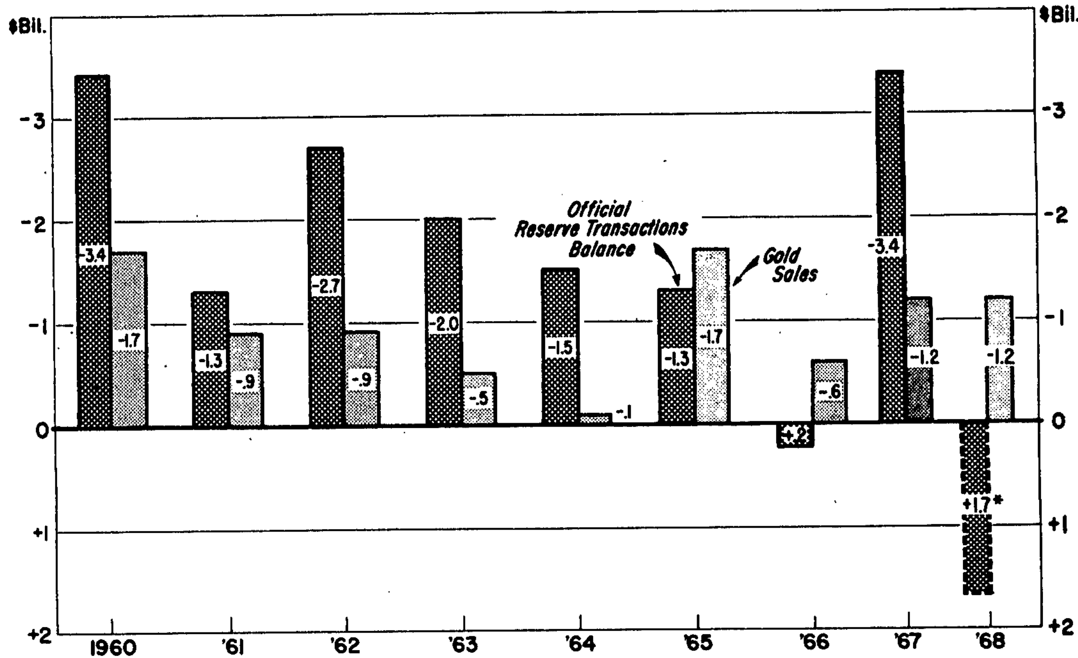
Since only increases in liabilities to foreign official holders (plus changes in U. S. reserve assets) are used to measure the official settlements balance, its changes from year to year reflect to a considerable extent shifts of dollar holdings between foreign private and foreign official holders in response to relative interest rates, here and abroad, and currency speculation.

The downward trend in the official settlements balance from 1960 through 1966--when there was a small surplus--was interrupted in 1967 due in part to the outbreak of private gold speculation in the Fall of that year.

In 1968 the official settlements balance moved into a strong surplus position, particularly in the second quarter of the year, reflecting a loss of reserves from official holders, particularly France. The tighter credit conditions in the U. S. towards the end of the year also helped to accentuate the 1968 official settlements surplus.

Chart 17

U.S. BALANCE OF PAYMENTS ON "OFFICIAL SETTLEMENTS" BASIS AND GOLD SALES



*Rounded preliminary figure.

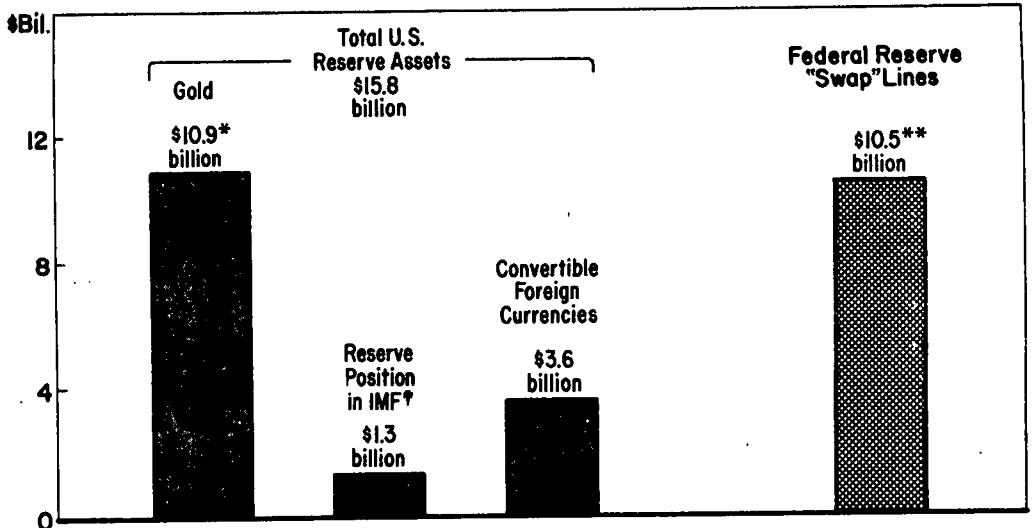
Note: The official settlements balance counts changes in dollar claims of foreign official monetary authorities — but not private holdings — in addition to reserve losses of the U.S. The liquidity balance counts changes in the liquid dollar holdings of all foreigners — private and public — as well as losses in reserves.

Chart 18

The U.S. international reserve position improved following establishment of the two-tier gold system in March 1968 and enactment of the fiscal restraint package at midyear. There was a rise in U.S. reserve assets from a low of $13.8 billion in the spring of this year to $15.8 billion by year-end. Gold losses were checked after the first quarter. By the end of the year, all U.S. drawings on the International Monetary Fund had been repaid. Federal Reserve swap lines were enlarged during the year to a total of $10.5 billion.

Chart 18

U.S. RESERVE ASSETS AND FEDERAL RESERVE "SWAP" LINES, LATE 1968



* Legislation in early 1968 removed the 25% gold cover requirement and freed the U.S. gold stock for international transactions.

† U.S. gold tranche position, which is available virtually automatically if needed. Under appropriate conditions the U.S. could draw additional amounts equal to the U.S. quota of $5.160 billion.

** U.S. drawings were less than $0.5 billion at the end of 1968.

Office of the Secretary of the Treasury

Table 1

FEDERAL SPENDING AND RECEIPTS, NIA AND UNIFIED BUDGETS
(In Billions of dollars)

	Actual				Estimate		Change from Previous Year					
	1965	1966	1967	1968	1969	1970	1965	1966	1967	1968	1969	1970
Expenditure Account Basis												
Receipts	116.8	130.9	149.6	153.7	186.1	198.7	+4.1	+14.1	+18.7	+4.1	+32.4	+12.6
Expenditures (excludes net lending)	117.2	130.8	153.3	172.8	182.3	194.4	-0.8	+13.6	+22.5	+19.5	+9.5	+12.1
Surplus or deficit	-0.4	0	-3.7	-19.2	+3.8	+4.3	+5.0	+0.4	-3.7	-15.5	+23.0	+0.5
Net lending	1.2	3.8	5.1	6.0	1.4	0.9	+0.7	+2.6	+1.3	+0.9	-4.6	-0.5
Total Unified Budget												
Receipts	116.8	130.9	149.6	153.7	186.1	198.7	+4.1	+14.1	+18.7	+4.1	+32.4	+12.6
Outlays (expenditures and net lending)	118.4	134.7	158.4	178.9	183.7	195.3	-0.2	+16.3	+23.7	+20.5	+4.8	+11.6
Surplus or deficit	-1.6	-3.8	-8.8	-25.2	+2.4	+3.4	+4.3	-2.2	-5.0	-16.4	+27.6	+1.0

Office of the Secretary of the Treasury
January 15, 1969

Table 2
UNIFIED BUDGET RECEIPTS AND EXPENDITURES,
VIETNAM AND NON-VIETNAM

	Fiscal Years						
	1964	1965	1966	1967	1968	1969(e)	1970(e)
Unified Budget							
Total Outlays	118.6	118.4	134.7	158.4	178.9	183.7	195.3
Total Receipts	112.7	116.8	130.9	149.6	153.7	186.1	198.7
(Surplus or deficit)	-5.9	-1.6	-3.8	-8.8	-25.2	2.4	3.4
Total Outlays, By Type							
Vietnam	-----	0.1	6.1	20.6	26.8	29.2	25.7
Non-Vietnam							
Trust	22.7	23.2	26.4	31.6	35.5	39.6	44.0
Other	95.9	95.1	102.2	106.2	116.5	115.0	125.5
Total Receipts, By Type							
Vietnam Receipts	-----	-----	1.2 1/	4.6 2/	1.5 3/	16.5 4/	17.2 4/
Non-Vietnam Receipts	112.7	116.8	129.7	145.0	152.2	169.6	181.5
Non-Vietnam Outlays	118.6	118.3	128.6	137.8	152.1	154.5	169.6
Non-Vietnam Receipts	112.7	116.8	129.7	145.0	152.2	169.6	181.5
(Surplus or deficit)	-5.9	-1.5	1.1	7.2	0.1	15.1	11.9

1/ Deferral of scheduled reduction in excise taxes on telephone service and automobiles.
2/ Tax Adjustment Act of 1966.
3/ Deferral of excise tax reduction.
4/ Effect of the Revenue and Expenditure Control Act of 1968 actual and proposed.

January 15, 1969

Table 3

NEW BUDGET CONCEPT[1] OF FEDERAL DEBT AND FEDERAL DEBT AS PERCENT OF GNP
(In Billions of Dollars)

End of Fiscal Year	Federal Debt		Federal Debt Held by the Public	
	Gross	Held by public	Change	Percent of GNP
1950	256.9	222.2	+4.6	84.4
Korea				
1951	255.3	217.2	-5.0	70.0
1952	258.8	217.5	+0.3	64.5
1953	265.7	221.1	+3.6	61.6
1954	270.8	224.5	+3.4	62.0
Peacetime				
1955	274.4	226.6	+2.1	59.9
1956	272.7	222.2	-4.4	54.3
1957	272.3	219.4	-2.8	50.9
1958	279.6	226.3	+6.9	51.4
1959	287.7	235.0	+8.7	50.1
1960	290.8	237.1	+2.1	47.9
1961	292.9	238.6	+1.5	47.1
1962	303.2	248.3	+9.7	45.8
1963	310.8	254.4	+6.1	44.4
1964	316.7	257.5	+3.1	42.1
1965	323.1	261.6	+4.1	40.0
Viet Nam				
1966	329.4	264.6	+3.0	36.7
1967	341.3	267.5	+2.9	34.9
1968	369.7	290.6	+23.1	35.3
1969e	365.2	276.6	-14.0	31.0

1/ This concept excludes Federal Land Banks', Federal Home Loan Banks', and District of Columbia debt and Federal security holdings, CCC certificate of interest, and non-interest bearing debt issued to international lending institutions; it includes defense family housing mortgages.

e - Estimated.

January 15, 1969

Table 4

Comparison of Tax Liabilities Under Proposed Surcharge Continuation 1/

Single Individual

Wage income	1963 tax	1967		1968		1969			1970	
		Tax 2/	Change from 1963	Tax 3/	Change from 1967	Tax 4/	Change from 1968	Change from 1963	Tax 5/	Change from 1969
$ 1,000	$ 62	$ 16	$ -46	$ 16	$ 0	$ 16	$ 0	$ -46	$ 16	$ 0
1,900	224	147	-77	147	0	147	0	-77	147	0
2,000	242	163	-79	166	3	167	1	-75	165	-2
3,000	427	333	-94	358	25	366	8	-61	350	-16
5,000	818	671	-147	721	50	738	17	-80	705	-33
7,500	1,405	1,168	-237	1,256	88	1,285	29	-120	1,226	-59
10,000	2,096	1,742	-354	1,873	131	1,916	43	-180	1,829	-87
12,500	2,887	2,398	-489	2,578	180	2,638	60	-249	2,518	-120
15,000	3,787	3,154	-633	3,391	237	3,469	78	-318	3,312	-157
20,000	5,900	4,918	-982	5,287	369	5,410	123	-490	5,164	-246
25,000	8,324	6,982	-1,342	7,506	524	7,680	174	-644	7,331	-349
35,000	13,778	11,627	-2,151	12,499	872	12,790	291	-988	12,208	-582

Office of the Secretary of the Treasury
Office of Tax Analysis

January 14, 1969

Note: There is no surcharge increase in 1968, 1969 or 1970 for a single person whose regular tax is $145 or less.

See other footnotes on **last page.**

Table 5

Comparison of Tax Liabilities Under Proposed Surcharge Continuation 1/

Married Couple, Two Dependents

Wage income	1963 tax	1967 Tax 2/	1967 Change from 1963	1968 Tax 3/	1968 Change from 1967	1969 Tax 4/	1969 Change from 1968	1969 Change from 1963	1970 Tax 5/	1970 Change from 1969
$ 3,000	$ 65	$ 4	$- 61	$ 4	$ 0	$ 4	$ 0	$- 61	$ 4	$ 0
5,000	420	290	- 130	290	0	290	0	-130	290	0
7,500	877	686	- 191	737	51	755	18	-122	720	- 35
10,000	1,372	1,114	- 258	1,198	84	1,225	27	-147	1,170	- 55
12,500	1,901	1,567	- 334	1,685	118	1,724	39	-177	1,645	- 79
15,000	2,486	2,062	- 424	2,217	155	2,268	51	-218	2,165	-103
20,000	3,800	3,160	- 640	3,397	237	3,476	79	-324	3,318	-158
25,000	5,318	4,412	- 906	4,743	331	4,853	110	-465	4,633	-220
35,000	9,037	7,529	-1,508	8,094	565	8,282	188	-755	7,905	-377

Office of the Secretary of the Treasury
Office of Tax Analysis

January 15, 1969

Note: There is no surcharge increase in 1968, 1969, or 1970 for a married couple whose regular tax is $290 or less.

See other footnotes on last page.

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Table 6

Comparison of Tax Liabilities Under Proposed Surcharge Continuation 1/

Married Couple, No Dependents

Wage income	1963 tax	1967		1968		1969			1970	
		Tax 2/	Change from 1963	Tax 3/	Change from 1967	Tax 4/	Change from 1968	Change from 1963	Tax 5/	Change from 1969
$ 2,000	$ 122	$ 58	$- 64	$ 58	$ 0	$ 58	$ 0	$- 64	$ 58	$ 0
3,000	305	204	- 101	204	0	204	0	-101	204	0
3,600	413	294	- 119	295	1	295	0	-118	294	- 1
5,000	660	501	- 159	533	32	543	10	-117	522	- 21
7,500	1,141	914	- 227	983	69	1,005	22	-136	960	- 45
10,000	1,636	1,342	- 294	1,443	101	1,476	33	-160	1,409	- 67
12,500	2,213	1,831	- 382	1,968	137	2,014	46	-199	1,923	- 91
15,000	2,810	2,335	- 475	2,510	175	2,568	58	-242	2,452	-116
20,000	4,192	3,484	- 708	3,745	261	3,832	87	-360	3,658	-174
25,000	5,774	4,796	- 978	5,156	360	5,276	120	-498	5,036	-240
35,000	9,601	7,997	-1,604	8,597	600	8,797	200	-804	8,397	-400

Office of the Secretary of the Treasury
Office of Tax Analysis

January 14, 1969

Note: There is no surcharge increase in 1968, 1969, or 1970 for a married couple whose regular tax is $290 or less.

See other footnotes on last page.

Footnotes:

1/ Tax liabilities assume minimum standard deduction or deductions equal to 10 percent of income, whichever is greater. Tax liabilities from optional tax table where income is under $5,000.
2/ From tax schedule revised in 1964 Tax Act.
3/ Includes 10 percent tax surcharge effective from April 1, 1968 to December 31, 1968 (i.e., 7-1/2 percent for calendar year). Surcharge liability from tables contained in the Revenue and Expenditure Control Act of 1968.
4/ Includes 10 percent tax surcharge proposed for full year. Surcharge liability computed as 10 percent of adjusted tax, but not to exceed 20 percent of adjusted tax in excess of $145 for single returns and $290 for joint returns.
5/ Includes 10 percent surcharge proposed for one-half year, effective from January 1, 1970 to June 30, 1970 (i.e., 5 percent for calendar year). Surcharge liability from tables prescribed for calendar year 1969 in the Revenue and Expenditure Control Act of 1968.

Chairman PATMAN. Now, Mr. Arthur M. Okun, Chairman of the Council of Economic Advisers. Mr. Okun, we will be glad to hear from you.

STATEMENT OF HON. ARTHUR M. OKUN, CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS

Mr. OKUN. Thank you, Mr. Chairman. In our closing days in office I can think of no more welcome opportunity for a valedictory than an appearance before this committee. As a member of the Council for 4½ years and as its Chairman during the past year, I have profited greatly from the advice, assistance, discussions, and consultation which the Joint Economic Committee has provided. The Council and the Joint Economic Committee are in a sense twin institutions on the executive and the legislative side and we have worked together effectively in promoting an unprecedented 8 years of economic expansion.

I wanted to turn my attention today to some of the tasks and problems that you people will continue to face in office and I will be observing as a private citizen in promoting a ninth year of unparalleled economic expansion for the Nation.

As 1969 begins, there is distinct evidence that the economy is moving toward improved balance. The advance of real output decelerated significantly from a 6½-percent rate early in 1968 to 4 percent by yearend. Still, a further slowdown is essential to achieve progress toward price and cost stability, to relieve pressures on our financial markets at home, and to strengthen our international trade performance.

Given the current situation and outlook, the fiscal restraint presently operating cannot be relaxed. It must be continued throughout 1969 and into 1970. Director Zwick will outline the administration's stringent program for Federal expenditures. On the revenue side an early expiration or reduction in the tax surcharge would be an unjustified and unwarranted move to fiscal stimulus in an economy that continues to need the firm hand of moderation. With the extension of the surcharge, the President's fiscal program seems well designed to meet the key objectives of providing moderation and yet avoiding excessive weakening of demand. Drastic restraint might make for somewhat faster improvement in our price performance, but only by imposing unconscionable human costs and enormous waste on the Nation.

BACKGROUND OF THE CURRENT SITUATION

To understand the current economic situation and tasks of policy, it is necessary to consider developments of the economy since the middle of 1965. At that time, we were advancing healthily in the longest and strongest peacetime expansion of our history. The subsequent upsurge in defense spending reinforced a strong advance of business investment, creating an unsustainable boom. From the second quarter of 1965 through the first quarter of 1966, the economy advanced much too rapidly. Prices and wages moved sharply upward in response to pressures of demand—particularly because of the speed at which demand was growing. Despite several measures adding to taxes and despite restraint in Federal civilian programs, fiscal policy was too stimulative in 1966, as defense requirements kept rising. In retrospect, there is general agreement that a tax increase would have been desirable at that time.

The economy experienced a welcome slowdown late in 1966 aided by a strong dose of monetary restraint. From late 1966 to the summer of 1967, the trend of prices improved, although it was still pushed up by earlier cost increases. Consumer prices and the overall price index of GNP both rose at annual rates of less than 2½ percent in the first half of 1967. Interest rates retreated, reflecting both the change of pace of activity and the shift toward easier monetary policy.

As of mid-1967, when the economy began to emerge from an inventory adjustment, we were moving back onto the track of reasonable price stability, and we were preserving our prosperity. To head off a new upsurge, the President then urged immediate enactment of a 10-percent surcharge on income taxes. If that recommendation had been promptly accepted, the economic history of the past year and a half would have been considerably more favorable.

RECORD OF 1968

Without action on taxes, however, the Federal budget became an engine of inflation. In the first half of 1968, the new boom took hold and prices advanced at a disturbing 4-percent rate. This was accompanied by a jump in imports; nervousness in international financial markets; and pressures on financial markets at home, which could not be appropriately accommodated by monetary policy.

By the time the Revenue and Expenditure Control Act became law in June, private demand was very strong and it had developed great forward momentum. There was a significant slowdown in the second half but not as large or prompt as we had expected and hoped. Late in the year, business investment spending moved strongly upward from its earlier plateau. Housing rebounded in the face of tighter credit conditions. Consumer spending rose sharply in the summer months. But the marked slowdown of consumption in the fourth quarter showed that the tax surcharge had begun to exert a restraining impact.

Thus, in some respects, 1968 was too big a year. Yet, the unprecedented 8th consecutive year of expansion brought a 5-percent gain in real output, a 2.1-million rise in nonfarm payrool employment, and a decline in the unemployment rate of 3.6 percent—indeed, to 3.3 percent by yearend.

OUTLOOK FOR 1969

The outlook points to a further appropriate slowing of overall activity in the first half of 1969. Inventory investment is likely to retreat from its recent unusually high rate. Although, the saving rate of the consumer could move downward, the growth of consumer spending is likely to be moderate. Homebuilding will do well to stay near current levels in today's financial markets. And indeed the 15-percent decline in housing starts for December reported today indicates the problems that housing may be beginning to have in these markets.

Federal purchases should change very little. Current evidence suggests that, in the first half—GNP may rise at an annual rate between 5 and 6 percent—slowly enough to achieve a desirable cooling off, but rapidly enough to maintain distinct advances of output and development.

If the tax surcharge were to expire at midyear, a marked fiscal stimulus would be applied to the economy, and a renewed major acceleration of activity would be likely. The only visible alternative to that acceleration in the event of expiration of the surcharge, would be a drastic dose of monetary restraint—a remedy which we should clearly avoid. Monetary restraint could do the job of stopping any incipient boom but it could do so only by pressing unevenly on homebuilding and its credit sensitive sectors of the economy and by disturbing the flows of credit in our financial markets.

In view of this diagnosis, I believe, one can conclude that the whole Nation will benefit if Congress makes clear that a timely and favorable verdict on the extension of the surcharge will be forthcoming. Of course, if peace is achieved, if the expenditure outlook changes markedly for other reasons, or if private demand softens dramatically, the program will require review. In that event, an easing of monetary policy—we well as an adjustment of fiscal policy—could respond to the changing needs.

To meet the possible need for flexibility in fiscal policy, the President has suggested that Congress review its procedures for changing tax rates. He has suggested that, for the immediate future, it might be desirable to give the President discretion to remove the surtax in whole or in part, subject to congressional veto. For the longer run, he suggests that Congress might give the President continuing limited authority to adjust tax rates up or down as needed for stabilization purposes, again subject to congressional veto. Or, alternatively, the Congress could reform its own procedures in such a way as to assure a prompt verdict—either way—on a Presidential request for stabilizing tax legislation.

I know this committee has studied these issues long and hard over the years. I think, in light of the experience of the past 2 years, another look at this important issue is in order.

With appropriate fiscal action, we look forward to a healthy but moderate advance in 1969. For the 4th year in a row, the unemployment rate should remain below 4 percent. Real incomes should advance generally, and prosperity should be extended. We should witness a moderation of import demand, a reduction of pressures in financial markets, and gradual moderation in price and wage increases.

We cannot, however, expect rapid or dramatic improvement in the trend of prices. The price-wage spiral simply cannot be halted within a single year.

ROAD TO PRICE STABILITY

Rather, we must look toward a gradual return to reasonable price stability in a prosperous environment. This will require first and foremost, high standards of fiscal and monetary policy. But those policies cannot do the job alone. They will need to be reinforced by measures to enlist voluntary restraint in the price and wage decisions of large corporations and strong unions. They will need to be reinforced by measures to improve the structural efficiency of the economy. In chapter 3 of the Council's report, we spell out a variety of private and public actions that may help to improve the price performance of a prosperous economy. These are an agenda for exploration rather than a program of specific reforms or legislative proposals. We do want to stress that the battle against inflation must be fought on many fronts. It must include steps to improve mobility and efficiency of our labor markets, to continue on the course of freer world trade, and to strengthen productivity and competition in our industries.

OTHER ISSUES

The Council's report also contains a detailed discussion of the international monetary system and of many proposals for further improvement in its operation. We hope our analysis will contribute to the careful and intensive dialog which must precede the adoption of any reforms.

Our report also analyzes the problem of poverty in our prosperous economy. The number of Americans below the poverty income line has declined from roughly 40 to 22 million between 1960 and 1968. We have a considerable way to go, but our recent progress certainly argues for redoubling our efforts rather than relaxing in the war on poverty. When we are at a position where 1 percent of our gross national product, if handed out individually to all the people who are poor, would be sufficient to bring them up to the poverty line, it seems a shame to have a continuing major blemish of poverty among 11 percent of our citizens.

Finally, let me point to the report of the Cabinet Coordinating Committee on Economic Planning for the End of Hostilities in Vietnam. It summarizes the studies made over the past 2 years to provide some guidance on how the Nation can best make the economic transition to peace. When that welcome day arrives, fiscal and monetary policy will be confronted by demanding challenges, but they should be equal to the task of promoting a reasonably smooth transfer of resources from the uses of war into the service of peace.

Thank you.

Chairman PATMAN. Thank you, sir.

Our next witness is Charles J. Zwick, Director of the Budget. We are glad to have you, sir, and you may proceed in your own way.

STATEMENT OF HON. CHARLES J. ZWICK, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. ZWICK. Thank you, Mr. Chairman.

First, let me second the comments of my colleagues. I found the exchanges with this committee to be both productive and gracious. I think they were important to policy formulation, and in leaving, we leave with the greatest of respect for this committee.

I have a prepared statement, Mr. Chairman, but in the interest of time I would be happy to paraphase it and submit it for the record, if acceptable.

Chairman PATMAN. Without objection, so ordered.

We will also include Secretary Barr's prepared statement in the record along with the supplementary materials.

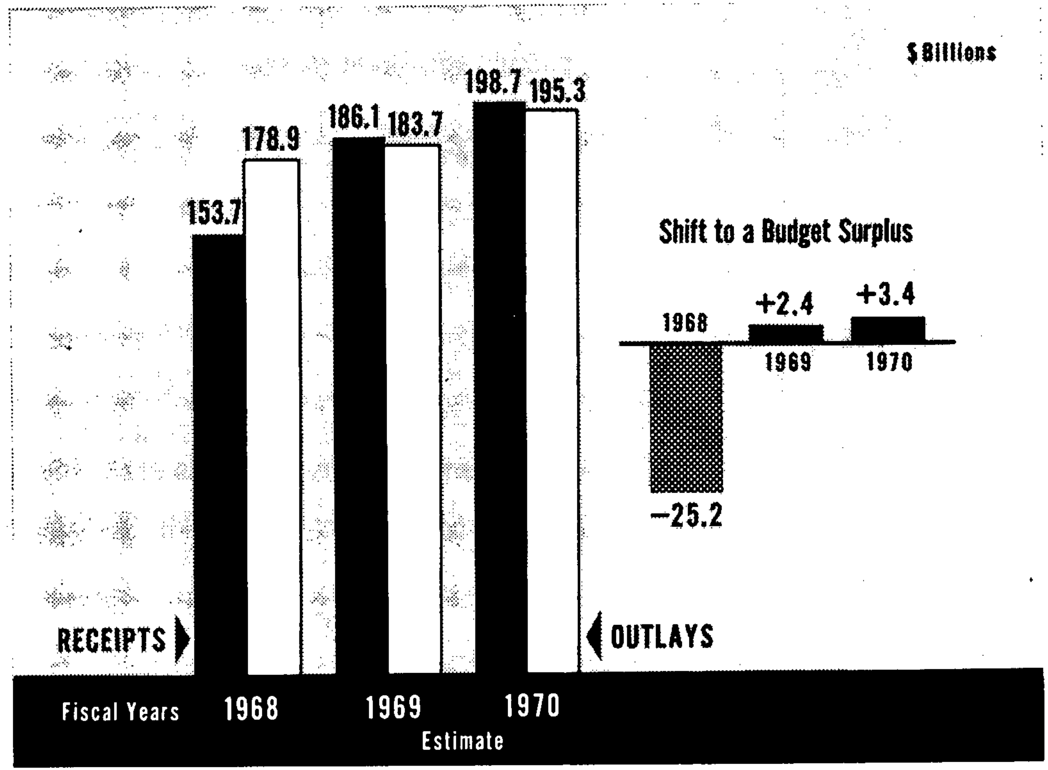
Mr. ZWICK. I would like to make a few comments and work from a set of charts that you have labeled the "1970 Budget Charts." You have some charts also from the Treasury there if you can distinguish between them.

Chairman PATMAN. Would you like to have it in the record at this point?

Mr. ZWICK. Yes.

(The "1970 Budget Charts" referred to follow:)

Budget Totals, 1968-1970



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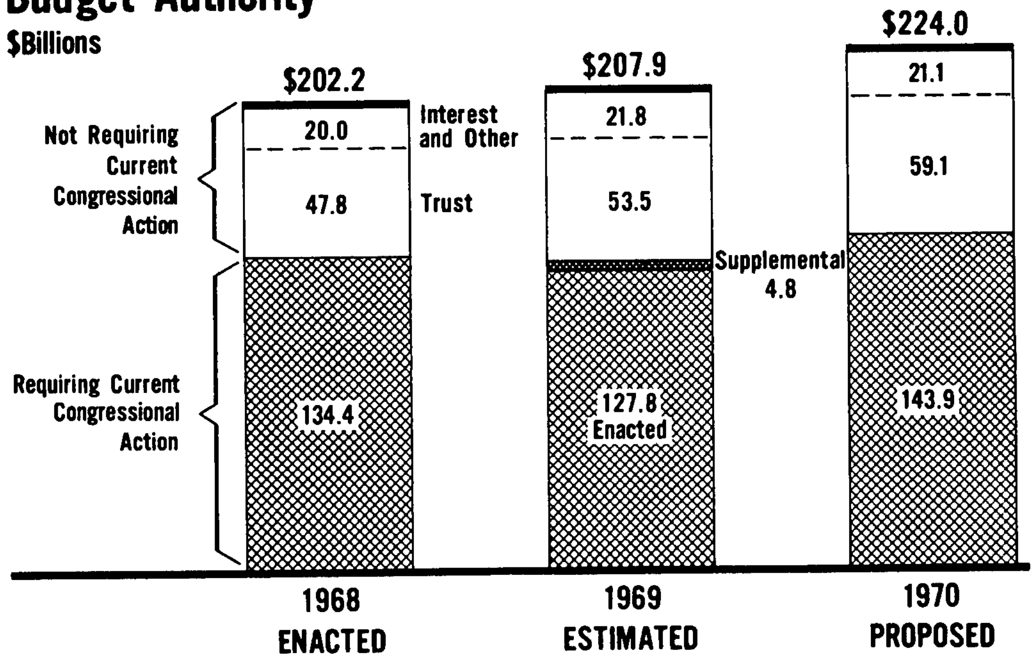
BUDGET AUTHORITY AND OUTLAYS FOR 1969—RELATIONSHIP TO PUBLIC LAW 90–364

$ Billions

Description	January 1968 estimate	Current estimate	Change
BUDGET AUTHORITY			
Programs excepted from Public Law 90–364 limitation	$98.4	$104.6	+$6.1
Remainder—covered by Public Law 90–364 limitation	103.3	90.1	–13.2
Total budget authority	201.7	194.6	–7.1
BUDGET OUTLAYS			
Programs excepted from Public Law 90–364 limitation	92.6	98.6	+6.0
Remainder—covered by Public Law 90–364 limitation	93.5	85.1	–8.3
Total budget outlays	186.1	183.7	–2.4

Budget Authority



NOTE: Amounts have not been Adjusted for:	1968	1969	1970
INTERFUND AND INTRAGOVERNMENTAL TRANSACTIONS	6.9	8.7	9.1
PROPRIETARY RECEIPTS FROM THE PUBLIC	4.7	4.6	4.8

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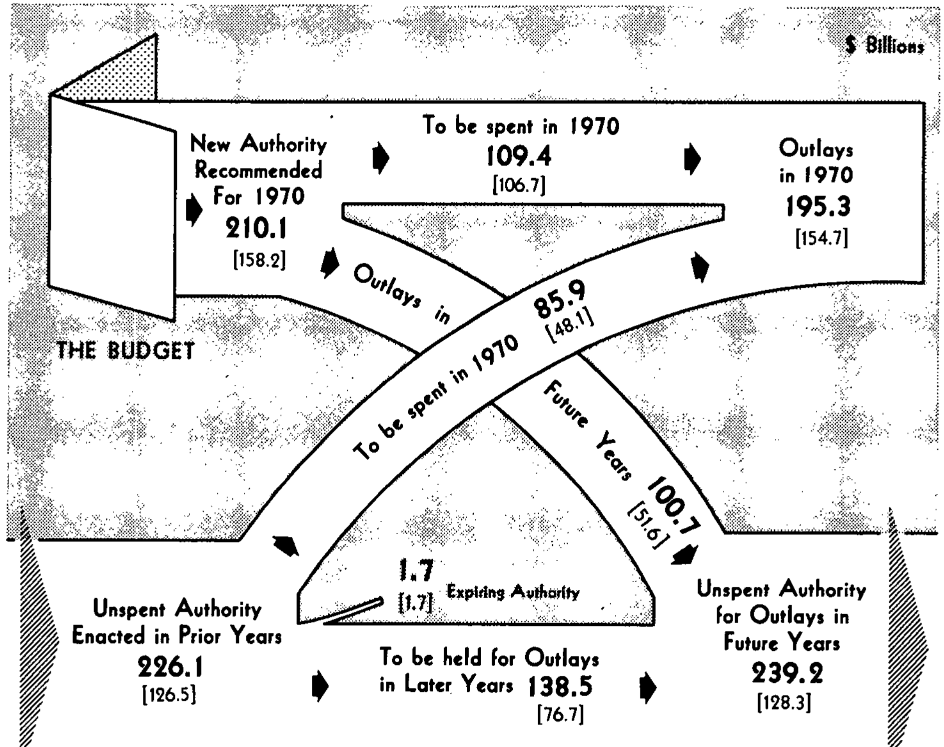
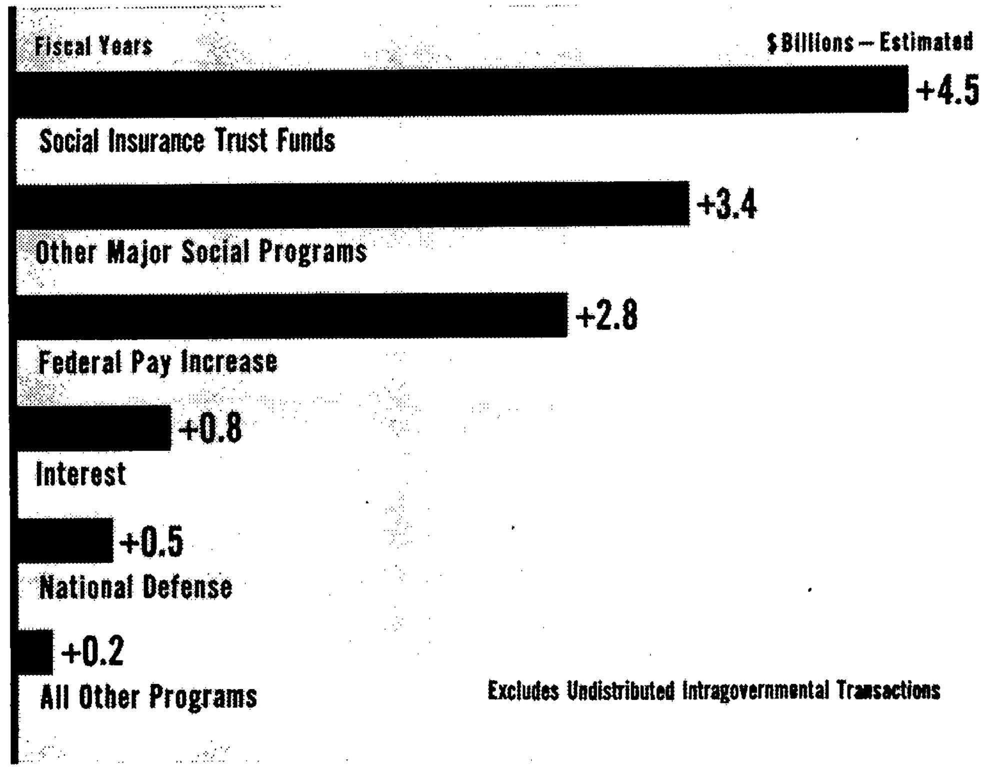
1970 Budget – Relation of Budget Authority to Outlays

Figures in brackets represent Federal funds only



NOTE: The difference between the total budget figures and Federal funds shown in brackets consists of trust funds and intragovernmental transactions between funds.

Change in Budget Outlays, 1969–1970



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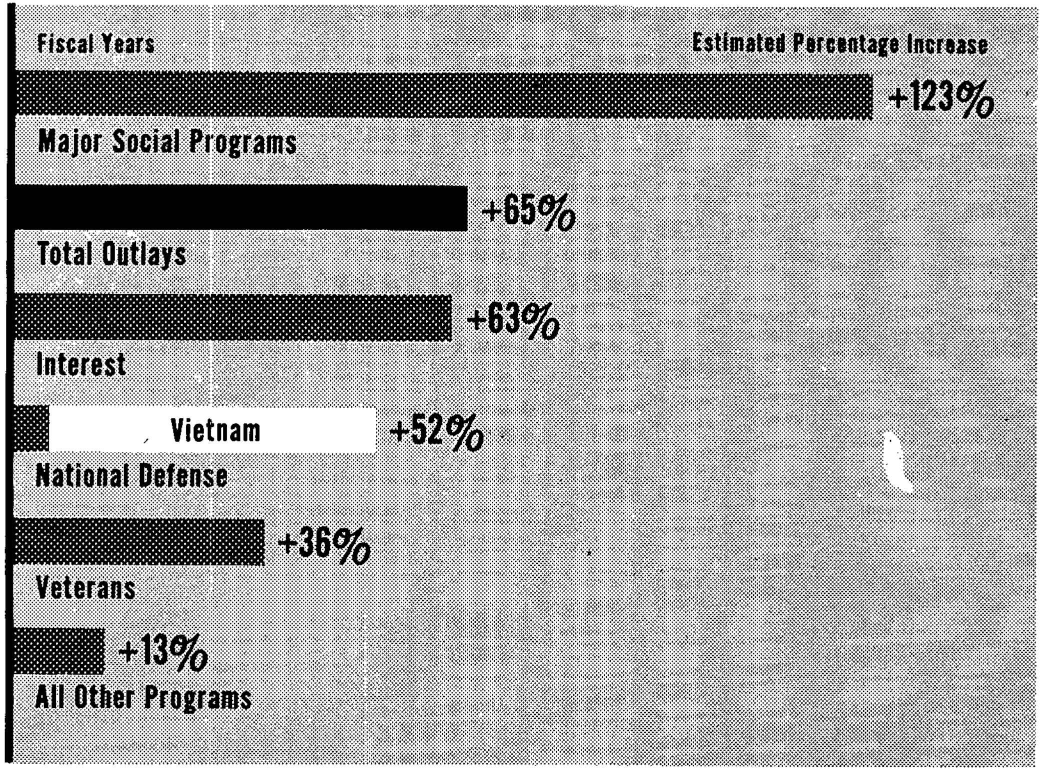
Trends in Federal Budget Outlays, 1964–1970



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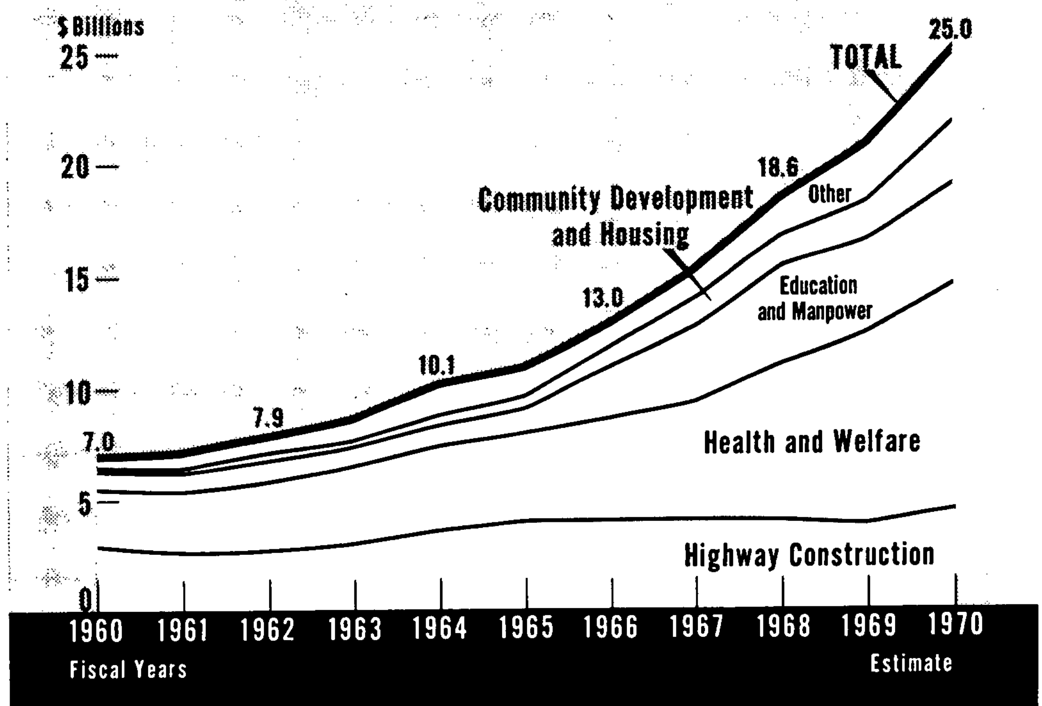
Federal Aid to State and Local Governments



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Secretary BARR. Mr. Chairman, the charts that were presented in my statement, may they be included in the record, too?

Chairman PATMAN. Yes, sir, they may be included with your statement.

Mr. ZWICK. The first chart gives the budget totals and the deficit-surplus situation. I would like to make three quick points with regard to this chart.

First, as the chart shows, there is a desirable turnaround from a big deficit in fiscal 1968 to a surplus for both fiscal years 1969 and 1970. A surplus of $2.4 billion is predicted for 1969 and another of $3.4 billion is estimated for fiscal 1970. As my colleagues have said, we believe this is appropriate to the economic and fiscal situation we are now facing.

The second point I would like to make is that the 1969 expenditures and revenue estimates are at this point, we believe, quite firm. We are 6 months through the year. Absent any major events—and, of course, something like a Middle East explosion could change this—but absent any major unforseen events, we think these are pretty accurate estimates. I first draw your attention to the $183.7 billion expenditure estimate for fiscal 1969. That compares with the $186.1 billion we projected a year ago this time and the $184.4 billion level that we projected in the midyear review last September.

Now, briefly, we have 5 months of objective information available to us, from July through November of this year. On the basis of those 5 months, if you adjust for the seasonality in the agricultural programs and construction programs—for example, the Corps of Engineers spends about 60 percent of its money in the first 6 months of any fiscal year because the work is done in the summer and the bills are paid in the fall—if you adjust for seasonality, outlays have been running in the first 5 months of this fiscal year at a rate of $181 billion. So, therefore, from here on out, the new administration can have outlays running at a rate of about $187 billion for the rest of the year and still meet the estimated expenditure level of $183.7 billion.

Second, we do have a preliminary estimate for Defnse for the month of December. It will be about another week before the Monthly Treasury Statement comes out for the month of December but we do have a preliminary estimate for the Defense and military assistance for the month of December. On the basis of that preliminary estimate, we believe that Defense and military assistance expenditures for the first 6 months of this year will be $38½ billion.

Now, the 1970 budget estimates Defense expenditures for fiscal year 1969 as a whole at $78.4 billion. In other words, the new administration can spend another $40 billion and still meet the $183.7 billion target that we are talking about. So, we think, absent any major change of events, and a continuation of the policies and procedures we have instituted, that the $183.7 billion is a fairly firm estimate of where we should be coming out in expenditures in 1969.

Similarly, data on 1969 revenues are pretty advanced and, therefore, the $2.4 billion surplus ought to be a quite good number.

The third point I would like to make with regard to this chart is that if you look at the increase in expenditures over the 2-year period 1968–1970—there has been some distortion in the 1969 figures because of the Revenue and Expenditure Control Act of 1968—if you look over the 2-year period, 1968 to 1970, you will find that expenditures have gone up from $178.9 to $195.3 billion, an increase of $16.4 billion, or, on the average, $8.2 billion a year. That is a fairly modest increase, I would say. Of that $16.4 billion, about $7 billion is trust fund increases. So, if you subtract out the trust fund increases, you have had an increase over 2 years of a little over $9 billion for Federal funds, an increase of $4½ billion a year.

Now, there is something like between 3 and 4 percent growth, about half as fast as the economy is growing. Therefore, this is indeed, in our estimation, a very tight budget.

The second chart, very briefly, is a table which shows what has happened under the Revenue and Expenditure Control Act of 1968 (Public Law 90–364). There were two mandatory provisions, as you are aware, with regard to appropriations and expenditures. One was that appropriations should be cut by at least $10 billion and the other was that expenditures should be reduced by $6 billion—in both cases excepting certain programs. The first bank of this table says that the Congress, plus reestimates, accomplished the first requirement of the law. Budget authority for the programs covered by the law is cut by $13.2 billion, so the administration did not have to take any further actions.

The second bank of figures on the chart says that we are not only cutting $6 billion but we are cutting $8.3 billion in the expenditures covered by the law, and that comes about through a series of special circumstances.

At the time of the midyear review, when we appeared before this committee, we were estimating a cutback in expenditures of about $6½ billion. At that time, as I indicated to you, we were assuming we had to absorb the increased costs of public assistance and CCC payments with the extra large worldwide crop this year.

Subsequent to that, Congress exempted the CCC overruns, the public assistance overruns, and $100 million for impacted school aid. It also enacted two laws which allowed the banks for cooperatives and the intermediate credit banks to convert to private ownership and therefore fall outside of the budget. The special circumstances associated with all of those actions and other smaller charges brought us up to about an $8.8 billion reduction in expenditures. We did put some money back into HEW and Agriculture as we promised we would if Congress enacted the exemptions for public assistance and CCC. So the net of all these factors led to an estimated reduction of $8.3 billion in expenditures.

The next two charts are technical charts on the appropriations process. I would suggest we skip them and go to a fourth chart which gives a breakdown as to what the changes are in the 1969–70 budget situation.

Chairman PATMAN. All of them will be placed in the record.

Mr. ZWICK. Thank you, sir.

Briefly, this chart points out that of the $11.6 billion increase in outlays between 1969 and 1970, $4½ billion is in the social insurance trust funds; $2.9 billion of that increase is under existing law. The remaining $1.6 billion increase assumes the enactment of the social security improvements that President Johnson recommended both in the state of the Union message and in his budget message.

Outlays for other major social programs are up by $3.4 billion. The major programs here include Model Cities, JOBS program—job training programs in general, but the JOBS program in specific—the program with the National Alliance of Businessmen, is doubled; it goes from 70,000 positions in 1969 to 140,000 positions in 1970. Medicaid and public assistance are also increasing. Community facilities, health, education, all of these are up from 10 to 15 percent. Feeding programs are also up. Across the board, total food assistance for the poor is up 44 percent from 1969 to 1970.

The other increases, then, are $2.8 billion for the Federal pay increase coming in July 1969, $800 million for interest, national defense up $500 million, and all other programs up $200 million.

Now, within that $200 million, however, there are a number of ups and downs. In fact, there are $2.2 billion of ups and $2 billion of downs. Programs for crime control are up about 35 percent. Overall, the budget anticipates close to $900 million for crime control programs.

There are expansions in the highway program, and an expansion in the airports and airways facilities programs, assuming that user charge legislation is passed. We have two elements in the FAA budget: One, about $45 million that we consider essentially a baseline increase in FAA, and then another $150 million for airways development contingent on the enactment of user charges to pay for these facilities. So that you do have a number of ups, almost offset by downs for the postal deficit, the space program and other decreases.

But I think this chart indicates the priorities that the Johnson administration has followed in putting this budget together.

Now, the next chart takes a look at the six budgets that President Johnson has submitted during his Presidency. The 1970 budget being his last budget, we thought it was appropriate to summarize the priorities of the entire period, and the result looks very similar to the chart you just looked at. If you look over those six budgets from 1964 through 1970, the total of outlays—the total budget—goes up by 65 percent. Major social programs go up almost twice as fast, 123 percent. Interest is up 63 precent. National defense is up 52 percent, the major part of that being for Vietnam. Veterans programs are up 36 percent. All other programs increased by 13 percent. So, I think the record is quite clear as to the priorities that the Johnson administration has set over the six budgets it submitted.

Lastly, let me say a few words about a subject on which I think there needs to be some clarification—Federal aid to State and local governments. The last chart in this series, I think, indicates quite dramatically the expansion in these aids, going from a $10.1 billion level in 1964 to a $25.0 billion level in this budget, a 2½ times increases. Compared with 1969, there is a $4.2 billion increase in fiscal 1970 for Federal aid to State and local governments.

This has meant a number of things. First, it means that State and local governments are now more dependent than ever on Federal revenues for carrying out their programs. In 1964, approximately 15 percent of the revenues available to State and local governments came from Federal grant programs. That now has increased to 18 percent. So, in other words, almost 20 percent of the money available to State and local governments to carry out their programs comes through grant-in-aid programs from the Federal Government. There has been a significant increase in these grant programs in recent years.

Second, there has been a major shift from rural to urban areas. I am sorry that Senator Javits is not here, His earlier comments were similar to those in the New York Times editorial yesterday on this subject.

I think if you would look at the Special Analyses volume of the budget you will find a sharply different picture than offered in that editorial. While total grants to State and local governments have gone up significantly, they have gone up even more rapidly to urban areas. Federal grants to metropolitan areas have gone from $5.6 billion in 1964 to $16.7 billion in 1970, roughly tripling over this period. In the 1970 budget, 67 percent of Federal aid programs are going to urban areas. That happens to be just about equal to the percentage of the total population that lives in urban areas. So there has been a major shift over these last 5 years in aid programs to urban areas.

Now, you can argue whether this shift has been fast enough or too fast, but there has clearly been a major shift from rural to urban emphasis. In 1964, 55 percent of Federal aid funds went to urban areas. Now 67 percent goes to urban areas.

Lastly, I think it is important to indicate two additional sources of support for urban areas. First, the tax expenditure analysis that Secretary Barr gave you earlier indicated a major investment in urban areas through tax credits, and secondly, the President recommended, and we think this is of critical importance, in his state of the Union message and in his budget message, the creation of an Urban Development Bank, a bank whereby moneys can be raised in the private market and channeled at lower interest rates to urban areas.

So, I think the record is quite clear that there has been a dramatic and important shift to urban areas during this administration. Whether it was enough or too much is obviously a matter on which we probably have as many opinions as we have people in the room. Mr. Chairman, that summarizes my statement.

(The prepared statement of Mr. Zwick follows:)

PREPARED STATEMENT OF DIRECTOR OF THE BUREAU OF THE BUDGET CHARLES J. ZWICK

Mr. Chairman and Members of the Committee, my colleagues have discussed the basic fiscal policy governing our overall tax and program recommendations for the fiscal year 1970. Let me just run through briefly the budget totals and some of the highlights of the budget outlay figures.

Given the uncertain outlook at this time with respect to Vietnam and the continued need for positive action to foster a return to relative price stability, we believe that the appropriate policy is to plan for surpluses in the Federal budget in the current and upcoming fiscal years. As you know, we ran a $25.2 billion budget deficit in fiscal year 1968. As a result, the Federal Government's borrowing requirements were exerting an extreme upward push on interest rates.

Now, for fiscal year 1969, we expect a sharp swing to a budget surplus of $2.4 billion. The budget recommendations for 1970 should produce a further surplus of $3.4 billion, with a restrictive expenditure policy and extension of the income tax surcharge and current automobile and telephone excise tax rates for another year. The fiscal restraint embodied in these surpluses—along with appropriate monetary policy and restraint by business and labor in their price and wage decisions—should contribute to an easing in the upward pressure on interest rates, further improvement in our basic balance of payments position, and a return to a sustainable rate of economic growth.

For fiscal year 1969, our estimates of outlays are, of course, influenced by the restriction placed on us by the limitation on some outlays included in the Revenue and Expenditure Control Act of 1968 (P.L. 90-364). Total outlays in 1969 are now estimated at $183.7 billion, compared with the $184.4 billion we esitmated last September in our Summer Review of the Budget. Actual data available for the year so far indicate that in the first five months—July through November—outlays ran at an annual rate of $181 billion, after correcting for the seasonality of agricultural and construction programs. Therefore, we could have a rate of about $187 billion for the rest of the year, and still hit the budget estimate.

BUDGET TOTALS

[Fiscal years. In billions]

Description	1968 actual	1969 estimate	1970 estimate
Budget receipts	$153.7	$186.1	$198.7
Budget outlays	178.9	183.7	195.3
Budget surplus (+) or deficit (—)	—25.2	+2.4	+3.4

We have a preliminary December figure for defense, including military assistance, which gives us a half-year defense total of about $38.5 billion. The estimate for the entire current fiscal year is $78.4 billion, so, again, defense could run at a higher rate in the last half of the fiscal year—up to $40 billion—and we would still make the estimate in the budget.

There are always unknowns in estimating, but all in all, we believe the 1969 estimates are sound. I might just add that for the programs excepted from P.L. 90-364, outlays are now estimated $6 billion higher than last January's budget. For those covered by P.L. 90-364, we are showing a decline of $8.3 billion from the original estimate, so that we are achieving the reduction required in the law and allowing leeway for unforeseen increases in the months ahead.

Turing to fiscal year 1970, I think the policy which guided us in our program recommendations can best be summed up by quoting a statement from the President's budget message:

"This Nation can and must bear the cost of the defense of freedom and must at the same time move ahead in meeting the pressing needs we face at home. But caution and prudence require that we budget our resources in a way which enables us to preserve our prosperity, strength the U.S. dollar, and stem the increased, price pressures we have experienced in the past few years."

The estimates for 1970 reflect a restrictive expenditure policy generally, and have also had to take into account distortions which have arisen as a result of the ceiling on outlays for 1969, which followed on a statutory percentage formula reduction in agency obligations enacted for 1968. We believed it would be unwise to try to correct these distortions all in fiscal year 1970, and have therefore found if necessary to continue a policy of outlay management in developing our 1970 estimates.

Within these constraints, the budget makes reasonable provision for ongoing programs, including reductions wherever possible, and proposes some selective expansions in urgent domestic activities which the Administration has stressed as a means of improving the lives of all Americans—for example, education, health, manpower training, housing, community development, greater security for the elderly, food assistance, and crime control.

In total, budget outlays are estimated to increase by $11.6 billion between 1969 and 1970. Of this amount, major social programs will be up by $7.9 billion, including $4.5 billion in the social insurance trust funds. A part of the trust fund increase reflects recommended legislation to raise overall social security benefits by 13% effective January 1, 1970, including at least a 10% increase for almost all beneficiaries, an increase in the minimum to $80 a month, an increase in the earnings limit before benefits are lost, and other improvements in the system. Other than through trust funds, outlays for major social programs are estimated to rise by $3.4 billion, including—

A doubling of the JOBS program, from 70,000 slots in 1969 to 140,000 in 1970.

A continuation of efforts under the 10-year housing program, with a goal of starting about 500,000 low and moderate income housing units next year.

An increase of over $450 million for the Model Cities program.

Substantial increases for health, education, welfare, and other community development programs.

Thus, the 1970 budget will maintain the momentum in key social programs, while holding down other parts of the budget.

The Federal pay raise due to take effect in July 1969 accounts for $2.8 billion of the overall increase. Interest costs will be up by $0.8 billion, while national defense outlays are estimated to rise by $0.5 billion, reflecting—for the first time in several years—an increase for forces not committed to Southeast Asia support, substantially offset by reductions in outlays for Vietnam.

Outlays for all ohter programs will increase, net, by only $0.2 billion. This net rise reflects both increases—totaling about $2.2 billion—and decreases—totaling about $2 billion. Major increases are provided for such activities as the highway program, the recently-enacted safe streets program, and a proposed expansion in our airways system contingent on enactment of increased aviation user charges. Among the decreases are a reduction in the postal deficit based on proposal postal rate adjustments, reductions for Commodity Credit Corporation price support operations and P.L. 480 shipments, and a continued decline in outlays for the space program.

CHANGING STRUCTURE OF FEDERAL BUDGET OUTLAYS

[Fiscal years. In billions]

Program	1964 actual	1968 actual	1969 estimate	1970 estimate	Change 1964-70
National defense	$53.6	$80.5	$81.0	$81.5	+$28.0
(Special Southeast Asia support)		(26.5)	(28.8)	(25.4)	(+25.4)
Major social programs:					
Social insurance trust funds (excluding medicare)	22.7	30.2	33.3	37.2	+14.4
Welfare payments and services	3.4	4.6	5.3	6.1	+2.6
Education and manpower training	1.6	6.4	6.5	7.2	+5.6
Health (including medicare)	1.8	9.7	11.4	13.0	+11.2
Low and moderate income housing	(1)	.9	.9	1.1	+1.1
Community and regional development	.8	1.8	2.4	3.3	+2.4
Subtotal, major social programs	30.4	53.7	59.8	67.8	+37.4
Interest	9.8	13.7	15.2	16.0	+6.1
Veterans benefits and services	5.7	6.9	7.7	7.7	+2.0
All other programs	22.1	28.6	25.0	24.9	+2.8
Allowances for pay increase and contingencies			.1	3.2	+3.2
Undistributed intragovernmental transactions	−2.9	−4.6	−5.1	−5.7	−2.8
Total	118.6	178.9	183.7	195.3	+76.7

1 Less than $50,000,000.

The priorities implicit in the 1970 budget can be sharpened by looking at the trends in outlays over the 6-year period covering the years of the Johnson Administration budgets. Between 1964 and 1970, total outlays will have risen by 65%. However, within that total, major social programs show an increase of 123%, more than doubling since 1964. This is twice the rate of increase for any other category of Government programs. Interest is up 63% in these years. National defense outlays, including special Southeast Asia support, are up 52%. Veterans benefits and services will have risen by 36% between 1964 and 1970. All the other programs of the Government show a growth of about one-eighth in this 6-year period, clearly reflecting, I believe, the policy of holding down on programs of less urgency and reducing outlays to the extent feasible, while giving highest priority to efforts to meet urgent domestic needs.

In these efforts, the Federal Government is increasingly relying on State and local governments, through rising amounts of Federal financial aid. Grants to State and local governments, are estimated to total $25 billion in 1970, compared with $20.8 billion in the current fiscal year. Since 1964, grants have doubled in amount and now make up more than one-fifth of total Federal spending for civilian domestic programs. Federal-aid outlays now represent about 18% of State and local revenues, compared with about 15% in 1964.

Of particular interest is the fact that within the total of Federal grants, there has been a major shift to urban metropolitan areas, where almost two-thirds of all Americans live. A considerable amount of direct Federal outlays goes into these areas in the form of transfer payments to individuals, such as social security benefits, or through construction projects, such as post offices. However, in addition, Federal grant programs have been increasingly focused on urban areas. In 1964, an estimated $5.6 billion, or 55%, of total Federal grants to State and local governments went to metropolitan areas. The 1970 budget provides $16.7 billion for aid to these areas, triple the amount in 1964, and representing about 67% of total Federal grants estimated for 1970.

Looking to the future, the President is recommending establishment of an Urban Development Bank to provide substantial amounts of long-term financing of public facilities in urban communities through the combined efforts of Federal, State, and local governments and private enterprise. This Bank would raise funds primarily by issuing federally guaranteed bonds to the public and, in addition to financial aid, would provide technical assistance to the Nation's urban areas.

In conclusion, I believe that the 1970 budget represents an appropriate response to the fiscal policy requirements for maintaining a healthy and vigorous economy and provides for continuing the progress we have made in meeting both the Nation's military needs and high priority domestic objectives.

Chairman PATMAN. Thank you very much, sir. Without objection, we will continue the traditional policy that this committee has had a long time of recognizing each member for 10 minutes to question our witnesses until each member present has had an opportunity to interrogate the witnesses.

Now, I will ask you gentlemen three questions here and I will ask you to answer them when you go over your transcript of the record of this proceeding. If that is satisfactory, we will save a little time that way.

We have very disturbing distortions in our economy. The excessive level of interest rates, the highest in our history, is threatening the housing industry and the small businessman. It is always the weakest who are hurt by tight money.

Do you not believe, as a responsible public official, that we have to do something about it and do it quickly?

(The following reply was submitted by the Council of Economic Advisers:)

COUNCIL OF ECONOMIC ADVISERS RESPONSE TO CHAIRMAN PATMAN

I would certainly agree that high interest rates and tight money create disturbing economic distortions. As you suggest, these bear down inequitably on particular groups in our economy such as homebuilders and home buyers. The only appropriate remedy and preventive strategy for countering these trends is greater reliance on fiscal policy for economic restraint. Relieving the pressure on financial markets was a key objective of the administration's tax proposals in 1967 and early 1968, and it is an important reason for extending the surcharge this year. If fiscal policy does not provide the needed restraint, tight money may become the only alternative to an inflationary boom which would be even more dangerous and more inequitable.

Under present circumstances, it would be unrealistic to expect a rapid reversal and decline of interest rates. It will take clear and distinct evidence of an economic slowdown to convince both borrowers and lenders that financial conditions will relax and to alter inflationary expectations which tend to raise interest rates. A bipartisan consensus in the Congress on supporting extension of the surcharge would have favorable effects on financial markets. With the stabilization program that we are proposing, the Federal Reserve should be able to reduce the restraint from monetary policy gradually within 1969.

(The following reply was submitted by the Treasury:)

TREASURY DEPARTMENT RESPONSE TO CHAIRMAN PATMAN

Interest rates are extremely high by historical standards. In key areas, they stand well above the peaks reached at the time of the "credit crunch" in 1966. However, while credit is expensive, it is much more generally available than during the 1966 period of stringency. It is hoped that a satisfactory degree of credit availability can be maintained and that there will be no repetition of the 1966 experience when home financing and construction, as well as other areas of the economy, experienced a heavy burden of adjustment.

The shift to fiscal restraint embodied in the Revenue and Expenditure Control Act of 1968 had as one of its important objectives the maintenance of adequate flows of credit and the avoidance of undue reliance upon monetary tightening. For the present, a degree of monetary and fiscal restraint is required in order to achieve a necessary moderation of inflationary pressure. But, the fiscal measures now in place should gradually ease the existing pressures on credit markets and allow monetary policy a needed degree of flexibility.

The improved Federal financial position resulting from the surcharge and expenditure control will be an important factor easing the strains on private credit markets. On the unified budget basis, there was a net Federal credit demand—borrowing from the public—of $23.1 billion in fiscal year 1968. In fiscal 1969, there is to be a repayment of $3.1 billion, and in fiscal 1970 a repayment of $4.0 billion. The Federal Government has shifted from being a net demander of funds from private credit markets and has become a net supplier of funds. In terms of immediate pressures on the markets, it is particularly signficant that between mid-March and June 30 of this year the total public debt will be reduced about $8 billion. Since the trust funds will be acquiring some debt, the paydown to private markets during this period will exceed $8 billion by a considerable margin.

In addition to its very important effect on the Federal finances, fiscal restraint is expected to exert a substantial impact on the economy in early 1969. A further moderate slowing in the overall pace of expansion should lead to some scaling down of private credit demands. This would further reduce the degree of pressure being placed on private credit markets.

(The following reply was submitted by the Bureau of the Budget:)

RESPONSE FROM BUDGET DIRECTOR ZWICK TO MR. PATMAN'S QUESTION CONCERNING INTEREST RATES

During the period of debate about the income tax surcharge, the Administration repeatedly called attention to the unfair burdens which rising interest rates create for small businessmen, farmers, the housing industry, and State and local governments, which depend heavily on the money markets for financing. A major reason for requesting the surcharge was to reduce these burdens. And it is a major reason for proposing, in the 1970 budget, that fiscal restraint be continued through fiscal year 1970.

In the absence of a policy of fiscal restraint, monetary policy would have to carry an undue share of the load of restraining the economy. We learned well in 1966 the consequences of relying too heavily on monetary policy—exceedingly tight credit, soaring interest rates, and inequitable restrictions on those sectors of the economy noted above. With fiscal restraint continuing through fiscal year 1970, a less restrictive monetary policy than is now necessary should be possible, and the high interest rates we are now experiencing should recede as the supply of funds becomes more plentiful relative to the demand for them.

A year ago, the Federal Government was a heavy borrower in the money markets and, thereby, a direct contributor to the upward push on interest rates. This year, and in the year ahead, the Government will be essentially neutral, since outlays in both years will be financed entirely from current revenues.

I would like each of you to comment on that as suggested.

Now, the Urban Development Bank mentioned by the Director of the Budget, I think, is a very interesting proposal and I am very much impressed with it. That will give us an opportunity in considering that proposal to consider whether or not we should have tax-exempt bonds or whether or not the Federal Government should pay the portion that the local communities would benefit from by tax-exempt bonds and get rid of them so it will help our entire economy and raise the amount of taxes very much and help the cause of tax reduction—if it is handled just exactly right and it could result in a much lower scale, lower interest rates for housing loans.

(The following material was subsequently submitted by the Treasury Department in response to Chairman Patman's suggestion:)

The enclosed copy of the draft Urban Development Bank Act of 1969 and the letter transmitting the proposed bill to the Speaker of the House are provided in further response to the question raised by Chairman Patman. Enclosed also are excerpts from three addresses by Under Secretary Deming and an address by Assistant Secretary Surrey bearing on the Urban Development Bank proposal. As stated in the letter transmitting the Urban Development Bank proposal to the Congress, the funds appropriated for payments to the Bank to reduce the Bank's lending rate would not involve a net cost to the Federal budget. Added tax revenues stemming from the fact that the Bank would issue taxable securities would offset the cost of the payments made to the Bank.

Also, as stated in the transmittal letter, the tax exempt market would continue to be available to State and local governments as a source of financing after the Urban Development Bank is established. Indeed, by tapping a broader segment of the capital market for loan funds to finance the public facilities needs of State and local governments, the Bank, by its operations, will reduce the growing pressure on the tax exempt market, and therefore indirectly help those governmental bodies which continue to utilize tax exempt securities to finance their capital needs.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,
OFFICE OF THE SECRETARY,
January 17, 1969.

HON. JOHN W. MCCORMACK,
Speaker of the House of Representatives, Washington, D.C.

DEAR MR. SPEAKER: Enclosed are five copies of a proposed bill "To establish an 'Urban Development Bank' to assist in broadening the sources and decreasing the cost of capital funds for State and local governments." Also enclosed are five copies of a section-by-section summary of the bill.

This proposed legislation would implement recommendations made by the President in the State of the Union and Budget messages. Enactment of the legislation will help the Nation, through a partnership of Federal, State and local governments, working with private enterprise, to move forward to meet the massive needs of our cities and their people.

It is now clear that we are undergoing a tremendous expansion in borrowing by State and local governments for capital expenditures. It is estimated that in the next ten years State and local governments may need to borrow over $200 billion to finance essential public facilities the communities of the Nation must have to provide a suitable living environment for their citizens.

A consensus of concern has arisen over the capacity of the capital markets, as now structured, to cope with the essential credit needs of State and local governments. Even at present levels of borrowing, the municipal bond market is strained from time to time and is not efficient and effective:

interest rates are inordinately high on State and municipal obligations;

maturities are unrealistically short for many development projects;

the range of investors is narrow, primarily commercial banks, and the market is particularly inadequate in times of credit stringency;

the rating system denies many communities the financing they need for essential facilities on reasonable terms; and

smaller communities whose issues are in small amounts or are not familiar to investors find no market.

These defects in the existing market can be expected to be magnified by many times in future years as State and municipal government credit needs increase and indeed may render the adequate financing of State and local public facilities impossible. We believe it should be a prime national concern to assure the continued availability of private financing for State and local capital needs. This proposed legislation is designed to expand the capital market available to States and localities by providing an additional financial mechanism which will help them to secure, on resonable terms, the financing they need to enable them to construct essential public facilities. It would establish a federally chartered bank—an Urban Development Bank—to finance the capital cost of State and local government public works and community facilities.

The activities of the Bank would be directed by a 17-member Board of Directors, the Chairman of which would be the president of the Bank. This official would be appointed by the President of the United States by and with the advice and consent of the Senate. The other 16 members of the Board of Directors would consist of not more than three Federal officials or employees appointed by the President of the United States; three representatives of local or State governments appointed by the President of the United States; and ten directors elected by three distinct groups of stockholders in the bank. Of these ten elected directors, four would be elected by State stockholders, four by local governments, and two by private corporations and individuals who subscribe to stock in the Bank.

An initial Board of Directors, to serve at least one year, would be appointed by the President of the United States, by and with the advice and consent of the Senate. Members of this initial Board of Directors would represent Federal, State, local and private interests

The Bank would secure funds necessary to finance its lending activities by selling its obligations in the private capital markets. To help protect holders of the Bank's obligations against possible losses of principal and interest and to assure the Bank adequate access to the capital market at reasonable interest rates, the Bank would also be authorized to borrow from the Treasury. This is the highly successful approach initially used to insure investor confidence in the Federal National Mortgage Association.

Interest on obligations sold by the Bank to finance its lending activities would be fully taxable. To enable the Bank to lend to State and local governmental bodies at favorable interest rates, however Federal payments would be made to the Bank to cover the difference between the Bank's borrowing cost and the amount of interest it receives on its loans.

The amount of those payments and the volume of Bank lending would be controlled by the Congress. The funds appropriated for payments to the Bank to reduce the Bank's lending rate, however, would not involve a net cost to the Federal budget. Added tax revenues stemming from the fact that the Bank would issue taxable securities would offset the cost of the payments made to the Bank.

The tax exemept market would continue to be available to State and local governments as a source of financing after the Urban Development Bank is established. Indeed, by tapping a broader segment of the capital market for loan funds to finance the public facilities needs of State and local governments, the Bank, by its operations, will reduce the growing pressure on the tax exempt market, and therefore indirectly help those governmental bodies which continue to utilize tax exempt securities to finance their capital needs.

The Bank would serve as an instrument to advance the welfare of our Nation's citizens while permitting each State and local government to pursue its developmental policies in the manner it deems best suited to the needs of its citizens. We believe this proposal exemplifies creative federalism at its best. The mechanism it creates to meet a national problem enlists the financial support and participation of all levels of government—Federal, State and local—as well as the private sector in a joint enterpries to enable communities to provide needed public facilities.

In summary, we believe creation of the Bank will further three broad purposes—

First, and foremost, it will make possible a greater allocation of capital to the development of needed public facilities.

Second, it will help to stimulate the construction of public facilities which will contribute to economy, efficiency and the comprehensively planned development of the area in which the facility is to be located.

Finally, it should help prevent disruption of the capital markets likely to result from the efforts of State and local governments to borrow funds to finance the large increase in public facilities expenditures which will take place in the next decade.

The financial problems of our State and local communities are both urgent and growing. The early establishment of an Urban Development Bank is both feasible and desirable. We recommend early action by the Congress.

The Bureau of the Budget advised on January 16, 1969 that there is no objection to the submission of this draft legislation to the Congress and that its enactment would be in accord with the program of the President.

Sincerely yours,

JOSEPH W. BARR,
Secretary of the Treasury.

ROBERT C. WOOD,
Secretary of Housing and Urban Development.

A BILL To establish an Urban Development Bank to assist in broadening the sources and decreasing the costs of capital funds for State and local governments, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Urban Development Bank Act of 1969."

FINDINGS AND DECLARATION OF PURPOSE

SEC. 2(a). The Congress hereby finds and declares that the sound and orderly development of the Nation's communities, as well as the creation of new communities and the expansion and enlargement of existing communities which must take place to accommodate our growing population, requires the adequate and timely provision of a wide variety of public works and community facilities, such as streets, water, sewers, schools, hospitals, libraries, airports, facilities for liquid and solid waste disposal, mass transit, recreation and other facilities which serve community needs.

The Congress further finds that the sources of funds currently available to State and local government to finance such public works and facilities are already strained and that there will be an increasing demand for such funds as State and local governments seek to meet their growing need for public works and facilities.

The Congress further finds that to meet the anticipated financial needs of our growing communities will require the full mobilization of the resources and skills of all levels of government, State, local and Federal, as well as the private sector in a coordinated and joint effort and that public investment in our Nation's communities, when efficiently planned and carried out, will add to the wealth of individual communities as well as of the Nation.

(b) It is the purpose of this Act to establish, with State and local governments and the private sector, an Urban Development Bank to make long-term development loans and to provide technical assistance to State and local governments and their agencies to help them meet needs for essential public works and community facilities, including the acquisition of land necessary thereto.

CREATION OF BANK

SEC. 3. There is hereby created a body corporate to be known as the Urban Development Bank, which shall have succession until dissolved by Act of Congres. The Bank, which shall not be an agency of the United States Government, shall maintain such offices as may be necessary or appropriate in the conduct of its business.

BOARD OF DIRECTORS

SEC. 4(a). The Bank shall have a board of directors which shall consist of seventeen persons, one of whom shall be the president of the Bank. The President of the United States, by and with the advice and consent of the Senate, shall appoint six directors, not more than three of whom shall be officers or employees of the United States and three of whom shall be persons identified with or representative of State or local government. Of the remaining members of the board, four shall be elected by the class A stockholders, four shall be elected by the class B stockholders, and two shall be elected by the class C stockholders. If at the time of any election of directors the aggregate par value of outstanding class C stock is less than $50 million, the President shall appoint one class C director, who shall be identified with or representative of persons qualified to subscribe for class C stock.

(b) Those directors who are officers or employees of the United States shall serve at the pleasure of the President and until their successors have been appointed and have qualified. Each such director may designate an alternate who shall be an officer or employee of the United States, to serve as director in his absence. The remaining directors shall each be appointed or elected for a term ending on the date of the next annual meeting of the common stockholders of the Bank. Any appointive seat on the board which becomes vacant shall be filled by appointment of the President. Any elective seat on the board which becomes vacant after the annual election of the directors shall be filled by the board, but only for the unexpired portion of the term. Any director who is a full-time officer or employee of the United States shall not receive compensation for his services as director.

(c) The board of directors shall meet at the call of its chairman, who shall require it to meet not less often than once each month.

(d) The President, by and with the advice and consent of the Senate, shall appoint a president of the Bank, who shall serve at the pleasure of the President. The president shall be chairman of the board of directors. Subject to the general policies of the board, the management of the Bank shall be vested in the president and he shall be the chief executive officer of the bank.

INITIAL BOARD OF DIRECTORS

SEC. 5. The initial members of the board of directors shall be appointed by the President, by and with the advice and consent of the Senate, for an initial term ending on the date of the first annual meeting of the common stockholders of the Bank representing all classes of common stock, but not less than one year. Members of the board appointed by the President for such terms shall be representative of Federal, State, local, and private interests.

INITIAL EXPENSES

SEC. 6. In order to facilitate the formation of the Bank, the Secretary of Housing and Urban Development is authorized to pay initial organizing and operating expenses. There is authorized to be appropriated a sum not to exceed $1,000,000, which sum shall be available for the purposes of this section for a period of three years from the date of enactment of this Act.

FUNCTIONS

SEC. 7(a). The Bank is authorized, subject to the provisions of this section, to make commitments to purchase and to purchase, service, or sell, on terms and conditions determined by the Bank, any obligation or participation therein, of a State or local government.

(b) Loans made by the Bank shall be in accordance with sound and prudent development banking principles. No commitment shall be entered into, and no purchase shall be made, unless the Bank determines that the proceeds of any such purchase will be used by the borrower to finance capital expenditures for public works and community facilities serving community needs.

(c) The Bank shall develop criteria to assure that projects assisted by it are not inconsistent with comprehensive planning for the development of the community in which the projects to be assisted will be located or disruptive of Federal programs which authorize Federal assistance for the development of like or similar categories of projects.

(d) Any loan made pursuant to this section may be in an amount not exceeding the total capital cost of the project to be financed with the loan; shall be secured in such manner and be repaid in such period, not exceeding 40 years, as may be determined by the Bank; and shall bear interest at a rate determined by the Bank which shall not be less than two-thirds the current average yield on outstanding obligations of the Bank as of the last day of the month preceding the date on which the loan is made.

COMMON STOCK

SEC. 8(a). The Bank shall have common stock, having a par value of $1,000 per share, which shall be divided into three classes—

(1) Class A stock, which shall not be transferable, to be issued by the Bank from time to time to each local government which is a member of the bank to evidence any capital subscriptions made by such member as required by subsection (e), and to be subscribed for in any amount by any local government;

(2) Class B stock, which shall not be tranferable, to be issued by the Bank from time to time to each State which is a member of the Bank to evidence any capital subscriptions made by such member as required by subsection (e), and to be subscribed for by the States in any amount but not less than an amount for any State which bears the same proportion to $100,000,000 as the population of that State bears to the population of all States; and

(3) Class C stock to be subscribed for by any private individual, partnership, corporation, foundation, society, association, or other organization, profit or nonprofit, in an amount at any time of not less than 10 shares.

(b) All classes of common stock shall be vested with all voting rights, each share being entitled to one vote with rights of cumulative voting at all elections of directors, except that any class C stock held by a stockholder in excess of 1,000 shares shall be nonvoting.

(c) Class B stock, except stock issued in return for capital subscriptions required by subsection (e), may be subscribed for upon payment of one-fifth of the price, with the remainder payable in equal installments over the succeeding four years.

(d) All moneys received by the Bank in return for its common stock shall be accumulated in a capital surplus account. All net earnings from the operations of the Bank shall annually be transferred to its general surplus account. Such dividends as may be declared shall be paid by the Bank to the holders of its common stock and shall be charged against the general surplus account, but in any one fiscal year dividends shall not exceed 6 per centum of the par value of the common stock issued and outstanding and shall be payable out of the net earnings of the Bank for that year.

(e) Each seller of obligations to the Bank pursuant to section 7 shall be a member of the Bank and shall be required to make payments of nonrefundable capital subscriptions, equal to not more than 2 per centum nor less than 1 per centum of the principal amounts of obligations purchased or to be purchased by the Bank from such seller. In addition, the Bank may impose charges or fees for its services with the objective that all costs and expenses of its operations should be within its income derived from such operations.

OBLIGATIONS OF THE BANK

SEC. 9(a). The Bank is authorized, with the approval of the Secretary of the Treasury, to issue and have outstanding obligations having such maturities and bearing such rate or rates of interest as may be determined by the Bank. Such obligations may be redeemable at the option of the Bank before maturity in such manner as may be stipulated therein. The aggregate amount of obligations of the Bank outstanding at any one time shall not exceed $2,000,000,000, which amount shall be increased by $5,000,000,000 on July 1, 1970, and by $5,000,000,000 on July 1 of each of the three succeeding years. The Bank shall insert appropriate language in all of its obligations issued under this subsection clearly indicating that such obligations, together with the interest thereon, are not guaranteed by the United States and do no constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the Bank. The Bank is authorized to purchase in the open market any of its outstanding obligations.

(b) In addition to the obligations of the Bank authorized to be outstanding in subsection (a) of this section, the Bank is authorized to issue obligations to the Secretary of the Treasury. The Secretary of the Treasury is authorized to purchase any such obligations in order to insure the financial integrity of the operations of the Bank, and for such purpose the Secretary of the Treasury is authorized to use as a public debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, as now or hereafter in force, and the purposes for which securities may be issued under the Second Liberty Bond Act as now or hereafter in force, are extended to include such purchases. Each purchase of obligations by the Secretary of the Treasury under this subsection shall be upon such terms and conditions as to yield a return at a rate not less than a rate determined by the Secretary of the Treasury, taking into consideration the current average yield on outstanding marketable obligations of the United States of comparable maturities. The Secretary of the Treasury may sell, upon such terms and conditions and at such price or prices as he shall determine, any of the obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such obligations under this subsection shall be treated as public debt transactions of the United States.

FEDERAL PAYMENTS TO THE BANK

SEC. 10(a). With respect to such amounts of loans of the Bank as may be specified in Appropriation Acts, the Secretary of Housing and Urban Development is authorized to make, and to contract to make, annual payments to the Bank in such amounts as are necessary to equal the amount by which the dollar amount of interest paid by the Bank on account of its obligations exceeds the dollar amount of interest received by the Bank on account of loans made by it pursuant to section 7 of this Act.

(b) There are hereby authorized to be appropriated to the Secretary of Housing and Urban Development such sums as may be necessary to carry out the provisions of the Act, including such sums as may be necessary to make the annual payments required by contracts entered into by the Secretary pursuant to subsection (a) of this section.

GENERAL POWERS

SEC. 11. The Bank shall have power:

(a) To sue and be sued, complain and defend, in its corporate name and through its own counsel.

(b) To adopt, alter, and use the corporate seal, which shall be judicially noticed.

(c) To adopt, amend, and repeal by its board of directors bylaws, rules, and regulations as may be necessary for the conduct of its business.

(d) To conduct its business, carry on its operations, and have offices and exercise the powers granted by this Act in any State without regard to any qualification or similar statute in any State.

(e) To lease, purchase, or otherwise acquire, own, hold, improve, use or otherwise deal in and with any property, real, personal or mixed, or any interest therein, wherever situated.

(f) To accept gifts or donations of services, or of property, real, personal or mixed, tangible or intangible, in aid of any of the purposes of the Bank.

(g) To sell, convey, mortgage, pledge, lease, exchange and otherwise dispose of its property and assets.

(h) To appoint such officers, attorneys, employees and agents as may be required, to determine their qualifications, to define their duties, to fix their salaries, require bonds for them and fix the penalty thereof.

(i) To enter into contracts, to execute instruments, to incur liabilities, and to do all things as are necessary or incidental to the proper management of its affairs and the proper conduct of its business.

TECHNICAL ASSISTANCE

SEC. 12. (a) The Bank is authorized to provide technical assistance to State and local governments in the preparation and implementation of comprehensive development projects and programs, including the evaluation of priorities and the formulation of specefic project proposals. The Bank may charge appropriate fees for its services under this subsection.

(b) The Bank is also authorized to undertake research and information gathering, and to facilitate the exchange of advanced concepts and techniques relating to municipal growth and development among State and local governments.

AUDIT OF FINANCIAL TRANSACTIONS

SEC. 13. The financial transactions of the Bank shall be audited by the General Accounting Office in accordance with the principles and procedures applicable to commercial corporate transactions and under such rules and regulations as may be prescribed by the Comptroller General of the United States. The audit shall be conducted at the place or places where the accounts are normally kept. The representatives of the General Accounting Office shall have access to all books, accounts, financial records, reports, files, and all other papers, things, or property belonging to or in use by the Bank and necessary to facilitate the audit, and they shall be afforded full facilities for verifying transactions with the balances or securities held by depositaries, fiscal agents, and custodians.

The expenses of any audit performed under this section shall be borne out of appropriations to the General Accounting Office, and appropriations in such sums as may be necessary are authorized. The Bank shall reimburse the General Accounting Office for the full cost of such audit as billed therefor by the Comptroller General, and the General Accounting Office shall deposit the sums so reimbursed into the Treasury as miscellaneous receipts.

AUDIT REPORT TO CONGRESS

SEC. 14. A report of each such audit for a fiscal year shall be made by the Comptroller General to the President and to the Congress and not later than six months following the close of such fiscal year. The report shall set forth the scope of the audit and shall include a statement (showing intercorporate relations) of assets and liabilities, capital and surplus or deficit; a statement of surplus or deficit analysis; a statement of income and expense; a statement of sources and application of funds; and such comments and information as may be deemed necessary to keep Congress informed of the operations and financial condition of the Bank, to gether with such recommendations with respect thereto as the Comptroller General may deem advisable, including a report of any impairment of capital or lack of sufficent capital noted in the audit. A copy of each report shall be furnished to the Secretary of Housing and Urban Development, the Secretary of the Treasury, and to the Bank.

TAX EXEMPTION

SEC. 15. The Bank, its property, its franchise, capital, reserves, surplus, security holdings, and other funds, and its income shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority; except that (1) any real property and any tangible personal property of the Bank shall be subject to Federal, State, and local taxation to the same extent according to its value as other such property is taxed and (2) any and all obligations issued by the Bank shall be subjected both as to principal and interest to Federal, State, and local taxation to the same extent as the obligations of private corporations are taxed.

OBLIGATIONS AS LAWFUL INVESTMENTS, ACCEPTANCE AS SECURITY

SEC. 16. All obligations issued by the Bank shall be lawful investments, and may be accepted as security for all fiduciary, trust, and public funds, the investment or deposit of which shall be under authority or control of the United States or of any officer or officers thereof. All stock and obligations issued by the Bank pursuant to this Act shall be deemed to be exempt securities within the meaning of laws administered by the Securities and Exchange Commission, to the same extent as securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States.

PREPARATION OF OBLIGATIONS

SEC. 17. In order to furnish obligations for delivery by the Bank, the Secretary of the Treasury is authorized to prepare such obligations in such form as the board of directors may approve, such obligations when prepared to be held in the Treasury subject to delivery upon order by the Bank. The engraved plates, dies, bed pieces, and so forth, executed in connection therewith shall remain in the custody of the Secretary of the Treasury. The Bank shall reimburse the Secretary of the Treasury for any expenditures made in the preparation, custody, and delivery of such obligations.

UNITED STATES NOT LIABLE

SEC. 18. The United States shall not be liable for any debts, defaults, acts, or omissions of the Bank.

ANNUAL REPORT

SEC. 19. The Bank shall, as soon as practicable after the end of each fiscal year, transmit to the President and the Congress an annual report of its operations and activities.

AMENDMENTS RELATING TO FINANCIAL INSTITUTIONS

SEC. 20. (a) The sixth sentence of the seventh paragraph of section 5136 of the Revised Statutes, as amended (12 U.S.C. 24), is amended by inserting "or obligations of the Urban Development Bank," immediately after "or obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association,".

(b) Section 5200 of the Revised Statutes, as amended (12 U.S.C. 84), is amended by adding at the end thereof the following new paragraph: "(14) Obligations of the Urban Development Bank shall not be subject to any limitation based upon such capital and surplus."

(c) The first paragraph of section 5(c) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1464(c)), is amended by inserting "or in obligations of the Urban Development Bank;" in the second proviso immediately after "any political subdivision thereof;"

(d) Paragraph (2) of section 14(b) of the Federal Reserve Act, as amended (12 U.S.C. 355) is further amended by inserting "or any obligation of the Urban Development Bank" immediately before the period at the end thereof.

DEFINITIONS

SEC. 21. As used in this Act—

(a) The term "Bank" means the Urban Development Bank created by section 3 of this Act.

(b) The term "State" means the States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Trust Territory of the Pacific Islands, or any agency or instrumentality of a State.

(c) The term "local government" means any county, municipality, or other political subdivision of a State, or agency or instrumentality thereof, or any school or other special district created by or pursuant to State law.

(d) The term "member of the Bank" means and State or local government which has sold its obligations to the Urban Development Bank pursuant to section 7 of this Act.

(e) The term "obligation" means any bond, note, debenture, or other instrument evidencing debt.

SEPARABILITY

SEC. 22. If any provision of this Act or the application thereof to any person or circumstance, is held invalid, the validity of the remainder of the Act, and the application of such provisions to other persons or circumstances, shall not be affected.

AUTHORIZATION FOR APPROPRIATIONS

SEC. 23. There are authorized to be appropriated, without fiscal year limitation, such sums as may be necessary to carry out the purposes of this Act.

SECTION-BY-SECTION SUMMARY OF THE URBAN DEVELOPMENT BANK ACT OF 1969

Section 1: This section provides for the Act to be cited as the "Urban Development Bank Act of 1969."

Section 2. Findings and declaration of purpose.—This section states the findings that the sound and orderly development of our Nation's communities requires the timely provision of a wide variety of public works and community facilities and that the present source of capital funds to finance these projects is inadequate, and states the purpose of the Act to establish an Urban Development Bank to make long-term development loans at reasonable interest rates and to provide technical assistance to State and local governments to help them meet needs for public works and community facilities.

Section 3. Creation of Banks.—This section would establish the Urban Development Bank as a non-Federal corporation and would authorize the Bank to establish regional or metropolitan offices.

Section 4. Board of Directors.—This section would provide for a 17-member board of directors to consist of the president of the Bank, not more than three Federal officials or employees appoointed by the President, three members appointed by the President representative of State or local government, four members elected by local governments holding class A stock of the Bank, four members elected by the States holding class B stock, and two members elected by private persons or organizations holding class C stock. Class C stockholders would elect only one director if their aggregate holdings were less than $50 million, the President to appoint the remaining director. The term of non-Federal members would be one year, and members who were Federal officials would serve at the pleasure of the President. The board would meet at least monthly and would determine general policies of the Bank. The president of the Bank would be appointed by the President and would be chairman of the board of directors.

Section 5. Initial Board of Direcors.—This section would authorize the President to appoint all directors for an initial term until all classes of common stock were represented, but not less than one year. The President's appointments would be representative of Federal, State, local, and private interests.

Section 6. Initial expenses.—This section would authorize an appropriation not exceeding $1 million, to remain available for three years, for the Secretary of Housing and Urban Development to pay initial organizing and operating expenses of the Bank.

Section 7. Functions.—This section would authorize the Bank to make loans, or participations in loans, to a State or local government to finance capital expenditures for public works and community facilities. Loans could not exceed the capital cost of the project, have a maturity exceeding 40 years, or an interest rate less than two-thirds the current average yield on the Bank's outstanding obligations. Projects financed by the Bank would not be inconsistent with comprehensive planning for the community, or disruptive of Federal programs assisting similar or like projects.

Section 8. Common stock.—This section would provide for three classes of common stock, class A to be issued to local governments; class B to be subscribed for the States; and class C to be subscribed for by private individuals and organizations, in a minimum of $10,000. Each share of stock would be entitled to one vote, except that any class C stock held by one person in excess of $1,000,000 would be non-voting. Borrowers from the Bank would be required to make nonrefundable capital subscriptions in amounts of not less than 1 nor more than 2 percent of the amount of the loan. The Bank would be authorized to impose fees for its serices to meet costs and expenses. Dividends declared by the Bank, limited to six percent annually, could be paid to the stockholders out of any net earnings.

Section 9. Obligations of the Bank.—This section would authorize the Bank to raise funds through the issuance of bonds or other debt instruments. The Bank's issues would be required to receive the prior approval of the Secretary of the Treasury. Obligations issued by the Bank would state that they are not guaranteed by the United States and do not constitute an obligation of the United States. The aggregate amount of outstanding obligaions would be limited to $2 billion, which amount would be increased by $5 billion on July 1, 1970, and by $5 billion on July 1 of each of three succeeding years. In addition to these obligations, the Bank could issue other obligations which the Secretary of the Treasury would be authorized to purchase in order to insure the financial integrity of the operations of the Bank.

Section 10. Federal payment to the Bank.—This section would authorize the Secretary of Housing and Urban Development to make, and to contract to make, annual payments to the Bank in amounts necessary to equal the amount by which the dollar amount of interest paid by the Bank on its obligations exceeds the dollar amount of interest received by the Bank on loans made by it. For this purpose, the amount of loans that could be made by the Bank would be approved in Appropriation Acts.

Section 11. General powers.—The section would provide the Bank with general corporate powers.

Section 12. Technical assistance.—This section would authorize the Bank to render technical assistance to State and local governments in the preparation and implementation of projects, and to gather and facilitate the interchange of advanced concepts relating to municipal development.

Section 13. Audit of financial transactions.—This section would require the financial transactions of the Bank to be audited by the General Accounting Office. The Bank would reimburse the Government for the cost of any audit.

Section 14. Audit report to Congress.—This section would require a report of each audit to be made by the Comptroller General to the President and the Congress, with copies of each report to the Secretary of Housing and Urban Development, the Secretary of the Treasury, and the Bank.

Section 15. Tax exemption.—This section would generally exempt the Bank and its income from all taxes. However, any real and personal property of the Bank would be subject to taxation and all obligations issued by the Bank would be subject both as to principal and interest to Federal, State, and local taxation to the same extent as obligations of private corporations.

Section 16. Obligations as lawful investments, acceptance as security.—This section would make obligations issued by the Bank lawful investments and acceptable as security for all fiduciary, trust, and public funds, and its stock exempt from SEC requirements.

Section 17. Preparation of obligations.—This section would authorize the Secretary of the Treasury to prepare, hold, and deliver obligations for the Bank on a reimbursable basis.

Section 18. United States not liable.—This section provides that the United States shall not be liable for any debts, defaults, acts, or omissions of the Bank.

Section 19. Annual report.—This section would require the Bank to transmit to the President and Congress an annual report of its operations and activities.

Section 20. Amendments relating to financial institutions.—This section would permit Federal Reserve banks, national banks, and Federal savings and loan associations to invest in or deal in obligations of the Bank.

Section 21. Definitions. This section would provide definitions.

Section 22. Separability.—This section would make the provisions and validity of the Act separable if any provision is held invalid.

Section 23. Authorization for appropriations.—This section would authorize appropriations necessary to carry out the purposes of the Act.

EXCERPT FROM REMARKS BY HON. FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS AT THE NATIONAL CONVENTION OF THE BANK ADMINISTRATION INSTITUTE, ATLANTA, GA.

THE SHORT AND LONG OF IT

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Financing public requirements over the longer term

The preceding discussion clearly suggests that, over the near-term future, the pressure on the securities market exerted by the public section should, in the aggregate, diminish very markedly. The technical task of financing these requirements, moreover, should not present undue difficulties.

When we look ahead to the longer term, however—for the next ten years or beyond—the picture is different. For here, the financing requirements that can be envisaged are truly formidable, and there is a pressing need for finding more imaginative and efficient means of mobilizing the needed capital.

The area that presents the greatest challenge relates to the financing of what I call the infrastructure for social welfare. In this area, needs have risen with dramatic force in the recent past—and promise to advance even more sharply in the years ahead. I include in this category urban redevelopment and renovation of ghettos, enlargement of public housing, restructuring of public transportation facilities, combatting air and water pollution, and enlarged and improved education and health facilities.

Some of these tasks involve continuation of past activities. Others are essentially new in character. But, in the total, the magnitude of the financing requirements will be massive. It may almost be said that the change in quantity is prospectively so great as to make the financing problem a change in kind, as well as in amount.

Some of the activities I have cited may be undertaken and financed entirely by State and local governments. Some others may be wholly within the sphere of Federal responsibility. But, for the most part, these activities will require some form of Federal assistance to, and Federal partnership with, the State and local governments.

What is needed now—and is, indeed, beginning to take place—is a searching and comprehensive look as to how this partnership can be developed in the most effective and satisfactory fashion. It will require a proper balance between orderly over-all direction and financial discipline and ample scope for local independence and flexibility. It will call for broad decisions on the absolute and relative amounts of the new needs to be financed directly from taxation and the extent to which they can be met initially by borrowing. Where taxation is involved, an optimum sharing of the burden between the Federal Government and States and localities is required. In the case of borrowing, questions arise as to the optimum mix between direct Federal borrowing, traditional State and local debt financing, and resort to other, and partly new, types of borrowing arrangements.

In all cases, there is a need to search for the most efficient, economical, and equitable means of financing—means that will optimize the benefits and minimize the overall costs to the taxpayer, means to permit the raising of funds in the capital markets at the lowest cost feasible, and means that can be flexibly adapted to changing needs. And, in my judgment, it is important that the financing procedure be clear and visible, so that intelligent choices among alternative methods can be made and subsidy elements can be clearly identified.

Let me concentrate here on those spending needs that are likely to be financed, at least in the first instance, largely through the issuance of debt, rather than by tax funds. Clearly, a major share of the emerging needs will have to be financed in this way. That does not mean, of course, that the Federal share can be met without a significant contribution from the tax side. This tax-financed contribution may come about in the form of debt service grants, involving payments of interest or of capital—or both— on locally issued debt; it may entail outright tax-financed Federal subsidies granted for projects that also require large public borrowing; it may result simply because States and localities can issue tax-exempt securities.

How large are the capital needs of the types considered here that are likely to arise over the next few years? How can they best be financed? And what impact is such financing likely to exert on capital markets generally?

The magnitude of the task

In 1947, net State and local debt was less than $15 billion. By 1957, it had grown to $47 billion; and, last year, it stood at $113 billion. A mere continuance of this growth trend would raise the level of outstanding State and local debt ten years from now my about $120 billion—to a level of $240 billion.

But this is only part of the story. On top of the normal growth projected, it appears that there will be a very substantial increase in State and local debt as a result of new and expanded programs involving Federal financial assistance. Estimates of the likely magnitude of this increase vary widely, not only because the costs of different programs to solve our urgent social and environmental problems are often very difficult to project, but also because of different assessments as to how fully the States and localities will actually seek to meet these problems.

Let me just cite one type of calculation that illustrates this point. In 1968, the Congress enacted, or came close to enacting, provision for Federal capital assistance in the form of debt service grants for a series of new or greatly expanded State and local programs. It is useful to look at the Congressional authorizing legislation for such assistance and then to calculate what it implies for the growth of State and local debt financing.

For example, Congress authorized additional debt service grants for public housing of $150 million a year for the next two years. This will make possible a total of about $3 billion a year in additional local debt financing for this purpose. If one assumes that additional Congressional authorizations will be maintained at the same level over the next decade, the total added debt from this program alone would come to $30 billion. I am not including projected Federal assistance to low income housing under this heading—this would be a much larger sum, since it would encompass private as well as public housing.

Using similar calculations for three other program areas on which Congress completed action in 1968, one finds a potential net increase in State and local debt over the next decade of about $20 billion for college housing, academic facilities, and the vocational education program, although some of this will presumably be for private nonprofit institutions.

The debt service grant approach was also authorized for the anti-water pollution program in legislation which passed both the House and the Senate this year, though it did not survive the adjournment rush. Assuming a continuation of the annual level of new dollar authorizations in the enabling legislation, the potential increase in State and local debt for these purposes over the next decade is $40 billion.

In addition, the Senate passed a bill in 1968 which authorized debt service grants on obligations issued by State and local bodies, as well as nonprofit institutions, for hospital modernization. The needs in this area have been estimated at over $10 billion.

Thus, assuming that the Congress follows through on the debt service grant approach in just these six program areas, the potential increase in State and local debt over the next decade is about $100 billion.

To this amount, one would need to add new financing requirements for mass transit, other urban redevelopment activities, municipal airports, anti-air pollution efforts, and other areas in which Federal programs have been established and are expected to be increased. Taking all this into account, it is not at all difficult to visualize a total rise in State and local debt over the next ten years of $150 billion or more, *in addition* to the "normal" growth of $120 billion cited earlier. That would mean that, in ten years, State and local debt would be rising by $30 to $35 billion or more a year, rather than by $10 billion, or less, as at present.

To some extent, the new programs cited may substitute for what I have counted as "normal" growth. But this overlap may no be large; the new programs cited will deal essentially with new types of needs. Also, the annual new dollar authorizations which Congress has now provided for the next few years may not be continued at the same level for a decade. Given the pressure of underlying needs, however, it seems at least as likely that, on the balance, we will see increases rather than reductions in Congressional authorizations as the decade progresses.

In citing these potentially very large figures, it has not been my purpose to suggest that the indicated requirements cannot be financed through debt issues. My hunch is, in fact, that, in a strongly growing economy and with continued progress in tapping new sources of savings, the task will, in the end, prove manageable. If the economy expands at a rate in real terms of 4 to 4½ percent over the next decade—which is quite practicable under intelligent economic policies in both public and private sectors working together—we would have a GNP in 1978 of some $1.3 trillion, which would generate a lot more tax revenues and a lot more savings. But there can be no doubt that, even so, the task will be more manageable only if we have major improvements in methods of mobilizing capital

The need for new financing approaches

In calling for such improvements, I assume that the traditional means of financing State and local government needs will have a continued role, particularly in the financing of tasks that have customarily been entirely in the province of such governments. But I do not think that these means alone will be adequate to cope with the huge additional demands generated by new types of programs or that they can fully satisfy the criteria of maximum efficiency and economy.

As I have indicated previously, by far the most promising approach for mobilizing the needed new capital in a more efficient manner would seem to lie in the establishment of a new central financing institution for domestic development—such as a National Urban Development Bank.

Many different proposals for such a central development financing institution have recently been offered, and the need is to reach agreement on the more precise characteristics of such an institution.

As I see it, the new institution would issue its own securities, backed by Federal guarantee, and relend the proceeds to program agencies—either to Federal lending agencies or directly to State and local bodies, depending on Congressional decisions as to individual program structure and control. Aside from the Federal guarantee, which would help marketing and minimize interest costs, a Federal contribution, to the extent necessary and desirable, could come from clearly identified interest rate subsidies given borrowers from the institution and provided by direct Congressional appropriations.

The advantages of the new approach would be manifold.

First, the new institution could develop one efficient marketing instrument—or family of instruments—with broad appeal to various investor classes. It could thus tap a much wider market than the many instruments now being issued by a great variety of Federal agencies and State and local agencies receiving Federal assistance. The market for such instruments would also be likely to attain much greater depth than alternative financing means for urban development purposes. Thus, secondary markets should develop which would allow ready "shiftability" of the securities among investors. In speaking of "one" efficient marketing instrument, I do not necessarily mean that the institution would issue only a single type of instrument. It could offer a number of closely related types of securities, but tailored in ways that broaden the range of reachable investors, similar to the spectrum of offerings now used in Federal debt management, itself. But these instruments should be carefully designed to fit into a coherent whole. Probably variations in types should be relatively few for some time; and their relation to the Treasury's debt, itself, would have to be carefully considered.

Second, in contrast to the present fragmentation of financing efforts, the new institution would automatically provide for coordination of issues and control over programs requiring finance. Thus, a central financing institution would have the greatest flexibility in going to market at the best time and with the volume, maturities, and other terms and conditions which would enable it to borrow at a significantly lower interest rate than could be obtained by several smaller, special purpose institutions, each with its own special problems of timing, seasonal factors, and other program considerations.

I do not think, incidentally, that the answer to the financing problems over the next decade will be to establish a separate new institution for each problem area, such as an education bank, a pollution control bank, a transportation bank, etc. The difficulty with this approach—in addition to the duplication of effort and the problem of finding that much financing talent—is the proliferation of financing instruments which would develop and the problem of coordinating these issues in the market. Of course, even a central financing institution could decentralize its lending activities, either in terms of loan purpose or geographic region. But I think there is a persuasive case for a centralized approach to mobilizing capital funds.

Third, the new approach permits the most economical financing of the growing new needs, looked at either from the viewpoint of the Federal Government or from the viewpoint of State and local governments.

If all of these new needs were to be financed in the tax-exempt municipal bond market, which, by its very nature, is limited in capacity, the additional volume of financing would tend to have the effect of significantly increasing State and municipal borrowing costs, not only for these new programs but across-the-board for all State and municipal government programs. The proposed new institution would avoid these problems by operating in a far broader market. The net cost to the Federal budget, moreover, would be minimized through the use of the proposed development bank, which would issue taxable securities.

These considerations give the Federal Government and State and local governments a community of interest in finding the financing means that will be most economical for all levels of government combined. And I am confident that means can be found which will not impinge in any way on the ultimate fiscal independence of State and local governments, which now rely mainly on the tax-exempt concept.

Some implications for capital markets

Even if the burgeoning new needs that we now envisage are financed in a much more efficient fashion than is now the case, such financing will be bound to have a major impact on capital and securities markets generally. Added to continuing large private requirements—and notably the likelihood that new housing needs will exert much greater pressures on the general capital markets than in the past—it will almost certainly mean that the average level of long-term interest rates will be higher than in the 1950's and early 1960's, when they were quite low.

This is not to imply that rates will not come down from their very high recent levels. But it does raise questions as to how long we can afford to continue accepting attitudes and practices that were essentially developed in periods when average interest rates were substantially below the levels indicated for the future. It suggests that continued maintenance of the statutory 4¼ percent ceiling on long-term Government bonds could become an increasingly troublesome obstacle to sound Federal debt management.

CONCLUDING COMMENT

So there you have the short and long of it. For the short-run, the pressure of Federal finance demand will diminish sharply, with consequently less pressure on interest rates. Over the longer run, the needs for social welfare infrastructure will place very heavy demands on the capital markets.

I welcome the lessened short-run pressure and wish my successors well in meeting the hard financial problems of the future.

EXCERPT FROM REMARKS BY HON. FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS, AT THE 50TH ANNIVERSARY CONVENTION OF THE AMERICAN GAS ASSOCIATION, PHILADELPHIA, PA., OCTOBER 7, 1968

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FINANCIAL PROBLEMS OF THE FUTURE

During the next ten years, two major problem areas of finance will challenge the best efforts of the United States and one, perhaps both of them, will require concentrated attention by other advanced countries of the world.

For the United States, the first problem—bigger by far than the second in terms of financial requirements—is to find ways to provide capital finance for public purposes designed to strengthen and improve what might be called social welfare infrastructure. By this term, I mean urban redevelopment, the renovation of the ghettos, the provision of public housing, the enlargement of public education and health facilities, the restructuring of transportation facilities, the provision of clean water and air.

In one sense, the problem is not a new one; in a more realistic sense, it is a brandnew one by virtue of its recognition and by virtue of the very size of its financial requirements. Let me give you some indication of its size.

Net State and local debt in 1947 was less than $15 billion. Last year, it was $113 billion—almost $100 billion larger than 20 years earlier. Mere continuance of that trend would make it $240 billion ten years from now. Add in the new programs noted above, and it is not difficult to visualize another $150 billion requirement. It is clear that requirements of this order of magnitude will demand the most efficient, imaginative, and sound means of mobilizing capital that we can devise.

I have spoken elsewhere of one approach to this problem—a National Urban Development Bank. Other suggestions have been made—for a Municipal Bond Guarantee Corporation; for a Community Development Bank; for a Domestic Development Bank. Each is aimed at the basic objective of providing an efficient means of mobilizing the Nation's capital resources. We shall need to come to a consensus on a particular approach.

That approach should embody two basic principles:

Development of one efficient marketing instrument with broad investment appeal.

Coordination of issues and control over programs requiring finance.

A development institution would issue its own securities, backed by Federal guarantee, and relend the proceeds to program agencies—either Federal lending acencies or directly to State and local agencies, depending on Congressional decisions as to individual program structure and control. Aside from the Federal guarantee, which would help marketing and minimize interest costs, a Federal Government contribution, to the extent necessary and desirable, could come from interest rate subsidies—clearly identified—provided by direct Congressional appropriations.

The second problem, which will affect both the United States and other advanced countries, is to find ways to provide increased developmental capital finance for the less-developed countries of the world—both for infrastructure and for expansion of the agricultural and industrial base.

The financial requirements for the United States, or for any other country, are significantly less than those for domestic social welfare infrastructure, but there are other problems—perhaps most notably the balance of payments problem. Methods must be devised to fit these financing needs into the balance of payments adjustment process so that, when a country is in surplus, it can export more capital to developing countries, and when in deficit, it can export less. At the same time, it is desirable to increase the total amount of capital export and assure that volume for a period of time.

The United States proposed an approach of this type in the current replenishment of funds for the International Development Association. The Organization for Economic Cooperation and Development, composed of some twenty countries, suggested, in a 1966 report on the adjustment process, that surplus countries open their capital markets more freely to borrowings by international financial institutions, such as the World Bank or the regional development banks. Both of these approaches need further development and implementation through international agreement. Both will lead to more multilateralization of development finance, which should be more efficient, both in terms of raising the capital and in terms of channeling it where it can do the most good.

Finally, I should note two points. Both of these financial problems—domestic social welfare infrastructure and development finance—can be resolved only within a framework of a strongly expanding domestic and world economy. That is an absolute requirement to generate the savings and the tax revenues for the needed finance. And growing economies, themselves, need the thrust of dynamic new investment, which, itself, requires high savings.

REMARKS BY HON. STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY, BEFORE THE FIFTH MUNICIPAL CONFERENCE, INVESTMENT BANKERS ASSOCIATION, NEW ORLEANS, LA., SEPTEMBER 27, 1968

THE FINANCING OF NEW SOCIAL PROGRAMS—AND TAX EXEMPTION

The Investment Bankers Association is to be congratulated on staging this forum on "The Federal Government's Role in State and Local Financing—Taxable or Tax Exempt?" The topic is one of direct and important concern to many—the Federal Government, State and Local Governments, those who invest in securities, and those like yourselves who participate in the marketing of securities. Unfortunately, most discussions which involve the sensitive subject of Federal-State relationships and the super-sensitive aspect of that relationship—tax exemption for State and local securities—proceed with a maximum of emotion, accusation and platitudes and a minimum of hard, objective analysis. Your desire for a forum with just the opposite approach is commendable and I trust my remarks will be seen as in keeping with your desire—for they certainly are so intended.

At present there are about $120 billion of outstanding State and local tax-exempt obligations and about $15 billion in new obligations are being issued annually (for a $9 or $10 billion net annual growth). I am *not* discussing these obligations or the merits of their tax exemption. I am *not* here to turn back any clocks or reverse history. I am here to consider what will happen if the clocks suddenly start to race madly forward.

My remarks relate to the enormous increase in new issues of these obligations that now looms up before us and the effects of adding this new huge volume of tax-exempt obligations to the present market. My concern and my message can be briefly summarized:

The possible high level of new issues of tax-exempt State and local bonds over the next decade raises very serious problems for State and local governments and for the equity of our Federal tax system. This high level can come about under the enormous financing requirements of the vast social programs so vitally necessary to meet our domestic needs.

The basic problem is that piling more and more reliance on the tax-exempt privilege as a way of helping States and localities to meet these financing requirements creates a powerful buyer's market for tax exempts. The State and local governments pricing their bonds on the basis of this exemption as a consequence will get less and less for it—that is, they will have to pay closer to the market rates of interest on taxable bonds—and their financing costs must inexorably rise. At the same time, the buyers would still get the tax exemption with even greater tax savings.

Those who are anxious to preserve the strength of State and local governments in the Federal system should give serious thought to these problems.

We should all consider whether *new financing techniques* are available and appropriate to avoid these problems—techniques which at the same time, and I stress this, preserve the independence of action on the part of State and local governments in our national system to which the principle of tax exemption has contributed.

Projections of State-Local Credit Demands

Let us first consider the rate of growth of new State and local issues that looms ahead. The Joint Economic Committee in 1966 made a projection of the likely level of growth capital needs and thus of State and local bond issues through

1975. The JEC figures themselves suggested that this growth would be in line with the likely growth in GNP. Since the supply of savings should also grow at about the GNP rate, the general conclusion would be indicated that the marketability of State and local bonds should not change markedly relative to other bonds.

But the Joint Economic Committee report itself emphasized one reservation about this outlook, namely, the heavy reliance placed on commercial bank takings. They recognized that if commercial banks, for example, were attracted more heavily into mortgages (e.g., by the much touted housing boom of the 1970's) there would be problems for State and local governments in floating even a level of State and local issues that was growing in line with GNP.

Another set of qualifications should be added to this forecast of marketability of State and local bonds. The JEC projections basically assumed a development of current programs. They did not make much allowance for new programs.

The expansion of Federal programs that lies ahead is likely to induce even more substantial increases in State and local government borrowing than may have been anticipated in the study. The Congress has already considered a wide range of new Federal programs in a variety of areas, such as pollution control and housing. In addition, pressures on the Federal budget have recently caused attention to be focused on the potentialities of debt service grants to State and local governments, as are now used in the public housing area, rather than the lump-sum grants that have been more traditional. From a financial viewpoint, these debt service grants would shift the financing of the Federal share of local project costs from the taxable market (i.e., away from the Federal bonds that provide the funds for the lump sum grants) to the tax-exempt market to absorb the local bonds that would be issued to finance the project (the debt service grants would help defray the interest and principal on these tax-exempt bonds).

Another factor that may well have been underestimated in the JEC work is the size of replacement needs. For example, much of the physical plant in our urban school system is aged and inadequate to the school needs of urban children. Replacement will be very expensive. These replacement needs alone could cause the annual net increase in State and local bonds to double in the next five to ten years.

In summary, the growth of new programs especially Federally aided ones, the increasing reliance on debt service grants to shift Federal debt to State and local debt, and exploding replacement needs could increase the annual net growth in State and local debt from the present $9 or $10 billion as high as $30 billion a year in 10 years. *This would represent a rate of growth twice as high as the rate of growth of the savings supply.*

If State and local governments are to sell this enormous increase in tax-exempt bonds, then they will be commanding a larger share of the savings flow. To do so they will have to compete more sharply with other borrowers, such as home owners and corporations. The question is whether tax exemption is an efficient instrument with which to conduct this competition. We can take as a fact of life the exemption on tax-exempt bonds in the present market. The experts say that this exemption is "inefficient" in the sense that State and local governments get less benefit from it in lower interest costs than the Federal Government gives up in lost tax revenues. As I said earlier this could, however, be regarded as the price paid for the independence of decision-making that the interest exemption offers in general to State and local governments. What we need now to do, however, is to give serious thought to the question of how this will work out if State and local governments suddenly try to become much heavier borrowers.

The Market for Tax-Exempt Bonds

To understand the significance of this enormous potential growth in tax-exempt bonds, it is necessary to remember that the institution of tax-exempt interest has an impact not only on Federal tax returns but also on bond markets. It does save State and local governments money by reducing interest rates on their bonds, but it does so by narrowing the range of customers for those bonds. It narrows the range to groups that find tax exemption valuable. You don't find exempt pension trusts buying tax-exempt bonds.[1]

The rate on tax exempts is determined, like any other price, by demand and supply. If the supply of tax exempts is limited, they can be sold to the buyers

[1] Tax-exempt entities have purchased tax-exempt obligations in the past and still do because of legal limitations on their investment powers. These limitations, however, are rapidly being removed.

who are most anxious to get them. If more tax exempts are to be sold, the price of those tax exempts will have to fall, i.e., their interest rate must increase. The price fall will be necessary to get existing buyers to take more tax exempts (and thus less of other investments) and to induce new buyers to enter the tax-exempt market.

It is significant that interest of all kinds—taxable and tax exempt together—is a modest component of the income of upper income individuals. That income consists mostly of dividends and capital gains, reflecting the fact that the wealth position of these individuals inclines them to the higher risk-higher return features of equity investment (which features are also associated with favorably taxed capital gains and untaxed unrealized appreciation). Inducing these investors into the relatively safe investment of State and local government bonds through tax exemption is in a sense swimming against the tide.

By and large since the most distinctive feature of these State and local bonds is their tax exemption, the process of selling more bonds must involve widening the market by appealing to taxpayers with lower marginal tax rates than those now acquiring tax-exempt bonds. The appeal must involve the process of selling tax-exempt bonds at rates more closely comparable to those on taxable bonds, so as to make the exempt bonds attractive to those who get less tax advantage from the exemption.

The Inevitable Increase in Interest Rates on Tax Exempts—and Higher Costs to Local Governments

It is not possible to say exactly how much tax-exempt bond interest rates would rise with an increase in the relative share of tax exempts in the market. Obviously, it depends for one thing on the levels of general interest rates, which are subject to a great many forces. We can make some progress if we assume the present level of rates and talk about the differential between high grade municipals and high grade corporates. Presently, high grade municipals sell at close to 70 percent of the rate on similar high grade corporates.

In 1945–46 the level of outstanding municipals, as well as new municipal issues, was very low. Municipals constituted only 3.2 percent of net public and private debt, and the interest yield on outstanding municipals was only 40 percent of the yield on corporate Aaa bonds. By 1954 the State and local indebtedness had risen to about 5.8 percent of net debt, and the yield ratio had risen to 70 percent of the corporate bond yield. The yield ratio has hovered about this level since 1954, rising to about 80 percent in 1957 and averaging about 67 percent in January–August, 1968. The large item accounting for the recent pattern of a wider spread despite a still increasing State and local debt share (now 8.0 percent of net debt) is the sharp growth in holdings of municipals by commercial banks (associated with some pause in the growth of demand for mortgage money between the immediate post-World War II housing boom and the coming housing boom that will be associated with the World War II baby boom) and the unusual spurt in corporate bond flotations.

I am including a Table—Table 1—that presents some estimates of the possible response of the State and local bond rate to future developments. The table covers a range of possibilities respecting the size of State and local borrowing and the role of commercial banks in the market, since they are now the dominant institutional investor in municipal bonds. The future course of that role is of obvious importance—can the banks continue that role, keeping in mind that business loans are their primary function? What happens when they reach the limits of their taxable income, as some are now doing, so that the use of expenses, in fact allocable to tax-exempt issues, against taxable income as now permitted no longer produces tax savings?

Table 1 shows that the interest rate increases resulting from a high volume of tax-exempt securities could be put as likely to be about one-half point (keeping in mind that it might come to a full point). At current levels of State and local debt issuance ($15 billion gross) this would mean an increased annual interest cost of around $75 million on one year's issues. This annual cost would of course cumulate if the increase persisted for subsequent new issues. With new issues rising at 10 percent a year, a persistent increase in the State and local bond interest rate of one-half point would increase the annual cost by about $500–$600 million in seven years. This increased cost, remember, does not include the increased debt service itself, which would be something in addition. The increased cost is just the cost of the interest *rate increase* caused by the increased debt. It is the increase in cost caused by going to the well too often.

This is a substantial burden to put on local property taxpayers.

The Inevitable Increase in Interest Rates on Tax Exempts—and Higher Tax Savings to Buyers

This is not the full story, however. This process of bidding up the interest rates on tax-exempt bonds means that their benefits will automatically become much larger to those upper bracket taxpayers who are already buying them and would, of course, continue to do so under such higher interest rates. In addition, the higher interest rates will bring more and more lower rate taxpayers into a position where the exemption makes holding State and local bonds attractive even at their lower marginal rates.

Table 2 shows for taxpayers at various effective rate brackets the value of tax exemption for investment in State and local bonds which yields $100 of exempt interest at current rates. The taxpayer in the 70 percent tax bracket who earns $100 in exempt interest when the exempt interest rate is 70 percent of the corporate rate is in effect initially sacrificing $43 of before-tax yield. But he is then rewarded by the larger after-tax benefits. Thus, if he had obtained a taxable bond paying $143 (of which 70 percent is $100), he would have paid a tax of $100 and would net $43. The purchase of a tax-exempt bond instead thus already produces a saving of $57 for every $100 he receives in exempt interest.

We can now see the increased benefits for taxpayers when the State and local governments go to the well too often. The increased interest cost indicated in Table 1 is an increased payment on bonds that would have been sold anyway to the present buyers. The result therefore is an automatic increase in the tax savings enjoyed by the present group of buyers of tax-exempt bonds, which they enjoy because the market discount on the bonds is less than the tax savings the bonds provide. Thus, if the interest rate on exempt bonds rises to 85 percent of the corporate bond rate, the net saving of $57 for a taxpayer in the 70 percent bracket will rise to $78—a gain of 37 percent.

TABLE 1.—SOME PROJECTIONS OF THE SPREAD BETWEEN STATE AND LOCAL (S. & L.) BOND RATES AND CORPORATE RATES [1]

Rate of growth of State and local bonds outstanding	Rate on high grade S. & L. bonds as a percent of corporate rates: With S. & L. market favorable [3]	With S. & L. market unfavorable	Difference in points between high grade S. & L.'s and corporates: With S. & L. market favorable	With S. & L. market unfavorable	Rate on high grade S. & L. bonds (in percent): With S. & L. market favorable	With S. & L. market unfavorable
GNP rate (6 percent) [2]	70	75	1.8	1.5	4.4	4.7
Moderate rate (10 percent)	75	80	1.5	1.2	4.7	5.0
High rate (20 percent)	80	87	1.2	.9	5.0	5.3

[1] Assumes corporate AAA rate at 6.2 percent. The 70-percent relationship used as a base point here reflects the typical relationship of recent yeers rather than the 67-percent current relationship.
[2] This would be a sharp slowdown for State and local government borrowing.
[3] The favorable-unfavorable distinction involves the role of commercial banks in this market. Rates will be favorable to State and locals if commercial banks remain a large holder. They will be unfavorable if commercial banks hold a smaller share.

Looking down Table 2 one can see that as the relative interest rate on State and local bonds rises, taxpayers at lower marginal tax rates come into the position where they would be saving more in taxes from the exemption than they would lose on the interest differential; that is, their tax savings (which is the Federal Government's revenue loss) would be greater than the savings in interest to the State and local governments. If the State and local rate rises to 85 percent of the corporate bond rate, even a taxpayer whose marginal tax rate is over 15 percent would find these bonds a good investment.

In summary, the penalties for excessive reliance on the tax-exempt privilege to finance new programs are substantial. These penalties will be visited upon State and local governments through increasing the interest rate on all the bonds they sell, including the basic school bonds that they will have to sell anyway. The result occurs because the advantage of the present tax-exempt privilege of State and local bond interest works in a limited market than can be swamped by overuse of the tax exemption.

TABLE 2.—VALUE OF TAX EXEMPTION FOR VARIOUS TAXPAYER SITUATIONS BEFORE AND AFTER A RISE IN EXEMPT BOND RATE RELATIVE TO CORPORATE RATE

Marginal tax rate (in percent)	Net advantage of tax exemption on an investment of $2,300[1] when the exempt rate relative to the corporate rate is— 70 percent	80 percent	85 percent
70	$57	$71	$78
60	43	57	64
48	26	40	47
30	0	14	21
20	−14	0	6
15	−22	−3	0

[1] An investment of $2,300 was chosen because it produces exactly $100 of exempt interest at current rates.

At the same time the tax savings to present buyers of bonds will rapidly pyramid and new groups of buyers will be drawn to these tax benefits. This expansion of the tax preference will be coming at a time when the patience of many with existing tax preferences is becoming exhausted—as is shown by the rapid and widespread rise in sentiment for a minimum income tax to counteract the effect of tax preferences that now permit many taxpayers with high annual incomes to pay little or no Federal income taxes.

State and local governments should look carefully at their "friends" who want to maximize the use of tax-exempt bonds in meeting the costs of new programs. These data would indicate that such maximization is really more likely to help bond buyers and to hurt the bond sellers—who are the State and local governments.

The recent experience with arbitrage bonds and industrial development bonds should cause some moments of quiet reflection for those who up to now have adamantly refused even to talk about these disturbing possibilities or consider solutions for them that woulld alter the traditional patterns. There were those who saw no abuses or dangers whatsoever when the volume of industrial development bonds suddenly skyrocketed last year and the size of such issues rose to $100 million and $150 million figures. When the Treasury Department called attention to this situation and to the severe effects that could occur if larger and larger volumes of private business financing were converted into tax-exempt financing, there were those who sought only to characterize its concern as an attack on the tradition of tax exemption.

The more perceptive—and your organization merits high marks in this regard—recognized however that the Treasury attitude and its subsequent action were designed to prevent a distortion of that tradition that could all too easily cause its erosion or destruction. And now that these large industrial issues have passed from the scene under the recent legislation and the local government bond market will not have to absorb the corporate bond market, even the voices that had called doom and calamity when the Treasury acted are now admitting to "abuses" they had not been able to see before. But in the meantime, that attitude of head in the sands, of see or speak or hear no evil, did not make it any the easier to shape the needed corrective steps. The task—difficult enough in itself—of structuring those steps, of meeting the many technical problems that corrective tax measures inevitably entail, is certainly not made any the lighter if those with knowledge of the operative facts choose to withhold their experience and refuse constructive cooperation in favor of an adamant stance that denies there is anything to worry about.

As a result, one would hope that there can be a calm appraisal of these possible new developments I have described and their consequences. And if they are likely to occur—as many believe—one would hope there can be a calm analysis of possible new financing techniques to avoid those consequences. Let us therefore turn to this phase of the discussion.

Possible New Financing Techniques—Local Taxable Bonds

In a talk on June 13, 1968 before the Municipal Forum of New York I described one possible new financing technique—that of local taxable bonds. I gave the example of a local project—it could be an anti-pollution project, an airport, an urban development project, and so on—as to which Federal assistance would be provided not through the traditional initial capital grant but through a system of paying part of the debt service of a bond issued by the locality to meet the cost of the project. The Federal share of the debt service—as respects both principal and interest—would be paid periodically over the life of that bond. I then indicated that instead of having the local bond a tax-exempt obligation, there could be used instead a *local taxable* obligation with two attributes: the Federal Government would fully guarantee the bond and, in addition, would use the tax revenue gained through the taxable status to pay to the local government an interest subsidy that would bring the interest cost to it down to a level lower than, or at least comparable to, the interest rate on a tax-exempt bond. This interest subsidy would be in addition to the share of the annual debt service provided by the Federal Government.

I described this approach as a new type of joint venture by the Federal and State and local governments for these social projects, with a method of financing that would benefit both governments. This was the approach presented earlier this year by the Administration as a way to start an increased number of antipollution projects.

The State and local government groups in general responded negatively—in a positive way!—and opposed the Administration's proposal, stating that the local bonds should be of the traditional tax-exempt type. Another suggestion was for a two-bond approach—a *taxable bond* issued by the local government for the Federal share and paid off by Federal funds, and a *tax-exempt bond* issued by the local government for its share.

Our bond experts then went to work to evaluate the comparative costs of the three approaches—single taxable bond, single tax-exempt bond, and two-bond approach. The crucial issue in this comparison is the cost to the local government.[2]

Here our experts believe that a tax-exempt approach either as a single bond or part of a two-bond suggestion, would cost the local government more than would the single taxable bond. Under their analysis the effect of the enlarged volume of these new tax-exempt issues on the interest rates for tax exempts generally—the point I have discussed earlier—would involve a higher cost to the local government on its overall borrowings than would the issuance of taxable bonds after the interest subsidy. Hence, a Mayor faced with paying for both a new school and a new social project would save his community money by choosing a single taxable bond for the social project rather than using a tax-exempt bond in whole or in part.

There are two questions in this analysis that deserve careful attention. The first is the possible rise in interest rates on tax-exempt securities if that market really faces the enormous increase in load I have earlier described; the second is the rates at which *local taxable bonds* would sell bad. I have the feeling that knowledgeable persons could reach a consensus on the first of these questions and that such consensus is likely to be along the disturbing lines our experts foresee. There may be a wider range of disagreement on the second question.

Some private analysts may doubt that the market prospects for *local taxable bonds* would be as good as our experts expect. They may believe that interest, especially bank interest, in local small, long-term serial issues would be limited to tax-exempt issues. The taxable local bond would be a new type of obligation—a new animal—and some analysists believe that the new animal would not be readily accepted by the market for a long time to come, if ever. Since the marketability of obligations depends on their ability to be readily sold and bought, this lack of ready acceptability could be an adverse factor. They say a bank that would buy a tax-exempt bond of City A won't buy a taxable bond of that city even if the taxable rate is adequate to cover the absence of tax exemption.

The impact on interest rates of the future pressures on local financing will therefore be less in their judgment if the local governments were to meet these pressures by using obligations of established acceptability rather than breaking new ground. They concede that a full Federal guarantee for the local taxable bonds could go a considerable way to counteract these attitudes since the guarantee would meet concerns as to credit and rating. But still they believe the

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[2] As respects the Federal Government, the cost of a tax-exempt approach, whether it be as a single bond or a part of the two-bond suggestion, is greater in view of the loss of the tax revenue that would come from using a tax-exempt bond. This loss is greater than the interest savings to the local government and therefore greater than the interest subsidy that would have to be paid to equalize the local government's borrowing costs. And we must remember that the cost of the debt-service approach is greater to the Federal Government than the initial capital grant approach, since the interest on taxable local obligations would be greater than the rate at which the Federal Government can borrow directly to cover the capital grant.

newness of the local taxable bonds would affect their marketability and cause their interest rates to be higher than our experts have assumed—and indeed perhaps to cause a rise in the whole range of market interest rates.

I am not here to weigh these doubts or come to a decision on the differing predictions. Rather, I wish to bring the questions to your attention and to urge their serious consideration. That consideration requires a careful effort to describe with particularity the weaknesses in the use of local taxable bonds, if weaknesses there be. The next step in the process must then be to ask whether other financing techniques could meet those weaknesses. For, if our belief that reliance on the traditional tax-exempt approach to meet the enormous future load on local financing has its own serious problems, to say that the taxable approach may have its weaknesses cannot end the inquiry—so does the tax-exempt approach and its weaknesses seem to be by far the greater.

Possible New Financing Techniques—a Central Financing Institution

Those who have doubts about the local taxable bond approach in large part place their concern on the difficulties of marketing these small novel issues. Would that concern disappear if a central institution took over the financing on a taxable basis? This possibility calls attention to recent Treasury discussion [3] of a National Urban Development Bank—a concept suggested by Vice President Humphrey on July 2, 1968 to help solve the problem of financing the needs of American cities.

In brief, as one possible framework, such a Bank would be a non-Federal institution financed initially by an appropriation of Federal funds and then through subscription of non-Federal funds. It would issue its own obligations in the market, and these would be taxable. They would be guaranteed by the Federal Government. The obligations could involve maturities, characteirstics and amounts that would make them marketable at competitive interest rates. Congressional control could be assured by requiring regular approval by the Congress of the dollar volume of obligations issued by the Bank.

The Bank, as one of its activities, could then accept obligations of local governments issued to meet their financing requirements for the new social projects. It could utilize affiliated regional banks for this purpose. It could accept such obligations at interest rates that would involve a subsidy so as to provide interest costs to the local governments lower than, or at least comparable to, the interest rates on tax-exempt bonds—the parallel to the subsidized local taxable bond approach. The cost to the Bank of this subsidy could be met by Federal appropriations to the Bank, with these appropriations in turn being financed ultimately (not earmarking necessarily) by the increase in revenue to the Federal Government through having the obligations of the Bank taxable, as compared with the revenue loss if traditional tax-exempt local financing were used.

Federal assistance for the local projects, such as the partial annual debt service grant I described earlier, could of course be a part of the arrangement. The terms of that assistance could be established under the particular substantive Federal legislation governing the social programs involved—anti-pollution, urban development, etc. The mechanics of that assistance could be handled through the Bank, thereby avoiding a proliferation of the channels of assistance. The financing of that assistance could be through Federal appropriations to the Bank. The Bank, of course, could make loans and provide assistance to private groups as well.

Such an Urban Development Bank—Community Development Bank might be a more descriptive term since it could handle rural as well as urban programs—would appear to meet the problems some may see in the local taxable bond approach previously discussed. The Bank, in effect, permits a pooling of the various local government obligations, so that the disadvantages of issue size, of lack of a ready market in which the local taxable bonds could be sold and bought, and of novelty are all eliminated. The bank instead would be raising the funds involved in the private market on a centralized taxable basis, in a volume sufficiently large and with a Federal guarantee so that the rate of its obligations would be as comparable as possible to taxable Treasury bonds. The financing

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[3] See Remarks of Frederick L. Deming, Under Secretary for Monetary Affairs, Graduate School of Banking, University of Wisconsin, August 27, 1968 (Treasury release F–1339); Remarks of Under Secretary Joseph W. Barr, California Savings & Loan League, Anaheim, California, September 18, 1968 (Treasury release F–1349); Remarks of Frank W. Schiff, Deputy Under Secretary for Monetary Affairs, Municipal Treasurers Association, Washington, D.C., August 21, 1968.

of the social programs would thus be made at a lower cost to the Federal Government than would be involved in the local taxable bond approach—where the size of the annual debt service grants of the Federal Government would be governed by the *local taxable* bond rate and not the rate on Federal obligations.

Finally, the State and local governments could participate directly in the management and control of the Bank itself. Use of the Bank would be on a voluntary basis however—any State or local government could still finance projects directly through its own obligations. Hence the accommodation to independence of State and local governments, that factor which these governments see as the essence of the tax-exemption privilege, can be achieved through a proper structuring of the Bank.

I commend the concept of a Development Bank to you for your close study and consideration. Here also you have the opportunity through objective analysis to weigh the possibilities of this new approach and then if it offers promise, to use your experience and wisdom to shape its structure and its future.[4]

Conclusion

In conclusion, let me return to the summary I gave you at the outset:

The possible high level of new issues of tax-exempt State and local bonds over the next decade—a level required to meet the huge financing requirments of the vast array of needed social programs—raises very serious problems for both State and local governments and the Federal Government. The price for the State and local governments in the use of tax-exempt bonds on such a greatly increased basis under those programs will be in very sizable increases in their interest costs. The price for the Federal Government will be in serious inroads on the equity of its tax system.

Those anxious to preserve the strength of State and local governments should seek to develop new financing techniques that avoid such a high price.

Two possible new financing techniques are offered for consideration: One is the use of local taxable bonds placed directly on the market. The second is a pooling of local obligations through a central non-Federal new financial institution which would raise its funds in the private market on a taxable basis.

Both approaches involve Federal guarantees for the obligations to be issued, and both permit the local governments to receive an interest subsidy to offset their departure from the use of the tax-exemption privilege. But also permit the social projects initiated by the local governments to receive Federal assistance for those projects according to the particular substantive programs affecting them. Finally, both approaches permit that independence of local government which is now obtained through the tax-exemption privilege, but do so without the inefficiency and consequent wastage of funds now associated with that historical solution to one of the problems of our Federal system.

In sum, there are paths to be explored by those who are willing to face this serious problem in a constructive way. That very exploration can in turn open up still other avenues for consideration. The proper Federal role and the proper State and local government role in the necessary Federal-State-local partnership required to meet the fast growing credit demand for new public facilities and social projects can thus be structured in the light of our pressing present needs.

For we are at a crucial crossroads. One way, a blind following of the past, could financially weaken State and local governments and thereby weaken the independence of these governments though outwardly preserving the trappings of independence. The other way, utilizing our knowledge of newly developed credit tools and the new financial institutions to operate them, can preserve and advance that independence.

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[4] One financing technique *not* suggested here is that of Federal tax incentives to private industry. This is not to say that Federal assistance to industry may not be part of the overall program to provide the needed social projects. It is to say that such assistance could far better come through direct Federal outlays, in the form of payments for industry services, or loans or grants. It is believed that such a direct approach rather than "back door" financing through tax incentives, with its inefficiencies and waste and non-disclosure in the Federal Budget, is far more appropriate. Indeed, for many similar reasons the direct approach of the financing techniques suggested in the text is presented as offering advantages over the tax route of tax-exempt obligations. But this is not the occasion to discuss tax incentives at length. Those interested may consider my remarks before the Dallas Chapter of the Financial Executives Institute, Dallas, Texas, *Taxes and the Federal Budget,* February 13, 1968 (Treasury release F–1161).

EXCERPT FROM REMARKS BY HON. FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS, AT THE GRADUATE SCHOOL OF BANKING, UNIVERSITY OF WISCONSIN, MADISON, WIS., AUGUST 27, 1968

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FINANCING NEW NEEDS

But, if life is easier now and prospects are for lesser problems in Treasury and agency finance throughout fiscal 1969, there are some major financing problems that lie ahead of us. I have referred to the problems of the urban areas; obviously, we must find ways to meet them and to meet them in sound financial style.

In a talk I gave in St. Louis in November, 1965, I discussed in some detail problems of coordinating the offerings of the multiplicity of Federal agencies dealing directly with the market, each with its own scheduling problems and each with fairly specific financing objectives or requirements. I also discussed the growth and diversity of the underlying Federal credit assistance activities which gave rise to these agencies. I suggested that we give pretty free rein to the imagination in considering alternative approaches to improve the coordination of the financing of these activities and, thus, to minimize the financing costs and the impact on financial markets.

In October, 1966, in New York, Under Secretary Barr also spoke of the problem of coordinating the financing of the myriad Federal credit program agencies. He suggested that perhaps the next step in this area might be the establishment of a new central Federal lending corporation, which would obtain funds for programs economically and efficiently by issuing its own obligations in the private market.

On July 2, 1968, Vice President Humphrey suggested the establishment of a National Urban Development Bank to help solve the central problems of financing the needs of American cities. This would be essentially a program for Federal underwriting of loans. The Bank would be financed initially by an appropriation of Federal funds and then through subscription of private funds. It would issue its own obligations in the market and would make loan funds available through affiliated regional banks at varying interest rates to help finance publicly-sponsored projects, especially, but not exclusively, in the inner cities. Federal appropriations would be provided to cover the differential between the interest rate paid in the market by the Bank and the subsidized rate to the borrowers.

I believe that such an approach offers a basic solution to the long-standing problem of providing effective Federal financial aid to State and local public bodies. The interest on obligations issued in the market by the Bank would be subject to Federal income taxation without involving the direct taxation by the Federal Government of obligations issued by States and localities themselves. This is the way we conduct our present programs of direct loans—since these programs are, in effect, financed in the market with taxable Treasury bonds—except that direct Federal loans require immediate Federal budget outlays.

The proposed new Urban Bank may require initial Federal contribution but would then require budget outlays only as necessary for interest subsidy payments over the term of the Bank's borrowings. Since the Bank would not require actual Federal stock ownership, it would not be included in the Federal budget.

This broad-purpose Urban Bank would go a long way in meeting the financing needs of the cities. It also would help avoid further proliferation of Federal lending agencies and would have the advantages of size and flexibility in its marketing operations which would assure orderly financing at the lowest possible borrowing rates.

The Urban Bank proposal may also suggest the proper future Federal role in the necessary Federal-State-local partnership to meet the growing credit demands for public facilities. I believe that the Federal role should be primarily that of guarantor. There is no reason why the Federal Government, itself, should be getting ever deeper into the essentially administrative chores of loan origination and servicing which can be performed just as well or better by existing private financial institutions or by new non-Federal institutions such as the proposed Urban Bank. Nor is it necessary or practical for the Federal Government itself to build up a large portfolio of loans. The essential Federal contribution can be provided in the form of debt service subsidies over the term of the loans and Federal assumptions of the unusual loan risks.

While a Federal backstop behind the Bank's obligations is an appropriate means of assuring the investor in these obligations against loss and thus minimizing the Bank's borrowing costs, the Federal guarantee should not be expected to be used, or looked upon as a means of providing further subsidy of protection to the local communities themselves. The defaults on State and local bonds over the past several decades have been virtually nonexistent, and I believe this record should be maintained. The Bank can serve as a useful channel for Federal interest and other subsidies for the benefit of local community projects; these subsidies should be in predetermined amounts sufficient to make the local projects economically viable. Any loan made by the Bank should have a reasonable assurance of repayment. The management and staffing of the Bank should be of the highest caliber. I think these principles are essential to the establishment of the Bank in the private market on a business-like and fully self-supporting basis.

The Bank should also not be viewed as a substitute for sources of credit already available in the private market. As the Vice President stated in his July 2 speech, the funds of the Bank would be available for programs which cannot be financed through other means.

There should be firm control by the Congress over any subsidies provided to local communities through the Bank. While it would be essential to the efficient marketing of the Bank's obligations to provide advance assurance that Federal interest subsidies will be forthcoming in a timely manner to meet the Bank's own debt service requirements, this can be done without any loss of Congressional control by requiring regular approval by the Congress of the dollar volume of new obligations issued by the Bank with a Federal commitment to pay part of the debt service.

Chairman PATMAN. In fact, it has many advantages, I think.

Mr. ZWICK. If I can just interrupt briefly, the bill we will submit for the Administration anticipates exactly that course.

Chairman PATMAN. I am pleased to hear that. You know, the commercial banks that manufacture their money under the Government's credit bought 94 percent of all tax-exempt bonds last year. And so if they were not using the Government's credit to buy tax-exempt bonds, we would have plenty of money for housing. So that is a fine giant step in the right direction.

I think it is an amazing record to change the budget situation from a big deficit to a surplus in 1 year. This is certainly good news. However, I think we all want to be sure that it is a realistic budget and that we will not find later on that it is too low, and I will ask you gentlemen to comment on that when you look over your transcript.

(The Council of Economic Advisers supplied the following:)

RESPONSE FROM COUNCIL OF ECONOMIC ADVISERS

The estimated increase in Federal revenues (excluding employment taxes) for the fiscal year 1970 is indeed a strikingly low figure. That rise of a little over $7 billion seems small not only in relation to the huge increase of fiscal 1969 but also to the normal growth that might be expected. As the Treasury response points out in detail, there are two principal sets of factors that account for this result. First, the retroactive features of the surcharge and the acceleration of corporate tax payments produced a non-recurrent addition to the level of receipts in fiscal 1969. Although this does not lower the *level* of receipts in fiscal 1970, it does make the *increase* from fiscal 1969 to fiscal 1970 smaller than would otherwise be the case. Second, the prospective moderation in the advance of economic activity, and particularly the very modest further increase expected in corporate profits, holds down the estimated growth of revenues during fiscal 1970.

(The Treasury Department subsequently furnished the following:)

RESPONSE FROM TREASURY DEPARTMENT

The key factors behind the change in the budget situation from a big deficit to a surplus are as follows:

Receipts in the fiscal year 1969 are estimated to rise $32.4 billion over actual receipts in fiscal 1968. This is substantially greater than any increase in the past. The large receipts reflect the combination of the record gain in economic incomes realized in the calendar year 1968 and legislative changes enacted in 1968 and in prior years.

GNP in calendar 1968 rose $71 billion over 1967. Reflecting this record gain in economic activity, personal income rose $57.0 billion—also a record. Corporate profits before tax rose $10.7 billion. Although not a record, this figure was exceeded only by the gains in profits in 1950 and 1965. As a result of these gains in income and economic activity, receipts in fiscal 1969 are expected to rise by approximately $14 billion.

Legislation contributes to an even greater degree to the increase in fiscal 1969 receipts—by approximately $18 billion. The income tax surcharge, the acceleration in corporation tax payments, and the excise tax rate extensions enacted in 1968 will increase receipts in fiscal 1969 by almost $14 billion over 1968 receipts. Employment taxes rose by $4.0 billion in fiscal 1969 because of legislation enacted in 1967. A part of the gain comes from the full-year effect in fiscal 1969 of the increase in the wage base from $6,600 to $7,800 effective January 1, 1968 (and only partially effective in fiscal 1968). The remainder arises from the part-year effect of the increase in the combined tax rate from 8.8 percent to 9.6 percent effective January 1, 1969.

(Note: The effect of legislation and growth in economic incomes is discussed in greater detail in the answer to the fourth question of the Chairman.)

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

BUREAU OF THE BUDGET RESPONSE TO MR. PATMAN'S QUESTION CONCERNING THE REALISM OF THE 1970 BUDGET

The estimates in the 1970 budget are, in my opinion, realistic and appropriate to the economic outlook and the Government's program commitments at home and abroad.

The basis for the revenue estimates is explained in the material submitted by the Treasury Department. With respect to outlays, as I pointed out in my testimony, barring some major development not now predictable, the estimate for fiscal year 1969 is reasonably firm. The expenditure levels for the first five months of the current fiscal year, July through November, were—after adjustment for seasonality of agricultural and construction programs—at an annual rate of $181 billion. The estimated total of $183.7 billion for the year could be met, therefore, even if the rate of outlays during the remaining months of the year increased to nearly $187 billion. Similarly, the defense figures to date allow leeway for a higher rate of outlays in the last half of the fiscal year than in the first half.

For fiscal year 1970, the budget reflects a general restrictive expenditure policy in recognition of the need for holding down Federal outlays in a time of inflationary pressure. The budget also recognizes the need for continued executive management of outlays, as an outgrowth of statutory controls imposed for fiscal year 1968, and particularly for 1969. For these years, the Congress departed from traditional appropriations procedures and placed direct restrictions, first on obligations, and then on the overall level of outlays. As a result, a considerable amount of enacted budget authority already obligated or now moving to the stage of obligation could convert to outlays in 1970, in addition to the amounts to be spent out of new budget authority recommended for 1970. Accordingly, a policy of strict management of outlays must be maintained in order to hold 1970 outlays to an appropriate level.

Within the necessary tight budget policy, the estimated outlays of $195.3 billion for 1970 represent a realistic effort to meet pressing national needs. Increases are provided for strengthening our defense forces and for expanding urgent domestic programs designed to further the economic and cultural advancement of disadvantaged groups within our society. The overall rise in outlays of $11.6 billion, estimated from 1969 to 1970, provides substantial increases for improving education, expanding health and welfare services, aiding our cities, enlarging the housing available to low and moderate income families, and combatting crime and disorder. These increases have been made possible by selective restrictions or reductions in programs elsewhere.

The priority choices which had to be made were difficult, but necessary. Limited budget resources, mandatory program requirements, and the need for responsible fiscal and economic policy were important in determining those choices. Given these considerations, the 1970 budget represents a sound and realistic program for the current and coming fiscal years. Continued economic growth, restraint over budget outlays, and extension of existing levels of income and excise taxes, as recommended in the budget, can reasonably be expected to produce the surpluses estimated for both fiscal years 1969 and 1970.

Chairman PATMAN. Why is the increase in tax receipts for 1970 so small? $5½ billion of this is social security taxes, so it leaves just about $7 billion for the normal increase from year to year. This figure has been higher in recent years.

Does this mean that you expect a sharp slowdown in the second half of 1969?

So, if you will answer that, please.

(The reply from the Council of Economic Advisers follows:)

The estimates for Federal expenditures in fiscal year 1969 should be reasonably firm. Those for fiscal year 1970 necessarily involve greater uncertaintly, but they are down-the-middle estimates consistent with the recommendations of the Johnson Administration. Mr. Zwick's reply covers these issues in detail.

(In reply, the Treasury Department answers:)

Unified budget receipts in the fiscal year 1970 are estimated at $198.7 billion, as compared with estimated receipts of $186.1 billion in fiscal 1969 and actual receipts of $153.7 billion in 1968 The increase from 1968 to 1969 is thus $32.4 billion; from 1969 to 1970, $12.6 billion. Excluding employment taxes, the increases in receipts are $26.8 billion in fiscal 1969 and $7.5 billion for 1970.

The much smaller increase for 1970 is due in part to the reduced rate of economic gain estimated for calendar 1969—the period most important in determining fiscal 1970 receipts—in comparison with the economic gain realized in calendar 1968, the period most important in determining fiscal 1969 receipts. The $60.3 billion GNP rise projected for calendar 1969 is less than the $71.0 billion rise realized in calendar 1968. Moreover, the relative composition of the income gains also reduces the rise in tax liabilities in calendar 1969 below that for calendar 1968. The corporate profits share of the projected economic gain in calendar 1969 is 6.1 percent. This is much smaller than the 15.1 percent share in 1968.

Although the effect on receipts of economic growth is less in fiscal 1970 than in fiscal 1969, the major reason for the substantially smaller increase in receipts (excluding employment taxes)—$7.5 billion for 1970 as compared with $26.8 billion in fiscal 1969—is the difference in the effects of legislation in the two years. As shown below, legislation and miscellaneous factors increased receipts in 1969 by $14.5 billion over fiscal 1968. In fiscal 1970 these factors reduced receipts as compared to 1969 by $1.7 billion. The major reason for this difference is that the income tax surcharge enacted in 1968 increased tax rates, whereas the proposed continuation keeps tax rates unchanged. The surcharge continuation does produce additional revenues in fiscal 1970 but the increase is not as large as in fiscal 1969. The additional revenues produced by the surcharge in 1970 are less than the additional revenues produced in 1969 because of the retroactive nature of the 1968 legislation.

The change in receipts for fiscal 1969 and 1970 is shown in detail below.

[Dollars in billions]

	Increase in receipts		Change	
	Fiscal year 1969	Fiscal year 1970	1969 and 1968	1970 over 1969
Other than employment taxes:				
Surcharge (enacted and proposed):				
Individual	+8.4	+8.0	+8.4	0.4
Corporation	+4.3	+3.3	+4.3	−1.0
Total	+12.7	+11.3	+12.7	−1.4
Acceleration of corporation payments (1968 act)	+1.0	+0.3	+1.0	−0.7
Total	+13.7	+11.6	+13.7	−2.1
Excise taxes	+0.2		+0.2	−0.2
Total, 1968 act	+13.9	+11.6	+13.9	−2.3
Other proposed:				
Quarterly payments of unemployment taxes		+0.3		+0.3
User charges		+0.4		+0.4
Miscellaneous (legislation prior to 1968 and change in payments patterns)			+0.6	−0.2
Total other than economic growth			+14.5	−1.7
Economic growth			+12.3	+9.2
Total other than employment taxes			+26.8	+7.5
Employment taxes			+5.6	+5.1
Total receipts, unified budget			+32.4	+12.6

Most of the increase in tax receipts due to economic growth is due to increases in income taxes, individual and corporate. The increase in individual income tax receipts in fiscal 1969 is $7.3 billion. This is 12.8 percent of the increase in personal income, calendar 1968 over 1967, of $57.0 billion. The gain in individual income tax receipts drops to $6.4 billion in 1970 because the increase in personal income projected for calendar 1969 falls to $50.2 billion. The receipts gain is 12.7 percent of the income gain, almost exactly the same as estimated for fiscal 1969.

Corporation income tax receipts in a given fiscal year reflect, for the most part, the profits of the calendar year ending in the fiscal year. A significant amount, however, arises from the first two payments of estimated tax for the current year. Thus, receipts in the fiscal 1969 depend primarily on profit levels for calendar 1968 and to some extent on profits for calendar 1969. Receipts in fiscal 1970 are derived mostly from calendar 1969 but also from calendar 1970 profits.

Corporation profits before tax are estimated at $92.3 billion for calendar 1968. The gain over 1967 is $10.7 billion. Corporation tax receipts in fiscal 1969 reflect the large increase in profits. The increase in receipts due to economic growth is $3.7 billion. Profits projected for calendar 1969 are $96.0 billion, an increase of $3.7 billion. Primarily as a result of this much smaller increase in profits, the increase in corporation income tax receipts in fiscal 1970 falls to $1.8 billion.

The two income taxes produce $11.0 billion of the $12.3 billion increase in fiscal 1969 receipts due to economic growth (excluding employment taxes) and $8.2 billion of the $9.2 billion increase in fiscal 1970. Other revenue sources produce $1.3 billion in receipts due to economic growth in 1969 and $1.0 billion in 1970. The difference of $0.3 billion is attributable to customs. Imports are not expected to show as sharp an increase in 1970 as in 1969 and further steps in the Kennedy Round duties reductions will limit customs receipts.

Chairman PATMAN. Now, we often talk about, before the Joint Economic Committee and Banking and Currency and other related committees, the great financial institutions like the commercial banks, State banks, national banks, Federal Reserve System, and savings and loan associations, but you seldom mention one great financial institution that has been growing by leaps and bounds in this country the last few years. Today we have over 20 million members of credit unions in the United States. The major States have more than 1 million each, many more than 1 million each. So they are doing a great service in my book, and should not be further overlooked. They have assets aggregating more than $14 billion and the work that they are doing to my mind, is next to the church in importance to the people of this Nation. And I have been urging an independent agency.

They are administered by civil service employees in one of the departments. In other words, we are almost treating them like they are stepchildren. And we should have a special independent agency for credit unions, I think. And I have been urging Mr. Barr to give consideration to this as Secretary of the Treasury and in my own time I will read a letter I have just received from him, dated January 17, 1969, because this is a matter of great importance, I think, to our Nation.

DEAR MR. CHAIRMAN: This is in response to your request for views on H.R. 2, "to amend the Federal Credit Union Act so as to provide for an independent Federal agency for the supervision of federally chartered credit unions and for other purposes." And I am in favor of the objective of providing an independent agency to supervise federally chartered credit unions.

Time has not permitted a detailed analysis of the provisions of the bill and in view of the need for expedition, this report has not been cleared with the Bureau of the Budget in the course of customary procedures.

Sincerely yours,

JOSEPH W. BARR.

Thank you very much, Mr. Barr.

Now, I yield to Mr. Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

First, to you, Mr. Secretary, Joe, we hate to see you go.

Mr. BARR. Thank you, sir.

Representative WIDNALL. As a colleague in the House, we always appreciated your ability, and your contributions. We admired and respected you and that admiration and respect has continued through your job as Under Secretary and now as Secretary. You have made a very fine contribution and all of it has been done with good humor and an understanding of the legislative process, which some in the agencies do not have. And I for one know that all of us wish you the very best, and we hope you are never foolish enough to make enough money now so that you have to divest yourself when you come back into the Government. [Laughter.]

To you, Mr. Secretary, the President's Economic Report states that our international accounts were in balance in 1968 for the first time since 1957, but this balance has been achieved through "special transactions" such as inducing foreign central banks to purchase U.S. Government securities. I understand in 1968 Germany purchased $500 million to help offset costs of U.S. troops in that country and Canada purchased a little more than $1 billion.

Are not special transactions merely forms of window dressing to achieve an accounting balance and not indicative of underlying U.S. competitiveness in world markets?

Secretary BARR. Mr. Widnall, I think that in the Economic Report and in Mr. Deming's statement to this committee it was emphasized that the United States must not take too much comfort in the fact that we achieved a balance on both standards of accounting, the liquidity measure and the official settlements measure.

As you point out, part of the balance was achieved through so-called special transactions. I will return to them in a second. The other part was achieved, however, for three reasons.

We had a huge inflow of capital into our stock markets, into our banks and into real estate investments, starting about April or May. Mr. Widnall, I think no one knows exactly why capital moves from country to country. We have asked our colleagues in other nations why this flow occurred, and they gave us three reasons.

No. 1. The U.S. Congress had the courage to raise taxes in an election year to cure the huge deficit we were running and demonstrated to the world that we did possess the courage to enforce fiscal discipline on ourselves.

No. 2. The disturbances in France caused somewhat of a tremor throughout the investment world.

And lastly, No. 3, the invasion of Czechoslovakia by Russia seemed to create a feeling in the world that perhaps Europe was not as safe as some had thought.

These were the answers that we received from our colleagues. I cannot improve on them, sir, and I only submit that a man who buys $10 million generator from Westinghouse or General Electric cannot sell it immediately. Usually he has to find a buyer. If he buys $10 million in their stock, he can reverse it in an hour. That is the difference in the flaws between a surplus in the trade accounts and in the capital accounts, Mr. Widnall.

So I say we cannot take too much comfort from these figures. Although they are accurate, they are accepted as traditional accounting procedures. The statistics, however, do not always give you the precise situation.

Now, as to the special transactions. One of the things that has really troubled me, and Secretary Fowler, and Secretary Dillon, and Mr. Okun, and his predecessors, Mr. Ackley, and Mr. Heller, all of us, and before that, the last Republican Secretary of the Treasury, Mr. Robert Anderson, was the terrible problem of how are we going to meet our security arrangements in the world? How are we going to keep the 7th Army in Europe as our share of the NATO defense, how are we going to keep the 6th Fleet in the Mediterranean, with the huge exchange costs that they both entail because we pay our troops in dollars? These dollars are spent overseas. The dollars are converted into deutsche marks or French francs or Italian lire which in turn can become a potential call on our gold reserves.

Now, we have attempted in every way we know to find a way as we put it, to "neutralize" the foreign exchange impact of these military deployment expenses. In other words, we are trying to find a way so that we can do what is proper and right for this country to do in sharing the military burden of keeping the peace of the world without bankrupting the international financial reserves of the U.S. Treasury.

One device we have hit on to cover part of the difference between the cost of our forces and the cost of military equipment other countries buy here—I do not insist it is the best but it is working at this time—is the so-called special transaction. For example when our forces spend money in Germany the dollars go to the German Central Bank and could be put to us for gold. However, the Germans have agreed to add these dollars to their reserves and not take our gold in exchange for dollars. What they will do is buy a medium-term U.S. Government obligation.

Now, I do not contend, Mr. Widnall, that this is the best answer in the world. I do not think it is as good as if they were neutralizing the full cost of our troops by buying military equipment as they used to. But that seems to have been nonnegotiable up to this time.

I submit, Mr. Widnall, you have hit on one of the most difficult issues that I know of, and my successor, Mr. Kennedy, is going to be wrestling with this problem. All of you are going to be wrestling with it. If you do not find an answer, I guess the only answer is to redeploy—pull back those troops.

Representative WIDNALL. I understand from your answer that you are saying that at the present time, we can expect these items to recur in the near future.

Secretary BARR. Maybe—I would hope that all of you can ponder and worry about this matter because it is crucial. It is one of the most difficult issues. It has been attacked by some of the best minds I know in this country and I will be frank to admit I do not think the answer is completely satisfactory. It puts us in the position—as one Member of Congress said to me publicly—of looking as though we are borrowing money from the Germans for the delicious pleasure of protecting them.

Now, that is putting it in the worst possible light. But it is a light that a tough politician can put it in, Mr. Widnall. The best light is that we are fulfilling our military obligations to keep peace in Europe and we are doing the best we can to prevent the Treasury's financial resources from being seriously impaired by doing so.

I am sorry this is a long answer, but you hit on a question that really troubles me.

Representative WIDNALL. I would like to ask you something important that goes along with that. Although these bonds are technically long-term nonliquid securities, is it not true that if either Germany or Canada found itself in balance-of-payments difficulties we would not refuse to redeem them?

Secretary BARR. Oh, that is quite correct, sir. There is an agreement we have worked out with them. If their reserves drop, I cannot remember the precise level, by a certain amount, they can get their money any time they want.

Representative WIDNALL. Was not the Canadian agreement to buy certain U.S. Government securities predicated on our exempting Canada from our controls on capital flows?

Secretary BARR. That is correct, Mr. Widnall. The Canadian situation is a much better one. I feel good about that. I like the Canadian arrangement and my only recommendation is that you try to keep it.

Here is the position we are in. It is a political situation really, and you gentlemen can understand it better than anyone. We are sitting here on a continent with a political boundary dividing two nations, Canada and the United States. Now, in effect, we have one economy. I hope my friends in Canada are not offended, but you cannot split the economy. The economy does not pay any attention to the political boundary.

What we have worked out with the Canadians, Mr. Widnall, is an arrangement whereby we allow investment, lending, borrowing to flow pretty freely across the border without restraints under our balance-of-payments program. The Canadians agreed to make sure that any U.S. funds that came in would not flow on to other countries and in that way evade our restraints and that they would put all of the dollars that came into their reserves except those they need for day-to-day working balances into long-term U.S. securities. This is why we got the billion-dollar investment from Canada. It will not be the Canadians' intention to build up their reserves by borrowing from us. This is the best way—this I am very happy with. I would say do not change it. I do not know of any better way to improve it although it is unique to Canada. There is not an economic barrier, even though national boundaries exist between the two countries.

My recommendation is to keep this. If you can improve on the German offset, do so. I certainly would, and I think there is room for improvement.

Representative WIDNALL. Thank you, Mr. Secretary.

Mr. Chairman, my time is up.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. First, I want to compliment you, Secretary Barr, for your charts on the comparisons of the budget outlays and tax function. We have needed this for a long time and I think it underlines the importance of our being careful about providing further tax credits, and so forth, which have a superficial appeal but which really have the same effect on our budget as expenditures do.

Secretary BARR. That is correct.

Senator PROXMIRE. The suggestion that Chairman Mills made, I think, that we find some way of incorporating this into the budget, I think is very good.

Secretary BARR. I agree.

Senator PROXMIRE. Very helpful if we had some kind of a separate budget so we would have them both in the congressional eye.

Secretary BARR. If we had more time I think we might have got it into the budget. We were a little bit late this year, but I support your recommendation.

Senator PROXMIRE. Now, I am very concerned—and except for the timing I would have gotten into this exchange with Senator Javits—I am very concerned about what happened to the tax reform package. In February of last year Secretary Fowler assured this committee that we would have the tax reform recommendations in 1968. We did not get them in 1968. And later on at another time the indication was if we passed the surtax, it would come shortly after that. It did not come shortly after that, or at all. Now it will come as I understand it, to the Senate Finance Committee and the House Ways and Means Committee, but not to the Joint Economic Committee.

I hope this is not a precedent because we need that in this committee. It is very important to this committee. And I hope it will not be a precedent with either President Nixon or in 1973 with President Kennedy. [Laughter.]

If this committee does not have that kind of information it is going to be very, very difficult for us to serve our purpose which is to advise the Congress on economic policy.

Secretary BARR. May I respond, Senator? I think you are aware—at least as I am aware as an ex-member of this club—of the great dangers in moving on congressional prerogatives. Now, under the Constitution—and you know I need not tell you how jealously the House guards this and the Ways and Means Committee guards it—they have the right to receive tax recommendations and act on them, sir.

Now, I quite agree that this committee needs this information, and I have worked out an orderly procedure, as I indicated, with Chairman Mills; and the Ways and Means and Finance Committees have agreed that next week, when Ways and Means is organized, they will instruct the chairman to request this information from Secretary-designate Kennedy. He has agreed to transmit it.

Senator PROXMIRE. Well, I understand that.

Secretary BARR. And at that time they will make the committee print available to all.

Senator PROXMIRE. What I am saying is I hope this will not be viewed as taking the Joint Economic Committee out of the action on tax reform recommendations or anything of the kind in the future.

Secretary BARR. No, sir.

Senator PROXMIRE. We have to have it.

Secretary BARR. May I comment?

Senator PROXMIRE. And it is just as essential to us as it is to the Ways and Means or Finance Committee.

Secretary BARR. I agree. I am not sure they do, but I do. [Laughter.]

Representative GRIFFITHS. Mr. Chairman, if you will yield, I do not know how the Senate Finance Committee got a copy.

Secretary BARR. They do not have a copy.

Representative GRIFFITHS. Or why they will get a copy. [Laughter.]

Secretary BARR. Well, I will be very candid here. The discussion in the joint committee was that the proper way to proceed was for the House to move first. The House is not organized. It was agreed that the Senate could get it. Senate Finance is an appropriate committee. But they did agree that in accord with the age-old procedures that have been followed in this Congress, that the House would move first. I am satisfied because we have a commitment. I am not going to comment, Mrs. Griffiths, on the procedures of the Congress of the United States since I am no longer a Member.

Senator PROXMIRE. Mr. Okun, you speak of the need for fiscal restraint. At the same time, you concede the enormous impact of the defense expenditures. The engine of inflation that you refer to in my view, is largely fueled by military expenditures and there is evidence that defense programs are loaded with fat. The last year's Congressional Quarterly—late last year, in November—indicated that there was $10.8 billion which they felt could be excised from the defense budget and I thought they made an excellent specific case in saying just where it ought to come out.

Now, the Economic Report hardly discusses defense expenditures. In view of its importance, do you not think the Council should analyze the economics of defense spending?

Mr. OKUN. Senator Proximire, I think we do take up the economic impact of defense spending. The very serious problems in the efficiency of the defense program and the planning of it are, I think, rightfully in the province of the budget message and the Budget Bureau. I do not feel that the Council really has the competence to evaluate these in detail. We did have some——

Senator PROXMIRE. You certainly have the only competence in Government as I see it, to evaluate the economic impact in detail, to tell us what defense spending is doing. For instance, yesterday we had testimony from Assistant Secretary Charles of the Defense Department, in which he conceded that there was extraordinary inflation in those industries in which we have a great deal of defense procurement, and I am convinced that the principal reason for this extraordinary inflation is because of the impact of our procurement policies and practices with the kinds of contracts we have, and so forth. This is something that seems to me in view of the problem of inflation that the Council of Economic Advisers should tell us about, explain to us, give us some recommendations on.

Mr. OKUN. We do call attention to that in chapter 3 of our Report.[1] We speak of the importance of efficiency in procurement practices and talk about some of the reforms and improvements there. I call your attention to pages 113 and 114 of the Council's Report.

Senator PROXMIRE. But at no place do you as I understand it, or perhaps the Council has and I missed it, recommended fiscal restraints on the defense budget.

Mr. OKUN. We feel that the estimate of defense expenditures in the budget has been reviewed and is the administration's view on what a minimum necessary budget is for that purpose. Obviously, any program is subject to further refinement and greater efficiency and if that can be achieved, all to the better. But I think our job has to begin by taking the figure that my colleague and his staff and the people in the Defense Department develop, present to the President, get his approval on it, as the desirable minimum defense needs of the country.

Senator PROXMIRE. Let me ask Mr. Zwick: the Subcommittee on Economy in Government has been holding hearings, Mr. Zwick, on military procurement, which is the largest single item, as you know, in the military budget. It is $40 or $43 billion, depending on precisely how you define it. Testimony has shown that there is widespread mismanagement and waste and inefficiency in defense purchasing. Mr. Charles, who some people feel wrote the book in the Air Force area on procurement, a very competent man, agreed yesterday with what Admiral Rickover had estimated—and others—that when we procure on a noncompetitive basis, we pay 30 to 40 percent more than if we procure on a competitive basis and, of course, the overwhelming amount of our procurement is noncompetitive.

Furthermore, Admiral Rickover estimates that at least $2 billion per year is wasted exclusive of that from procurements because of high profits. So I would like to ask you this question: Does the Bureau of the Budget scrutinize the defense budget with the knowledge of the immense waste in this program? [Laughter.]

Mr. ZWICK. Let me comment several different ways. Let me first join with all in our interest in efficient government and efficient management. A major responsibility of the Bureau of the Budget is this

[1] "Economic Report of the President, Transmitted to the Congress, January 1969, Together with the Annual Report of the Coucil of Economic Advisers," available from Superintendent of Documents, U.S. Government Printing Office, Washington, D.C.

area of management efficiency. Second, let me go directly to the general charges of waste. They are obviously easy to make. The Congressional Quarterly study in particular is one that both Secretary Clifford and I commented on last fall when you asked for our comments on them. I find a great number of items in which I certainly cannot concur. It is not only waste we are dealing with, but an issue of national security.

Senator PROXMIRE. That is why I asked Mr. Okun about the Congressional Quarterly. I would wholeheartedly agree that the Congressional Quarterly recommendations which I support are a matter of defense strategy in part, although they said that half of their recommendation was to reduce military personnel which they say was wasted so badly. They point out, for example, that we have 20 officers in Vietnam for every command post; that we have the greatest ratio of logistical supply to supply troops in the history of mankind by far in Vietnam. But I am asking you about whether or not the defense budget is scrutinized as carefully as, for example, dollar for dollar, as the OEO budget and HUD budget, and so forth.

Mr. ZWICK. This is a replay on our discussion last September. Defense is a big department. We obviously do not get into as great detail in that Department as we do in some other departments. This varies from department to department.

The analogy—the counterexample I gave you last September—was the Post Office. At that time the Postmaster General was about to close down certain fourth-class post offices because of the Revenue and Expenditure Control Act employment rollback provision.

I do not try to second guess the Postmaster General as to how to reduce personnel. Similarly, I do not try to second guess the Joint Chiefs of Staff as to the need for support personnel in Vietnam. Obviously, that is related to providing essential equipment to the people in the field, and we have to think a little bit about effectiveness in support of our people.

I cannot say to you that we give equal, evenhanded treatment to all agencies. But I think it is a mistake to say that we treat Defense in one fashion and all other agencies in another fashion.

Senator PROXMIRE. I will be back. My time is up.

Chairman PATMAN. Mr. Rumsfeld?

Representative RUMSFELD. Mr. Zwick, I would like to turn the conversation from a discussion of simply the quantitative approach which seems to be the focus of much of the material before us, and ask some questions about the qualitative aspects of some of this.

I notice in one of your budget documents, the smaller one,[1] on pages 66 and 67, that you have a budget outlay by function and subfunction.

Mr. ZWICK. Yes.

Representative RUMSFELD. Now, obviously these subfunctions cut across different departments and agencies. Some programs that are tabulated there with dollar figures for fiscal years 1959 through 1970 are in one department, some in another, within the same function. Is that correct?

Mr. ZWICK. That is correct.

[1] "The Budget in Brief, Fiscal Year 1970," available from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C.

Representative RUMSFELD. Now, to compile that information you use computers and feed in figures that have come from various agencies after you have decided which functional category you want to use. Then you ascertain which activities in each department or agency fit within that function or subfunction. Is that right?

Mr. ZWICK. Yes.

Representative RUMSFELD. So somewhere you have a list of all the programs by statute that comprise each one of the aggregate figures in each function and subfunction. Right?

Mr. ZWICK. We have all the appropriation accounts classified by function and subfunction.

Representative RUMSFELD. Right. But I mean arranged by function and subfunction.

Mr. ZWICK. Yes.

Representative RUMSFELD. Comumnity development and housing; education and manpower is another function.

Mr. ZWICK. Yes.

Representative RUMSFELD. Commerce and transportation; natural resources; right?

Mr. ZWICK. Right.

Representative RUMSFELD. Now, if you have that material then you also have material that would indicate what the cost or funding for each one of those statutory programs might be, regardless of the department, arranged by function, and so forth.

Mr. ZWICK. Right; yes.

Representative RUMSFELD. Then, you also have information which would indicate the units of some kind of a benefit or goal. For example, if it is housing, the number of housing units. If it is training, the number of hours of training per person; right?

Mr. ZWICK. You are, of course, defining the planning, programing, and budgeting system.

Representative RUMSFELD. Right.

Mr. ZWICK. I will be happy either to interrupt at this point and say what we are doing——

Representative RUMSFELD. You have that?

Mr. ZWICK. We have attempts at this type of information. Again, I think it would be unfair to leave the impression that we have somewhere down in the Executive Office nice, neat, benefit-to-cost ratios so that you can just array all programs and then slice the line at some point, and "above" they go in and "below" they go out. Let me give you an example.

Representative RUMSFELD. No. Let me go on a minute. I want to make sure I understand exactly what you do and do not have. You have had this information broken down roughly by the types of people that benefit, for example, by sex, by age group?

Mr. ZWICK. That is right; in some cases.

Representative RUMSFELD. By race, by the area they live in, urban, suburban, rural, that kind of information. You have all of that?

Mr. ZWICK. No; I am sorry.

Representative RUMSFELD. You have part of it?

Mr. ZWICK. We are making attempts to gather that information. The certainty with which you are saying this is what is making me nervous. The concept——

Representative RUMSFELD. The last thing I want to do is make you nervous at one of your last appearances.

Mr. ZWICK. The concept is fine. The detail and accuracy I still question.

Representative RUMSFELD. You talked about all the money you are going to spend in crime, as I recall, when you were responding to one of the questions.

Mr. ZWICK. Right.

Representative RUMSFELD. Do you have a function on crime here?

Mr. ZWICK. We have a new special analysis on crime reduction in the "Special Analysis" volume of the 1970 Budget. I think again, it is a very good example of the point you are making. We thought this was a very important new cross-cutting look which we ought to take at the budget.

Representative RUMSFELD. What is the name of that book?

Mr. ZWICK. "Special Analysis of the 1970 Budget" [1] We have for the first time an analysis of crime control programs in the Federal Government, across agencies and by activities within the agencies. Now, again, that is a preliminary first start. Hopefully, next year it will be better, and the year after that it will be still better. But certainly we agree in spirit, I think, with what you are saying.

Representative RUMSFELD. Well now, with regards to the kinds of data I have just described, what percentage of input into this system do you have? In other words, where are you, for example, in natural resources, commerce and transportation, by these broad functions? Do you have 50 percent of the data you need to present an intelligible analysis of what we are doing with the taxpayers' money or do you feel we are down around 30 percent total?

Mr. ZWICK. The best way I can answer that question is to try to measure the progress we have made. I do not quite know what the base is but I know the progress we have made and I am——

Representative RUMSFELD. We started from a very low base.

Mr. ZWICK. I am quite clear that we have made significant progress. I think over the last 3½ years since the planning-programing-budgeting system has been put in, we have demonstrated to my satisfaction the applicability of this approach across the Government. In some areas we have better data; in other areas, poorer data. A composite index that says that it is 58 or 72, I just do not know how to construct that. You will also find, Mr. Rumsfeld, in this special analyses volume for the first time, we have a new analysis which lays out the analytical program structures of the PPB system, the first time you have it available to the Congress. This analysis shows, by agency, the program structure and requested appropriations and other budget authority. It is the very last analysis, starting on page 258, and you will note the first word is "selected," but I think that

[1] Available from Superintendent of Documents, U.S. Government Printing Office, Washington, D.C.

"selected" covers roughly 95 percent of the budget authority, so that I think I can say we have made substantial progress. I would be less than candid if I did not say we have got a very, very long way to go in this area.

Representative RUMSFELD. OK.

Mr. ZWICK. But the dialog has been improved significantly.

Representative RUMSFELD. You have seen the data so you can make a judgment as to how far we have to go. I would be curious to know how far we have to go. You have just described the information that you have by function and subfunction and you have indicated you have some of the data, and you do not have some. Taking "natural resources" as a function, or even as one of these subfunctions, if I asked you for the kinds of information that you do have, how it affects people, areas, types of people, and costs and unit benefit, could you supply that information to this committee?

Mr. ZWICK. We have worked with all committees. Again, what I would not like to provide you—let me tell you what I would not want to provide.

Representative RUMSFELD. Can you provide the data I just asked for.

Mr. ZWICK. We would provide all useful data. There are some first runs on benefit-cost analysis which I do not believe answers all you want.

Representative RUMSFELD. I understand that.

Mr. ZWICK. All I am trying to say is what I think is the most——

Representative RUMSFELD. What you think is reasonably accurate——

Mr. ZWICK. Surely.

Representative RUMSFELD (continuing). You could supply it in the format that I described?

Mr. ZWICK. Yes. All agencies work with their appropriations committees now and given them that sort of information. So that I do not think there is any problem.

Again, I went through a similar dialog with Chairman Proxmire last September. I do not think the problem is information downtown compared with information uptown. I think the problem is intellectual. We do not understand some of these things. The problem is just plain hard work. We have got to collect data, clean up data, et cetera.

Representative RUMSFELD. There is a great deal I do not understand.

Mr. ZWICK. I think it is really a mistake to think the problem is what data one side of the Government has and the other side of the Government does not have. It is just that we have a long way to go in developing data.

Let me just give you one very specific example in the manpower area.

Representative RUMSFELD. In a minute a piece of paper is going to be put in front of me saying my 10 minutes are up, and before that happens I would like to request that the chairman suggest that your Bureau, supply the committee with the data that you do have and that you say you would be happy to make available.

Chairman PATMAN. We have an understanding oftentimes that the member can submit the question in writing.

Representative RUMSFELD. I do not have a question. I have a request.

Chairman PATMAN. Well, you can get it up and including the request. And the——

Representative RUMSFELD. I am making the request. It is a simple one. I would like to see the data in each of these functions and subfunctions arrayed the way that you have just described you have it, supplying only the data you feel is accurate.

Chairman PATMAN. Is that information indicated on a certain page of a certain document?

Representative RUMSFELD. Only he has the document. We do not have it. It is not in any of these books he has provided.

Chairman PATMAN. If you could be more specific——

Mr. ZWICK. Mr. Rumsfeld, I first suggest that most of it is in these documents. You know, the budget document consists this year of six different items. One, the message and the rest of the budget document that you normally think of. Two, the special analytic studies——

Representative RUMSFELD. I can count but you——

Mr. ZWICK. And there is——

Representative RUMSFELD. It is not arrayed the way that you just indicated you have it.

Chairman PATMAN. Mr. Zwick, will you try to provide that information when you look over your transcript of the testimony here?

Mr. ZWICK. I would be happy to.

Chairman PATMAN. To the best of your knowledge and ability.

Mr. ZWICK. Subject to two constraints. One, it is not easy because the question of what data is good and what data is bad is a very tough one and, two, I will not be here after Monday noon. [Laughter.]

So, I want to be quite clear on the question that you are asking and the cavalier spirit with which I can say surely, we will give you all the information that we have available. [Laughter.]

Representative RUMSFELD. You are not suggesting that you do not understand my question.

Mr. ZWICK. I am saying that your statement that it is a simple question was incorrect. I do not think that is a simple thing to do.

Representative RUMSFELD. First, I asked you if you had it, and you said yes, so if you have it I cannot imagine why it would be difficult for you to supply it.

Mr. ZWICK. The question is "it" and you qualified "it" as reasonable material, not all material, but reasonable material, and that is the difficult part of it. I am not trying to——

Representative RUMSFELD. You said you did not want to send out any information you did not feel was accurate. That is fine. Do not.

Mr. ZWICK. Fine, but I am saying sorting through——

Representative RUMSFELD. If it ends with a function for "Natural Resources" with a blank paper then we will know exactly on what the Bureau of the Budget feels they have good data. Nothing. And if it is 50-percent full, we will know that you feel it is 50-percent accurate. Do you follow me?

Mr. ZWICK. Yes; I follow you very well.

Representative RUMSFELD. You make the judgment, I do not make the judgment.

Mr. ZWICK. I follow you very clearly.

Representative RUMSFELD. There is that slip.

Chairman PATMAN. And if you can supply it, his successor will be available, I am sure, after Monday.

(The following material was subsequently supplied by the Bureau of the Budget in response to the suggestion of the Chairman:)

MATERIAL SUBMITTED BY BUDGET DIRECTOR ZWICK

As I indicated during my appearance before the Committee, dollar figures and reliable program information underlying each function and subfunction used in the functional classification of the budget are generally available, either in the budget documents printed by the Bureau of the Budget or in the extensive justification materials provided by the agencies to the Appropriations Committees of Congress.

Table 17 of the regular budget document (pages 527–530) summarizes budget outlays by function and subfunction. Code numbers are shown for each function and subfunction. Table 14 of the budget (pages 513–524) moves to a greater level of detail, showing the agencies included under each subfunction. A still more detailed breakdown is provided in Part 4 of the budget (pages 173–479), where each appropriation account of the Government is shown, by agency, with the subfunctional code number identified for each account.

A discussion of the program content of each function is included in the budget in Part 3, "Federal Activities by Function" (pages 67–171). Part 3 describes, through text and tables, the programs covered by the budget, classified by function, including relevant tables and charts on beneficiaries, workloads, or other available output measures. Samples of these tables are enclosed as Attachment A.

Additional information of this type is presented in the Appendix volume of the budget, and, as noted above, in the agency justification materials.

The Special Analyses volume contains various cross-cutting views of Federal programs which are more comprehensive than the functional categories and cover *all* activities in particular fields, even if the activity has a different primary purpose. Among the fields covered are education, manpower, health, and crime reduction.

As in the case of Part 3, these Analyses, through text and tables, portray the programs involved in each field and—to the extent available—provide data on numbers and characteristics of the beneficiaries. Samples of tables printed in the Special Analyses are enclosed as Attachment B.

In the 1970 Special Analysis volume of the budget, a new Analysis is printed entitled "Selected Agency Budgets by Program Categories." This Analysis, a copy of which is also enclosed, presents for the first time the budget authority of most Government agencies classified in terms of the program structures used in their Planning-Programing-Budgeting (PPB) systems.

As part of the PPB system, staff of the Bureau of the Budget and other executive branch agencies are using available data on benefits and beneficiaries of various programs ,in an attempt to identify the most efficient approaches to achieving program objectives. As the system progresses, there is every reason to expect that the agencies will continue their efforts to obtain more reliable data and improve the methods of measuring the efficiency of alternative means of reaching specified goals.

ATTACHMENT A
SELECTED TABLES FROM THE BUDGET ACCOUNT

SUMMARY OF ACTIVE FORCES

Description	Actual: June 30, 1961	Actual: June 30, 1968	Estimated: June 30, 1969	Estimated: June 30, 1970
Military personnel (in thousands):				
Army	859	1,570	1,534	1,508
Navy	627	765	771	772
Marine Corps	177	307	313	315
Air Force	821	905	869	861
Total, Department of Defense	2,484	3,547	3,487	3,455
Selected military forces:				
Strategic forces:				
Intercontinental ballistic missile squadrons:				
Minuteman		20	20	20
Titan		6	6	6
Atlas	5			
Polaris submarines/missiles (in commission)	5/80	41/656	41/656	41/656
Strategic bomber squadrons:				
FB-111				5
B-52	39	34	30	24
B-58	6	6	6	6
B-47	80			
Manned fighter interceptor squadrons	42	24	19	19
Bomarc interceptor missile squadrons	7	6	6	6
Army air defense missile battalions	49½	20¼	15	14½
General purpose forces:				
Army divisions	11	18	18	18
Army maneuver battalions	124	218	217	218
Army aviation units	67	212	235	235
Army special forces groups	3	7	7	7
Warships (in commission):				
Attack carriers	15	15	15	15
Antisubmarine warfare carriers	9	8	7	6
Nuclear attack submarines	13	33	41	47
Other	328	328	299	279
Amphibious assault ships (in commission)	110	157	157	141
Carrier air wings/groups (attack and ASW)	28	23	21	20
Marine Corps divisions/aircraft wings	3/3	4/3	4/3	4/3
Air Force tactical forces squadrons	93	144	147	138
Airlift and sealift forces:				
Airlift aircraft squadrons:				
C-5A				2
C-130 through C-141	16	44	44	41
C-118/C-124 and C-7	35	17	12	7
Troopships, cargo ships, and tankers	101	130	124	124
Addenda:				
Active aircraft inventory (all programs):				
Army	5,564	10,465	11,622	12,018
Navy	8,793	8,491	8,594	8,452
Air Force [1]	16,905	15,327	15,058	14,993
Helicopters included in service aircraft, above	4,047	10,188	11,468	12,014
Commissioned ships in fleet (all programs)	819	932	906	895

[1] Includes aircraft provided for support of allies.

LOW AND MODERATE INCOME HOUSING PROGRAMS—ADMINISTERED BY FARMERS HOME ADMINISTRATION

[Estimated units started or acquired. In thousands]

Program	1968 actual	1969 estimate	1970 estimate
New construction	22	36	80
Rehabilitation	3	3	12
Purchase and repair of existing housing	8	6	7
Rural rental housing	2	3	3
Subtotal, new or rehabilitated housing	35	47	102
New or rehabilitated housing with aid from homeownership program [1]	---------	1	10
Subtotal, new or rehabilitated	35	48	112
Purchase of existing housing	8	6	8
Total, housing for low- and moderate-income families	**43**	**54**	**120**

[1] Funded by the Department of Housing and Urban Development and included in the community development and housing function.

MAIL VOLUME

	1965 actual	1966 actual	1967 actual	1968 actual	1969 estimate	1970 estimate
Millions of pieces	71,873	75,607	77,858	79,800	82,266	84,798
Percent increase from previous year	3.2	5.2	3.0	2.5	3.1	3.1

LOW AND MODERATE INCOME HOUSING

[Estimated units started. In thousands]

Program	1968 actual	1969 estimate	1970 estimate
Low rent public housing	51	75	130
Rent supplements	12	21	20
Rental assistance program	---------	7	84
Homeownership assistance	---------	9	93
Loans for low and moderate income housing (GNMA special assistance)	44	50	32
Housing for the elderly	7	8	7
Rehabilitation loans and grants	8	16	35
Other housing in rural communities [1]	35	47	102
Total	157	233	503

[1] Funded by the Farmers Home Administration and discussed in the agriculture and agricultural resources function.

ELEMENTARY AND SECONDARY EDUCATION PROGRAMS FOR DISADVANTAGED

Program indicator	1968 actual	1969 estimate	1970 estimate
Education of children from low-income families:			
Obligations (millions)	$1,187	$1,123	$1,226
Number of children participating (thousands)	9,000	9,000	9,000
Preschool and school classes for the handicapped:			
Obligations (millions)	$14	$29	$29
Number of children participating (thousands)	24	182	182
Special bilingual and dropout prevention projects:			
Obligations (millions)	---------	$12	$34
Number of children participating (thousands)	---------	10	35
Head Start and Follow Through:			
Obligations (millions)	$336	$348	$398
Number of children in Head Start programs (thousands):			
Full year classes	218	218	235
Summer classes	477	477	477
Parent and Child Centers	4	4	4
Number of children in Follow Through classes (thousands)	15	31	64

SELECTED MANPOWER TRAINING PROGRAMS

Program indicator	1968 actual	1969 estimate	1970 estimate
Job Opportunities in the Business Sector (JOBS):			
Outlays (millions)	$4	$121	$239
Total individuals served (thousands)	33	167	220
Individuals aided with Federal funds (thousands) [1]	16	80	160
Percent less than high school graduates	90	92	95
Percent male	60	75	80
Work Incentive (WIN) program:			
Outlays (millions)	----------	$90	$163
Number of States participating	----------	38	50
Individuals served (thousands) [1]	----------	130	175
Percent female	----------	80	80
Children receiving child care (thousands)	----------	50	146
Job Corps:			
Outlays (millions)	$318	$277	$283
Number of centers	108	113	113
Individuals served (thousands) [1]	65	70	70
Percent less than high school graduates	88	90	92
Concentrated Employment Program (CEP):			
Outlays (millions)	$71	$163	$193
Areas served	62	82	82
Individuals served (thousands) [1]	54	105	115
Percent male	48	55	65
Percent less than high school graduates	78	78	78

[1] The number of individuals served is greater than the number of "slots" or "job opportunities" because several individuals may receive training through a single federally funded position.

HEALTH RESOURCES

[Dollars in millions]

Program indicator	1960 actual	1964 actual	1968 actual	1969 estimate	1970 estimate
General hospitals:					
Cumulative number of beds meeting construction standards at end of year	(1)	(1)	535,000	560,000	580,000
Total number of beds constructed or modernized during year	(1)	(1)	28,000	30,000	28,000
Number of beds aided by Hill-Burton program during year	14,057	14,834	15,708	17,000	15,000
Outlays	$149	$142	$134	$159	$160
Long-term care facilities:					
Cumulative number of beds meeting construction standards at end of year	(1)	(1)	480,000	510,000	535,000
Total number of beds constructed or modernized during year	(1)	(1)	56,000	55,000	54,000
Number of beds aided by Hill-Burton program during year	4,412	8,106	8,495	10,000	9,000
Outlays	$18	$35	$57	$49	$49
Community mental health centers:					
Federally aided centers (cumulative)	----------	----------	331	443	556
Outlays for:					
Construction aid	----------	----------	$12	$25	$44
Staffing support	----------	----------	$24	$17	$38
Population served (millions)	----------	----------	51	69	86
Medical and osteopathy schools:					
Number in the Nation	91	92	100	104	106
Number federally aided (construction)	----------	----------	10	9	15
Federal outlays for construction	----------	----------	$41	$61	$85
Physicians and osteopaths:					
Total number of students enrolled	31,984	33,901	36,438	36,900	37,900
Number graduated	7,508	7,690	8,395	8,301	8,500
Number of students receiving Federal scholarships or loans	1,500	3,263	15,582	16,276	16,688
Outlays for scholarships and loans	$0.9	$2	$19	$19	$19
Nurses:					
Total number of students enrolled	115,057	124,744	141,948	146,000	150,000
Number of students graduated	30,113	35,259	40,000	38,700	39,200
Number of students receiving Federal scholarships or loans	(1)	(1)	24,532	27,000	29,000
Outlays for scholarships and loans	(1)	(1)	$18	$20	$24

1 Comparable data not available.

SELECTED FEDERAL HEALTH CARE PROGRAMS

[Dollars in millions]

Program indicator	1960 actual	1964 actual	1968 actual	1969 estimate	1970 estimate
Medicare (millions):					
Number of aged individuals			19.8	20.1	20.5
Covered by hospital insurance			19.6	19.8	20.1
Using insurance during the year			3.9	4.1	4.2
Covered by insurance for doctor bills			18.2	18.8	19.1
Using insurance during the year			7.7	8.2	8.5
Outlays (trust funds)			$5,332	$6,222	$6,851
Medicaid: [1]					
Number of States and jurisdictions participating			42	47	54
Number of individuals served (millions)	2.6	4.1	8.6	9.5	10.2
Total Federal, State, and local payments	$420	$1,144	$3,686	$4,612	$5,797
Federal outlays	$197	$538	$1,806	$2,384	$2,971
Maternal and child health:					
Crippled children served (thousands)	372	423	485	500	500
Number of maternity centers			53	53	54
Admissions to maternity centers (thousands)			162	187	190
Number of youth care centers			58	58	59
Number served at youth care centers (thousands)			220	285	400
Number of federally aided family planning participants (thousands)			420	850	1,325
Outlays	$38	$58	$164	$193	$216
Indians:					
Number eligible (thousands)	362	380	390	404	408
Admissions to hospitals (thousands)	77	90	92	95	96
Outpatient visits to hospitals and field clinics (thousands)	1,130	1,294	1,575	1,660	1,775
Outlays	$54	$66	$84	$105	$110
Other beneficiaries:					
Number eligible (thousands)	379	399	404	414	418
Admissions to hospitals (thousands)	52	51	50	50	50
Outpatient visits to hospitals and field clinics (millions)	1.2	1.4	1.7	1.8	1.9
Outlays	$50	$53	$75	$82	$80

[1] Numbers prior to 1968 refer to medical assistance for the aged and general medical assistance provided under public assistance programs.

SOCIAL INSURANCE

Program indicator	Number of beneficiaries (thousands)			Payments [1] (millions of dollars)		
	1968 actual	1969 estimate	1970 estimate	1968 actual	1969 estimate	1970 estimate
Social Security:						
Retired workers and their dependents	15,085	15,526	15,951	14,837	16,996	17,715
Disabled workers and their dependents	2,141	2,366	2,524	2,088	2,521	2,658
Survivors of deceased workers	5,535	5,853	6,185	5,423	6,191	6,430
Disabled children of retired and deceased workers	219	232	247	160	194	209
Benefits to noninsured persons age 72 and over	729	679	598	318	329	282
Railroad Retirement:						
Retired workers and their dependents	542	542	541	849	914	922
Disabled workers and their dependents	99	99	99	179	192	194
Survivors of deceased workers	315	320	325	326	362	370
Supplemental annuities	34	49	62	25	38	45
Civil Service:						
Retired workers and their dependents	432	451	470	1,285	1,418	1,566
Disabled workers and their dependents	174	182	190	380	419	463
Survivors of deceased workers	260	271	283	291	321	355
Unemployment Insurance:						
Workers receiving compensation:						
Unemployed workers insured under State accounts	4,336	5,000	5,000	2,074	2,210	2,290
Unemployed railroad workers	296	174	170	76	96	93
Unemployed Federal civil servants	71	71	71	47	49	51
Unemployed ex-servicemen	148	149	149	58	62	64

[1] Does not include increases of $1.6 billion in social security benefits and $19 million in railroad retirement benefits which will result from proposed legislation.

PUBLIC ASSISTANCE

[Dollars in millions]

Program indicator	1968 actual	1969[1] estimate	1970[1] estimate
Old age assistance:			
Average number of recipients (thousands)	2,055	2,099	2,084
Payments to recipients:			
Total, Federal, State, and local	$1,700	$1,833	$2,030
Federal share	$1,137	$1,204	$1,308
Aid to the blind:			
Average number of recipients (thousands)	82	83	84
Payments to recipients:			
Total, Federal, State, and local	$89	$92	$99
Federal share	$52	$54	$5
Aid to the permanently and totally disabled:			
Average number of recipients (thousands)	646	715	785
Payments to recipients:			
Total, Federal, State, and local	$620	$726	$850
Federal share	$367	$434	$499
Aid to families with dependent children: [2]			
Average number of recipients (thousands):			
Families	1,308	1,504	1,702
Children	4,013	4,594	5,196
Recipients: Children and adults	5,349	6,146	6,956
Payments to recipients:			
Total, Federal, State, and local	$2,536	$3,232	$3,944
Federal share	$1,395	$1,731	$1,847
Emergency assistance:			
Average number of recipients (thousands)	----------	15	37
Payments to recipients:			
Total, Federal, State, and local	----------	$11	$32
Federal share	----------	$6	$16
Total: [3]			
Average number of recipients (thousands)	8,132	9,058	9,955
Payments to recipients:			
Total, Federal, State, and local	$4,945	$5,894	$6,955
Federal share	$2,950	$3,428	$3,730

[1] Includes Federal payments for intermediate care which will amount to $33 million in 1969 and $82 million in 1970. Total Federal, State, and local payments will amount to $61 million in 1969 and $149 million in 1970.

[2] Freeze on AFDC caseload assumed in effect as of July 1, 1969.

[3] Excludes a reduction of $81 million in outlays which will result from proposed legislation increasing social security benefits.

SERVICE-CONNECTED COMPENSATION

Program indicator	1968 actual	1969 estimate	1970 estimate
Veterans:			
Disability 30% or less:			
Average number of beneficiaries (thousands)	1,437	1,441	1,438
Total payments (millions)	$606	$624	$641
Average annual payment	$422	$433	$446
Disability 40%-100%:			
Average number of beneficiaries (thousands)	566	574	582
Total payments (millions)	$1,348	$1,460	$1,568
Average annual payment	$2,382	$2,544	$2,694
Survivors:			
Average number of beneficiaries (thousands)	365	369	373
Total payments (millions)	$517	$526	$532
Average annual payment	$1,416	$1,425	$1,426

NON-SERVICE-CONNECTED PENSIONS

Program indicator	1968 actual	1969 estimate	1970 estimate
Veterans:			
Average number of beneficiaries (thousands)	1,170	1,146	1,143
Total payments (millions)	$1,272	$1,286	$1,293
Percent for pensioners with $1,000 or less outside income	43.5	43.8	44.2
Average annual payment	$1,088	$1,123	$1,131
Survivors:			
Average number of beneficiaries (thousands)	1,049	1,106	1,170
Total payments (millions)	$779	$850	$905
Percent for pensioners with $1,000 or less outside income	60.9	61.0	61.1
Average annual payment	$743	$769	$773

LIFE INSURANCE

Program indicator	1968 actual	1969 estimate	1970 estimate
Veterans life insurance trust funds:			
Number of policies (thousands)	4,814	4,745	4,664
Insurance in force (billions)	$31.2	$30.7	$29.9
Payments to policyholders and beneficiaries (millions)	$846.1	$903.1	$942.3
Veterans life insurance revolving funds:			
Number of policies (thousands)	899	895	888
Insurance in force (billions)	$7.5	$7.5	$7.5
Payments to policyholders and beneficiaries (millions)	$37.9	$46.1	$53.3
Servicemen's group life insurance: [1]			
Number of policies (thousands)	3,800	3,800	3,800
Insurance in force (billions)	$37.8	$37.8	$37.8
Payments to policyholders and beneficiaries (millions)	$202.9	$217.0	$186.0

[1] Funded under the Department of Defense, in the national defense function.

EDUCATION AND TRAINING

Program indicator	1968 actual	1969 estimate	1970 estimate
Veterans education and training (GI Bill):			
Higher education:			
Average number of trainees (thousands)	169	244	289
Payments (millions)	$335	$466	$513
Below college level:			
Average number of trainees (thousands)	135	177	199
Payments (millions)	$93	$120	$156
Vocational rehabilitation for disabled veterans:			
Average number of trainees (thousands)	7	10	12
Payments (millions) [1]	$23	$31	$38
Children of deceased or totally disabled veterans:			
Average number of trainees (thousands)	17	18	18
Payments (millions)	$38	$38	$38
Widows of deceased or totally disabled veterans:			
Average number of trainees (thousands)	---------	1	9
Payments (millions)	---------	$1	$17

[1] Includes subsistence payments classified under other veterans benefits and services.

VA HOSPITAL SERVICES

Program indicator	General hospitals				Psychiatric hospitals			
	1968 actual	1969 estimate	1970 estimate	Percent change, 1970 over 1969	1968 actual	1969 estimate	1970 estimate	Percent change, 1970 over 1969
Number of patients treated (thousands)	643	652	665	1.9	119	115	110	−4.1
Average daily patient load (thousands)	54	52	52	−.8	44	42	40	−4.1
Estimated length of stay (days)	31	29	28	−2.7	134	132	132	....
Average cost per day of care (dollars)	39	43	46	7.1	20	22	24	7.0
Cost per patient treated (dollars)	1,198	1,267	1,320	4.1	2,634	2,918	3,122	7.0
Total cost (millions of dollars)	770	827	878	6.2	314	335	343	2.6

TREASURY PROGRAMS

[Budget authority in millions]

Program indicator	1968 actual	1969 estimate	1970 estimate
Collection of internal revenue and customs duties	$747.8	$815.8	$867.5
Number of returns processed by Internal Revenue (millions)	107.6	110.3	112.8
Number of returns examined and disposed of (millions)	2.9	2.7	3.0
Number of formal import entries filed (millions)	2.3	2.4	2.6
Number of persons arriving in United States (millions)	213.8	225.0	238.0
Administration of Government finances	$98.6	$107.0	$110.4
Number of savings-type securities issued (millions)	130.1	144.1	148.2
Number of savings-type securities retired (millions)	112.7	116.8	126.4
Number of checks issued (millions)	440.4	459.9	472.1
Manufacture and distribution of coins, currency, and other financial instruments	$14.2	$15.2	$19.4
Currency produced and shipped (billions of pieces)	2.1	2.4	2.6
Coins produced (billions of pieces)	5.9	5.6	7.5
Special law enforcement	$63.5	$73.1	$86.4
Number of investigations and cases completed (thousands)	149.5	150.0	171.6

ATTACHMENT B
SELECTED TABLES FROM SPECIAL ANALYSES VOLUME

Table J-6. **NUMBER OF CHILDREN ENROLLED IN PROGRAMS FOR THE DISADVANTAGED** (in thousands)

Federal program	1968 actual	1969 estimate	1970 estimate
Education of children from low-income families	9,000	9,000	9,000
Special classes for the mentally and physically handicapped	24	182	182
Head Start:			
Full year	218	218	235
Summer	477	477	477
Parent and Child Centers	4	4	4
Follow Through classes	15	31	64
Dropout prevention projects and classes for children from non-English-speaking homes	----------	10	35

Table J-7. **NUMBER OF TEACHERS IN TRAINING OR RETRAINING**

Federal program	1968 actual	1969 estimate	1970 estimate
Office of Education:			
Education Professions Development Act:			
Short-term	23,010	26,580	30,300
Full-year graduate fellowships	3,941	5,145	5,240
Short-term trainees under grants to States	----------	9,000	9,000
Teachers of the handicapped:			
Short-term	8,938	11,184	11,184
Full-year graduate fellowships	4,331	5,306	5,173
Civil Rights Educational assistance:			
Short-term	8,468	8,468	12,410
Teacher Corps members in service	1,873	1,979	2,389
Subtotal, Office of Education	50,561	67,662	75,696
Office of Economic Opportunity: Head Start:			
Short-term training	50,000	50,000	50,000
National Science Foundation: Short-term	44,915	41,613	41,996
Total, teachers in training	145,476	159,275	167,692

Table J-8. NUMBER OF SECONDARY SCHOOL STUDENTS IN VOCATIONAL EDUCATION (in thousands)

Vocational program	1968 actual	1969 estimate	1970 estimate
Occupational education:			
Basic grants to States	2,775	3,300	4,150
Cooperative school employer programs	------	------	98
Exemplary vocational projects	------	------	45
Subtotal, occupational	2,775	3,300	4,293
Homemaking and consumer education	2,000	2,000	2,000

Table J-9. NUMBER OF CHILDREN PARTICIPATING IN SPECIAL FEDERAL PROGRAMS (in thousands)

Program	1968 actual	1969 estimate	1970 estimate
Enrolled in overseas dependents schools	166	191	197
Federally "connected" children in "impacted area" schools	2,564	2,688	2,688
Enrolled in Department of the Interior Indian schools	56	58	60
Enrolled in Trust Territory, Guam, and Samoan schools	53	56	61

Table J-12. NUMBER OF UNDERGRADUATE STUDENTS RECEIVING STUDENT AID, AND AVERAGE AMOUNT PER RECIPIENT, BY MAJOR PROGRAM AND STUDENT FAMILY INCOME QUARTILE: 1966-67 (number of students in thousands; average amount of aid in dollars)

Student aid program	Highest family income quartile		Lowest family income quartile		Total, all family income quartiles	
	Number of students	Average amount of aid	Number of students	Average amount of aid	Number of students	Average amount of aid
State and private aid administered by institutions	83	$169	231	$628	660	$400
Federally supported student aid:						
Work-study	13	462	97	1,052	184	826
Educational opportunity grants	4	250	56	589	134	433
Veterans benefits	32	990	20	990	157	990
Student loans, NDEA	63	635	125	552	376	588
Guaranteed loans	159	874	65	800	430	837
All student aid programs—estimated students, unduplicated	274	847	285	1,477	1,171	1,035
Total full-time undergraduate students in U.S. institutions	1,940	------	302	------	4,058	------
Percent undergraduates receiving aid	14	------	94	------	29	------

Source: Adapted from tables 10, A-18 and A-21, *Students and buildings*, Office of Education Planning Document 68-2, May 1968.

Table J-14. **UNDERGRADUATE STUDENT SUPPORT**[1]

(Outlays in millions of dollars; number of awards in thousands)

Sublevel and agency	Total outlays			Grants			Loans			Work-study		
	1968 actual	1969 estimate	1970 estimate	1968 actual	1969 estimate	1970 estimate	1968 actual	1969 estimate	1970 estimate	1968 actual	1969 estimate	1970 estimate
Total	1,059	1,300	1,454	1,062	1,269	1,379	864	1,093	1,221	349	349	344
2-year institutions	245	307	360	298	357	375	172	243	293	56	56	56
Other undergraduate	814	993	1,094	764	912	1,004	692	850	928	293	293	289
Defense	17	18	20	12	14	15						
Health, Education, and Welfare:												
Office of Education	390	462	530	243	259	309	[2] 839	[2] 1,066	[2] 1,188	349	349	344
Health Services and Mental Health Administration and NIH	19	239	25	8	10	12	25	27	33			
Social Security Administration	306	368	392	341	381	413						
Veterans Administration	323	425	482	[3] 454	[3] 601	[3] 627						
Other	5	5	5	4	3	3						

[1] Involves some duplication because students may be assisted under more than one program.
[2] Includes insured loans: 474 thousand in 1968; 690 thousand in 1969; and 850 thousand in 1970.
[3] Total number of individual students aided which differs from the average number of veterans in training during the year used in other references in the 1970 Budget

Note.—Number of awards is based on outlays and may not be consistent with data based on budget authority in other parts of the budget.

Table J-15. **GRADUATE STUDENT SUPPORT**[1] (excludes graduate support for elementary and secondary teachers shown on p. 120)

(Outlays in millions of dollars; number of awards in thousands)

Sublevel and agency	Total outlays			Fellowships, traineeships and other grants			Loans		
	1968 actual	1969 estimate	1970 estimate	1968 actual	1969 estimate	1970 estimate	1968 actual	1969 estimate	1970 estimate
Total	396	452	481	213	250	264	106	126	133
Graduate and professional	315	366	395	203	236	251	106	126	133
Post-doctoral	81	86	86	10	14	13			
Health, Education, and Welfare:									
Office of Education	49	50	54	29	29	30	[2] 106	[2] 126	[2] 133
Health Services and Mental Health Administration and NIH	183	198	207	81	88	98			
Other	8	8	9	3	3	3			
Veterans Administration	118	154	174	[4] 85	[4] 118	[4] 122			
National Science Foundation	22	25	25	9	8	8			
Other [3]	16	15	13	6	5	4			

[1] Number of awards may involve some duplication because students may be assisted under more than one program.
[2] Includes insured loans: 41 thousand in 1968; 60 thousand in 1969; and 74 thousand in 1970.
[3] Includes AEC, NASA, DOT, HUD, and DOD.
[4] Total number of individual students aided which differs from the average number of veterans in training during the year used in other references in the 1970 Budget.

Note.—Number of awards is based on outlays and may not be consistent with data based on budget authority in other parts of the budget.

Table K-1. **FEDERAL OUTLAYS AND INDIVIDUALS SERVED BY PROGRAM**

(dollars in millions, individuals in thousands)

Program	Outlays				Individuals served [1]			
	1964 actual	1968 actual	1969 est.	1970 est.	1964 actual	1968 actual	1969 est.	1970 est.
Job Opportunities in the Business Sector (JOBS)	-------	4	121	239	-------	16	80	160
Concentrated Employment Program (CEP)	-------	71	163	193	-------	54	105	115
Work Incentive Program (WIN)	-------	-------	90	163	-------	-------	130	175
Vocational Rehabilitation	84	281	369	509	179	335	415	505
MDTA Institutional and OJT training	98	321	338	330	78	272	290	290
Job Corps	-------	318	277	283	-------	65	70	70
Neighborhood Youth Corps (NYC) [2]	-------	336	321	321	-------	538	490	490
U.S. Employment Service (ES)	181	312	341	378	([3])	([3])	([3])	([3])
Other programs	40	395	421	448	21	242	220	230
Subtotal	403	2,038	2,441	2,864	278	1,522	1,800	2,035
Civilian skill training—Defense	332	570	595	630	([3])	([3])	([3])	([3])
Grand total	735	2,608	3,036	3,494	278	1,522	1,800	2,035

[1] Individuals served for each program are estimated new participants during a fiscal year and are greater than the number of "slots" or "job opportunities" because several individuals may receive training through a single federally funded position. Persons served by several programs are counted only once. Agency data for individuals served by program are not always comparable, and several of the above entries are derived figures.

[2] Amounts for summer programs reported in this analysis are on a calendar year basis.

[3] Data for this program are not comparable to other programs.

Table K-2. **INSTITUTIONAL TRAINING PROGRAM LEVELS**

(dollar amounts in millions, individuals in thousands)

Program	Outlays			Budget authority 1970 est.	Individuals served		
	1968 actual	1969 est.	1970 est.		1968 est.	1969 est.	1970 est.
MDTA Institutional Training	254	268	260	239	147	160	160
Job Corps	318	277	283	280	65	70	70
WIN and CEP	30	112	171	199	19	80	90
Other	24	24	42	51	27	35	45
Total	626	681	756	769	258	345	365

Table K-3. ON THE JOB TRAINING PROGRAM LEVELS
(dollar amounts in millions, enrollees thousands)

Program	Outlays			Budget authority 1970 est.	Individuals served		
	1968 actual	1969 est.	1970 est.		1968 actual	1969 est.	1970 est.
JOBS	4	121	239	420	16	80	160
MDTA Regular OJT	67	70	70	66	125	130	130
New Careers [1]	24	35	38	47	12	15	20
Industry Incentive	6	12	14	20	3	5	10
Other	12	63	91	97	26	55	50
Total	113	301	452	650	182	285	370

[1] Includes estimated portion of CEP funding for New Careers.

Table K-4. REHABILITATION PROGRAM LEVELS
(dollar amounts in millions, enrollees in thousands)

Program	Outlays			Budget authority 1970 est.	Individuals served		
	1968 actual	1969 est.	1970 est.		1968 est.	1969 est.	1970 est.
Vocational rehabilitation	281	369	509	564	335	415	505
Veterans vocational rehabilitation	23	31	38	38	9	15	15
Total	304	400	547	602	344	430	520

Table K-5. **WORK SUPPORT PROGRAM LEVELS**
(dollar amounts in millions, enrollees in thousands)

Program	Outlays			Budget authority 1970 est.	Individuals served		
	1968 actual	1969 est.	1970 est.		1968 est.	1969 est.	1970 est.
NYC school and summer [1]	193	185	185	188	413	375	375
NYC out of school	143	136	136	134	125	115	115
Operation Mainstream	31	38	38	42	13	15	15
WIN and CEP	25	97	118	134	22	125	170
Other	184	121	75	76	165	110	105
Total	576	577	552	574	738	740	780

[1] Persons served by both school and summer programs are counted only once.

Indicators of the Level of Effort

Table K-7. **INDIVIDUALS AND MAN-YEARS BY MAJOR APPROACH**
(in thousands)

Approach	Individuals served		1970 Average duration (months) est.	Man-years	
	1968 est.	1970 est.		1968 est.	1970 est.
On-the-Job Training	182	370	6.3	53	205
Institutional training	258	365	5.3	114	170
Disability rehabilitation	344	520	12.9	389	560
Work Support:					
School	531	475	3.4	241	180
Post-school	207	305	5.1	127	140
Total	1,522	2,035	----------	924	1,255

TABLE K-8. 1970 PARTICIPANT AND MAN-YEAR UNIT COST[1]

Approach	Man-year cost est.	Participant cost est.	Estimated distribution of participant cost by percent		
			Allowances	Education and training	Other
On-the-job training	$2,500	$1,300	14	10	76
Institutional training	4,750	2,100	34	31	35
Disability rehabilitation	1,200	1,300	32		68
Work support:					
In-school	1,550	450	85	2	13
Post-school	2,300	1,000	51	16	33

[1] Includes State and local cost sharing.

Table K-9. ESTIMATED CHARACTERISTICS OF GENERAL LABOR FORCE, ADULT POVERTY POPULATION, AND MANPOWER PROGRAM PARTICIPANTS—(in percent)

Characteristics	Total U.S. work force 1967 (age 16–64), civilian, noninstitutional	Poverty population 1966 (age 16–64), civilian, noninstitutional	Manpower programs, individuals served 1968 (age 14 and above)[1]
Aged 21 or less	14	22	64
Aged 55 or more	14	20	4
Male	63	39	57
Less than high school education	[3] 39	(2)	80
8th grade education or less	[3] 19	(2)	11
Poor	11	100	86
Welfare recipients	1	15	23
Nonwhite	11	35	44

[1] Agency data are not always comparable and all of the entries are estimates.
[2] Not available.
[3] For work force age 18–64.

Table K-10. ESTIMATED CHARACTERISTICS OF ENROLLEES BY APPROACH IN 1968—(in percent)

Approach	Poor	Less than high school	Non-white	21 or younger	Male	Welfare recipient
OJT	53	50	41	30	68	8
Institutional	80	68	63	57	62	19
Rehabilitation	68	58	23	22	56	12
Work support:						
In-school	98	98	50	100	56	28
Post school	99	80	52	55	50	45
Total	86	80	44	64	57	23

Table L-2. FEDERAL OUTLAYS FOR HEALTH RESEARCH (in millions of dollars)

	1968 actual	1969 estimate	1970 estimate
Basic and targeted research	1,482	1,417	1,564
Selected targeted research:			
Cancer research	(181)	(155)	(171)
Cardiovascular research	(158)	(140)	(153)
Mental health research	(46)	(52)	(52)
Neurological diseases and blindness research	(113)	(95)	(109)
Air pollution and environmental research [1]	(63)	(76)	(90)
Research facilities construction	65	59	75
Research, total	1,547	1,476	1,639

[1] HEW only. Estimates for other agencies not available.

Table L-3. FEDERALLY AIDED HEALTH TRAINING AND EDUCATION

	Outlays (in millions of dollars)			Numbers (in thousands) [1]		
	1968	1969	1970	1968	1969	1970
Degree or certificate training:						
Research training	106	120	118	13.7	14.3	13.5
Physician training	82	112	133	26.2	31.5	27.1
Completing training				4.3	4.8	3.4
Dentist training	15	24	33	9.5	10.5	9.6
Completing training				2.3	2.4	2.1
Nurse training	53	57	56	38.9	45.0	42.6
Completing training				16.2	18.6	16.6
Other health professions training	58	71	80	14.5	18.8	19.5
Completing training				5.3	6.4	6.9
Paramedical training	8	9	10	6.7	9.2	9.7
Completing training				19.8	25.3	27.6
All other training	305	359	381	79.4	117.5	126.1
Total	626	752	812	236.8	304.3	304.7

[1] Numbers in any given year may reflect the impact of expenditures in prior years.

Table L-4. **FEDERALLY AIDED HEALTH PROFESSIONS SCHOOL CONSTRUCTION**

	Outlays (in millions of dollars)			First-year spaces added [1]		
	1968	1969	1970	1968	1969	1970
Medical schools	43	60	81	450	279	439
Dental schools	9	15	19	200	114	180
Other health professions schools	1	3	4	164	94	149
Nursing schools	8	11	17	1,336	1,235	570
Allied health professionals schools	*	*	*	337	400	--------
Total	61	89	121	--------	--------	--------

*Less than $500 thousand.
[1] Numbers reflect the impact of obligations in given years.

Table L-5. **HILL-BURTON PROJECTS APPROVED, COMPLETED, AND IN OPERATION, JULY 1, 1947-JUNE 30, 1968**

Type of facility	Total projects approved			Projects completed and in operation		
	Beds or (projects)	Cost (millions) Total	Cost (millions) Federal share	Beds or (projects)	Cost (millions) Total	Cost (millions) Federal share
Total	413,797	$10,048	$3,108	333,518	$7,486	$2,376
General hospitals	305,310	7,446	2,246	250,923	5,657	1,759
Long-term care	80,021	1,178	395	55,371	759	252
Mental hospitals	21,042	247	78	19,850	221	74
Tuberculosis hospitals	7,424	75	27	7,374	74	27
Diagnostic or treatment centers	(927)	482	158	(738)	314	108
Rehabilitation facilities	(454)	327	107	(360)	231	78
Public health centers	(1,189)	244	85	(1,084)	190	69
State health labs	(38)	49	12	(34)	41	9

Table L–6. **HOSPITAL AND HEALTH FACILITY CONSTRUCTION**

	Outlays (in millions of dollars)			Numbers of beds or (projects) [1]		
	1968	1969	1970	1968	1969	1970
Federally supported construction of hospitals and other facilities:						
General hospitals	138	168	173	15,906	17,053	15,224
Long-term care facilites	75	71	74	8,495	10,000	9,128
Community mental health centers	12	25	44	(62)	(86)	(86)
Sewer and sanitation facilities	80	140	156			
Other	60	25	78			
Federal hospitals and health facilities:						
Hospitals	70	105	144	2,607	8,486	3,671
Nursing homes	5	2	1	1,709	662	
Other facilities	30	59	58			
Total outlays	470	595	728			

[1] Numbers in any given year may reflect the impact of expenditures in prior years, and include beds added, modernized, and replaced.

Table L–8. **PROVISION OF HOSPITAL AND MEDICAL SERVICES**

	Outlays (in millions of dollars)			Numbers treated (in thousands)		
	1968	1969	1970	1968	1969	1970
Provision of direct Federal hospital and medical services	2,738	2,896	2,996			
Inpatients treated	1,905	2,031	2,095	2,240	2,297	2,331
Clinic and physician visits	833	864	901	65,971	68,969	71,361
Payments for hospital and medical services	8,025	9,622	10,981			
Inpatients treated	5,530	6,598	7,666	6,803	7,345	7,686
Clinic and physician visits	2,496	3,024	3,316	(1)	(1)	(1)
Total	10,764	12,518	13,977			

[1] Not available.

Table L-9. SELECTED INFANT MORTALITY RATES[1]

	Infant mortality rate per 1,000 live births			
	1964	1965	1966	1967
Nationwide	24.8	24.7	23.7	22.1
Major cities with maternity and infant care projects:				
Baltimore	[2]31.0	28.4	28.0	26.8
Chicago	[2]30.4	33.3	32.5	29.4
District of Columbia	34.5	[2]34.7	35.3	32.6
Houston	28.4	25.0	[2]26.4	22.1
New York City	[2]26.9	25.7	24.9	23.9

[1] Years shown are calendar years.
[2] Indicates year projects began operation.

Table L-10. ESTIMATED HEALTH CARE OUTLAYS BY POPULATION AND INCOME GROUPS (in millions of dollars)

	1967	1968	1969	1970
Total, all recipients	7,831	10,764	12,518	13,977
Aged (65 and over)	4,379	6,619	7,765	8,677
Other adults (19–64)	2,535	2,783	3,105	3,392
Children and youth (0–18)	917	1,362	1,648	1,907
Indigent, total[1]	3,178	4,122	4,998	5,791
Aged (65 and over)	1,968	2,654	3,153	3,586
Other adults (19–64)	850	804	979	1,149
Children and youth (0–18)	360	664	866	1,056
Nonindigent, total	4,653	6,642	7,520	8,186
Aged (65 and over)	2,411	3,965	4,612	5,091
Other adults (19–64)	1,685	1,979	2,126	2,243
Children and youth (0–18)	577	698	782	852

[1] Indigency as defined by OEO poverty guidelines.

Table L-12. **REPORTED CASES OF SELECTED DISEASES**[1]

	1960	1964	1967
Red measles	441,703	458,083	62,705
Polio	3,190	122	41
Whooping cough	14,809	13,005	9,718
Rheumatic fever, acute	9,022	7,491	3,985
Typhoid	816	501	396

[1] HEW, Morbidity and Mortality, Annual Supplement, Summary, 1967.

Table L-13. **AUTOMOBILE EMISSION CONTROL**[1] (in millions of tons per year)

	1966	1967	1968	1969	1970	1971
Auto emissions removed by control devices:						
Hydrocarbons	1	2	3	4	5	7
Carbon monoxide	(2)	1	6	11	18	25
Auto emissions released to the atmosphere:						
Hydrocarbons	10	11	11	11	10	10
Carbon monoxide	62	65	66	67	66	59

[1] Unpublished data furnished by the National Center for Air Pollution Control, HEW.
[2] Less than 500 thousand tons.

Table L-14. ESTIMATED OBLIGATIONS FOR FAMILY PLANNING SERVICES, RESEARCH, AND TRAINING (in millions of dollars)

	1968	1969	1970
Health, Education, and Welfare:			
Childrens Bureau	6.5	18.5	31.5
Medicaid and public assistance	9.5	13.0	17.0
National Institutes of Health	8.5	10.1	13.6
Health Services and Mental Health Administration	1.2	1.7	2.4
Food and Drug Administration	.7	.8	1.1
Office of Education	2.8	3.2	3.5
Total, Health, Education, and Welfare	29.2	47.3	69.1
Office of Economic Opportunity	9.6	13.0	15.0
Department of Defense	4.0	4.7	4.8
Total, domestic	42.7	65.0	88.9
Agency for International Development	34.6	49.7	50.0
Department of State	.7	1.3	4.1
Total international	35.1	51.0	54.1
Total estimated family planning obligations	78.0	116.0	143.0

Table L-16. **FEDERALLY FUNDED HEALTH CENTERS**

	1968	1969	1970
Total Federal outlays (millions)	$119.7	$191.5	$245.1
Number of centers funded	502	622	754
Number of centers in poverty areas	300	352	415
Number of persons served in year (thousands)	1,125	1,742	2,400

Table L-17. **FEDERAL OUTLAYS FOR MEDICAL AND HEALTH-RELATED ACTIVITIES BY CATEGORY** (in millions of dollars)

	1960 [1]	1963	1964	1965	1966	1967
Development of health resources, total	1,016.9	1,528.9	1,806.1	1,806.9	1,955.7	2,430.2
Health research	509.5	892.1	1,069.2	1,040.1	1,167.3	1,363.7
Training and education	217.4	256.5	298.4	316.9	410.4	593.6
Construction of hospitals and health facilities	290.0	380.3	438.5	449.9	378.0	391.0
Improving the organization and delivery of health services [2]	----------	----------	----------	----------	----------	81.9
Provision of hospital and medical services, total	2,164.8	2,783.0	2,904.4	2,935.8	3,520.8	7,831.0
Direct Federal hospital and medical services	1,701.3	1,877.3	1,971.4	2,022.0	2,199.0	2,551.7
Hospital and medical services, indirect	463.5	905.7	933.0	913.8	1,321.8	5,279.3
Prevention and control of health problems, total	325.6	346.1	392.8	417.6	451.0	539.8
Total outlays from Federal and trust funds	3,507.3	4,658.0	5,103.3	5,160.3	5,927.5	10,801.0

[1] Report of the Committee on Government Operations, U.S. Senate; "Coordination of Federal Agencies" programs in biomedical research and in other scientific areas," report No. 142, Mar. 30, 1961.

[2] Not tabulated in 1960–66 as a separate subcategory.

Table M-2. INCOME REPLACEMENT PROGRAMS: BENEFIT OUTLAYS AND BENEFICIARIES, BY PROGRAM

Program	Benefit outlays (millions)			Number of beneficiaries (thousands)		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Income replacement programs:						
Social Security:						
OASI	$20,737	$23,711	$24,636	21,863	22,597	23,254
DI	2,088	2,434	2,624	2,258	2,441	2,600
Railroad Retirement	1,388	1,527	1,553	1,039	1,045	1,050
Federal employee retirement systems:						
Military	2,095	2,441	2,720	624	695	760
Civil Service	1,957	2,158	2,384	866	904	943
Coast Guard	48	52	56	13	14	14
Foreign Service	11	13	15	2	2	2
PHS officers	6	7	10	1	1	1
Judiciary	4	4	4	1	1	1
ESSA officers	1	1	1	†	†	†
Special annuities (CSC)	1	1	1	1	1	1
Unemployment insurance (including compensation for Federal employees and ex-servicemen)	2,181	2,321	2,406	4,555	5,220	5,220
Railroad unemployment	76	97	93	296	174	170
Employees compensation	82	85	87	27	28	28
Veterans programs:						
Disability and dependents indemnity compensation	2,471	2,610	2,741	2,369	2,385	2,393
Life insurance (Federal funds)	29	33	36	28	32	35
Life insurance (trust funds)	427	443	457	410	427	440
Other benefits	82	81	84	252	266	278
Proposed legislation			1,519			
Total, income replacement programs	33,684	38,019	41,427	[1] 34,605	[1] 36,233	[1] 37,190

† Less than 500.
[1] Totals include duplication due to program overlap. Estimated unique totals are 31 million, 32 million, and 33 million.

Table M-3. RETIREMENT BENEFITS: BENEFIT OUTLAYS, BENEFICIARIES, AND AVERAGE PAYMENTS, BY PROGRAM

Program	Benefit outlays (millions)			Number of beneficiaries (thousands)			Average monthly payments [1]		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Retirement benefits:									
Social Security (OASI)	$15,208	$17,247	$18,064	16,047	16,464	16,849	$79	$87	$89
Railroad Retirement	969	1,065	1,082	669	666	664	121	133	136
Federal employee retirement systems:									
Military	1,707	2,005	2,244	499	559	613	285	300	306
Civil Service	1,285	1,418	1,566	432	451	470	248	262	278
Coast Guard	41	45	48	10	10	11	338	356	358
Foreign Service	10	11	13	1	1	2	609	679	677
PHS officers	6	7	10	1	1	1	592	607	739
Judiciary	3	3	3	†	†	†	(2)	(2)	(2)
ESSA officers	1	1	1	†	†	†	730	787	817
Special annuities (CSC)	1	1	1	1	1	1	71	73	74
VA retired officers pay	2	2	2	†	†	†	220	226	227
Total, retirement benefits	19,233	21,805	23,034	[3] 17,660	[3] 18,153	[3] 18,611			

† Less than 500.
[1] Payments per beneficiary, may differ from payments per retiree.
[2] Not available.
[3] Totals include duplication due to program overlap. Estimated unique totals are 17 million, 17 million, and 18 million.

Table M-4. **DISABILITY BENEFITS: BENEFIT OUTLAYS, BENEFICIARIES AND AVERAGE PAYMENTS, BY PROGRAM**

Program	Benefit outlays (millions)			Number of beneficiaries (thousands)			Average monthly payments [1]		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Disability benefits:									
Social Security (DI)	$2,088	$2,434	$2,624	2,258	2,441	2,600	$77	$83	$84
Railroad Retirement (permanent disability)	73	77	78	42	40	39	144	160	167
Railroad unemployment (temporary disability)	34	44	43	88	92	90	[2] 51	[2] 63	([3])
Federal employee retirement systems:									
Military	380	426	466	119	129	139	266	275	280
Civil Service	380	419	463	174	182	190	182	192	203
Coast Guard	7	8	8	3	3	3	208	216	212
Foreign Service	1	1	1	†	†	†	750	750	750
Employees compensation	52	54	56	13	14	14	332	321	332
Veterans programs:									
Disability compensation	1,954	2,084	2,209	2,004	2,015	2,020	81	86	91
Life insurance (Federal funds)	3	3	3	5	5	5			
Life insurance (trust funds)	20	21	22	38	39	40			
Other benefits	8	8	8	2	1	1			
Total, disability benefits	5,000	5,579	5,981	[4] 4,746	[4] 4,961	[4] 5,141			

† Less than 500.
[1] Payments per beneficiary, may differ from payments per disability case.
[2] Average weekly payments.
[3] Not available.
[4] Totals include duplication due to program overlap. Estimated unique totals are about 3 million for each year.

Table M-5. SURVIVORS BENEFITS: BENEFIT OUTLAYS, BENEFICIARIES, AND AVERAGE PAYMENTS, BY PROGRAM

Program	Benefit outlays (millions)			Number of beneficiaries (thousands)			Average monthly payments [1]		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Survivors benefits:									
Social Security (OASI)	$5,529	$6,464	$6,572	5,816	6,133	6,405	$79	$88	$85
Railroad Retirement	347	385	394	340	352	358	85	91	92
Federal employee retirement systems:									
Military	8	10	10	6	7	8	107	108	109
Civil Service	291	321	355	260	271	283	93	99	104
Coast Guard	*	*	*	†	†	†	71	77	83
Foreign Service	1	1	1	†	†	†	250	278	278
PHS officers	*	*	*	†	†	†	157	151	153
Judiciary	1	1	1	†	†	†	327	(2)	(2)
ESSA officers	*	*	*	†	†	†	(2)	(2)	(2)
Special annuities (CSC)	*	1	1	†	†	†	91	108	112
Employees compensation	31	31	32	14	14	14	183	186	188
Veterans programs:									
Dependents indemnity compensation	517	526	532	365	369	373	118	119	119
Life insurance (Federal funds)	26	30	33	23	27	30			
Life insurance (trust funds)	407	422	435	372	388	400			
Other benefits	72	71	74	250	265	277			
Total, survivors benefits	7,230	8,263	8,440	[3] 7,446	[3] 7,826	[3] 8,148			

* Less than $0.5 million.
† Less than 500.
[1] Payments per beneficiary, may differ from payments per surviving family.
[2] Not available.
[3] Totals include duplication due to program overlap. Estimated unique totals are 6 million, 7 million, and 7 million.

Table M-6. UNEMPLOYMENT BENEFITS: BENEFIT OUTLAYS, BENEFICIARIES, AND AVERAGE PAYMENTS, BY PROGRAM

Program	Benefit outlays (millions)			Number of beneficiaries (thousands)[1]			Average weekly payments		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Unemployment benefits:									
Workers insured under State laws	$2,074	$2,210	$2,290	4,336	5,000	5,000	$40	$42	$44
Federal employees and ex-servicemen	107	111	116	219	220	220	44	45	46
Railroad unemployment	42	52	50	233	92	90	50	62	(2)
Total, unemployment benefits	2,223	2,373	2,456	4,788	5,312	5,310			

[1] Number of "first claims" paid.
[2] Not available.

Income support programs.—The two major programs which base benefits on current need are public assistance and veterans pensions.

Table M-7. INCOME SUPPORT PROGRAMS: BENEFIT OUTLAYS, RECIPIENTS, AND AVERAGE PAYMENTS, BY PROGRAM AND RECIPIENT GROUP

Program and recipient group	Benefit outlays (millions)			Recipients (thousands)			Average monthly payments[1]		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Income support programs:									
Public assistance (Federal share):									
Old age assistance	$1,137	$1,204	$1,308	2,055	2,099	2,084	$69	$71	$76
Aid to the blind	52	54	59	82	83	84	90	91	96
Aid to the permanently and totally disabled	367	434	499	646	715	785	80	83	87
Aid to families with dependent children	1,395	1,731	1,847	5,349	6,146	6,965	40	44	48
Total, public assistance (Federal share)[2]	3,052	3,320	3,719	8,132	[3]9,058	[3]9,955			
Total (State and local share)	(1,996)	(2,467)	(3,286)						
VA pensions:									
Veterans	1,272	1,286	1,293	1,170	1,146	1,143	91	94	94
Survivors	779	850	905	1,049	1,106	1,170	62	64	64
Total, VA pensions	2,051	2,135	2,198	2,219	2,252	2,313			
Assistance to refugees	25	37	49	36	47	62			
General assistance to Indians	9	7	9	21	22	22			
Proposed legislation			−87						
Total, income support programs	5,137	5,499	5,888	10,408	11,379	12,352			

[1] Total payments, including State and local contributions where applicable.
[2] Categorical financial data are obligations and do not add to total because of collections and adjustments.
[3] Includes recipients of emergency assistance not itemized above.

Table M-8. AVERAGE MONTHLY PAYMENT LEVELS FOR PUBLIC ASSISTANCE, BY CATEGORY

Public assistance category	July 1968 payment levels (per recipient)		
	National average	Average in lowest State	Average in highest State
Old age assistance	$68.40	$36.00	$107.00
Aid to the blind	91.45	45.35	138.85
Aid to the permanently and totally disabled	81.80	44.45	128.85
Aid to families with dependent children	42.15	8.50	71.00

Table M-9. BENEFITS IN KIND: OUTLAYS AND RECIPIENTS FOR SELECTED PROGRAMS

Type of benefit and program	Outlays (millions) [1]			Recipients (thousands) [2]		
	1968 actual	1969 est.	1970 est.	1968 actual	1969 est.	1970 est.
Health care:						
Medicaid (Federal outlays)	$1,806	$2,364	$2,971	8,600	9,500	10,200
Medicaid (Total Federal, State, and local payments)	3,686	4,612	5,797			
Food and nutrition:						
Food stamps	187	273	338	2,488	3,630	3,950
Child nutrition	217	246	367	18,800	19,400	22,300
Special milk	104	104	15	17,000	17,500	-------
Removal of surplus commodities	385	598	725	25,500	26,000	29,000
Housing:						
Public housing	[3] 290	[3] 335	[3] 456	2,600	2,800	3,200
Rent supplements	2	14	30	[4] 3	[4] 19	[4] 45

[1] Includes benefits and administrative expenses.
[2] Total number of individuals benefited.
[3] Benefits only.
[4] Number of households (number of individuals not available).

SPECIAL ANALYSIS R

SELECTED AGENCY BUDGETS BY PROGRAM CATEGORIES

Reprint of Pages 253 to 273 From
Special Analyses, Budget of the United States, 1970

Detail will not necessarily add to totals because of rounding

BUREAU OF THE BUDGET
January 1969

SPECIAL ANALYSIS R

SELECTED AGENCY BUDGETS BY PROGRAM CATEGORIES

The tabulations shown in this analysis reflect for 3 years—1968, 1969, and 1970—the programs of selected agencies as classified in the categories and subcategories used in the agency Planning-Programing-Budgeting (PPB) systems.

While program structures have hitherto been published for most of the major agencies, this is the first time that data on budget authority have been presented in these terms. Since all agencies have not reached an equal stage of PPB development, some executive agencies in the Federal Government are not covered in this analysis.

The PPB System in the Federal Government

Installation of the Planning-Programing-Budgeting system on a Government-wide basis was initiated by the President in August 1965. PPB is an effort to promote more systematic use of modern management tools that have been demonstrated to be of value in Government. The PPB approach was employed to enable the Government agencies and the President to:

- Identify national goals with greater precision and determine which goals are the most urgent;
- Develop and analyze alternative means of reaching goals most efficiently;
- Provide information on the total long term systems cost of programs on a basis that can be related to the benefits derived from each program;
- Set out specific proposed plans for several years ahead to achieve stated objectives; and
- Permit better control over programs and budgets by strengthening measurement and analysis of program performance in relation to costs.

Progress Under the Planning-Programing-Budgeting System

While the impact of PPB is still of modest proportions in the civilian agencies, its effects are becoming evident.

- Most major agencies have created a PPB System to carry out the President's directive. Many of these agencies have dedicated staff resources specifically to the PPB process.
- These agencies, with only a few exceptions, have established end purpose-oriented PPB program structures, as illustrated in the tables, enabling them to classify their funds by major program categories and subcategories. These program structures were used, in varying degrees, in the decisionmaking process leading to the budgets for 1968, 1969, and 1970.
- Major program issues are being identified in advance of the time when budget decisions have to be made and subjected to systematic analysis.
- The introduction of PPB has provided an impetus toward increased use of formal analysis in the decisionmaking process. The development and consideration of alternatives has been

stepped up, both in the programing stage and at the budget decision stage. The emphasis on cost effectiveness analysis as part of the analytical effort has drawn attention to ways of achieving given objectives at least cost, or attaining maximum results from given outlays. Benefit/cost analysis, which had been previously practiced chiefly in the military agencies and the water resources field, is now underway on various programs in most major agencies of Government.

- As experience has been gained, the various elements of the PPB approach and the annual budget process gradually are being more effectively interrelated, so that the analytical results of PPB are playing a greater role in decisionmaking for the annual budget.

Program Distribution of Budget Authority

The following tables for each agency distribute budget authority by PPB program category and, in many cases, by subcategory. In preparing the 1970 budget, a substantial portion of the budget review process was carried out in these program structure terms. However, the budget is presented to and acted upon by Congress in terms of the appropriation structure as presented in the Budget Appendix. The amounts shown by program category and subcategory in this analysis are derived by distribution of the appropriation totals. This distribution is only as precise as the underlying agency accounting system permits. Statistical allocations have been used where necessary to distribute the appropriation amounts to the program structure.

Not all budgetary items are covered by the program structure. For example, adjustments to agency budget authority totals for proprietary receipts from the public are usually not related to the program structure. Each table, however, reconciles the total amounts shown in program structure terms to total budget authority for the agency—identifying items excluded from the program structure and any necessary adjustments.

Seventeen agencies are covered by this special analysis; they account for $200.2 billion, or 95 percent of the total proposed budget authority of $210.1 billion for 1970 for the entire Federal Government. The budget authority not covered in this analysis is largely accounted for by numerous smaller agencies, most of which have not been required to install a PPB system. Many of the agencies not included, however, are employing PPB techniques in varying degrees.

DEPARTMENT OF AGRICULTURE

The programs of the Department of Agriculture seek to provide an adequate supply of food, fiber, and timber; maintain farm income; improve the nutritional level and protect the health of the entire population; and promote the continuing development of rural areas. To achieve these goals the Department performs research, education, conservation, marketing, regulatory, domestic and foreign food aid, agricultural adjustment, credit, insurance, national forest management and rural development activities.

The program structure shown below consists of a set of subcategories representing the major missions of the Department. The subcategories are grouped under four major categories representing the broad unifying goals that provide a focus for the Department's program planning efforts, and one general support category.

Table R-1. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Income and abundance:			
Farm income	3,359.1	5,358.5	4,023.2
Agricultural production capacity	606.1	586.6	496.4
Agricultural marketing and distribution system	108.4	114.6	113.4
Category total	4,073.7	6,059.7	4,632.9
Growing nations—new markets:			
Food for Freedom	1,606.6	301.1	1,017.7
Export market development	79.9	88.8	28.1
Agricultural development	6.2	3.5	11.5
International agricultural services	7.2	7.4	7.5
Category total	1,699.9	400.9	1,064.8
Dimensions for living:			
Diets and nutrition	912.0	1,041.8	1,102.7
Health and safety	84.4	110.8	134.1
Education and training	21.7	22.5	23 5
Services for living	44.5	44.9	45.7
Category total	1,062.6	1,220.0	1,305.9
Communities of tomorrow:			
Community development services	29.1	31.0	40.0
Housing	253.0	29.7	62.6
Public facility and business expansion	430.2	354.6	371.6
Resource protection and environmental improvement	245.7	215.6	204.3
Recreation, wildlife, and natural beauty	60.7	63.6	67.9
Timber	326.6	333.4	337.3
Category total	1,345.3	1,027.8	1,083.8
General support:			
General administration	4.6	4.8	5.1
Program support	38.8	39.9	45.4
Category total	43.4	44.7	50.4
Total distributed to programs above	8,224.8	8,753.2	8,137.8
Deductions for offsetting receipts	−395.4	−415.1	−435.0
Total budget authority, Department of Agriculture	7,829.4	8,338.1	7,702.8

DEPARTMENT OF COMMERCE

The statutory functions of the Department of Commerce are to foster, promote, and develop the foreign and domestic commerce and the manufacturing and shipping industries of the United States. Related functions include the promotion of area and regional economic development and performance of Government scientific and technical activities. These progams are conducted in appropriate relation to the overall requirements of business and industry as well as to the broad social and economic objectives of the Nation.

The Department's functions are grouped into eight program categories as shown in the following table:

Table R-2. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Business development:			
International business development	16.4	20.0	28.5
Promotion of travel to the United States	3.0	4.5	6.0
Business assistance	7.8	8.3	8.7
Export control	5.4	5.5	5.5
Foreign direct investment control		3.7	4.7
Category total	32.5	41.9	53.4
Area and regional development:			
Areas	156.1	117.0	94.5
Districts	26.0	53.5	84.1
Urban areas	20.3	16.7	25.0
Special problem areas	17.9	18.4	18.7
Indian areas	18.4	30.0	31.5
Regional development	21.1	26.2	35.7
General administration	19.8	20.4	22.0
Category total	279.6	282.2	311.5
General purpose data production, analysis, and statistical services:			
Data production	34.1	42.8	167.4
National income and product accounts	2.9	3.1	3.3
Statistical assistance and services	2.6	3.0	3.0
Data processing equipment and systems development	4.2	.2	.2
Category total	43.9	49.1	174.0
Physical environment:			
Weather and marine forecasts and warning services	77.7	83.8	90.5
River and flood prediction and warning services	3.9	4.1	4.6
Earth description, mapping, and charting services	12.5	13.0	13.9
Marine description, mapping, and charting services	18.0	19.3	20.9
Telecommunications and space services	3.6	4.2	3.9
Environmental satellite services	30.6	22.5	12.3
Environmental data services	4.8	5.6	5.5
Research	13.6	13.3	13.8
Retired pay, commissioned officers	1.0	1.2	1.2
Category total	165.7	166.9	166.6
Physical measurements and standards program:			
Basic measurements and standards	11.0	13.1	14.2
Materials measurements and standards	15.8	17.5	18.7
Technological measurements and standards	5.0	5.8	7.2
Category total	31.7	36.4	40.0
Marine transportation:			
Active foreign trade capability	364.7	345.8	247.6
Research and development	9.4	6.9	11.3
Reserve capability for emergency needs	5.4	5.5	5.4
General support	14.8	14.2	15.8
Category total	394.3	372.4	280.0

Table R-2. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY—Con.**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Technology:			
Intellectual-industrial property protection	38.8	42.5	46.1
State technical services	6.5	5.3	5.8
Information dissemination	3.0	4.3	4.6
Innovation policy and encouragement	.2	.2	.2
Category total	48.6	52.4	56.8
General administration	4.7	5.2	5.8
Total distributed to programs above	1,000.9	1,006.4	1,088.1
Deductions for offsetting receipts	−26.3	−21.3	−21.8
Intragovernmental transactions	−4.7	−6.8	−5.7
Total budget authority, Department of Commerce	969.9	978.3	1,060.5

DEPARTMENT OF DEFENSE—MILITARY

The military programs of the Department of Defense provide for the security of the United States. Forces are grouped—regardless of the branch of military service—according to the national security missions or programs to be accomplished as shown below:

Table R-3. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category	1968 actual	1969 estimate	1970 estimate
Strategic forces	7,364.5	8,309.6	9,087.4
General purpose forces	31,124.3	29,606.0	29,856.3
Intelligence and communications	5,492.4	5,697.2	5,832.4
Airlift and sealift	1,813.0	1,402.0	1,889.2
Guard and Reserve forces	3,166.0	2,565.5	2,848.6
Research and development	4,395.4	4,598.0	5,500.3
Central supply and maintenance	8,175.4	8,662.8	8,848.8
Training, medical, and other general personnel activities	9,358.3	9,481.7	9,967.8
Administration and associated activities	1,292.1	1,404.3	1,407.3
Support to other nations	1,736.8	2,450.7	2,408.8
Retired pay	2,095.0	2,450.0	2,735.0
Total distributed to programs above	76,013.0	76,627.8	80,381.8
Undistributed nonprogram financing adjustments	415.5	−132.9	−144.3
Total budget authority, Department of Defense	76,428.5	76,494.9	80,237.5

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

The Department has responsibility for the administration of a broad range of Federal health, education, and welfare programs.

Its programs have been grouped into four program categories and an overall management category as shown in the table below. Each program category is further divided into subcategories according to major purpose.

Table R-4. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Education:			
Development of basic skills	2, 389.0	2, 289.3	2, 179.0
Development of vocational and occupational skills	269.3	268.3	304.1
Development of academic and professional skills	1, 330.9	966.2	1, 020.7
Library and community development	87.9	86.8	96.0
General research (nonallocable research)	25.7	25.6	31.1
General support	35.5	41.3	45.3
Category total	4, 138.3	3, 677.5	3, 676.2
Health:			
Development of health resources	2, 315.0	2, 185.7	2, 395.6
Prevention and control of health problems	457.1	480.8	480.5
Provision of health services	7, 345.7	9, 980.3	10, 739.0
General support	48.5	54.9	64.4
Category total	10, 166.5	12, 701.8	13, 679.4
Social and rehabilitation services:			
Improving individual capability for self-support	408.9	596.4	853.6
Improving the social functioning of individuals and families	225.7	321.5	399.2
General development of social and rehabilitation resources	114.6	127.9	132.6
General support	32.0	37.7	43.1
Category total	781.3	1,083.5	1,428.5
Income maintenance:			
Aged assistance	18,476.8	21,339.4	24,787.0
Disability assistance	3,207.0	4,196.6	4,842.6
Other individual and family support	7,755.5	9,500.6	10,769.6
General support and increasing knowledge	236.4	277.0	327.3
Category total	29.675,7	35,313.6	40,726.5
Executive direction and management (Office of the Secretary)	24.0	25.0	35.2
Total distributed to programs above	44,785.8	52,801.5	59,545.8
Net deductions for interfund transactions and receipts from the public not distributed above	−97.5	−964.4	−522.3
Total budget authority, Department of Health, Education, and Welfare [1]	44,688.2	51,837.1	59,023.5

[1] While the budget authority for the Department of Health, Education, and Welfare agrees with that shown in the budget document, there may be minor differences in the distribution among categories and subcategories. These result from some differences in classification of budget authority. For example, emergency health in Part 3 is classified as National Defense and is therefore excluded from the health tally in Part 3. It has however been included in the budget authority shown above.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

The Department has the responsibility for administering the principal Federal programs which provide assistance for housing and for the development of the Nation's communities; assisting the President in coordination of Federal activities which affect urban community, suburban, or metropolitan development; encouraging local and private solution of housing and urban development problems; promotion of interstate, regional, and metropolitan cooperation; and increasing the efficiency of the private homebuilding and mortgage lending industries. These activities are grouped below in five major program categories plus supporting services.

Table R-5. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Assuring decent housing for all Americans:			
Assuring an adequate supply of low- and moderate-income housing	3,148.3	1,300.8	746.2
Promoting the efficient functioning of private housing markets	1,062.9	296.5	2.5
Category total	4,211.2	1,597.3	748.7
Assuring adequate and efficient local public and private facilities and services	402.3	202.8	195.7
Improving the physical environment of urban communities	850.0	1,062.5	1,112.2
Improving the social environment of urban communities:			
Creating model neighborhoods in demonstration cities	212.0	312.5	750.0
Assuring equal opportunity in access to housing and other facilities		4.0	14.5
Category total	212.0	316.5	764.5
Improving management of community development activities:			
Improving governmental planning and executive management of community development	45.0	43.8	65.0
Improving urban information and technical assistance support to State and local governments	2.2		5.0
Additional education and training for efficient urban development and management	3.5	3.5	9.0
Category total	50.7	47.3	79.0
Improving management of departmental programs and resources:			
Research and demonstrations in urban technology	10.0	18.3	32.7
Provide executive direction and general support	50.1	57.0	74.1
Category total	60.1	75.3	106.8
Total distributed to programs above	5,786.3	3,301.7	3,006.9
Intragovernmental transactions and other adjustments, net	−.5	−58.5	
Total budget authority, Department of Housing and Urban Development	5,785.9	3,243.2	3,006.9

DEPARTMENT OF THE INTERIOR

The Department of the Interior is concerned with the management, conservation, and development of the Nation's water, energy, minerals, fish, wildlife, forest, and outdoor recreation resources. It also has major responsibilities for Indian and territorial affairs. The Department's functions are grouped into the following nine major program categories:

Table R-6. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category	1968 actual	1969 estimate	1970 estimate
Water supply and control	671.7	652.8	667.6
Energy production, distribution, and supply	218.3	209.5	223.6
Minerals exploration, production, and supply	42.0	40.2	41.6
Land-forage-timber	118.7	121.2	118.3
Aquatic living commercial resources	50.0	49.5	51.4
Recreation use and preservation	366.5	429.0	422.3
Indians	361.4	351.0	359.4
Territories	58.2	55.8	69.2
Other programs	85.6	93.8	97.5
Total distributed to programs above	1,972.4	2,002.9	2,050.8
Deductions for offsetting receipts	−1,518.1	−1,477.2	−1,568.2
Intragovernmental transactions	−38.9	−32.0	
Total budget authority, Department of the Interior	415.3	493.7	482.6

DEPARTMENT OF JUSTICE

The chief purposes of the Department of Justice are to provide means for the enforcement of the Federal laws, including those pertaining to immigration and naturalization; to furnish legal counsel in Federal cases; to construe the laws under which other departments act; and to provide assistance to States and localities in law enforcement. It conducts all suits in the Supreme Court in which the United States is concerned, supervises the Federal penal institutions, and investigates and detects violations against Federal laws. It represents the Government in legal matters generally, rendering legal advice and opinions, upon request, to the President and to the heads of the executive departments. The Attorney General supervises and directs the activities of the U.S. attorneys and marshals in the various judicial districts, and coordinates much of the Federal activity which seeks to assure civil rights. The Department's programs are grouped into 11 major categories as shown below.

Table R-7. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Reduction of crime:			
Organized crime	15.1	18.4	20.1
Interstate crime	45.4	50.9	52.5
Federal crime	62.8	67.5	69.2
Crime prevention	1.3	1.7	1.8
Category total	124.6	138.6	143.7
Law enforcement assistance:			
Improvement of State and local law enforcement planning	1.7	19.0	20.0
Improvement of State and local law enforcement operations	3.3	29.0	230.0
Research and development of devices, systems, and procedures	.3	3.0	22.8
Support to law enforcement personnel for education and training	25.0	36.4	49.8
General support	.5	2.2	3.8
Category total	30.7	89.6	326.3
Correction of offenders:			
Custody and physical security of offenders	12.3	12.1	14.2
Inmate care and maintenance and operation of institutions	38.3	37.5	49.1
Rehabilitation of offenders	14.1	13.7	17.1
Assistance to non-Federal correctional systems		.1	2.6
Research	.2	.4	1.1
General support	.9	.8	.9
Category total	65.8	64.6	84.9
Control of narcotics and dangerous drug abuse:			
Identification of dangerous drugs		.3	.4
Control of traffic in narcotics and dangerous drugs	6.0	16.5	20.7
Treatment of narcotics and dangerous drug offenders	.2	.9	3.3
Law enforcement assistance		.2	.4
Public education		.1	.4
Research	.4	.9	1.3
General support	.3	1.8	2.8
Category total	7.0	20.7	29.3
Internal security and governmental integrity:			
Integrity of Government personnel	19.6	21.6	22.3
Security of Government, Government programs, and Government property	1.2	1.3	1.3
Security of Government international affairs	.5	.6	.6
Identification, exposure, and control of subversive movements	26.2	28.2	28.9
General support	.1	.1	.1
Category total	47.6	51.7	53.2
Civil rights and community relations:			
Equal employment opportunity	1.7	2.0	2.1
Housing	.4	.9	1.2
Public education	1.2	1.4	1.6
Interference with civil rights	11.7	13.3	13.8
Voting	1.4	1.7	1.7
Federally assisted programs	.4	.4	.5
Public accommodations and facilities	.6	.2	.2
Community relations assistance	2.0	2.3	3.7
Category total	19.4	22.0	24.8

Table R-7. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY—Con.**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Competition in the American economy:			
Anticompetitive conduct	4.0	4.3	4.6
Anticompetitive market structures	3.2	3.5	3.7
Governmental intervention and influence	.9	1.0	1.1
Category total	8.2	8.8	9.4
Legal representation and advice to Federal officers and agencies:			
Integrity of the revenue system	7.1	7.6	8.1
Defense of monetary claims	5.6	6.2	6.6
Recovery of money owed the United States	5.1	5.9	6.4
Integrity of administrative action	4.1	4.6	5.0
Land acquisition	2.8	3.0	3.3
Protection and development of natural resources	1.2	1.4	1.6
Category total	25.8	28.7	30.9
Support of the Federal judicial system:			
Recommendations of judicial appointments	.1	.1	.1
Facilitation of litigation	17.0	18.4	19.8
Protection of the integrity of the judicial system	1.2	1.4	1.6
General support	1.1	1.2	1.3
Category total	19.5	21.0	22.8
Immigration and naturalization:			
Control of persons entering the United States	45.3	48.0	50.3
Control of aliens in the United States	25.4	26.0	27.1
Naturalization	4.5	4.9	5.0
Central information record	7.1	7.4	8.0
General support	4.6	4.9	5.0
Category total	87.0	91.3	95.4
General support:			
Executive direction	2.4	2.5	3.3
Personnel	.4	.5	.5
Information	.5	.7	.7
Administrative services	2.9	3.2	4.2
Category total	6.2	6.8	8.7
Total distributed to programs above	441.9	543.7	829.4
Deductions for offsetting receipts	−4.4	−4.6	−4.6
Total budget authority, Department of Justice	437.5	539.1	824.8

DEPARTMENT OF LABOR

The basic goals of the Department of Labor are to increase the employment and productive potential of the civilian labor force, particularly the disadvantaged; to minimize the effects of unemployment by providing income support; and to promote and protect the rights and interests of all Americans who are actual or potential members of the work force.

Programs to achieve these overall goals are carried out by the Department's constituent bureaus and other organizations under a variety of subgoals and objectives. At present, the Department's programs are grouped into six major program categories plus a general support category as follows:

Table R-8. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY

(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Manpower development assistance:			
Training	396.4	412.2	666.3
Special manpower programs	20.3	15.8	18.0
Work programs	13.0		
Research	5.0	5.0	5.2
Policy planning and evaluation	2.0	2.4	2.6
Comprehensive manpower program planning			34.0
Information	.1	.2	.8
Manpower management data systems	.8	.8	3.5
Administration	2.3	2.6	3.0
Category total	439.9	439.0	733.4
Employment assistance:			
Employment market information	18.0	20.3	21.1
Job development and placement services	145.6	143.9	149.2
Employability assistance	69.3	91.0	94.5
Civil rights compliance	1.1	.9	.9
Administration	80.8	86.3	90.3
Category total	314.9	342.4	356.0
Income maintenance:			
Unemployment insurance	93.0	154.5	116.9
Workmens compensation	61.4	69.5	60.9
Unemployment trust fund (excluding amounts distributed to other subcategories)	3,461.8	3,407.9	3,716.2
Administration	13.6	20.7	21.2
Category total	3,629.9	3,652.6	3,915.2
Wage and labor standards:			
Wages and working conditions	23.3	25.3	25.3
Occupational fatalities and injuries	2.6	2.9	3.4
Utilization of women workers	.7	.7	.8
Research in the area of wage and labor standards	2.2	2.2	2.3
Administration	1.6	2.2	2.2
Category total	30.4	33.3	34.0
Labor-management relations:			
Administration of reporting and disclosure laws	6.6	6.8	6.9
Veterans reemployment rights	.8	1.0	1.2
Labor-management relations assistance	.3	.4	.4
Research and policy development	.3	.3	.3
Administration	.6	.6	.6
Category total	8.6	9.0	9.4

Table R-8. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY—Con.**

(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Data collection, analysis, and dissemination:			
Manpower and employment statistics	7.7	8.2	8.7
Prices and living conditions	3.5	3.6	3.7
Wages and industrial relations	3.5	3.6	3.7
Productivity, technology, and growth	1.2	1.4	1.4
Foreign labor and trade	.5	.5	.5
Field services	1.2	1.3	1.3
Administration	3.5	3.5	3.6
Revision of the Consumer Price Index			.6
Category total	21.0	22.0	23.5
General support:			
Executive direction and management	4.4	4.9	5.1
Legal services	4.8	5.2	5.1
International labor activities	1.3	1.4	1.4
Category total	10.6	11.4	11.6
Total distributed to programs above	4,455.3	4,509.7	5,083.1
Deductions for offsetting receipts	−3.2	−.6	−4.1
Pay supplemental and other separate transmittal		1.8	
Total budget authority, Department of Labor	4,452.1	4,510.9	5,079.0

POST OFFICE DEPARTMENT

The program structure of the Post Office Department is descriptive of the major functions involved in providing postal services from the acceptance of mail through delivery and the supporting activities required to maintain an effective service. Currently, the Department's functions are grouped into eight program categories as shown below.

Table R-9. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**

(in millions of dollars)

Program category	1968 actual	1969 estimate	1970 estimate
Direct services to mailers	1,273.8	1,400.2	1,438.7
Processing of mail	1,453.1	1,585.8	1,622.8
Delivery services	2,053.6	2,244.4	2,295.5
Transportation	602.9	630.0	645.0
Enforcing postal laws and regulations	24.9	28.2	32.0
Research, development, and engineering	22.1	34.0	50.0
Administrative postal support	441.2	522.7	576.2
Logistical postal support	764.2	899.1	1,095.9
Total distributed to programs above	6,635.8	7,344.4	7,756.2
Financing adjustments	61.9	−20.9	
Postal revenues	−5,505.3	−6,287.6	−7,006.4
Total budget authority, Post Office Department	1,192.4	1,036.0	749.8

DEPARTMENT OF TRANSPORTATION

The broad objectives of the Department of Transportation are to:

- Increase economic efficiency through improved transportation;
- Increase safety in transportation;
- Increase the benefits derived from the preservation and enhancement of environmental social values, when impacted by transportation; and
- Support other national objectives, such as national defense and scientific research.

The objectives of the specific programs of the Department are identical with, or in support of, these broad departmental objectives. The Department's programs are grouped into four major program categories plus a general support category as follows:

Table R-10. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Urban transportation:			
Highways	1,868.0	2,153.2	2,171.3
Urban mass transit		168.5	202.0
Category total	1,868.0	2,321.7	2,373.3
Interurban transportation:			
Highways	2,804.0	3,238.4	3,281.2
Rail	16.0	18.6	23.3
Air	679.7	829.3	1,156.8
Water	181.6	184.5	194.5
Intermodal	2.5	2.4	2.4
Category total	3,683.9	4,273.2	4,658.1
International transportation:			
Highways	5.0	2.0	
Air	143.9	1.4	1.4
Water	59.6	58.4	49.3
Category total	208.4	61.8	50.8
Other national interests:			
National security, boundaries, and treaties	93.7	90.7	89.1
Support of science	9.4	25.8	21.5
General transportation safety	153.5	141.1	177.7
Other highway programs	129.4	104.0	106.5
Category total	386.1	361.7	394.8
General support:			
Research and development	33.1	37.1	59.5
General highway planning	54.8	61.9	62.2
Administration	251.2	288.6	318.6
Coast Guard retired pay	48.2	52.4	55.7
Category total	387.3	440.1	496.1
Total distributed to programs above	6,533.7	7,458.5	7,973.0
Deductions for offsetting receipts	−19.7	−27.8	−20.4
Intragovernmental transactions	−15.1		
Total budget authority, Department of Transportation	6,498.9	7,430.7	7,952.6

DEPARTMENT OF THE TREASURY

The Treasury Department is responsible for the central fiscal operations of the Federal Government. The Treasury PPB system deals with the operating elements of the Department, which are funded mainly through annual appropriations but also receive a substantial amount of reimbursements and other miscellaneous funds.

The Department's functions are grouped into program categories as shown in the table. Not included in the PPB structure is interest on the public debt, which accounts for most of the budget authority for the Department, and several permanent appropriations which are aggregated in the adjusting entry in the table.

Table R-11. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Administration of Government finances:			
Public debt	55.9	58.5	61.0
Issuance, payment, and servicing of Government checks	37.9	43.9	44.9
General activities	4.8	4.6	4.5
Category total	98.6	107.0	110.4
Collection of revenue:			
Revenue accounting and processing	143.6	151.2	158.1
Taxpayer assistance and services	62.3	68.7	69.8
Delinquent accounts operation	78.4	85.6	89.4
Delinquent returns operation	22.4	23.2	28.8
Audit of tax returns	237.6	262.4	281.7
Tax fraud investigations—taxpayers in general	27.1	27.3	25.9
Taxpayer appeals	33.2	35.6	37.4
Alcohol and tobacco revenue and regulatory controls	16.0	18.0	19.8
Collection of customs duties	78.2	87.4	93.3
General activities	48.9	56.4	63.3
Category total	747.8	815.8	867.5
Manufacture and distribution of coins, currency, and other financial instruments	14.2	15.2	19.4
Special law enforcement:			
Tax fraud investigations—racketeer segment	9.5	14.9	17.2
Alcohol and firearms investigations	19.8	22.3	25.9
Other investigations	26.2	24.7	28.4
Security responsibilities	7.9	10.3	12.9
General activities	.1	.1	.1
Construction of facilities	---------	.8	1.9
Category total	63.5	73.1	86.4
Policy determination and related activities	7.0	7.8	8.5
Total distributed to programs above	931.1	1,018.9	1,092.2
Items not included in the program structure:			
Interest on the public debt	14,573.0	16,000.0	16,800.0
Other appropriations not included in the program structure	312.7	303.0	278.4
Deductions for offsetting receipts	−1,077.2	−978.4	−1,115.2
Intragovernmental transactions	−82.0	−86.3	−81.4
Total budget authority, Treasury Department	14,657.6	16,257.2	16,974.0

ATOMIC ENERGY COMMISSION

The Atomic Energy Commission conducts a variety of production, research and development, and supporting activities to discharge its responsibilities for national defense and the peaceful applications of atomic energy. The agency's functions are grouped into eight major program categories, as follows:

Table R-12. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Procurement and production of source and special nuclear materials:			
Procurement of uranium concentrates	125.5	104.3	66.3
Production of special nuclear materials	360.4	371.1	361.5
Category total	485.8	475.4	427.8
Military applications:			
Nuclear weapons	886.8	1,139.4	950.4
Naval propulsion reactors	115.0	128.5	139.8
Category total	1,001.7	1,267.9	1,090.2
Development of space applications:			
Space propulsion	72.8	59.1	55.5
Space electric power	56.1	51.7	38.8
Category total	128.9	110.8	94.4
Development of central station nuclear power:			
Converter reactors	24.2	26.0	19.5
Advanced converter and low-gain breeder reactors	52.0	31.8	32.8
High-gain breeder reactors	84.5	163.2	116.6
Desalting applications	2.8	7.9	5.0
General research and development	3.4	3.0	2.8
Category total	166.9	231.9	176.7
Development of other civilian applications:			
Merchant ship propulsion reactors	.1	1.4	--------
Terrestrial electric power development	6.9	4.1	4.7
Isotopes development	8.3	8.5	8.1
Civilian applications of nuclear explosives	17.9	15.2	14.5
Category total	33.2	29.2	27.3

Table R-12. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY—Con.**
(in millions of dollars)

	1967 actual	1968 estimate	1969 estimate
Basic research:			
High energy physics research	152.8	186.9	242.9
Other physical research	175.4	214.1	184.3
Biomedical research	93.2	101.9	97.9
Category total	421.4	502.9	525.1
Nuclear science and technology support:			
Supporting reactor development activities	114.2	154.2	130.2
Training, education, and information	18.0	17.9	17.4
Category total	132.2	172.1	147.6
General support:			
Program direction and administration	95.3	108.6	114.7
Community support	6.4	6.8	10.1
Security investigations	6.8	7.7	7.9
Cost of work for others	14.3	31.3	13.1
Construction planning and design	1.4	3.9	--------
Category total	124.2	158.3	145.8
Total distributed to programs above	2,494.3	2,948.5	2,634.9
Adjustments to budget authority, net	13.9	−377.7	−196.7
Total budget authority, Atomic Energy Commission	2,508.2	2,570.8	2,438.1

GENERAL SERVICES ADMINISTRATION

GSA provides, on a centralized basis where it is efficient to do so, a variety of goods and services for the agencies of Government. Among the things provided are: office and other building space, supplies, automatic data processing equipment, property and stockpile management, communications, motor transport, records management services, and other common services. It also operates the National Archives and presidential libraries.

GSA's PPB system groups these diversified activities into five basic program categories to facilitate analyses of costs and effectiveness. A sixth program category covers agency direction and a variety of support services.

Table R-13. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Facilities:			
Acquisition	163.6	94.3	114.7
Management	274.4	288.3	301.7
Service direction	1.5	1.5	1.6
Category total	439.5	384.1	418.0
Supply services:			
Provision of supplies	58.8	65.2	65.2
Supply management	1.1	1.2	1.2
Automated data management services	11.6	2.4	2.4
Service direction	1.9	2.0	2.0
Category total	73.5	70.9	70.8
Other property management and disposal services:			
Property management	13.5	13.3	14.4
Real property disposal	4.3	4.5	4.4
Personal property disposal	7.4	8.0	8.3
Program support	1.0	1.0	1.0
Service direction	.6	.6	.6
Category total	26.8	27.5	28.8
Transportation and communications services:			
Transportation (other than motor equipment)	2.4	2.4	2.4
Motor equipment	.4	.4	.4
Communications	1.8	1.9	1.9
Public utilities	.1	.1	.1
Service direction	.7	.7	.7
Category total	5.4	5.5	5.5
Records services:			
Management	11.7	13.1	13.5
Archival services	4.8	5.9	7.0
Federal Register	.6	.6	.7
Service direction	.6	.7	.7
Category total	17.8	20.4	21.9
Agency direction and support services:			
Executive direction	1.8	1.9	1.9
Administrative operations	12.8	13.7	13.8
Allowances and services to former Presidents	.3	.3	.4
Presidential transition	---------	.9	---------
Category total	14.9	16.8	16.2
Total distributed to programs above	577.8	525.2	561.3
Deductions for offsetting receipts	−196.8	−205.9	−273.9
Total budget authority, General Services Administration	381.0	319.3	287.4

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

The principal statutory functions of NASA include conducting research for the solution of problems of flight within and outside the earth's atmosphere, conducting activities required for the exploration of space with manned and unmanned vehicles, and arranging for the most effective utilization of the scientific and engineering resources of the United States with other nations that are engaged in aeronautical and space activities for peaceful purposes.

These functions are reflected in the program structure shown below. The table shows the NASA budget authority distributed to the category level except for the general support category which is shown at the subcategory level.

Table R-14. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Extension of manned space flight capability	2,829.7	2,180.8	2,011.0
Lunar exploration	46.5	13.6	22.5
Planetary exploration	109.1	106.8	174.6
Astronomy	92.9	90.1	76.4
Space physics	73.9	64.4	62.0
Space biology	37.5	30.0	28.0
Space applications	110.3	105.0	148.6
Space technology	237.7	193.7	198.5
Aircraft technology	84.6	94.9	105.4
Supporting activities:			
Tracking and data acquisition	275.9	279.7	298.0
Other supporting activities	102.4	70.2	102.1
Research and program management	639.3	648.6	650.9
Total support activities	1,017.6	998.5	1,051.0
Total distributed to programs above	4,639.8	3,877.8	3,878.0
Financing adjustments	−51.0	117.2	−117.5
Deductions for offsetting receipts	−1.5	−2.9	−3.0
Total budget authority, National Aeronautics and Space Administration	4,587.3	3,992.1	3,757.5

VETERANS ADMINISTRATION

The Veterans Administration administers laws authorizing benefits for former members of the Armed Forces, and for their dependents and survivors. The agency's functions are grouped into six major program categories, as follows:

Table R-15. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Compensation for service-connected disabilities and death:			
Compensation for veterans disabilities	1,950.4	2,080.0	2,162.6
Compensation to survivors	515.6	525.2	532.4
Miscellaneous	16.3	10.2	10.3
Administrative support	37.7	40.7	44.6
Category total	2,520.1	2,656.1	2,749.9
Alleviation of financial needs of veterans and survivors not connected with military service:			
Veterans pensions	1,270.3	1,283.5	1,286.6
Survivors pensions	778.2	848.6	904.7
Burial allowances and related benefits	66.9	71.0	20.2
Administrative support	44.7	47.9	52.4
Category total	2,160.1	2,251.1	2,263.8
Educational and training assistance:			
Readjustment educational assistance to veterans	378.5	570.5	668.6
Rehabilitative training of disabled veterans	22.8	31.0	37.9
Educational assistance to children of deceased and disabled veterans	33.2	37.2	37.6
Administrative support	38.5	45.8	46.6
Educational assistance to wives and widows		1.4	17.4
Category total	473.0	685.8	808.1
Housing and other credit assistance:			
Credit assistance for homes, farms, and businesses	149.0		
Servicing and management of loans and properties	701.6	9.5	5.7
Administrative support	38.7	40.6	43.3
Category total	889.3	50.1	49.1
Insurance:			
Veterans life insurance trust funds	744.7	754.3	760.4
Veterans life insurance revolving funds	1.6	4.3	6.0
Administrative support	18.2	19.3	21.2
Category total	764.6	777.9	787.5
Health services:			
Direct medical care	1,280.3	1,369.1	1,427.5
Medical and prosthetic research	45.9	48.1	59.7
Research and development in health services	4.9	5.0	4.8
Education and training	64.1	79.1	96.1
Medical support and miscellaneous services	41.1	44.7	49.2
Construction of facilities	56.6	11.9	101.4
Category total	1,492.9	1,557.9	1,738.7
Total distributed to programs above	8,300.0	7,978.9	8,397.1
Deductions for offsetting receipts	−494.0	−483.9	−480.1
Intragovernmental transactions	−5.4	−6.0	−5.6
Total budget authority, Veterans Administration	7,800.7	7,489.1	7,911.4

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NATIONAL SCIENCE FOUNDATION

The fundamental purpose of the National Science Foundation is to strengthen basic research and education in the sciences. The Foundation's activities are reflected in the program structure shown below.

Table R-16. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Support of scientific research:			
Scientific research project support	170.6	177.3	197.0
Specialized research facilities and equipment	18.9	7.0	15.0
National research programs	15.5	13.0	23.2
National research centers	31.5	25.7	25.7
Category total	236.5	223.0	260.9
National sea grant program	5.0	6.0	10.0
Computing activities in education and research	22.0	17.0	22.0
Institutional support for science	83.2	41.0	74.0
Science education support:			
Precollege education in science	54.7	49.0	48.8
Undergraduate education in science	21.5	20.0	20.5
Graduate education in science	48.7	47.1	48.2
Category total	124.8	116.1	117.5
Science information activities	14.4	11.0	14.0
International cooperative science activities	1.4	1.8	2.0
Planning and policy studies	2.4	2.5	2.9
Program development and management	15.4	16.6	17.0
Total distributed to programs above	505.2	435.0	520.3
Adjustments to budget authority, net	−10.2	−35.0	−20.3
Deductions for offsetting receipts	−3.5	−1.1	−1.1
Total budget authority, National Science Foundation	491.5	398.9	499.0

OFFICE OF ECONOMIC OPPORTUNITY

The Office of Economic Opportunity contributes to the national goal of eliminating poverty by aiding in the development of Federal antipoverty policies and programs and by administering or coordinating various antipoverty program efforts. Achievement of this goal involves the provision of opportunity for people and communities to help themselves through work, education, and training in a decent and dignified environment. Effort to reach these subgoals is carried out through activities under several major program categories, as shown in the table.

Table R-17. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Employment:			
Job training and work experience assistance	625.6	752.7	825.1
Other employment assistance	16.2	16.5	17.0
Category total	641.8	769.2	842.1
Individual and family improvement:			
Compensatory and other educational assistance	568.4	577.0	614.7
Health assistance	60.7	95.5	127.8
Other individual and family assistance	8.3	8.8	10.8
Category total	637.4	681.4	753.3
Community betterment:			
Resource mobilization assistance	293.5	294.8	312.2
Volunteer assistance	29.2	32.0	37.0
Housing assistance	11.9	14.1	24.4
Legal assistance	35.9	42.0	50.0
Loan assistance	17.0	6.0	12.0
Economic development assistance	21.6	23.9	48.0
Other community betterment assistance	62.1	66.1	72.0
Category total	471.2	478.9	555.6
Poverty research and evaluation	3.6	3.6	13.0
General support:			
Executive direction and administration	11.9	12.5	12.6
Coordination and other	1.5	2.5	3.4
Category total	13.4	15.0	16.0
Total distributed to programs above	1,767.4	1,948.0	2,180.0
Deductions for offsetting receipts	−.5	−.5	−.5
Total budget authority, Office of Economic Opportunity	1,766.8	1,947.5	2,179.5

Chairman PATMAN. Mr. Bolling of Missouri is recognized.

Representative BOLLING. Mr. Chairman, I really do not have any questions but I have got a couple of comments.

We have seen two examples at least today of the difficulties that these gentlemen have faced for their tenure in office, in dealing with an institution which likes to place all the blame for any misadventure on the Executive. I cannot understand frankly—and I think I can say that all of these gentlemen before us are friends of mine—how they have managed over the years to keep their good humor and even their sanity in dealing with an institution which, while they themselves head relative modern institutions in the executive, has not troubled to modernize itself.

As one—and it is no help to be a Cassandra as most of you have been—as one who supported publicly a tax increase in January 1966, I should think that by now the institution to which I belong which must start all tax measures and the institution to which others on the committee belong, might recognize that we have not been overwhelming success in acting in a timely fashion on fiscal matters.

I have been an advocate of a limited authority for the President to increase and decrease tax rates for so many years I am not quite clear as to when I first started. And I would like to say categorically that as an observer with some experience in the House of Representatives, that the delay in the enactment of a tax increase falls in the lap of the House of Representatives in particular. It was long delayed there and it was the House's fault, and plenty of room for plenty of bipartisan complaints because both parties were responsible.

Now, as far as this question of the waste and inefficiency in Defense are concerned. I think again it might be very, very well if we in the Congress looked to ourselves because I have some awareness of the occasional pressures that are brought by regions and areas on the Defense Establishment and the Executive, and I get a little tired as a 20-year member of the House of Representatives, of hearing people criticize the Executive for things that are actually done largely on the Hill. That is not to say for a moment that the Executive is perfect. I do not think so. But I do think that it is time that we began to look at the place where the greatest difficulty lies.

Mr. Rumsfeld was talking about the need for greater information and I think Mr. Zwick's reply made a lot of sense. It is not an adversary situation because we are not an adversary. I think that we in the House of Representatives have taken modern methods of storing and retrieving information to the extent of installing one computer in the Clerk's office. I hope the Senate has done better. We are using techniques on the Hill and we pass on the budget just as the administration submits it, which are not even up to the day of the early Model "T." And frankly, I compliment you gentlemen for your service. I wish you well, and I hope that each one of you separately will tell me how you kept your sanity and your sense of humor in dealing with the Congress. [Applause.]

Senator PROXMIRE (now presiding). Senator Percy?

Secretary BARR. Mr. Bolling, I will speak for all my colleagues. It has not been difficult. After all, you know you get harassed a little bit but when you meet the fellow who has been harassing you at a cocktail party it seems in the last analysis that you are all pretty good fellows, you know, and ladies. None of us have bled. We are all in good health and good spirits.

Senator PROXMIRE. They also get paid more.

Representative BOLLING. That is good, too.

Senator PROXMIRE. I just observed to Mr. Bolling they also are getting paid a lot more than we are.

Senator Percy?

Senator PERCY. Mr. Chairman, I would like to use this occasion to eypress my appreciation to Secretary Barr for the fine relationship I have had with him for 2 years. We have agreed completely on the necessity of a tax increase and I hope I was somewhat helpful in this regard. We disagreed on the matter of Federal backing of homeownership bonds, but every point of view that I and my colleagues have had has been given full hearings and I am most appreciative of that.

I understand that this morning there was some discussion of the balance of payments, particularly with respect to purchase of bonds by Germany. I attended the NATO parliamentary sessions a couple of months ago as part of the Senate delegation and it seemed to me, as we worked on the Economic Committee, that it was a precarious thing to leave to annual negotiations; for us to go hat-in-hand and to be subject to the political problems of a country like Germany—when it might not be a very popular thing for a government to buy our bonds. It seemed that this is a continuing problem.

It we could adopt as a principle the position that no country should benefit or lose in a balance of payments sense as a result of its contribution to the mutual defense of the 15 NATO countries, then we ought to be able to be ingenious enough to create a mechanism for doing this automatically rather than in these annual negotiations.

I found the 15-member nation body very receptive to the unanimously approved resolution that I presented to the Economic Committee to the effect that such a device be worked out. I was pleased that the Ministers at their meeting included this section in their report. This would save us about $750 million a year in balance of payments.

Secretary BARR. In Europe alone.

Senator PERCY. It would get us out of this 4½ year short-term bond. They ought to be for 15 or 20 years. There ought to be some sort of a central bank set up to do this automatically by the purchase of bonds from the debtor countries, and the sale to surplus countries by some central bank.

Now, this resolution, has been adopted.

Would you recommend that this be a high item of priority by the new administration? Is the Treasury Department the right place to implement this and make all the necessary arrangements?

Secretary BARR. First of all, Senator Percy, I think the country—I do not want to get too flowery here—and the whole world owes you and the people working in this area a deep debt of gratitude because the one thing we have never had to do and the one thing I pray that Secretary Kennedy does not have to do is go to the Defense Department and say we simply do not have the reserves to keep the 7th Army in Germany or we are going to have to pull the 6th Fleet out of the Mediterranean because we do not have the foreign exchange reserves.

It is difficult to brings these things down to where you can explain them to your constituents, but let me give you something I think all Americans can understand. This is something I have never told before, but I think it belongs in this record.

You will remember the days of the financial crisis of last March when we called our partners in the gold pool to Washington. The London exchanges closed down. I went over to visit my colleague, Mr. Nitze, in the Defense Department on Saturday afternoon while we were still negotiating. He was talking on the phone to Germany and I could hear somebody yelling on the other end of the line. Nitze said, "Just a minute. The right man has just walked in." He was speaking to our commanding general in Germany, I do not know the gentleman's name. Well, I will not repeat the words the general was using. He was talking like a general, I can tell you, but his complaint was that his troops were out on the streets and when they tried to get a dollar cashed to buy a beer, the money changers would give than only 85 cents. They would write a check on the post exchange bank, or whatever they have, to pay their rent, and people would not take their checks.

That is an example of the bind that you can get in—that is the ultimate end of the road, Mr. Percy, and that end is chaos and really it would be a dreadful blow to world peace. Then you would have Europe just helpless. It would be helpless. It would be defenseless.

So let me say if we all want to stay alive, peace is the highest priority. There is no higher priority I know for the new administration.

Now, you have moved with resolution. May I suggest, Mr. Percy, that you continue to push, but be tolerant and be helpful, because it is a long way from a resolution to a specific plan. You will find that the Finance Ministers of these countries and their Parliaments have difficulties when they get down to trying to implement the plan. We have tried several times with all sorts of plans. It is an extremely difficult thing. I will tell you what happens. A good offset arrangement, Mr. Percy, inevitably gets into their budgets and they have to vote to raise taxes and they have to vote to raise expenditures, and I am sure the committee will agree with me, this is not easy in any country. That is the nub of the problem.

Maybe you can work it out financially. We have not found any way out of it except the German offset which I will agree is not completely satisfactory. The satisfactory way is to do it in the budget through the appropriation and tax system and that is hard business in any country—but keep pushing. If you would like, one of the great experts in this area, one of the deep thinkers, is Mr. Okun, who has puzzled and worried over this problem as much as anybody I know. Mr. Okun can supply you a list of people this long—and I will be glad to come in and give you any political or practical advice I can give.

Secretary Fowler has worked years on this. So had Secretary Dillon and Secretary Anderson before him. I just want to tell you the priority is high; the solution is difficult. I congratulate you for trying.

Senator PERCY. I very much appreciate your statement on this. I think you have to strike while the iron is hot. We have a resolution that has now been approved by the NATO parliamentary group and by the Ministers and the conditions are favorable right now. But if we let too much time go by, this opportunity may slip by.

They have directed me to report back in May that steps have been taken. The initiative will not be taken by any other country. We are the real benefactor here in the short run. In the long run all NATO countries are the benefactors because we may some day say we are quite willing to take the budget impact of this but we can't stand balance-of-payments impact. And we know the bulk of the spending is going to be in Europe.

Secretary BARR. That will indeed be correct after the Vietnam conflict is terminated.

Senator PERCY. I will send to your office today one suggested proposal. If the Treasury Department can undertake immediately to consider this proposal, I will then in the transition period take it up with the incoming Secretary of the Treasury to see if we can't move forward rapidly and have something concrete to suggest by May when NATO meets again.

Secretary BARR. May I suggest, Senator Percy, that it is my understanding that Prof. Richard Cooper of Yale University, is coming down to assist Mr. Kissinger in this foreign policy area. It has been my experience that Professor Cooper—would you agree, Mr. Okun—has done as much work in this area as anyone. He is young and imaginative in this area.

Mr. OKUN. A Yale faculty member. [Laughter.]

Secretary BARR. No commercial plugs, please. But I would suggest, sir, that you are getting the right man. Mr. Kissinger is bringing in the right man, the best man I know outside of Mr. Okun to attack this problem.

Senator PERCY. Mr. Chairman, could I make just one last comment? I am very sorry I wasn't here for the full testimony on this Economic Report. I would just like to register the fact that I am concerned about the new budget. I think there have been some items slashed out of it that are going to be dangerous in their impact on the country, one of them being, I think, the whole area of health.

In the President's state of the Union message another program has been talked about. Yet we have a totally inadequate base for sustaining the existing programs that we have. We have a lot of work ahead of us, I think, to look into this to see whether or not the surplus is really a genuine surplus or whether we have turned the crank awfully tight and we simply aren't going to be able to live with those figures and we would be foolish to think that we can——

Secretary BARR. Senator Percy, this budget was peculiar. Most Presidents, when they are leaving office, don't really agonize about their last budget because they will not be around to work with it. President Johnson really did have to agonize on it and all of us did because we had to have a budget that was responsible and realistic. We also had to try to make our best estimates as to what the Congress would do to these proposals, not because we are going to be around to implement them, but because we were recommending that the surtax be extended.

We had to have a credible budget to support the recommendation that the surtax be extended and a surplus be maintained.

I don't know how well we did, Senator Percy, but we did do our best to be responsible, to be realistic, and also to try to figure out what you gentlemen are going to do to that budget down here in the Congress.

Mr. ZWICK. Let me just add two comments, Senator Percy. One; it is a tight budget, no doubt about that. I think we can demonstrate that fact in a number of different ways.

Two; there is always the issue of how you set your priorities. I just would not want to let the record be left without indicating that we did increase significantly health expenditures by 12 percent, and that is clearly more than the budget on the average went up. Whether 12 percent is enough or too little or too much is a matter of legitimate concern and debate, but certainly health expenditures did go up in this budget.

Senator PERCY. Thank you.

Senator PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much, Mr. Chairman.

I would like to say to you, Mr. Secretary, that I think one of the problems of being a high appointive official is that you have first to convince your friends that you are competent to hold the job—and I can remember when President Kennedy first put you in the Cabinet, I thought he had run out of potential appointees rather quickly. [Laughter.]

At any rate, I would like to say to you today, that you convinced me.

Secretary BARR. Thank you.

Representative GRIFFITHS. I think you have done a marvelous job and I would like to say to you that I treasure as one of the really best statements ever made by a high appointive official your statement last year—before, I believe, a Senate committee—that if you gave $5 billion to Wilbur Cohen, it would take him quite a little while to spend it, but if you gave it to the Defense Department, in 2 weeks they wouldn't know where it has gone. I agree. [Laughter.]

Secretary BARR. That caused me a little trouble, Mrs. Griffiths. [Laughter.]

Representative GRIFFITHS. I liked it and I agree with it and I think it took great courage to say it, and I think you were right, absolutely right. And I notice that in this Economic Report there is a statement that total package procurement, a major procurement innovation of the 1960's, has extended competition and permitted more fixed-price contracts.

Well, it is an innovation and it does have a sort of fixed price. But I would like to show you—Senator Proxmire and I examined one of these yesterday afternoon—how this thing operates.

The contract extended for 6 years. That is 2 years beyond the term of a President. That is twice the tour of duty of a military officer in the Pentagon. That is approximately the tour of duty of a Senator. It is three times the tour of duty of a Congressman. There will be nobody with any responsibility for the prices in this contract. Not at all.

This is not the way to go. The way to go is to break these into component parts, into simpler items over which someone has some control and for which somebody has some responsibility.

This type of contract is for all practical purposes a retainer contract to the industry to which it is offered. We will never arrive at the goal toward which I think both you and I would like to strive. That is to reduce the prices paid in the Defense Department.

Now, they have proved through the years that they really aren't capable of buying even screws, nuts, and bolts. Time after time it has been proved that they have paid too much and each time it has, they have said, well, of course, that is the ony instance, the only instance.

Now, anybody that knows anything about purchasing knows that this isn't true. This contract could be repealed, this type of contract form should be repealed by this Congress if necessary. This contract is foolish.

I hope the next time you come back, Mr. Secretary, you are made Secretary of Defense and we cut down on the price they are paying for these items.

Thank you.

Secretary BARR. Mrs. Griffiths, I have the greatest respect in the world for you and I think that the Congress and the country took a great step forward when they put a woman on the tax-writing committee, but, for goodness' sake, Mrs. Griffiths, don't wish Secretary of Defense on me. [Laughter.]

I would even prefer to be Secretary of Agriculture first. [Laughter.]

Senator PROXMIRE. Senator Javits?

Senator JAVITS. There is one thing, Mr. Zwick, that I would like to ask you. I know you gentlemen have other engagements, so I will be very brief.

I must apologize for leaving you but we had Ambassador Lodge before us in the Foreign Relations Committee, and I am sure you will agree that this was a very urgent priority for all of us.

I gather you took some exception to my feeling that this administration had not realy set an order of priorities and pointed to the trend in the Federal budget outlays to demonstrate that fact.

Now, would you say that there was—that there was some deliberate decision on priorities, Mr. Zwick, and if so, what was it?

Mr. ZWICK. Yes. I think there clearly was a deliberate decision on priorities, and it is reflected in the two charts I discussed earlier, the 6-year budget chart which shows that we doubled our expenditures on major social programs—or increased them by 123 percent—when the overall budget went up 67 percent, which clearly reflects a set of priorities. That 6-year chart is very consistent with the chart which shows the changes between 1969 and 1970.

Now, I will say two other things very quickly. One, we can all have an opinion as to whether we have gone far enough, or too far; whether we have the right amount, the right mix. Obviously, this is a matter of great difficulty and of diverse opinion. The only point I was really trying to make is if you look at a special analysis which we have on "Aid to State and Local Governments," you will find that they have gone up 150 percent since 1964. They have a big $4.2 billion increase in fiscal 1970 over 1969.

And we have also shifted dramatically from 55 percent of those aids going to urban areas in 1964 to 67 percent in the 1970 budget.

Now, it turns out that that happens to be equal to the proportion of people living in urban areas. And in addition we have Urban Development Bank and other proposals to funnel funds into the urban area.

Now, I am not saying that therefore all the needs of urban areas have been met. Far from that, Senator Javits. I am not arguing that point. I just want the record to show that there has been a shift toward urban areas and a concern on the part of this administration for urban areas, no more than that.

Senator JAVITS. Of course, the big argument about what you say with respect to this administration has been that expenditures, for example, for farm price supports, highways, that is public works, have continued at a high level during the course of the war, while our urban problems and needs have not received a high enough priority and adequate funds. I would like to ask unanimous consent to include in the record at this point a recent editorial from the New York Times of yesterday, January 16, entitled, "Unbalanced Budget Priorities."

Senator PROXMIRE. Without objection, that will be printed in the record.

(Editorial mentioned follows:)

[From the New York Times, Jan. 16, 1969]

UNBALANCED BUDGET PRIORITIES

President Johnson's last budget is fiscally balanced, but woefully unbalanced in terms of social priorities. Government expenditures are likely to be matched by revenues in the coming fiscal year, a relationship highly desirable for an economy gripped by inflation. But too little money is allocated to the cities with their explosive human problems while too much is funneled into Federal programs that fulfill less urgent needs—programs with claims based on inertia, tradition and the political influence of narrow interest groups.

In one respect, however, the budget is outstanding. Thanks to the reforms initiated by President Johnson and formulated under the direction of David M. Kennedy, Mr. Nixon's Treasury Secretary-designate, the budget for the fiscal year 1970 is virtually free of the gimmickry that was used to overstate revenues and understate expenditures in former years. Within the limits inherent in any attempt to look eighteen months into the economic future, the budget represents the most objective and authentic projection in many years.

Mr. Johnson forecasts a $2.4-billion surplus for the current fiscal year and $3.4-billion surplus for the year ending June 30, 1970. These estimates are predicated on such uncertain factors as smaller outlays for farm price supports and the passage of revenue measures which Congress has in the past rejected. But the precise size of the surpluses or deficits is of secondary importance in a period when inflation inevitably distorts both the expenditure and receipt sides of the budgetary ledger. What is important is that the 1969 and 1970 budgets are likely to be roughly in balance, thus obviating further Treasury borrowing and a more inflationary monetary policy.

Under the current circumstances—which could be radically altered by success in negotiating an end of the war in Vietnam or by changing business conditions—a budgetary balance requires the extention of the 10 per cent income tax surcharge beyond its June 30 expiration date. Fortunately, both President Johnson and President-elect Nixon are in essential agreement on this issue.

Defense programs account for more than half of the total of $195.3 billion in expenditures budgeted for 1970. Because of the bombing halt and fewer heavy construction projects, outlays for the war in Vietnam are expected to decline by $3.5 billion. But over-all defense outlays will go up anyway. Included in the $5 billion of increases outside of Vietnam are more funds for the production and deployment of the Sentinel antiballistic missile system. That project is supposed to provide a defense against a possible Chinese attack, but its more certain and disquieting impact will be an escalation of the nuclear arms race with the Soviet Union. Funds which are freed by virtue of a cessation of hostilities in Vietnam should be transferred to urban renewal and antipoverty programs, not siphoned off for military hardware that will actually increase American insecurity by spurring a new competition in instruments of mass destruction.

The imbalance in the setting of national priorities is not limited to the defense budget. Two-thirds of all Americans live in urban areas, and in recent years urban areas accounted for more than 80 percent of the national population growth. Yet those facts of life find no rational reflection in the budget. The total outlays for "community development and housing"—a group of programs that encompasses urban renewal—are estimated at $2.3 billion in fiscal 1969 and less than $2.8 billion in 1970. In the same years the expenditures on "farm income stabilization"—the farm price-support programs that raise the cost of food and clothing to the poor—are estimated at $4.5 and $3.9 billion respectively. A visitor from outer space might read the budget and conclude that ours is still a rural society.

Among the other misallocations are the $219 million to be spent in the year ahead on the supersonic air transport and the nearly $9 billion for highways. Neither sum is justified when outlays for urban mass transportation are limited to $400 million.

It is commonplace to point to political obstacles whenever it is suggested that radical changes in budgetary priorities are required. But unless those barriers are surmounted, the social imbalance in the Federal budget will have even more disruptive consequences than would a lack of control on the fiscal side. The test for the incoming Nixon Administration will be to reorder the priorities and address itself at once to the ill-met needs of the cities.

Mr. ZWICK. May I just make one comment. On farm price supports, for example, I did a calculation last year on the 1967, 1968, and 1969 budgets. If you take the three last Eisenhower budgets, and the 1967, 1968, and 1969 budgets, you will find that the growth in those programs was much smaller than the tremendous growth in the social and urban programs.

I am still not saying that is necessarily the right mix. I am just saying there have been shifts and I thought that New York Times editorial missed that point. Obviously, they haven't had a chance to read the special analyses.

(The following was later submitted by the Budget Director:)

With the approval of the Joint Economic Committee, I would like to have inserted in the record the following letter, which I have sent to the Editor of the *New York Times* concerning the editorial of January 16 entitled "Unbalanced Budget Priorities."

BUREAU OF THE BUDGET,
OFFICE OF THE BUDGET DIRECTOR,
January 18, 1969.

THE EDITOR,
The New York Times,
New York, N.Y.

SIR: I was dismayed by the inaccuracies and lack of sophistication in your lead editorial of January 16, entitled "Unbalanced Budget Priorities."

My heart was warmed—as would any Budget Director's be—by your assessment that President Johnson's 1970 budget "represents the most objective and authentic projection in many years." And, of course, there are always understandable differences in judgment. But the readers of the *Times* have the right to expect the same accuracy on the editorial page as they have become accustomed to on the news pages. Most of the judgments in this editorial are based on careless disregard for readily available facts in articles that appear elsewhere in the very same edition of the *Times.*

The editorial focused on the amount of resources which the Federal Government is channeling to urban areas. The President's Budget Message contains an entire section labeled "Aids to Urban Areas," reprinted in the same edition of the *Times* on page 20. However, the editorial writer appears to have read only the first paragraph.

After reporting correctly that the number of people living in metropolitan areas is almost two-thirds of our population and that more than 80% of our population growth between 1960 and 1966 did occur in such areas, the quality of reporting deteriorates. Outlays for the functional grouping "community development and housing," as used in the editorial, clearly fall short of all Government outlays to aid urban areas. Federal aid to State and local governments—the direct flow of resources between governments—has channeled a rising share of funds to meet the needs of the city. Quoting from the President's Message, as reported on page 20 of the *Times*: "In 1964 we spent an estimated $5.6 billion, or 55% of total Federal grants in such areas. The 1970 budget provides $16.7 billion for aid in metropolitan areas, about 67% of total Federal grants." This represents almost a tripling in only six years, with the *increase* alone greater than the total aid to urban areas in 1964. Let me repeat that this is only the most easily measured flow of "aid," and does not count direct Federal spending or payments to individuals.

The implications of the editorial are doubly unfortunate in a year in which the budget will provide for a start on more than 500,000 housing units for families with low incomes—more than triple the number started last year. Beyond that, the budget includes President Johnson's proposal of an Urban Development Bank, to channel more private and other governmental resources into badly needed community facilities. Even in a very tight budget, Model Cities grants increase more than $475 million, and urban renewal outlays rise by over $175 million. Advance appropriations sought for each of these programs in 1971 will be $1.25 billion. These facts and others are stated quite clearly in the Budget Message.

This is not to argue that we should be sanguine about our efforts to meet the urgent needs of our cities. As President Johnson said in his State of the Union Message, a great deal of what we have committed needs additional funding. The question is one of what *can* be done. Viewed in this light, I believe the 1970 budget is both attainable and a further step in the direction President Johnson has set in the six budgets he has submitted to Congress. A basic emphasis in all of these budgets has been on social—especially urban—problems.

CHARLES J. ZWICK, *Director*.

Senator JAVITS. Well, I shall read it and we will have other witnesses before us. I am rather hopeful, Mr. Chairman, when we get the Economic Report of this administration with Dr. McCracken as the Chairman, that you gentlemen will be available to testify because I think that the country can profit enormously, Mr. Chairman. These gentlemen will appear in their own private capacity at that point. I hope very much that they will agree to do that because I think it would be extremely important to the Nation to have the addition of debate if any debate is occasioned, or if it is not, so much the better, to have the fortification of support so that we may know what the former chief fiscal officers of the Government believe about the same set of figures and the same set of facts upon which the new fellows will be commenting.

Senator PROXMIRE. Senator Javits, I think that is an excellent suggestion. I certainly favor it and support it and, of course, it will be up to Chairman Patman, but I will support you on that enthusiastically.

Senator JAVITS. I really think you could help the country enormously if you could allow us to have that leave.

I have just one other point about the Urban Development Bank. I have made myself the proposal, and I have the legislation, for a "Domestic Development Bank." Can any of you tell us, perhaps you Mr. Zwick, as you mentioned it, whether there is any fundamental conceptual difference between the administration's proposal and my own. The name is immaterial. I just wondered whether he had something else in mind.

Mr. ZWICK. I am not completely familiar with your proposal except in general terms. I think they are quite consistent, but——

Senator JAVITS. Quite consistent.

Mr. ZWICK (continuing). But I would have to sit down and examine it item by item.

Senator JAVITS. The reason I asked that, because it happens to be critically important, not because I have proposed it but because President Nixon has endorsed it. [Laughter.]

Secretary BARR. Senator Javits, is this the plan in which you were joined by Senator Goodell and Mr. Widnall and others?

Senator JAVITS. That incorporates it. That is the Community Self-Determination Act and incorporates the Domestic Development Bank.

Secretary BARR. I have been intimately involved with the development of the Urban Development Bank. There is a great deal of similarity. I don't think ours is as far-reaching as yours but perhaps you can look with interest at it. The Urban Development Bank has been the product of a huge amount of staff work. We worked on this for 2 years. It may well be possible to make improvements, but there already is a lot of work involved.

Senator JAVITS. Where is the detail?

Secretary BARR. I will sign the letter covering the legislation this day.

Mr. ZWICK. We will have a bill up.

Secretary BARR. There is a legislative proposal, a bill drafted.

Senator JAVITS. I am very grateful to you, Mr. Chairman, and gentlemen. I am sorry to have been so late and I apologize.

Senator PROXMIRE. Mr. Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Chairman, Secretary Barr has said that is finishing a decade of public service for which I can testify because 10 years ago Joe Barr and I were first elected to Congress and started to serve sitting side by side on the Banking and Currency Committee, and it might interest you to know that freshman Congressman Barr suggested to me that we travel around the country at our own expense visiting the Federal Reserve banks and meet and talk with bankers so that we could better understand our duties on the Banking and Currency Committee.

Coincience would have it that one stop was at the Continental Illinois Bank in Chicago were we met with Mr. David Kennedy, who of course will be the successor to Secretary Barr. No one succeeds like a defeated Congressman.

In this last testimony that you made before the committee, Mr. Secretary, I commend you. I appreciate especially your candor on the tax reform issue. Your bank may have lost some oil company depositors. [Laughter.] I am also interested that you have come out very strongly in favor of a more multilateral foreign aid program.

I remember that in our freshman year in Congress we worked together on the International Development Association. I think you would like to know that Mr. William Gaud made some very cogent and eloquent remarks—I suppose you would call him a bilateral AID man in favor of IDA and multilateral aid before a subcommittee of this committee.

I know that you have been, and I think very wisely, a strong advocate of the surtax. I might say, like Congressman Bolling. I also had a tax increase bill introduced in 1966, which was an election year, and I want to just throw one idea out to you as Secretary and as a former Member of Congress.

What do you think of a proposal that would—unlike Congressman Bolling's proposal which would permit the President to raise or lower taxes—permit the President to raise but not to lower tax rates—subject to a congressional veto—because I believe we have learned the theory and the political popularity of cutting taxes? I think if a President would want us to cut taxes, I think that the procedures of the Congress are such that we could move quickly. [Laughter.]

Secretary BARR. That has been amply demonstrated. The record supports your statements, Mr. Moorhead, and I have stated publicly that when we first went forward with Walter Heller's variable tax proposal—I think it was 1962 or 1963—we made one mistake. We should have followed the line that you did. In other words—what you are suggesting, Mr. Moorhead—to give the President the authority to raise taxes. He can take the heat if he has to, and when economic conditions dictate that he must. Rest assured that the Congress will cooperate completely and promptly when the suggestion to reduce taxes is laid before them.

I think it is a very practical political solution.

Representative MOORHEAD. Also, I think it is a dangerous congressional delegation of political power to provide the President with discretionery power to cut taxes.

A President could use this power judiciously before reelection time and almost assure his reelection.

Secretary BARR. Mr. Moorhead, I am sure no Presidents are going to be unscrupulous or vicious, but I have heard the argument made, you know, in a little different context, that he gets the delicious pleasure of reducing them while others get the onerous chore of increasing them.

You are quite correct. It is a good idea.

Representative MOORHEAD. As I see it, we are not eroding the congressional prerogative in the tax field with this plan.

Secretary BARR. No. I support your position on the bill. I think it is an excellent idea and it is practical.

Representative MOORHEAD. Mr. Zwick, I was also puzzled by the New York Times editorial that is now a part of the record at Senator Javits' request, and I was particularly puzzled by the figure of $9 billion for highways for fiscal 1970. Is that a correct figure?

Mr. ZWICK. No, sir. The regular highway trust fund program in fiscal 1970 is set at about the same level as in fiscal 1969—$4.8 billion of obligations. As of now, spending is going to go up because of the way we held down spending in fiscal 1969, but the obligation level—and that is really the best index of program level for the highway program—has been held constant, year to year, for the regular Interstate A–B–C program.

Now, in addition, we have added some new programs to the trust fund. We have taken the existing safety program and highway beauty program and put them into the trust fund. There are also new programs, such as TOPICS which go up. But if you take out the new programs and look at the Interstate and A–B–C program, which is the basic highway program, we held in the 1970 budget about the same program level as we did for 1969, and I am sure we are going to hear some concern that it didn't go up enough. I don't know where the $9 billion came from. It is not $9 billion in any case. The basic program level will be $4.8 billion.

Senator PROXMIRE. Maybe they are referring to public works as including the highways which would be close to $9 billion.

Mr. ZWICK. Could be, but certainly not the highway program.

Representative MOORHEAD. Mr. Zwick, concerning the highway program it seems to me unfortunate that we always refer to it as the highway program. What we should be thinking about, it seems to me, is the problem of moving people and goods, particularly into and out of cities. Would it not be more economical for this effort to earmark certain public funds in a mass rapid transit system?

Mr. ZWICK. Well, I can't answer that categorically. You have to look at the volume of traffic, the geographic situation, and everything. But I agree with your basic principle, that we ought to be looking at transportation functions, urban transportation functions, cross-modes, intercity transportation functions.

Of course, that was the whole drive that created the Department of Transportation and moved urban mass transit out of HUD into the Department of Transportation.

Representative MOORHEAD. Have there been any studies showing the net benefit to the motorist of a reduction in traffic jams, resulting from the development of a mass rapid transit system, which would hopefully handle the bulk of commuter traffic—a system possibly funded with a portion of highway trust money?

Mr. ZWICK. Yes. That argument, of course, has been made for a number of years. We haven't been quite that bold in this proposal. Our proposal does have a number of innovations. It does include the so-called TOPICS program which is a traffic control system to use the highway fund not only for building additional highways, but to do work on traffic control, to get greater utilization out of existing rights-of-way.

We use our existing rights-of-way quite inefficiently. We use them as parking lots in the first place, curbside parking.

We don't get anywhere near the flow down these streets that we could if we had a better traffic control system. So we have initiated a new program in this area. We sent up a bill last year, I believe, to include some parking as part of the highway fund.

So I think there is a movement to broaden the definition of what the moneys in the highway trust fund can be used for.

Now, when you go as far as using them for non-highway uses, you will create quite a storm, but I suspect over the next several years as the Interstate System comes to an end—the original Interstate System is going to be completed and these revenues continue to come into the highway trust fund—there is going to be a very significant and very important public policy decision as to whether we eliminate these taxes, whether we transfer them back to general revenue, or whether we change the concept of the highway trust fund. I think it is one of the most important policy decisions that you are going to be facing over the next several years.

Secretary BARR. May I add to that briefly, Mr. Moorhead. You are going to be here. We are not. But as Mr. Zwick correctly pointed out, these huge revenues are pouring in and, for heaven's sake, I hope you gentlemen and Mrs. Griffiths will not let them pave the whole country.

Representative MOORHEAD. Amen to that, Mr. Secretary.

Mr. Okun, although we have the first surplus in our balance of payments since 1957, I am very much disturbed that it is such a tenuous surplus because of the unnaturally high inflow of capital and the deterioration of the balance of trade.

To what extent can we look for an improved picture in the merchandise trade balance during 1969?

Mr. OKUN. I think we do see a prospect for a significant improvement providing the program to keep the growth of the economy moderate is implemented and is successful. The story last year was the 22-percent surge in our imports of good and services. That certainly reflected the fact that an overheated economy which couldn't meet all the demands that were being placed on it shunted some of those demands to foreign goods. Our exports had a healthy growth, 9 or 10 percent.

What we would see for this year is a continuation of that growth of exports with a very modest growth of imports and that should begin to widen our trade surplus.

But it is going to be a long uphill course to get back to the kind of healthy trade surpluses we had in 1964 and 1965 which did provide a very firm foundation for our balance of payments. There is no question that the United States has to have a significant trade surplus to maintain the fundamental strength of the dollar in the years ahead.

Representative MOORHEAD. Thank you, sir. My time has expired, Mr. Chairman.

Senator PROXMIRE. I know the hour is late. I know you have another engagement. I am going to be as brief as I can.

I do wish to get into the balance of payments. I think it has been in the worst shape it ever has been, at least in the years I have been here, especially because of the merchandise balance and the balance on goods and services, which we were told about by Mr. Deming yesterday is minus 1.8 billion.

We have this extraordinary inflow of capital at $7 billion capital account which is favorable, but that is so tentative and so temporary.

Let me get back to Mr. Zwick with two questions.

No. 1, Mr. Zwick, this follows up the questioning I had before: Why does the Bureau continue to approve budget requests for programs where exorbitant cost overruns are repeated year after year such as the C-5A cargo plane, the F-111, F-4, Minuteman, and almost every other major program?

We had testimony from Mr. Charles that on the average during the 6-year life or so of the big weapon procurement programs they escalate 200 to 400 percent, and we have talked to analysts at the working level in the Bureau of the Budget who were very disturbed about this and very concerned. Why doesn't the Bureau of the Budget ever say no, or are you in a position to say no?

Mr. ZWICK. Of course, the issue is modernization in the Military Establishment versus efficiency in procurement, and that is always a difficult tradeoff. If we would procure standard items, stop modernization, clearly we could improve efficiency.

Senator PROXMIRE. What I am getting at, if you could only get into this operation which I think is something which has been neglected, we haven't had a report on it, certainly it has been neglected by those of us in the Congress. We haven't investigated it the way we should have, and it is the biggest expenditure we have, and there just seems to be no justification for these big increases.

They can't justify them on the grounds of inflation. The inflation is a very, very small proportion of this.

Mr. ZWICK. I think it is design change, overly optimistic expectations about technological advances, and so forth, that leads into them.

Senator PROXMIRE. If you gentlemen could get into it, I think it would be so helpful for us in Congress in making up our minds in these areas. We have votes on the floors of the House and Senate on these programs and if we can get some notion of whether or not we should agree with—I am on the Senate Appropriations Committee, too, where we have votes on this.

Mr. ZWICK. Let me assure you I am not sanguine with the current situation. It is a very difficult area. It is an area where you are pressing the technology. People are making assumptions that if you invest x dollars you will be able to push the state of the art to y. And therefore it will cost that much.

Senator PROXMIRE. Have you gentlemen ever said no on any of this? You have said no on some of the other projects, civilian programs. Do you feel you are in a position to recommend to the President that we not go ahead?

Mr. ZWICK. Yes. I participate in these decisions.

Senator PROXMIRE. Have you done that?

Mr. ZWICK. Yes, sir.

Senator PROXMIRE. You have said no.

Mr. ZWICK. Yes. I sometimes win, and usually [laughter] we don't know quite how we come out on those, but I have as much to say about these issues as I do any other.

Senator PROXMIRE. Let me finally ask you about the Trinity River project.

The Trinity River project, as you know, is a project that would provide for, as I understand it, developing a waterway between Fort Worth and the Gulf of Mexico.

Mr. ZWICK. That is right.

Senator PROXMIRE. Dredge a channel. And there are those critics who say, and I think with considerable conviction and reason, that it would be cheaper to move Fort Worth to the gulf. On that, I am not saying that this proposal which is going to cost three-quarters of a billion dollars before it is through and which has a very small—$150,000—advance engineering project, is in the budget because Texas has extraordinary influence in this administration. But certainly it is something to think about.

Here is a project which has a benefit-to-cost ratio of 1.5 on the 3¼-percent discount basis. It has a benefit-to-cost ratio of 1.09 on the 4⅝, which is now, as I understand it the discount basis that is being used.

Now, if we recognize, as we should, it seems to me, and I know it is very difficult because of the way Congress in working on this, if we recognize that the only reason it has a positive benefit-to-cost ratio at all is because we show in here the savings which shippers experience in using the waterway rather than the appropriate concept of savings in the national resources, if we showed it on a national resources basis, it would have a negative benefit-to-cost ratio and heaven knows if we used the discount ratio recommended to us by Otto Eckstein and the other experts, a discount ratio of around 7 or 10 percent in this very, very risky project, it would show a negative benefit-to-cost ratio.

How can you at a time when we have a so-called tight budget go ahead with a project which is going to cost such an enormous amount on such a flimsy—has such flimsy support on the merits?

Mr. ZWICK. Mr. Proxmire, as I am sure you are aware, this is a project that has been under study for years. It was authorized several years ago—I am not sure whether it was 3 or 5 years by the Congress, subject to restudy. It was restudied. The Corps of Engineers, given the same ground rules they are using for other projects, reported a 1.5 benefit-to-cost ratio. You are now questioning whether that is an appropriate evaluation procedure for all projects.

Senator PROXMIRE. You come up with a new—as I understand it, the executive branch has agreed to the 4⅝.

Mr. ZWICK. That is right, for projects that are being evaluated from here on out, but the ground rule was that for any projects which up to this date were approved and authorized by Congress, we would use the old procedure. So we are using a consistent procedure.

Senator PROXMIRE. This is in the 1970 budget. We haven't approved the initial expenditure. Once we do, it is likely to be done forever, as you know, so this is coming up now.

Mr. ZWICK. There is money in the 1970 budget for initial planning and design work, that is correct.

Senator PROXMIRE. Why shouldn't we do it on the 4⅝ percent now in view of the fact it is not even going to be planned until 1970?

Mr. ZWICK. You would change the procedure. What you are saying, if I understand you correctly, is that you would change the procedure that the executive branch is recommending for all projects. There is no special treatment for this project. You are saying we ought to go back and re-do all the ones we have.

Senator PROXMIRE. For 1970.

Mr. ZWICK. That is up to Congress if you want to do it. We thought it would be most appropriate to have a consistent policy across projects, and so we arbitrarily said that projects approved before a certain date would use the old formula and new projects would be evaluated with the new formula.

Secretary BARR. Mr. Chairman, we will be delighted to come back this afternoon, but we do have our last Cabinet meeting.

Senator PROXMIRE. I understand. It won't be necessary for you to come back. I appreciate it. All you gentlemen have done a marvelous job. I know Mr. Barr has been praised by all, but certainly Mr. Okun and Mr. Zwick have done superb work. We are very grateful to you. You have been very helpful and persuasive.

Secretary BARR. That is the way we feel precisely about you and your committee, sir.

Senator PROXMIRE. Thank you very much. We will include as an appendix to this day's hearing a Treasury Department document called "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy."

(Whereupon, at 12:20 p.m., the Joint Economic Committee adjourned, subject to call of the chair.)

MAINTAINING THE STRENGTH

of

THE UNITED STATES DOLLAR

in

A STRONG FREE WORLD ECONOMY

A 1968 PROGRESS REPORT

THE DEPARTMENT OF THE TREASURY

December 1968

FOREWORD

In January, I released for public information the U.S. Treasury Department report entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy."

That report gave the history of the United States balance of payments position and described various programs that had been undertaken to resolve our balance of payments problem. The paper also described in detail the Action Program that President Johnson announced in his Message to the Nation on the Balance of Payments on January 1, 1968.

As the President said in his message, our efforts to bring our balance of payments into equilibrium and keep them there are "a national and international responsibility of the highest priority." This is certainly just as true now as it was in January. We have progressed greatly in implementing many of the steps called for by the Action Program. Unfortunately, some recommendations were not implemented as quickly as we would have liked and certain ones not at all.

The results for the first three quarters of 1968 are a source of encouragement. We have made steady progress during the year in bringing our balance of payments closer to equilibrium. Nevertheless, there is still a great deal to be done. We will have to continue the policies and programs detailed in the Presidential message of January 1, 1968, if we are to bring our balance of payments into durable equilibrium.

As Secretary of the Treasury and Chairman of the Cabinet Committee on Balance of Payments, I am releasing this Treasury Department report entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy—A 1968 Progress Report." This supplemental paper describes the progress we have made so far in 1968 and points out the actions still required.

Henry H. Fowler

HENRY H. FOWLER,
Secretary of the Treasury.

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BALANCE OF PAYMENTS

Statement by the President Outlining a Program of Action, January 1, 1968

WHERE WE STAND TODAY

I want to discuss with the American people a subject of vital concern to the economic health and well-being of this nation and the free world.

It is our international balance of payments position.

The strength of our dollar depends on the strength of that position.

The soundness of the free world monetary system, which rests largely on the dollar, also depends on the strength of that position.

To the average citizen, the balance of payments, and the strength of the dollar and of the international monetary system, are meaningless phrases. They seem to have little relevance to our daily lives. Yet their consequences touch us all—consumer and captain of industry, worker, farmer, and financier.

More than ever before, the economy of each nation is today deeply interwined with that of every other. A vast network of world trade and financial transactions ties us all together. The prosperity of every economy rests on that of every other.

More than ever before, this is one world—in economic affairs as in every other way.

Your job, the prosperity of your farm or business, depends directly or indirectly on what happens in Europe, Asia, Latin America, or Africa.

The health of the international economic system rests on a sound international money in the same way as the health of our domestic economy rests on a sound domestic money. Today, our domestic money—the U.S. dollar—is also the money most used in international transactions. That money can be sound at home—as it surely is—yet can be in trouble abroad—as it now threatens to become.

In the final analysis its strength abroad depends on our earning abroad about as many dollars as we send abroad.

U.S. dollars flow from these shores for many reasons—to pay for imports and travel, to finance loans and investments, and to maintain our lines of defense around the world.

VIII

When that outflow is greater than our earnings and credits from foreign nations, a deficit results in our international accounts.

For 17 of the last 18 years we have had such deficits. For a time those deficits were needed to help the world recover from the ravages of World War II. They could be tolerated by the United States and welcomed by the rest of the world. They distributed more equitably the world's monetary gold reserves and supplemented them with dollars.

Once recovery was assured, however, large deficits were no longer needed and indeed began to threaten the strength of the dollar. Since 1961 your Government has worked to reduce that deficit.

By the middle of the decade, we could see signs of success. Our annual deficit had been reduced two-thirds—from $3.9 billion in 1960 to $1.3 billion in 1965.

In 1966, because of our increased responsibility to arm and supply our men in Southeast Asia, progress was interrupted, with the deficit remaining at the same level as 1965—about $1.3 billion.

In 1967, progress was reversed for a number of reasons:

—Our costs for Vietnam increased further.

—Private loans and investments abroad increased.

—Our trade surplus, although larger than 1966, did not rise as much as we had expected.

—Americans spent more on travel abroad.

Added to these factors was the uncertainty and unrest surrounding the devaluation of the British pound. This event strained the international monetary system. It sharply increased our balance of payments deficit and our gold sales in the last quarter of 1967.

THE PROBLEM

Preliminary reports indicated that these conditions may result in a 1967 balance of payments deficit in the area of $3.5 to $4 billion—the highest since 1960. Although some factors affecting our deficit will be more favorable in 1968, my advisors and I are convinced that we must act to bring about a decisive improvement.

We cannot tolerate a deficit that could threaten the stability of the international monetary system—of which the U.S. dollar is the bulwark.

We cannot tolerate a deficit that could endanger the strength of the entire free world economy, and thereby threaten our unprecedented prosperity at home.

A TIME FOR ACTION

The time has now come for decisive action designed to bring our balance of payments to—or close to—equilibrium in the year ahead.

IX

The need for action is a national and international responsibility of the highest priority.

I am proposing a program which will meet this critical need, and at the same time satisfy four essential conditions:

—Sustain the growth, strength, and prosperity of our own economy.

—Allow us to continue to meet our international responsibilities in defense of freedom, in promoting world trade, and in encouraging economic growth in the developing countries.

—Engage the cooperation of other free nations, whose stake in a sound international monetary system is no less compelling than our own.

—Recognize the special obligation of those nations with balance of payments surpluses to bring their payments into equilibrium.

THE FIRST ORDER OF BUSINESS

The first line of defense of the dollar is the strength of the American economy.

No business before the returning Congress will be more urgent than this: To enact the anti-inflation tax which I have sought for almost a year. Coupled with our expenditure controls and appropriate monetary policy, this will help to stem the inflationary pressures which now threaten our economic prosperity and our trade surplus.

No challenge before business and labor is more urgent than this: To exercise the utmost responsibility in their wage-price decisions, which affect so directly our competitive position at home and in world markets.

I have directed the Secretaries of Commerce and Labor, and the Chairman of the Council of Economic Advisers to work with leaders of business and labor to make more effective our voluntary program of wage-price restraint.

I have also instructed the Secretaries of Commerce and Labor to work with unions and companies to prevent our exports from being reduced or our imports increased by crippling work stoppages in the year ahead.

A sure way to instill confidence in our dollar—both here and abroad—is through these actions.

THE NEW PROGRAM

But we must go beyond this, and take additional action to deal with the balance of payments deficit.

Some of the elements in the program I propose will have a temporary but immediate effect. Others will be of longer range.

All are necessary to assure confidence in the American dollar.

X

TEMPORARY MEASURES

1. Direct Investment

Over the past three years, American business has cooperated with the government in a voluntary program to moderate the flow of U.S. dollars into foreign investments. Business leaders who have participated so wholeheartedly deserve the appreciation of their country.

But the savings now required in foreign investment outlays are clearly beyond the reach of any voluntary program. This is the unanimous view of all my economic and financial advisers and the Chairman of the Federal Reserve Board.

To reduce our balance of payments deficit by at least $1 billion in 1968 from the estimated 1967 level, I am invoking my authority under the Banking Laws to establish a mandatory program that will restrain direct investment abroad.

This program will be effective immediately. It will insure success and guarantee fairness among American business firms with overseas investments.

The program will be administered by the Department of Commerce, and will operate as follows:

—As in the voluntary program, overall and individual company targets will be set. Authorizations to exceed these targets will be issued only in exceptional circumstances.

—New direct investment outflows to countries in continental Western Europe and other developed nations not heavily dependent on our capital will be stopped in 1968. Problems arising from work already in process or commitments under binding contracts will receive special consideration.

—New net investments in other developed countries will be limited to 65% of the 1965–66 average.

New net investments in the developing countries will be limited to 110% of the 1965–66 average.

This program also requires businesses to continue to bring back foreign earnings to the United States in line with their own 1964–66 practices.

In addition, I have directed the Secretary of the Treasury to explore with the Chairmen of the House Ways and Means Committee and Senate Finance Committee legislative proposals to induce or encourage the repatriation of accumulated earnings by U.S.-owned foreign businesses.

2. Lending by Financial Institutions

To reduce the balance of payments deficit by at least another $500 million, I have requested and authorized the Federal Reserve Board *to tighten its program restraining foreign lending by banks and other financial institutions.*

Chairman Martin has assured me that this reduction can be achieved:

—Without harming the financing of our exports;

—Primarily out of credits to developed countries without jeopardizing the availability of funds to the rest of the world.

Chairman Martin believes that this objective can be met through continued cooperation by the financial community. At the request of the Chairman, however, I have given the Federal Reserve Board standby authority to invoke mandatory controls, should such controls become desirable or necessary.

3. Travel Abroad

Our travel deficit this year will exceed $2 billion. To reduce this deficit by $500 million:

—*I am asking the American people to defer for the next two years all nonessential travel outside the Western Hemisphere.*

—*I am asking the Secretary of the Treasury to explore with the appropriate congressional committees legislation to help achieve this objective.*

4. Government Expenditures Overseas

We cannot forego our essential commitments abroad, on which America's security and survival depend.

Nevertheless, we must take every step to reduce their impact on our balance of payments without endangering our security.

Recently, we have reached important agreements with some of our NATO partners to lessen the balance of payments cost of deploying American forces on the Continent—troops necessarily stationed there for the common defense of all.

Over the past three years, a stringent program has saved billions of dollars in foreign exchange.

I am convinced that much more can be done. *I believe we should set as our target avoiding a drain of another $500 million on our balance of payments.*

To this end, I am taking three steps.

First, I have directed the Secretary of State to initiate prompt negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Europe. Our allies can help in a number of ways, including:

—The purchase in the U.S. of more of their defense needs.

—Investments in long-term United States securities.

I have also directed the Secretaries of State, Treasury and Defense to find similar ways of dealing with this problem in other parts of the world.

Second, I have instructed the Director of the Budget to find ways of reducing the number of American civilians working overseas.

Third, I have instructed the Secretary of Defense to find ways to reduce further the foreign exchange impact of personal spending by U.S. forces and their dependents in Europe.

LONG-TERM MEASURES

5. Export Increases

American exports provide an important source of earnings for our businessmen and jobs for our workers.

They are the cornerstone of our balance of payments position.

Last year we sold abroad $30 billion worth of American goods.

What we now need is a long-range systematic program to stimulate the flow of the products of our factories and farms into overseas markets.

We must begin now.

Some of the steps require legislation:

I shall ask the Congress to support an intensified five year, $200 million Commerce Department program to promote the sale of American goods overseas.

I shall also ask the Congress to earmark $500 million of the Export-Import Bank authorization to:

—Provide better export insurance.

—Expand guarantees for export financing.

—Broaden the scope of Government financing of our exports.

Other measures require no legislation.

I have today directed the Secretary of Commerce to begin a Joint Export Association program. Through these Associations, we will provide direct financial support to American corporations joining together to sell abroad.

And finally, the Export-Import Bank—through a more liberal rediscount system—will encourage banks across the Nation to help firms increase their exports.

6. Nontariff Barriers

In the Kennedy Round, we climaxed three decades of intensive effort to achieve the greatest reduction in tariff barriers in all the history of trade negotiations. Trade liberalization remains the basic policy of the United States.

We must now look beyond the great success of the Kennedy Round to the problems of nontariff barriers that pose a continued threat to the growth of world trade and to our competitive position.

American commerce is at a disadvantage because of the tax systems of some of our trading partners. Some nations give across-the-board tax rebates on exports which leave their ports and impose special border tax charges on our goods entering their country.

International rules govern these special taxes under the General Agreement on Tariffs and Trade. These rules must be adjusted to expand international trade further.

In keeping with the principles of cooperation and consultation on common problems, I have initiated discussions at a high level with our friends abroad on these critical matters—particularly those nations with balance of payments surpluses.

These discussions will examine proposals for prompt cooperative action among all parties to minimize the disadvantages to our trade which arise from differences among national tax systems.

We are also preparing legislative measures in this area whose scope and nature will depend upon the outcome of these consultations.

Through these means we are determined to achieve a substantial improvement in our trade surplus over the coming years. In the year immediately ahead, we expect to realize an improvement of $500 million.

7. Foreign Investment and Travel in the United States

We can encourage the flow of foreign funds to our shores in two other ways:

—*First, by an intensified program to attract greater foreign investment in U.S. corporate securities, carrying out the principles of the Foreign Investors Tax Act of 1966.*

—*Second, by a program to attract more visitors to this land. A Special Task Force headed by Robert McKinney of Santa Fe, N. Mex., is already at work on measures to accomplish this. I have directed the task force to report within 45 days on the immediate measures that can be taken, and to make its long-term recommendations within 90 days.*

MEETING THE WORLD'S RESERVE NEEDS

Our movement toward balance will curb the flow of dollars into international reserves. It will therefore be vital to speed up plans for the creation of new reserves—the Special Drawing Rights—in the International Monetary Fund. These new reserves will be a welcome companion to gold and dollars, and will strengthen the gold exchange standard. The dollar will remain convertible into gold at $35 an ounce, and our full gold stock will back that commitment.

A TIME FOR RESPONSIBILITY

The program I have outlined is a program of action.

It is a program which will preserve confidence in the dollar, both at home and abroad.

The U.S. dollar has wrought the greatest economic miracles of modern times.

It stimulated the resurgence of a war-ruined Europe.

It has helped to bring new strength and life to the developing world.

It has underwritten unprecedented prosperity for the American people, who are now in the 83d month of sustained economic growth.

A strong dollar protects and preserves the prosperity of businessman and banker, worker and farmer—here and overseas.

The action program I have outlined in this message will keep the dollar strong. It will fulfill our responsibilities to the American people and to the free world.

I appeal to all of our citizens to join me in this very necessary and laudable effort to preserve our country's financial strength.

Exchange of Letters Between President Johnson and Secretary Fowler Announcing the 1969 Balance of Payments Program

THE WHITE HOUSE,
December 18, 1968.

DEAR MR. SECRETARY:

I have reviewed and approved the report of the Cabinet Committee on Balance of Payments setting forth recommendations for 1969.

Our balance of payments program consists of a series of ongoing policies in a number of related areas. It must at all times be coordinated and pulled together. We have made our recommendation for 1969 at this time to facilitate an effective transition to the new Administration and the orderly development of future policies in this important area.

We have made a great deal of progress in 1968 toward our goal of a healthy equilibrium in our balance of payments. More progress must be achieved to assure the continued strength of the United States dollar. The stability of the international monetary system, and the great amount of world trade which it supports, depends upon that strength.

I would like to thank you and the other members of the Cabinet Committee on Balance of Payments for your determined efforts to propose and to do whatever is necessary to keep the dollar strong.

Sincerely,

(Signed) LYNDON B. JOHNSON.

The Honorable,
HENRY H. FOWLER,
Secretary of the Treasury

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THE SECRETARY OF THE TREASURY,
Washington, D.C., December 17, 1968.

DEAR MR. PRESIDENT:

Near the end of each year beginning in 1965, your Cabinet Committee on Balance of Payments has submitted a recommended Program to guide and coordinate the many Federal activities relevant to our international balance of payments. This letter report will set forth the recommendations of the Cabinet Committee on Balance of Payments for the 1969 Program. Your approval of this Program should facilitate an effective transition and orderly development of future policies in this important area.

With my colleagues on the Cabinet Committee and the aid of your staff, we have coordinated the execution of the Action Program contained in your Balance of Payments Message to the nation last New Year's Day. A 1968 Progress Report will be separately submitted.

We have also considered together the nature and extent of the program needed for 1969 if the nation is to build on the progress made in 1968 and achieve a viable and durable equilibrium in our international balance of payments. It is submitted below.

The Cabinet Committee on Balance of Payments has worked with me in preparing the 1969 Program. The following participants join with me in these recommendations:

The Secretary of Defense
The Secretary of Commerce
The Secretary of Transportation
The Under Secretary of Agriculture
The Under Secretary of State for Political Affairs
The Administrator of the Agency for International Development
The Special Representative for Trade Negotiations
The Director of the Bureau of the Budget
The Chairman of the Council of Economic Advisers
The Chairman of the Federal Reserve System.

A few preliminary comments are in order concerning the overall policy framework in which these recommendations are submitted.

Our determination to achieve equilibrium in our international accounts is as vital today as it was on January 1, 1968, the day you announced your Balance of Payments Action Program. The removal of our international payments deficit remains "a national and international responsibility of the highest priority".

The execution to date of the broad and comprehensive Action Program you announced on last New Year's Day has substantially improved our balance of payments situation. A huge deficit in 1967 has been whittled down to near equilibrium in the second and third quarters of this year on the liquidity basis of measure. There is a substantial surplus for the first three quarters on the official settlements basis.

We are pleased that the nation is making substantial progress toward achieving equilibrium in our international balance of payments. But we cannot be satisfied with the relative composition of its components. Our progress is spotty and some of it may be transitory. It is spotty because two big elements in our current account—trade and tourism—are far from satisfactory, and a third—a reduction in net deficit in Government military expenditures in Southeast Asia—must in large measure await the restoration of peace in the area.

There is reasonable prospect of continuing improvement next year. This assumes that there is no dismantling of the ongoing elements of your Action Program. It also assumes that the initiatives launched in that program to improve our trade surplus and reduce the net deficits in military expenditures abroad and private travel will be vigorously pursued. Until these elements of the program are effectively executed, we will not have the durable surplus or the assurance of a long-term equilibrium that will enable us to abandon some of the temporary and less desirable measures we have been forced to employ.

These temporary measures have served us well. They helped bring the necessary immediate improvement in our balance of payments and have given renewed confidence in the strength of the United States dollar. These temporary measures, appropriately modified, are needed for some additional period. As the longer-term measures, instituted last year and in some of the preceding years, yield increasingly larger benefits, the restraint achieved by the temporary measures may be phased out.

To complete our task, a continued and sustained effort will be needed. This is the quickest and surest route to the strong and viable payments position which will permit us to eliminate those aspects of our program that are not wholly compatible with the free flow of trade and capital movements.

These are the underlying principles which your Cabinet Committee on Balance of Payments believes should govern the program in 1969.

1. A Stable Economy and the Restoration of a Healthy United States Trade Surplus Should be the Primary Objective for 1969.

The keystone of a sound international financial position of the United States and of the dollar is a trade surplus. Without it, the United States cannot do what is natural and desirable for its role in the Free World—to export capital, to provide its share of the common defense, to give foreign aid, and to have large numbers of its citizens traveling abroad.

Hence, the first order of business in your last New Year's Day Message was for Congress to enact an anti-inflation tax, which, coupled with expenditure restraint and appropriate monetary policy, could help stem the inflationary pressures which threatened our economic prosperity, stability and our trade surplus. You also urged labor and management restraints in wage-price decisions and instructed your principal officers in the economic area to work with leaders in business and labor to make effective a voluntary program of wage-price restraint. A similar instruction on preventing our exports from being reduced and our imports increased by crippling work stoppages was prescribed.

Unfortunately, delays in attending to this first order of business in 1968 contributed to a continued instability in the economy and a very substantial decline in our trade surplus. However, the progress that has been made in recent months has laid the foundation for a much better national performance in the area in 1969 and years ahead, *if* the nation carries through with the program now in progress.

The Revenue and Expenditure Control Act, finally enacted in late June, established our commitment to fiscal restraint.

The Congress and the President will have to decide in the months ahead on fiscal policy for the period beginning July 1, 1969. This policy will require decisions on expenditures and taxes necessary to provide that degree of fiscal restraint which is a fundamental element in an adequate follow-through in the ongoing process of disinflation, restoration of our competitive position and provision of a healthy trade surplus. This fiscal policy, coupled with appropriate monetary policy by the Federal Reserve Board, will make possible the avoidance of the excessive demand that has contributed to the decline in our trade surplus. It will also enhance our competitive position by arresting inflation and enabling the economy to move back toward reasonable price stability, given accompanying voluntary restraint in wage-price decisions.

The Cabinet Committee on Price Stability, after consultation with business and labor leaders, including the President's Labor-Management Advisory Committee, is submitting a report on the progress made and the plans for future cooperative efforts on the wage-price front.

In 1968 we witnessed the adverse effects on our international trade position of the work stoppage in copper and the potential work stoppages in steel and on the docks. These focused renewed attention on the need for both labor and management to recognize the implications of their actions and their positions on wage disputes and their relationship to the protection of our national interest in maintaining the strength of the dollar.

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2. Initiatives Pursued in 1968 To Assure Fairness to United States Trade in World Markets Should Culminate in 1969 in Cooperative Action by the United States and Our Trading Partners.

In 1969 further reduction of non-tariff barriers and appropriate changes in the General Agreements on Tariff and Trade rules on border tax adjustments must be achieved. International trading rules and practices are established through multilateral consent and negotiated in the multilateral forum of the GATT. In early 1968 United States representatives inaugurated a determined effort to eliminate non-tariff barriers, review agricultural trade, achieve improvements in the trading rules and minimize the disadvantages to our trade which arise from differences in the application of national tax systems to exports and imports.

The GATT Committee on Industrial Products has developed a catalog of non-tariff barriers to trade and is now turning to the removal of these restrictions. Similarly the Agriculture Committee of the GATT is conducting a general review of agricultural trade problems. In attempting to solve problems in these areas, we must be realistic in our objectives and timetable. On the other hand, we cannot be satisfied without real progress soon to eliminate the significant non-tariff barriers. We must bear in mind that the Trade Expansion Act of 1962 does not permit the United States to compensate with trade concessions the removal by others of illegal non-tariff barriers.

The GATT Working Party on Border Taxes must complete its task as early as possible next year. We believe there is a structural disadvantage to the United States, and to other predominantly direct-tax countries, which arises from the border tax adjustment system as presently permitted under the GATT rules. The lack of an overall limitation on border tax adjustments, the proliferation of the practice, and the unequal treatment prejudicial against one tax system as opposed to another are problems in the GATT rules which must be addressed.

The United States has also raised the issue of the provisions in the GATT rules which pertain to the process by which international payments imbalances are adjusted. Under the GATT, countries suffering temporary balance of payments difficulties may introduce short-term trade restricting practices such as quotas but the GATT is silent on the responsibilities of surplus countries.

We have seen, in the month of November, two countries employ other measures which also facilitate the adjustment of their balance of payments position. Through the manipulation of border tax adjustments, both France and Germany are endeavoring to influence their trade accounts in a manner conducive to better overall payments equilibrium. This course of action was chosen as an alternative to a change in parity—an action which would have a permanent effect on trade. This experience should be examined to consider its lasting implications for the process by which a nation's international payments are brought into balance.

3. The Department of Commerce Should Intensify Efforts to Expand Commercial Exports Generally and in Conjunction with Foreign Assistance, and the Agency for International Development Should Continue Measures to Assure Additionality and to Minimize Substitution in Foreign Assistance.

The long-term trade promotion program which you outlined in your New Year's Day message should be pursued vigorously. These efforts have been helpful to date, and they will have to be reinforced. The recent recommendations of the National Export Expansion Committee provide suggestions for reinforcements. These should be considered.

The efforts of AID and other concerned agencies to minimize the balance of payments cost of bilateral economic assistance have been successful in keeping these costs to a minimum. The principles by which this is done are established. The implementation of these principles has now been under way for some time; and the regular, vigilant administration of these methods is what is required and is what we are receiving.

Some of the most important by-products of economic assistance are the trading benefits arising from the development and growth of viable economies abroad. We trade and prosper together. Our tied bilateral economic assistance, which transfers real resources has the effect of facilitating the introduction of American goods and services to these foreign markets. In distant areas, purchases of capital goods, often bought to last for a lifetime, provide a continuing introduction of the product names of our factories to foreign buyers.

In 1969 we must concentrate on developing follow-up sales after these early "calling cards" have been delivered. Industry, assisted, if need be, by Government, must expand upon the export opportunity created by our economic assistance. This will require a sustained and positive program.

The Commerce Department has cooperated closely with AID in seeking ways to maximize United States commercial exports following upon the foreign assistance program. In the area of publicity, Commerce provides information on AID business opportunities through a variety of media such as *International Commerce* and *Quarterly Summary of Future Construction Abroad.*

In addition to information available through these publications, Commerce provides information on AID export opportunities and guidance on the procedures for selling under the AID programs directly to American businessmen through personal contacts. The Commerce Department also puts together annual United States trade and investment programs for approximately 60 countries of main commercial interest in the world. Specific informational, promotional, and policy activities to be carried out in support of the program objectives are delineated. For countries with AID Missions, the AID operations generally constitute an important factor in achieving progress toward the investment program objectives. Additionally, the Department of Commerce through its trade programs, commercial exhibits and trade missions actively assists the United States exporter.

4. Consistent with Our Security Commitments, the Nation in 1969 Should Continue to Minimize Its Net Military Deficit by Reducing These Expenditures Whenever Conditions Permit and by Neutralizing Them Through Cooperative Action by Our Allies.

We should stand by the principles which you enunciated in the January 1 program:

> "We cannot forego our essential commitments abroad, on which America's security and survival depend.
>
> "Nevertheless, we must take every step to reduce their impact on our balance of payments without endangering our security."

As we look at our overall balance of payments position and prospects, it remains a key concept that the foreign exchange drain from United States defense expenditures outside our borders for mutual security is an extraordinary item in the balance of payments. It should be met by special governmental action—it does not result from normal economic developments; nor is it subject to normal economic management through fiscal, monetary and incomes policies.

We need to maintain existing programs and constantly seek new ways to reduce our defense expenditures abroad. The types of actions by the Defense Department to reduce net foreign exchange costs during the years 1961–1967, as described in "Maintaining the Strength of the United States Dollar in A Strong Free World Economy", Tab B, United States Treasury Department, January 1968, and in the Supplemental Progress Report for 1968, must be constantly pursued.

We welcome the extensive cooperation from countries in the North Atlantic Treaty Organization and in other parts of the world during 1968 to minimize our military foreign exchange costs through:

—Purchase in the United States of their defense needs; and
—Investments in long-term United States securities.

In 1969 we will want to continue cooperation and conclude new arrangements, with particular emphasis on NATO Europe. In the coming year, we will want to build on past experience in ways which:

—Proceed from the NATO recognition of the principle that the solidarity of the Alliance can be strengthened by cooperation between members to alleviate burdens arising from balance of payments deficits resulting specifically from military expenditures for the collective defense;

—Increase the emphasis on purchases in the United States to meet country needs for the improvements NATO has recently called for in country forces; and

—Reduce reliance on investments in long-term United States securities as a means for dealing with our foreign exchange costs resulting from defense expenditures outside our borders, since these investments do not provide the basis for a long-term solution.

In other parts of the world, we should give particular attention to the Far East. Military expenditures related to Vietnam and the prospective longer-term security situation in the region may be expected to continue a heavy drain on United States foreign exchange. We will be looking to countries in the region to continue and expand their cooperation with us to deal with this problem on a continuing basis. Active negotiations to this end should be a continuing responsibility of the Secretaries of State, Treasury, and Defense.

Of course, the principal opportunity to achieve actual reductions in our gross defense expenditures abroad, without damage to our long-term mutual security interests, is most likely to occur in connection with progress in the negotiations looking to a peaceful settlement of the conflict in Southeast Asia.

Even before our susbtantial involvement in military operations in Vietnam in 1965, United States military expenditures in the major Far Eastern countries were considerable. The direct foreign exchange costs of these expenditures averaged about $700 million per year before 1965. They are currently running approximately $1.5 billion *higher*.

This heavy direct loss of dollars to and through East Asia must be reduced when the fighting stops.

Therefore, a high priority must be given to the problem of neutralizing, to the maximum possible extent, the balance of payments cost of our security forces in East Asia while the fighting continues, and reducing the gross cost when the fighting diminishes or ceases.

5. The Mandatory and Temporary Foreign Direct Investment Program, as Announced in Modified Form by the Secretary of Commerce on November 15, 1968, Should Be Maintained.

The mandatory direct investment control program for 1968 has not interrupted the high, indeed, unprecedented, level of total American investment abroad. It has had the intended effect of reducing capital outflows from this country by increasing the use of funds borrowed overseas for direct investment by United States affiliated enterprises.

Our base for future earnings continues to increase and the present balance of payments costs are maintained within tolerable limits. The private sector has for the most part understood this. The best way to keep the program temporary is to press ahead vigorously on all features of the balance of payments front.

There is little disagreement that this program should be temporary and terminated as soon as possible. It is the view of your Cabinet Committee that it is not possible to terminate the program in 1969 without running a grave risk that our progress toward balance of payments equilibrium would be reversed and a heavy deficit become a likely prospect. As stated earlier in the principles governing the formulation of the 1969 program, until the nation has a durable surplus or the assurance of long-term equilibrium, it would be unwise to abandon some of the temporary and less desirable measures that it has been forced to employ.

This has a special relevance to the Foreign Direct Investment Program as the following observations underscore:

First, overseas investments by American business (excluding Canada, which is exempt from the direct investment program) are projected to increase again in 1969, with plant and equipment expenditures reaching close to $8 billion—up from an estimated $7.5 billion this year, and up from $4.6 billion in 1964, the last year before the introduction of the voluntary program.

Second, in order to hold the balance of payments impact of such investment in 1968 to the $2.6 billion you targeted last January, it may be necessary for United States companies and their foreign affiliates to utilize between $2 and $2.5 billion of the proceeds of foreign borrowing in addition to foreign borrowing for day-to-day working capital requirements. To meet the new target for foreign direct investment of $2.9 billion in 1969, we project it may be necessary for business to utilize another $2–2.5 billion in foreign borrowing next year.

Third, growing restraint upon capital flows from the United States since the start of the voluntary program in February 1965 has resulted in a substantial, and to some extent abnormal level of foreign debt by United States companies and their foreign affiliates, as compared to what it might otherwise have been without the foreign direct investment programs. We do not have any precise way to measure its size, but it could approach $5 billion by the end of this year.

Fourth, during the past four years, in cooperation with the capital programs, many United States companies have decreased their overseas liquidity through the reduction of inter-company accounts and the repatriation of earnings, and, as a result, are more active, albeit reluctant, borrowers for working capital purposes.

All of this suggests that termination of capital controls in 1969 could result in a sharp increase in capital outflows and retained earnings—it is difficult to estimate the precise amount for much will depend upon market conditions and other factors, but there is a potential exposure of as much as $3–$4 billion. The outlook for 1969 does not permit taking the risk of that much additional direct investment hampering progress in our balance of payments program.

Basically, the 1969 Foreign Direct Investment Program will follow closely the format of this year's program. However, some additional leeway is needed (a) to provide additional flexibility for companies with limited or no overseas investment experience; (b) to make the Regulations more responsive to those companies whose investment quotas are unrealistically low in relation to the return flow of earnings from their direct investments; (c) to assure that the program does not unnecessarily inhibit the growth of inter-company exports of American goods and services to foreign affiliates; and (d) to enable the Office of Foreign Direct Investments to be more responsive to special industry problems and some of the inequities in the Regulations which have become apparent during 1968.

We recognize that just to maintain their existing overseas operations on a sound basis, companies must have the capability to retain abroad a certain percentage of their foreign earnings. Furthermore, retention of a portion of foreign earnings will be necessary to insure an orderly retirement of the growing debt being contracted abroad. We therefore recommended that the target level of direct investment be increased to insure that every company has, in 1969, an investment quota of at least 20 percent of its 1968 earnings from foreign direct investment. This change was announced on November 15.

Some adjustment in the target was also necessary to assure that United States companies have additional quotas to expand exports of goods and services through their foreign affiliates.

Further adjustments of the target were needed to make the Program more responsive to hardships arising from the application of the Regulations to special industries such as the international construction and transportation industries, whose operations and accounting procedures do not dovetail with the Regulations; to provide relief for companies whose ability to meet the repatriation requirements of the Regulations is restricted by law or lack of control; to encourage private investment of a developmental character in the less developed areas, and to provide companies with no or limited prior overseas investment experience with a somewhat higher level of permitted direct investment.

Finally, to enable companies to plan ahead and to insure that investment projects with important future balance of payments potential are not discouraged, the Office of Foreign Direct Investments evolved its incremental earnings formula, under which additional direct investment in future years is authorized on the basis of future incremental earnings.

6. The Federal Reserve Voluntary Foreign Credit Restraint Program Should be Maintained with Present Ceilings on Foreign Lending from the United States, but in the Coming Year Attention Should be Given to Possible Modifications to Encourage Further the Promotion and Financing of Exports by the Commercial Banking System.

The Federal Reserve program has required a great deal of United States financial institutions and they have responded well. Since 1964, United States commercial banks have not increased the volume of United States credits to foreign borrowers, even though the foreign banking business has grown substantially in all other respects. In their international operation, United States banks have had to meet the demands of clients for foreign loans within their voluntary ceilings and through the extensive use of resources in foreign branches.

The prospects for 1969 do not permit any basic change in the need for restraint on foreign lending of United States banks and other United States financial institutions. Accordingly, the existing voluntary ceilings for foreign lending by these institutions should be continued for 1969.

During the coming year, attention should be given to the effect of the program on increasing United States receipts as well as on reducing United States capital outflows. Since 1964, annual exports from the United States have increased by about 32 percent. Financing to support the growth in exports has become available as banks have changed the composition of their portfolios of foreign credits in response to the voluntary program and to a lesser extent by the use of funds in foreign branches and by the expansion of the Export-Import Bank's direct lending. The Federal Reserve Board intends, in the light of developments in the United States and abroad, to review its Voluntary Foreign Credit Restraint program early in 1969 in order to determine whether additional flexibility for financing United States exports might usefully be provided in the program's guidelines.

7. The Interest Equalization Tax, which Expires July 31, 1969, Should be Extended with the Existing Authority to Vary the Rate from 1½ Percent Down to Zero, Depending on Circumstances.

The size and efficiency of the American capital market necessitated the Interest Equalization Tax in 1963. This tax has served to facilitate greatly the expansion of the European capital market and to develop additional techniques for employing savings around the world in productive investments. Through preserving an exemption for lesser developed countries, the access they need for development assistance is assured. In 1967, Congress granted the President certain discretionary authority in order that the purpose of the legislation—which is to limit but not prevent access to the capital market from developed countries—is best served.

In 1969, this legislation will need to be extended. In order that we have available a method for phasing out this tax, the existing authority to vary the rate of the tax from zero to 1½ percent per annum should be retained.

8. A Five-Year Program is Needed to Narrow the Travel Deficit Through Promotion of Foreign Travel in the United States by Both Public and Private Action.

As has been pointed out repeatedly to the public and to the appropriate Committees of Congress, the trend of the contribution of travel to and from the United States to our balance of payments deficit is such that the United States cannot continue to ignore the problem.

It was for this reason that in your New Year's Day Message you sought to reduce the travel deficit by calling for voluntary action and appropriate legislation. In 1967 this deficit exceeded $2 billion. If the nation is to prevent the tourist deficit from continuing to rise and possibly exceed $4 billion by 1975 (as United States disposable income and the portion of it spent on foreign travel increases, and the new airplanes with larger capacities and greater speeds bring lower fares), the nation must begin to implement *now* a comprehensive long-term program to increase rapidly the amount of foreign travel to this country.

The President's Commission, formed in 1967, has provided numerous suggestions worthy of attention, not only for immediate measures already taken in 1968, but for the longer-term future.

Although final figures are not yet available, we must anticipate a continued large travel deficit in 1968. It might well have been larger but for the fact that many of the remedial measures recommended by your Commission were carried out by Government and voluntarily by the private sector.

The longer-term measures recommended by your Commission to promote travel to the United States will require regular and adequate financing. The simple fact is that the United States has a smaller annual budget for promoting tourism than that of almost any other industrial country.

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One way to finance an appropriate and effective travel promotion program would be to eliminate the exemption of international flights from the long existing five percent tax on airline tickets and to dedicate a portion of the proceeds to a special fund to be used and expended for travel promotion during the fiscal years 1970–74. There are, of course, other ways. Early Congressional action is highly desirable.

We must not allow an increased tourist deficit to jeopardize progress in other areas of the balance of payments nor to necessitate the maintenance of temporary restrictive measures on capital flows, nor to handicap the United States in discharging its national security commitments outside the United States.

The Cabinet Committee on Balance of Payments believes that these policies will continue the very real gains already achieved under the Action Program you announced last New Year's Day, will maintain the strength of the dollar, and will contribute to a strong free world economy. In the year ahead, these policies will help to preserve these gains and their contribution to a strong free world economy.

Faithfully yours,

HENRY H. FOWLER.

The PRESIDENT,
The White House.

I. The International Monetary System in 1968—Progress and Problems

The year 1968 has been a crucial one in the evolution of the international monetary system—probably the most significant year since the establishment of the Bretton Woods institutions in 1944–45. Conceivably this year will prove the most important turning point in the monetary system since the emergence of the pre-war international gold exchange standard system.

There have been two major developments during the year.

The first was the establishment of the two-tier gold price system drawing a clear distinction between the role of gold as a monetary reserve and the private commodity market for gold.

The second was the completion of negotiations on a Proposed Amendment to the Articles of Agreement of the International Monetary Fund establishing the facility for Special Drawing Rights. This amendment was approved by the Governors of the Fund for submission to member governments. When this Amendment is ratified by the requisite number of member countries of the IMF, it will enable the nations of the Free World for the first time to create international reserves by deliberate multilateral decision. They will, thereby, bring to an end the traditional reliance on uncertain supplies of newly-mined gold or the growth of liquid claims in the form of dollars, sterling or other reserve currencies, associated with balance of payments deficits of the reserve currency countries.

Role of Gold in the Monetary System

Following the devaluation of the pound sterling on November 17, 1967, the international monetary system was placed under severe pressure by heavy speculation in gold. Large amounts of gold were purchased in the London market by foreign holders of dollars and other currencies. This demand far exceeded current supplies of newly-mined gold, and was met from gold supplied by the active members of the gold pool—Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom, and the United States. (France withdrew from active participation in the pool in the summer of 1967.) Through selling gold in the market the pool was able to maintain the commodity price of gold in London at about $35.20, a figure roughly equivalent to the monetary price plus handling charges and costs of shipping gold to London from the United States.

The active members of the gold pool met in Frankfurt, Germany, on November 26, 1967, and issued a statement reiterating their agreement to continue gold pool operations. For a short time this statement calmed the speculation. But the private demand for gold continued at an abnormally high level in December and in the first twelve weeks of 1968.

During the last quarter of 1967 and the first quarter of 1968, the gold reserves of monetary authorities and international agencies were drawn down by about $2.7 billion. Purchases were primarily for non-monetary purposes, going into the hands of private holders.

The major loss was borne by the United States, whose gold reserves dropped by $2.3 billion. The conversion of liquid assets into gold on such a large scale placed a very serious strain on the international money market, and short-term interest rates tightened severely. The world faced the possibility of a severe financial squeeze, with rapidly constricting international credit.

The members of the gold pool had continued to supply gold during January, February, and the first half of March, in the hope that the unusual speculative demand would disappear. One factor in this excessive demand was the United States statute requiring gold to be held as a domestic reserve equivalent to 25 percent of Federal Reserve notes in circulation. This gold cover requirement, an historical survival from earlier days when gold and currency notes both circulated domestically, was regarded in the market as a possible limitation on the amount of gold which the United States would be prepared to pay out. The Administration, therefore, recommended legislation to eliminate the gold cover requirement. The House of Representatives approved the measure on February 21, and the Senate acted on March 14. This provided the United States with the flexibility of policy needed to undertake a new approach to the gold problem.

On March 16–17, the Governors of the Central Banks actively participating in the gold pool met in Washington, under the chairmanship of Chairman Martin of the Federal Reserve Board. They adopted the so-called "two-tier" gold price system under which the private commodity price of gold is permitted to fluctuate without official intervention, while the official price of gold in its monetary role remains fixed at $35 per ounce in transactions among monetary authorities. The participants agreed that in view of the forthcoming faciilty for Special Drawing Rights, they "no longer felt it necessary to buy gold from the market". The decisions taken in Washington have been broadly supported by most of the monetary authorities of the Free World. During the IMF meeting in Washington in early October 1968 this position was reinforced during some special sessions of the central bank governors of the active gold pool members plus those from Canada, Japan and Sweden.

Under the two-tier system, the commodity price for gold has fluctuated within a range of about $38 to $42 per ounce and the loss of monetary gold to the commodity market has ceased. Monetary authorities have continued to cooperate in a responsible manner in managing their transactions in monetary gold at the official price, and the gold reserves of the United States have risen since the end of March 1968.

The Washington Communique of March 17 made clear the fact that it is unnecessary to rely in the future on gold as a major source of additional monetary reserves. Existing monetary gold reserves will continue to play their role but over time should gradually become a smaller part of total world reserves. Special Drawing Rights, which will serve as a supplementary reserve to both gold and dollars, will be the long-run growth element in world reserves.

Facility for Special Drawing Rights

The second major development in 1968 was the completion of the Proposed Amendment establishing the Special Drawing Rights Facility in the International Monetary Fund and its approval by the Governors for submission to member governments for formal ratification. This process of ratification is now in progress. The new facility comes into existence when 67 members of the Fund (three-fifths of the membership), having 80 percent of the votes in the Fund, formally ratify the Amendment and when, in addition, members of the Fund having 75 percent of the total quotas in the Fund certify to the Fund that they are qualified and able to participate in the facility. The process of ratification and certification is expected to be completed early in 1969.

Although an Outline Plan for the Special Drawing Rights had been approved at the Annual Meeting of the Fund in Rio de Janeiro in September 1967, some further negotiations were required to complete the detailed provisions of the plan and to prepare certain other amendments to the Fund's Articles of Agreement proposed by the continental European countries. These other amendments strengthen to some extent the position of the creditor countries in the Fund.

These issues were resolved among the Group of Ten Ministers and Governors at a meeting in Stockholm on March 29–30, 1968. The French representative, however, did not join with the other members of the Group of Ten in approving the compromise text of the omnibus Proposed Amendment, but reserved France's position. Following the Stockholm meeting, the Executive Directors were able to complete the formal legal text of the Proposed Amendment. This was submitted to the Governors of the Fund on April 16, 1968, and subsequently received the favorable vote of the Governors of the Fund.

The Proposed Amendment was then submitted to the member governments for formal ratification.

In the United States, the National Advisory Council on International Monetary and Financial Policies prepared a Special Report on the Proposed Amendment which Secretary Fowler transmitted to the Congress on April 26, 1968. President Johnson addressed a Special Message to the Congress on April 30, 1968, entitled *Strengthening the International Monetary System*, recommending approval of the Amendment and authorization of participation by the United States in the Special Drawing Rights facility. The House of Representatives approved the necessary legislation on May 10, 1968, by an overwhelming majority of members of both parties, and the Senate on June 6, 1968, by a voice vote. The United States became the first member of the Fund to complete acceptance of the Proposed Amendment and certification of participation in the facility.

Special Drawing Rights will not be created until the Amendment has been ratified and "activation" is decided upon by the participants in the new facility. To assure that there is a very wide consensus among the members of the plan as to the amount of Special Drawing Rights to be created, a decision to activate must be approved by an 85 percent weighted vote of the participating members of the Fund.

An excessive addition to international reserves could give some impetus to world inflationary pressures. However, a deficient supply of world reserves can create a difficult and persistent strain on the international monetary system. When there is no increase in global reserves, one country can add to its reserves only at the expense of some other country or countries. The resulting competition for reserves can lead to an escalation of world interest rates, and to a cumulative spreading of restrictions on international transactions, as countries try to protect their existing levels of reserves or make additions to their reserves. It is already clear that few countries are prepared to look with equanimity on any sizable or prolonged reduction of their reserves, even when these reserves have grown substantially in recent years, as is the case in continental Western Europe. These are some of the considerations that will be taken into account in the initial decision as to activation of the Special Drawing Rights.

It is very clear, however, that despite a general beneficial effect on the equilibrium of the monetary system as a whole, the Special Drawing Rights will not remove nor even appreciably modify the need to achieve equilibrium in the balance of payments of individual countries through appropriate adjustment policies. While Special Drawing Rights can moderate the extreme severity of balance of payments pressures that would occur in the absence of any reserve creation, the process of adjustment of international balances remains one of the most difficult and challenging problems in the field of economic policy and international economic cooperation.

The Franc-Deutschemark Crisis, November 1968

In May and June 1968, the French franc came under pressure in the exchange markets as a result of an outbreak of strikes and student disorders on a large scale. Settlements in labor negotiations were estimated to increase wage rates within a range of 10 to 14 percent, or about double the previously anticipated annual rise in money wages. The shock of the May-June events was reflected in a heavy outflow of capital from France; French reserve of gold and foreign exchange were drawn down from $6 billion at the end of April to $4 billion at the end of November.

In September, the pressure on the franc was accentuated by rumors of a possible appreciation of the Deutschemark. These rumors subsided soon but resumed in early November when liquid funds again began to flow into Germany in large volume. The speculation was encouraged by the continuation of a very large German trade surplus and by the market's belief that the Federal Republic of Germany could not maintain sufficient long-term capital outflows to offset its current account surplus.

The market situation worsened at mid-November. The major European exchange markets were closed on November 20, and a special meeting of the Ministers and Governors of the Group of Ten was called for November 20 in Bonn. Secretary Fowler, who had attended the North Atlantic Treaty Organization Ministerial Meeting in Brussels and was paying a series of farewell visits to his colleagues in Europe, took an active role in the calling of the meeting .

The primary objective of the United States, supported by the other Ministers, was to obtain assurances that the pressures of the crisis would not result in any excessive exchange rate adjustment that would seriously undervalue any currency and introduce the threat of cumulative or competitive devaluations. The United States set forth the basic principle that exchange rate changes of major financial powers should not take place without consultation between the governments of these major countries.

The decisions associated with the November meeting did not in fact result in any exchange rate adjustments. The German authorities proposed, as their principal contribution to reducing the German surplus, an adjustment in border taxes having effects somewhat similar to a revaluation of the Deutschemark but applicable only to trade in physical goods. They estimated that this measure would reduce Germany's annual trade surplus in 1969 by about one-fourth. The French decision, announced on November 23, was to maintain the value of the franc without change. France also announced measures of internal restraint, restored tight exchange controls, and made limited adjustments in border taxes designed to strengthen its trade position. The impact of these measures on France's current account alone has been estimated to be as much as $1 billion in 1969. Finally, the authorities of the United Kingdom introduced a system of import deposits, increased internal taxation, and imposed additional credit restraints as a means of assuring their balance of payments objective of a substantial surplus by the end of 1969. At the same time, a large multilateral credit arrangement, amounting to $2 billion, was established by the monetary authorities of the Group of Ten, Switzerland, Norway, Denmark and the Bank for International Settlements, to support the French franc.

Thus the franc-Deutschemark speculative crisis was met by a further instance of international cooperation, in which actions were taken to reduce imbalances by both deficit and surplus countries, and financial support was mobilized for a threatened currency. The exchange difficulties in November were confined to the major European currencies. Unlike the gold crisis earlier in the year, there was no drain on the reserves of the United States.

Since November 25, the pressure on the franc has subsided and funds have been flowing from Germany.

Nevertheless, this crisis demonstrated once again that very large amounts of funds may move in response to concerns regarding domestic inflation or the possibility of gain through monetary appreciation. It underlined the need for continuing efforts to strengethen cooperation among the monetary authorities.

One important aspect in the pursuit of this ideal is the completion of ratification and the early activation of the Special Drawing Rights facility. Other techniques for strengthening the system will need to be explored as experience accumulates.

Further evolution of the international monetary system may not involve such fundamental changes as we have seen in 1968. However, it is important that, while conserving our proven arrangements, we be prepared to consider future changes in the international monetary system with an open mind. It is also essential that we continue to build upon the foundations of multinational cooperation that have been developed in recent years.

At many times in the past, there has been a tendency to look upon international monetary problems from a narrow nationalistic and short-range view. In recent years, we have made significant progress toward establishing the principle of cooperative multilateral action in handling the financial affairs which affect the major countries and major currencies. If this principle is observed, we can be assured that future changes in the system will be discussed and agreed upon in a cooperative way by a preponderant majority of the nations that have a large stake in the functioning of the international monetary system. Hopefully, the acceptance of this principle will also mean that future destabilizing influences will be contained by the cooperative action of all of the nations immediately concerned.

In Secretary Fowler's speech at the Annual Meeting of the International Monetary Fund in Washington in October 1968 he noted the approval of the new facility for Special Drawing Rights. He pointed out that this major step in the evolutionary process of improving the international monetary system resulted from the thorough study and painstaking discussion of the problem in international bodies, in legislative committees, and in academic circles and the press. He expressed the hope that:

> "Further evolutionary changes in the international monetary system would emerge in the same way. The only appropriate way to seek improvement in the system is through the same procedure of careful study, widespread official and public discussions, and carefully considered action."

Secretary Fowler also commented that:

> "We started with the strong foundation built at Bretton Woods. We built an impressive network of international cooperation on that foundation. We built a major addition to that foundation in the Special Drawing Rights Amendment. We must be prepared in the future, as we have in the past, to approach together and to work out together additional ways to strengthen the international monetary system. To do less is to fail in our responsibilities to maintain and advance our public trust."

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II. United States Balance of Payments—The Record to Date

For three successive quarters,[1] our over-all balance of payments position has improved under the impetus of the President's Action Program. The huge liquidity deficit of $1,742 million in the fourth quarter of 1967 was reduced this year to $680 million in the first quarter and $160 million in the second quarter. In the third quarter, the United States achieved a small surplus of $35 million, the first quarterly surplus since the second quarter of 1965.

Improvement of the official settlements balance was also impressive. The fourth quarter, 1967 deficit of $1,082 million was reduced to $552 million in the first quarter of this year. Surpluses of $1,523 million and $439 million were recorded in the second and third quarters, respectively.

For the first nine months of 1968 the liquidity deficit showed a $1 billion improvement over the same period in 1967, while the official settlements balance showed a $3.7 billion improvement between the two nine-month periods.

These results are encouraging and they have contributed to a strengthened position of the dollar in foreign exchange markets. But the gains in these over-all measures do not reflect a balanced improvement in all the major balance of payments components covered by the President's Action Program.

The trade account, which began deteriorating in the fourth quarter of last year, continued that trend in the first two quarters of this year. Only a mild turn-around occurred in the third quarter.

Exports have performed creditably, except in the agricultural sector; but there has been an extraordinary surge of imports. This resulted partly from the excessive level of domestic demand fostered by the tardy passage of the anti-inflation fiscal package. But strikes and the threat of strikes in various industries caused extraordinary imports of between $600 and $700 million, representing an irreversible loss to the balance of payments.

The trade position must be restored to a much higher level of surplus in order to sustain the over-all improvement in the balance of payments.

Achievement of the program goals was also thwarted in the travel account. The Congress has not approved recommended measures to

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[1] Data given here are those contained in the report for the third quarter of 1968 released by the Department of Commerce on November 15, 1968; some preliminary figures there in are subject to later revision.

reduce the growing tourist deficit. While that deficit is running somewhat below the 1967 level (when Canada's "Expo '67" attracted an unusually large number of American visitors) the underlying trend of increased net outflows is likely to continue far into the future. Gross expenditures of American tourists are approaching $4 billion per year, not much less than total military expenditures abroad.

The continued increase in foreign purchases of American securities has been a particularly favorable factor this year. This result is in part attributable to the efforts set in motion by a Presidential Task Force Report in 1964 on Promoting Foreign Investment in United States Corporate Securities. The increase in these purchases in the first three quarters of 1968 over the same period a year ago was about $800 million (excluding a large capital input by a foreign firm into its American subsidiary).

While part of this increased investment was influenced by political disturbances abroad, it must be borne in mind this trend started long before the events of May in France or the invasion of Czechoslovakia in August. Indeed, reflecting the continued high preference for the dollar, the level of net foreign purchases of portfolio equity securities actually accelerated between November 1967 and February 1968. After the gold crisis in early March, the level of inflow continued to increase substantially.

The Foreign Direct Investment Program of the Department of Commerce has progressed favorably toward its goal of a $1 billion reduction between 1967 and 1968 in direct investment subject to the program. In the first three quarters of this year, utilization of funds borrowed abroad has been several times greater than in the corresponding period of last year and remitted earnings from direct investment were running 14 percent above the level of the same period a year ago. At the same time the program would not appear to be interfering in any serious degree with overseas plant and equipment expenditures by American firms.

The 1968 goal of the Voluntary Credit Restraint Program of the Federal Reserve Board is to achieve a $500 million improvement in our balance of payments from a reduction of loans to foreign borrowers by United States banks and other financial institutions. This target seems likely to be exceeded on the basis of performance in the first ten months of this year.

The programmed $500 million reduction in net government expenditures outside the United States will probably be exceeded. Special financial arrangements to reduce or offset our military expenditures abroad are proceeding satisfactorily, particularly in the NATO-European area. The Agency for International Development is reducing its cash transfer below last year's level and is striving to insure that exports of American goods which it finances are additional to normal commerical sales. The program for reduction of civilian employees overseas is on schedule.

The above developments attest to the importance and large measure of success of the January 1 program. These achievements occurred during a year in which the excessively rapid growth of the domestic economy, serious strikes and strike threats, and the lack of legislative authority to deal adequately with the tourist deficit presented formidable obstacles to improvement in the balance of payments.

III. An Intensified Effort to Achieve and Maintain a Healthy United States Trade Surplus

A. Introductory Comments

The cornerstone of the United States balance of payments position has always been a substantial trade surplus. In the years 1950–55, the surplus averaged $2.2 billion; in 1955–60, it averaged $3.8 billion; and in 1960–65, it averaged $5.2 billion. Our trade surplus reached an all-time high of $6.7 billion in 1964, when some particularly favorable factors were operating; however, since 1964, it has steadily declined. The surplus narrowed to $4.8 billion and $3.7 billion in 1965 and 1966, respectively. The 1967 surplus was reduced to the somewhat lower level of $3.5 billion. In 1968, our trade surplus has deteriorated sharply from the 1967 level, and it is expected that it will be less than $1 billion or $3 billion less than the target established in the President's January 1 balance of payments message and $2.5 billion less than the 1967 total.

Certainly, the most disappointing aspect of our recent balance of payments performance has been the steep decline of our trade surplus which started in the latter part of 1967 and continued through the first half of 1968.

It has been natural for the United States, as the most economically advanced nation in the world with a comparative trade advantage in a wide range of products, to have a surplus in its trade account. The United States has special responsibilities because of its role of leadership in the Free World. Therefore, it is necessary for the United States to have a sufficient surplus in its trade account so that it will be able to export capital, to pay its fair share of the collective defense and foreign aid efforts, and to phase out the temporary restraints in the balance of payments program.

United States' exports and imports are strongly influenced by the pressures generated in our economy which affect the competitiveness of American products and also by the economic and trade policies followed by the major trading nations of the world. Future trade prospects for the United States will depend upon:

—sound management of our domestic economy;

—success in our efforts to obtain reasonably free access to foreign markets for our goods;

—the level of demand in our markets abroad; and

—the realization of the export potential of our industry through selective export expansion programs.

B. Soundly Managing the United States Economy To Keep It Competitive and Stable

President Johnson stated in his January 1 Message On The Balance of Payments that the first order of business was to take the necessary steps to stabilize our economy. Enactment of the Revenue and Expenditure Control Act of 1968 was the key to stability. The President also urged labor and management restraint in wage-price decisions and instructed the principal officials in the economic area of the Administration to work with leaders in business and labor to make effective a voluntary program of wage-price restraint. A similar instruction dealt with preventing costly work stoppages which could reduce exports and increase imports.

Unfortunately, delays beyond the reach of the Executive Branch in accomplishing this first order of business contributed to continued instability in the American economy and thus to an unsatisfactory performance in the trade areas. Our exports grew by a very satisfactory rate of 9.1 percent during the first nine months of 1968 to a level of \$25 billion—or an annual rate of \$33.4 billion. A large part of the deterioration in the trade account was due to overheating in the domestic economy which led to an excessive high rate of imports. Imports rose by 24.9 percent in the first nine months of 1968, as compared with 1967, to reach a level of \$24.8 billion—an annual rate of \$33 billion. Our trade account in 1968 has been hurt also by a series of major work stoppages or threats of strikes in industries such as copper, steel and aluminum. It is estimated that the trade account suffered in the first nine months by over \$600 million as a result of these labor difficulties. There has also been the threat of a possible strike by the East and Gulf Coast Longshoremen Association now a reality, this strike if continued for any length of time will affect the balance of payments adversely.

Passage of the Revenue and Expenditure Control Act of 1968, although delayed to midyear, had an important effect on stabilizing the domestic economy. The outlook today is for a small budget surplus for Fiscal Year 1969 as compared with an estimated deficit before passage of the legislation of approximately \$25.4 billion for FY 1968. Also passage of this tax and expenditure control legislation, particularly in an election year, did much to restore confidence in the United States Government's determination to manage its financial affairs appropriately. As a result, the recent disturbances in the foreign exchange markets of the world hardly affected the dollar. The Revenue and Expenditure Control Act expires on June 30, 1969. Decisions will be necessary in the months ahead on the appropriate fiscal and monetary policies for the period beginning July 1, 1969, and on the desirability of extending the income tax surcharge.

Our overall performance in 1968 with regard to wage-price restraint has not been at all satisfactory. Some settlements were clearly excessive. The Cabinet Committee on Price Stability, after extended study and consultation with business and labor leaders, including particularly the President's Labor Management Advisory Committee, is submitting recommendations for a more lasting and effective effort on the wage-price front.

C. Making United States Industry more Export Minded Through Selective Export Expansion Programs

Our objective has been to encourage the nation's producers to export more. We have employed active and direct measures to supplement our efforts to achieve a soundly managed economy and an open trading community. To this end, the United States Government is involved in making American industry more export minded through a number of export expansion programs.

In 1968, we established and activated the following programs:

—The $500 million Export Expansion Facility was created within the Export-Import Bank to expand and improve export financing, guarantee and insurance facilities available to American exporters. This facility, enacted into law in early July, through November had already helped to finance over $90 million of American exports.

—The Export-Import Bank announced a liberalized discount system on April 1 that has been well received in the financial community. In the period between April 1 and November 30, 1968, export credits totalling $184 million were financed through this facility. This compares to a total activity of $270 million from the program's inception in September 1966 to March 30, 1968.

The Commerce Department has launched the five-year, $200 million comprehensive export program announced by the President in January. Although budgetary limitations have been present, Commerce has achieved the following results:

—The first Joint Export Association contracts are in the final stages of negotiations and will be signed early in January 1969. Under these contracts the Department of Commerce will provide financial assistance to groups of American firms in developing overseas markets.

—The Department of Commerce has expanded its overseas commercial exhibition program and related activities in the United States to make American business more export minded.

—Foreign markets are being systematically and continuously analyzed and the best markets for American industries are being pinpointed, product by product.
—Significant improvements in automated informational services have been made.
—Two new Trade Centers are in the process of being established. The first will open in Paris in the fall of 1969.
—A national strategy for expanding exports over the next five years is in process of development.

These positive, carefully planned, long-range efforts yield important results. For example, during the FY 1964–67 period, Commerce spent $19.9 million promoting exports by means of overseas trade fairs, trade centers and American Weeks. Confirmed first year sales that resulted from these promotions amounted to $300.5 million—more than 15 times the initial cost. On a balance of payments basis, results are even more favorable. Since only about 45 percent of our appropriated funds for these three programs is expended overseas, the direct impact on the balance of payments has been $33 in export sales within one year of the export promotion event for each Commerce dollar spent overseas.

Recent analysis indicates that $300.5 million in sales will generate tax receipts by the Treasury of $18 million. Thus the net cost of the program during this four-year period, on the basis of one year sales results, was $1.9 million. Succeeding year sales and revenue receipts are obviously very large and could more than offset this cost.

To make these long-term programs effective, energetic and continuous efforts, and adequate funding, are required. Comparatively small amounts of carefully spent dollars yield important dividends in the future, both in revenue and in balance of payments terms. In the competing requests for budgetary funds positive programs to achieve long-range balance of payments effects must get an important and a reliable commitment of financial resources over the long run.

D. Keeping World Markets Open and Fair

The United States has consistently taken the lead in bringing the world community toward more liberal trade. Our policy has been directed toward a freer flow of goods, services, and capital. President Johnson emphasized this policy in his New Year's Day Message: "In the Kennedy Round we climaxed three decades of effort to achieve the greatest reduction in tariff barriers in all the history of trade negotiations. Trade liberalization remains the basic policy of the United States."

The world of international trade and finance has come a long way since World War II. Reconstruction of the industrialized countries reached the point some time ago where the generation of capital and savings was sufficient to satisfy their domestic needs. The improved economic and financial position of the industrialized countries has enabled them to assume, for the most part, their responsibilities to end currency restrictions as provided under Article VIII of the International Monetary Fund Agreement. Since post-war economic reconstruction has long since been completed, the United States can no longer look aside when any of these industrialized countries takes action which prejudices our own trading and payments position. The United States can no longer be as tolerant, as it was in the early post-World War II period, of harmful trade measures employed or continued too long by other countries. President Johnson took note of this point in his New Year's Day Message:

> "We must now look beyond the great success of the Kennedy Round to the problems of nontariff barriers that pose a continued threat to the growth of world trade and to our competitive position. American commerce is at a disadvantage because of the tax systems of some of our trading partners . . . ."

Steps Underway To Reduce Non-Tariff Barriers

Efforts to achieve and maintain a healthy United States trade surplus must be directed not only toward obtaining price stability at home but toward expanding liberal trading practices which provide equal access to the markets of the world. This past year has seen a pronounced increase in our efforts to make world markets more open and fair.

Most of these efforts have been pursued multilaterally, through the General Agreement on Tariffs and Trade, where international trading rules and practices have been codified and established. Basically, the rules limit the extent to which countries can raise new nontariff barriers and they provide a framework for the reduction of such barriers. Countries in balance of payments difficulties are permitted to maintain or establish quantitative import restrictions and are required to consult with other countries in the General Agreement on Tariffs and Trade under a waiver procedure. The United States has increased the emphasis it places upon the GATT by furthering multilateral discussions on compliance with its provisions. To this end, we have participated in complaints regarding specific practices of others. In addition, we have initiated new efforts to examine old or unclear rules of GATT, with the intention of relating them more closely to the experiences of recent years and the requirements of the future.

Compliance with the GATT

Review is presently underway in the GATT of several specific actions or failures to act by other countries. The United States is participating through this multilateral forum to make sure that rules and objectives of the GATT are followed by others as well. For example, several countries—Brazil, Chile, and Israel—have revised their tariff schedules and Austria and Spain have taken actions which adversely affect American trade. The United States is negotiating with these countries to obtain new concessions to offset the effect of their actions. Should redress not be achieved through the avenue of first recourse, the action may be advanced to a point where under GATT, if ultimately unsatisfied, other nations would be permitted to take specific and compensating trade measures to offset the losses suffered from these unfair practices.

Bilaterally, we have insisted on compensation for any new trade restrictive measures imposed on our exports even temporarily. For example, Canada gave tariff concessions in agricultural trade as compensation for the introduction of temporary special import charges on imports of potatoes and corn into Canada.

Through the Organization for Economic Cooperation and Development (OECD) in Paris in a matter closely related to the GATT, the United States has initiated consultations to examine the trade effect of forthcoming tax measures in the Netherlands and Belgium. In the course of harmonizing the indirect tax system of the member countries, within the Common Market, the Netherlands and Belgium will be changing their indirect taxation from existing cascade tax assessment to the turn-over, value-added system. In a similar move a year ago, the Federal Republic of Germany achieved a significant trade benefit.

After World War II, in an effort to protect local industry and foreign exchange, many countries employed import quotas. As these industrial countries improved their economies and their international balance of payments positions, they were able to assume the responsibilities of nations with freely convertible currencies as described in Article VIII of the Agreement of the International Monetary Fund. A country may qualify as an "Article VIII country" without having fully achieved the removal of all its quota restrictions; however, it is the understanding of an Article VIII status that these restrictions will be progressively removed over not too long a period of time. For the most part, this has been done—but in nations such as France and Japan quota restrictions (among others) linger. We started using the GATT framework to achieve the removal of these restrictions well before 1968 with respect to France. With respect to Japan, we are presently negotiating bilaterally. In the summer of 1968, we successfully obtained a relaxation of the Japanese restrictive trade practices with respect to our automotive trade and investment in that country. Nevertheless, many other areas of our trade remain encumbered by restrictive Japanese practices. We are vigorously pressing ahead to make this important market open and fair.

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A Fresh Look at Provisions of the GATT

At the GATT Minsterial Meeting in November 1967, it was agreed that new Committees in industry and agriculture would be established to examine nontariff barriers (NTB's) and other trade restrictions. The rules, laws, administrative practices, commercial practices, and preferences employed around the trading world are numerous, insidious and always difficult to identify. Therefore, the first task was to establish a useful if incomplete catalog of these nontariff barriers. This has been accomplished. The GATT Committees are now turning to the more difficult task of preparing for the negotiation of the reduction and removal of these nontariff barriers.

The normal objective in negotiating bilateral or multilateral trade provisions is to achieve a neutral trade effect. This means that one nation will agree to make an adjustment involving a certain amount of trade, on the condition that another country makes a compensating gesture involving an opposite and equal amount of trade. In negotiating the removal of illegal nontariff barriers, this principle of balance must be set aside. It is clearly unfair to have a country impose a nontariff barrier and then, as a condition for its removal, demand a compensating trade benefit.

At the November 1967 GATT Ministerial Meeting it was also agreed to establish a Working Party on countervailing duties, export subsidies and other export incentives. During the Kennedy Round negotiations, many countries complained about the countervailing duty law of the United States and its exemption from the provisions of the GATT. This legislation, passed in 1896, requires the United States to impose an equal and compensating import levy (countervailing duty) for an export subsidy (bounty or grant) used by a foreign nation to aid its exporters. This requirement to countervail is unrelated to the degree of trade injury to the United States resulting from the foreign subsidy.

The GATT recognizes countervailing duty practices and the laws that many countries have in this field. However, the GATT authorizes a nation to countervail only to the extent that it is injured, and then only after efforts to achieve removal of the export subsidy through normal GATT procedures have failed.

In view of the 1947 GATT Agreement and our prior legislation, the United States is not covered by the GATT provisions. The absence of an injury requirement in our legislation is heavily criticized by foreign countries—some call it a major United States nontariff barrier. During the course of the Kennedy Round we agreed to discuss this subject with other countries. This was in keeping with the tradition that trading partners, when they have differences, should be willing to discuss them freely. We have refused, however, to have our countervailing duty law subjected to multilateral review, without simultaneous detailed examination of export subsidies of other countries, which are the target of this statute. Unfortunately, more than a year of negotiation has failed to reach agreement on the terms of reference of this Working Party. The European Community has not found it possible to agree to a basic examination of all export subsidies.

Progress in the review of border taxes received a boost from President Johnson's New Year's Day Message in which he called for both short-term and long-term trade measures to improve our trading position:

> "American commerce is at a disadvantage because of the tax systems of some of our trading partners. Some nations give across-the-board tax rebates on exports which leave their ports and impose special border tax charges on our goods entering their country.
>
> "International rules govern these special taxes under the General Agreement on Tariffs and Trade. These rules must be adjusted to expand international trade further."

Border Tax Adjustments

In 1968 a new Working Party was established on the question of border taxes.

The rules of the GATT permit goods sold for export to be relieved of the indirect taxes the products would have borne if sold in domestic markets. There is no such privilege pertaining to direct taxes. Imported products are burdened with the domestic indirect tax. These rules were established over twenty years ago, when indirect taxes were low. In the late 1940's they were employed by relatively few countries, and covered only a small portion of the volume of goods traded internationally. With the rapid growth of world trade and the increased revenue needs of the industrial nations, the use of indirect taxes broadened and their levels rose to rates undreamed of in 1946. With regard to the experiences of recent years and the requirements of the future, it is necessary to renegotiate the GATT rules on border tax adjustments in order that they are more neutral or equitable with respect to trade.

The United States undertook this effort when it requested GATT in March 1968 to convene the Working Party agreed to in November, 1967. At the first meeting of the Working Party, last April 30, and in four subsequent meetings, the United States has explored, with its trading partners, the history, the provisions, and the implications of the existing GATT rules on border taxes. We have pointed out that countries which employ primarily a system of direct taxation are disadvantaged by the GATT trading rules, vis-a-vis countries that employ indirect taxes significantly. We have argued that there is absolutely no limitation under the existing rules of GATT on the degree of border tax adjustments permitted for indirect taxes. We have also demonstrated a proliferation of these adjustments over the past few years. Finally we have pointed to the changes that the future will see in the adoption of indirect taxes by additional countries with the explicit objective of obtaining the trading advantages offered by the GATT rules on border taxes.

The United States delegation at the GATT has demonstrated that changes in the form of indirect taxes cán also have an effect upon the patterns of trade. It is now clear that the provisions of the GATT lack precision and, therefore, encourage interpretations which frequently have the effect of improving a nation's trading position.

The time has now come to transcribe our understanding and new experience into constructive language in the GATT.

Temporary Border Adjustment for Balance of Payments Purposes

The President's New Year's Day Message stated:

"In keeping with the principles of cooperation and consultation on common problems, I have initiated discussions at a high level with our friends abroad on these critical matters—particularly those nations with balance of payments surpluses.

"These discussions will examine proposals for prompt cooperative action among all parties to minimize the disadvantages to our trade which arise from differences among national tax systems.

"We are also preparing legislative measures in this area whose scope and nature will depend upon the outcome of these consultations."

In the days following President Johnson's message, Under Secretary of State Katzenbach, Under Secretary of the Treasury for Monetary Affairs Deming, Ambassador Roth, the President's Special Trade Representative, and Ambassador to the Organization for Economic Cooperation and Development Trezise visited with officials of our major trading partners in Europe to discuss the United States balance of payments program. Under Secretary of State for Political Affairs Rostow made a similar trip to Asia.

These emissaries in addition to describing the elements of our new balance of payments program, emphasized the necessity of restoring confidence in the exchange markets and the need for cooperative action to support the international monetary system. They distinguished between the long-term effects to be achieved through negotiations in the GATT on rules governing border tax adjustments and consultations with our trading partners to consider the best temporary actions to improve the United States' trade account. In these extensive consultations, we explored whether a temporary United States export rebate and import surcharge would necessitate or provoke similar measures by others which would have the effect of neutralizing the benefits the United States was seeking.

An alternative scheme was suggested by some which had the benefit of demonstrating a responsive attitude and a multilateral approach toward achieving short-term benefits to the United States trade account. This involved a proposed *acceleration* of the timing of the Kennedy Round tariff cuts by our trading partners and a *deceleration* or postponement of the implementation of some of our own tariff cuts. This acceleration/deceleration proposal appeared promising; however, our trading partners linked the implementation of this scheme to legislative approval of the elimination of the American Selling Price (ASP) system of valuing certain chemicals and other goods for customs duty purposes—an American nontariff barrier of sorts.

The acceleration/deceleration proposal was not implemented and thus did not benefit our trade account in 1968. However, the principle of multilateral consultations on short-term trade measures to meet countries' temporary balance of payments problems was firmly established.

This important principle was employed during the Group of Ten Ministerial Meeting in Bonn in November 1968. The Federal Republic of Germany agreed to manipulate its border tax adjustments for the explicit purpose of reducing its trade surplus by a substantial amount. This was done in consultation with Germany's trading partners—and with their approval. Another outcome of this meeting and of the monetary crisis occurring at the time was a decision by the French Government to alter its tax system and its border tax adjustments in such a way as to benefit France's trading position, and thus to help France meet her short-term balance of payments problems. This was recognized to be an alternative during the course of the Bonn Meeting; France's trading partners have accepted these temporary measures designed to improve her trade account. In the circumstances, it is an appropriate alternative to the more permanent effect created by a change of parity.

The General Agreement on Tariffs and Trade in Article XII permits a country with balance of payments problems temporarily to employ direct measures to improve its balance of trade. These recent actions by Germany and France are new examples of direct measures that can be employed. The use of border tax adjustments by surplus and deficit countries to help improve a temporary balance of payments problem is an alternative preferable to quota restrictions and it could develop into an appropriate additional temporary measure under certain circumstances. Never substituting for appropriate fiscal and monetary policy and perhaps other measures, short-term border adjustments can contribute to the workings of the process by which balance of payments equilibrium is reestablished in a nation's accounts.

IV. An Intensified Program to Moderate the Foreign Exchange Costs of Government Expenditures Abroad for Security, Development and Other Activities

A. Military

1. Measures to Reduce the Net Impact of Military Expenditures Abroad

The Department of Defense has continued its efforts to minimize the net impact of its expenditures on our balance of payments. (These efforts were detailed in Tab B of the Treasury publication, "Maintaining the strength of the United States Dollar in a Strong Free World Economy," January, 1968.) Nevertheless, owing primarily to the continuing Vietnam conflict and wage and price increases overseas, DOD expenditures continued to increase during 1968. This increase, however, is expected to be markedly less than those experienced during 1966 and 1967. Defense expenditures worldwide increased from \$3.8 billion in 1966 to \$4.4 billion in 1967 and are expected to increase by some \$200 million in 1968 to a level of about \$4.6 billion. These increases have appeared largely in the Far East area. In Western Europe, we expect to achieve a slight decrease in expenditures during the year; nevertheless, these expenditures are still running at about \$1.6 billion annually.

In its efforts to restrain expenditure increases, DOD has continued programs in effect prior to 1968. Construction and subsistence expenditures abroad have been held down as a result of special efforts. In addition, new programs were undertaken to reduce the number of American civilians working overseas and the expenditures for official travel overseas as a part of government-wide efforts in these areas. During the year DOD also completed a redeployment of about 35,000 United States military personnel from Germany under previously announced plans.

Special efforts also were made during this past year to limit the foreign exchange impact of personal spending by American forces and their dependents in Europe. Primarily, DOD has encouraged individuals stationed overseas voluntarily to contain their spending on the local economy and to increase savings. Working within these guidelines, DOD undertook a general re-emphasis of its existing voluntary programs relating to personal spending, including (a) an expanded internal information program on the balance of payments problem and DOD programs, reaching military and civilian personnel serving at home as well as overseas; (b) improved stocking of American goods in military exchanges overseas; (c) increased promotion of the use of American sales facilities; (d) re-emphasis of American controlled recreation facilities overseas; and (e) renewed emphasis on current savings programs.

It is recognized, however, that owing to price increases overseas as well as pay increases to American personnel, the ability of DOD to achieve substantial reductions in personal spending overseas depends primarily on the reduction of the number of personnel. Accordingly, DOD has undertaken new efforts, particularly in the areas of reducing staffs in overseas headquarters and streamlining overseas support and administrative operations in an effort to reduce the number of persons employed overseas.

2. *Actions to Offset United States Expenditures by Encouraging Foreign Procurement in the United States of Military Equipment*

As a part of the Action Program, we have intensified our efforts, particularly with the financially capable countries of Western Europe, to enlist their balance of payments cooperation through procurement of more of their defense needs in the United States. Additional military sales arrangements were consummated with a number of countries in Europe and elsewhere during the year. These sales will provide balance of payments benefits to the United States during the next several years. DOD receipts, stemming primarily from sales of military equipment, will decline about $300 million from the 1967 level but will nevertheless total approximately $1.2 billion on a global basis in 1968. In 1967, our receipts benefited from an unusually high level of payments from Germany to complete the existing offset arrangements.

3. *Financial Neutralization*

In order to assist in further neutralizing the deficit on the military account, we increased our efforts in 1968 to obtain special financial arrangements, principally through sales of long-term United States securities. We have made considerable progress in this area, particularly in Western Europe, and have commitments for about $1.4 billion of cooperation in this form from other countries this year. If these materialize fully (through November about $1 billion had been realized), we would reduce our net adverse balance in the military account to about $2 billion. This would be an improvement of over $600 million as compared to 1967. It should be noted, however, that these special transactions cannot be regarded as a satisfactory long-term solution to the deficit in our military account.

Cooperation in the military portion of the balance of payments has included countries in the Far East as well as Europe. However, we have focused particular efforts in Europe, both bilaterally and within NATO. In a broader sense, the United States has pursued with its NATO allies the principles that the Alliance requires a foundation of financial viability in addition to political and military strength, and that the members of the Alliance should cooperate through appropriate bilateral arrangements to deal with military balance of payments problems. The communique at the NATO Ministerial Conference in Brussels on November 16, 1968, specifically acknowledged for the first time as a multilateral policy that such cooperation strengthens the solidarity of the Alliance when it stated:

> "They (the Ministers) also acknowledged that the solidarity of the Alliance can be strengthened by cooperation between members to alleviate burdens arising from balance of payments deficits resulting specifically from military expenditures for the collective defense."

B. Development Assistance

On January 11, 1968, the President instructed the AID Administrator to reduce overseas expenditures in calendar year 1968 by a minimum of $100 million below the 1967 level—or to less than $170 million. Preliminary estimates indicate that these expenditures will in fact be in the neighborhood of $140 million in 1968—well below the target figure for the year.

The President also instructed AID to review and improve the effectiveness of the arrangements with individual countries to assure that AID-financed goods shipped to recipient countries will be additional to commercial exports from the United States to those countries. The principle here is to assure that the AID program results in a transfer of real resources rather than financial assets.

Our efforts to minimize the adverse balance of payments impact of our bilateral foreign assistance programs are well established and enjoy a high priority in our overseas foreign economic policy objectives. We have been very successful in this area to date. These efforts will have to be continued and reinforced wherever necessary.

In the future, we will have to place increased emphasis on assuring that original AID financing leads to an adequate level of follow-on commercial sales from the United States. This is primarily the responsibility of the American business community; however, it will be necessary to develop better liaison between the AID field staff and American exporters.

We have been pressing for policies and attitudes that give weight to balance of payments considerations in multilateral development activities. This year the Congress authorized a $300 million contribu-

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tion to the Fund for Special Operations of the Inter-American Development Bank. Disbursement of these funds will be controlled in such a way as to assure the financing of American exports which would not otherwise be financed. In addition, we have received assurances that the ordinary capital funds of the IDB will be managed so as to minimize their adverse impact on the U.S. balance of payments. The proposed International Development Association replenishment contained similar balance of payments safeguards. Most significantly, a good deal of progress has been made in 1968 in developing the capital markets of other countries, particularly those with balance of payments surpluses, as a source of long-term capital for development purposes.

The continuation of these balance of payments safeguards will be an important factor in enabling the United States to contribute, in full and fair measure, its share of the financial requirements of the multilateral development institutions. The premise is becoming well established that multilateral development activities should give adequate consideration to balance of payments factors, particularly in the cases of deficit countries. This premise supports the general proposition that the activities of these institutions should not be conducted in a manner which would exacerbate disequilibrium in international payments.

C. Reduction of United States Government Employees Stationed Abroad

The Government announced the initiation of an extensive two-phased program—called "BALPA", short for "balance of payments"—to reduce the number of people employed abroad by the United States Government. Under BALPA, the number of direct hire Americans stationed abroad is being reduced by approximately 4,000, or 18 percent. The number of local employees is also being reduced by 4,000, or 16 percent.

The present schedule is to have 75 percent of Phase I of this program take place before the end of 1968, with the balance taking place in the first six months of 1969. Of the reductions under Phase II, 75 percent will take place before June 30, 1969, with the balance taking place in the third quarter of 1969.

Balance of payments savings under Phase I will total approximately $20 to $22 million on an annual basis after completion of the scheduled reductions. Completion of Phase II is expected to add additional savings of approximately $8 to $10 million per year. The balance of payments savings of the BALPA program have significance beyond the amounts involved. Implementation of this program will give evidence of the Government's determination to make its own contribution to the over-all balance of payments program.

V. An Intensified Effort for Temporarily Reducing Outflows of Capital from the United States.

Private capital outflows from the United States have played a vital role in the expansion of world trade and investment since World War II. The United States has been a major source of funds for capital-short areas; United States direct investment has helped to spread advanced technology and management skills; and our foreign investment has yielded good returns to the American investor and to the balance of payments of the United States.

In the 1960's, however, the large flows of investment abroad has been a major factor in the deficit of the United States. Although our net private international investment position has risen substantially throughout this decade, we have built up an increasingly high level of liquid liabilities to foreigners while accumulating non-liquid long-term investments overseas. This growing volume of liquid liabilities has been one factor in the instability of the international monetary system in times of stress.

The action measures on foreign investment announced January 1, 1968, struck directly at both shorter and longer-run needs. The new capital restraint programs were designed to strengthen the United States balance of payments in a major way in 1968 through the reduction of capital outflows and increased reflow of earnings from foreign investments. At the same time, the programs emphasized longer-range goals—to give priority to high yielding investments and to expanding American exports; to encourage the growth of European capital markets; and to assure the continuity of a liberal flow of direct investment in the less developed countries and areas traditionally dependent upon United States capital.

Direct Investment

The goal of the 1968 Foreign Direct Investment Program was to reduce the balance of payments deficit on direct investment by $1 billion from the 1967 level. It appears that this mandatory program, administered by the Department of Commerce, will reach this target notwithstanding the exemption given to investment in Canada in March 1968.

Over 3,000 firms have effectively complied with this program. The regulations have not reduced the over-all level of foreign investment by United States companies. In fact, the total will likely set a record high in 1968, thus providing a base for growing income from direct investment in future years. This sustained level of overseas activity, however, has been financed to a far greater extent from foreign sources of capital. Indeed, United States firms will have raised this year close to $2 billion of long-term capital from foreign sources, thereby reducing their transfers of funds from the United States and their reliance on reinvestment of foreign earnings. At the same time, firms will have reduced their liquid balances held abroad and increased their remittances of foreign earnings.

In 1969, there is a clear need to preserve the savings achieved in 1968. Therefore, on November 15, 1968, the Secretary of Commerce announced a continuation of the Foreign Direct Investment Program, with modifications to adjust to the changing pattern of direct investment and the needs of American companies. Importantly, the program will introduce foreign earnings as a criterion for increasing the allowable direct investment of each company. It will also provide additional flexibility for firms with limited or no foreign investment experience; relieve inequities for companies that received investment quotas unusually low in relation to direct investment earnings; remove potential blocks to the growth of exports by American firms to their foreign affiliates; and reduce some unique problems for special industries which became apparent in 1968.

Foreign Lending

The Federal Reserve voluntary program announced on January 1, 1968, set reduced ceilings on loans from United States institutions to foreign borrowers to achieve a net inflow of at least $500 million during the year. Savings for the balance of payments were to be achieved primarily by reducing outstanding United States bank credits to the developed countries of continental Western Europe.

The foreign credit restraint program has continued to function effectively in 1968. Banks reduced their foreign assets subject to the ceilings by $469 million in the first quarter and by another $193 million in the second quarter, compared with a target of $400 million for the whole year. This early response to the Action Program contributed greatly to the rapid improvement in the United States balance of payments in 1968 and thus to renewed stability and confidence in international financial markets.

For the year as a whole, it is expected that banks will preserve most of the savings of over $600 million achieved in the first ten months and that they will meet the target for the year. The non-bank financial institutions in the first half also bettered the targeted savings—a reduction of $100 million of covered foreign assets. As in the case of the Department of Commerce program, these savings were achieved without major dislocation of trade and investment. Here again, the rapidly growing international capital market has proved an effective alternative source of both bank loans and long-term investment funds.

In view of the necessity to preserve the savings achieved in 1968, the Federal Reserve Board has announced a continuation of the voluntary credit restraint program for the coming year. The basic ceilings on foreign lending will be maintained, and the guidelines will continue:

—to encourage lending institutions to give priority to export credits and loans to less developed countries in the use of any leeway;
—to ask banks not to renew or replace maturing term loans to continental Western Europe; and
—to provide leeway for banks to participate in export credits supported by agencies of the United States Government.

Interest Equalization Tax

In July, 1967, the IET was extended for two years with discretionary authority for the President to vary the rate of tax. In 1968, the rate was maintained at the level of 1¼ percent per annum, less than the permissible maximum. It served effectively to place a premium for American investors on portfolio investments and term loans to developed countries. This effective deterrent continued when interest rates in the United States and in other major capital markets gradually declined from the excessively high levels brought about by the crisis in international financial markets in late 1967 and early 1968.

VI. A Long-Range Program for Promoting Foreign Private Investment in United States Securities

Foreign investors have dramatically increased their net purchases of American corporate debt and equity issues since 1964. Net inflows (excluding liquidations by the United Kingdom) increased from $147 million in 1965 to $783 million in 1966 and to nearly $1½ billion in 1967. Through the first three quarters of 1968 these purchases have increased to a record level of about $3½ billion at an annual rate.

The promotion of foreign purchases of American securities has been an important part of the Government's program to improve the balance of payments since 1963. An Industry-Government Task Force in 1964 recommended a series of specific steps to increase inflows of foreign investment capital. One of the key elements in the recommended program called for revisions of the Internal Revenue Code to improve the tax status for foreign investors in the United States. Enactment of the Foreign Investors Tax Act of 1966 accomplished this goal. This was followed by a series of actions by various groups designed to provide foreign investors with better information on investment conditions in the United States.

A special industry group has also sponsored visits to the United States by key foreign investment decision-makers, in order to assist them in contacting policy-level officials in both industry and government. In addition, various segments of the American securities industry have expanded their contacts with foreign investment organizations by establishing new offices overseas and by devoting an increasing amount of attention to servicing the needs of foreign investors.

In addition, the Government has sought to develop a responsible fiscal and monetary policy which will insure the stability and continued growth of the economy of the United States in order to retain the confidence of foreign investors. These efforts have contributed importantly to improvements in the balance of payments, in general, and especially to the establishment of an improved two-way flow of investment capital between the United States and Europe.

Given the substantial increase in net volume of foreign funds flowing into American securities over the past several years, the extent to which this renewed interest by foreigners remains permanent will be important.

Foreign investors typically point to the relative technological superiority of the large American corporations, many of which are, in fact, international corporations headquartered in the United States. The high rates of earnings and reinvestment for continued growth by these firms are key reasons for renewed European interest in American coporate securities. The United States remains the largest single market in the world, with a strong steady growth rate equal to or better than that of most industrialized countries, and a tradition of political and social stability which seems increasingly crucial to investors in these days of national and international instability elsewhere. Investors see the United States as an eminently secure economy in which to hold a portion of their investment portfolios—both safely and profitably.

In addition, the basic features of the American securities market continue to be attractive to foreign investors. These features are the size of the equities market, the availability of information on corporate activities, and the added touch of credibility due to the efforts of the Securities and Exchange Commission and the work of the exchanges to police themselves.

In order to sustain investment inflows from abroad, we must insure that the American economy, both domestically and in terms of its international impact, continues its steady advance. This requires continuation of the Administration's programs to achieve growth with price stability at home and to maintain worldwide confidence in the dollar as a long-term investment vehicle as well as a fundamental transactions currency underlying international trade and payments.

VII. A Long-Range Program for Narrowing the Travel Gap Through Promotion of Foreign Travel in the United States and Temporary Measures to Reduce Travel Outlays Abroad by United States Residents

Results of our efforts to reduce the travel gap in 1968 have been disappointing. Although complete data will not be available until early next year, it seems clear that we will not reach our goal of saving $500 million on the tourism account.

We have been more successful in implementing our long-range program to stimulate foreign travel to the United States than we have been in containing American travel abroad. Most recommendations made in the February report of the Industry-Government Special Task Force on Travel have been put into effect. Some, however, including the waiving of visa requirements for temporary visitors to the United States have not yet been implemented. Full implementation of all recommendations must be achieved before the United States can be said to have a meaningful program designed to attract foreign travelers to this country.

The Administration's short-term efforts to secure legislation in the Congress to reduce the outflow of tourist dollars abroad in 1968 were not successful. A bill reducing Customs exemptions and establishing a 5 percent ticket tax on international air travel passed the House of Representatives in June but failed to pass the Senate. The Administration's proposal to levy a graduated expenditures tax was not reported out by the House Ways and Means Committee.

On July 31, Secretary Fowler sent a letter to Senator Long, Chairman of the Senate Finance Committee, in which he proposed a method whereby the short-term and long-term efforts of the United States to reduce its chronic travel deficit could be combined. Under the proposal, a portion of the proceeds from the proposed ticket and expenditure taxes would be used, up to a limit of $30 million per year over a five-year period, to fund our long-range effort to increase foreign travel to the United States. In this fashion, the proposed taxes would take on a dual character. In addition to accomplishing an immediate balance of payments saving by prompting American travelers abroad to keep their expenditures within reasonable bounds, the law would also constitute a positive measure to promote tourism to the United States. Both steps are necessary to bring our travel deficit within a manageable range. Funding the long-range travel program with revenues raised from the short-term program should be the cornerstone of future United States programs in this area.

In summary, our progress in the travel area has been one of the most disappointing parts of our 1968 balance of payments program. We believe that the basic premises upon which we based our legislative recommendations to the Congress in 1968 are still valid, and that they will remain so in 1969. In the absence of meaningful measures to reduce the travel gap, we may well have an annual travel deficit of $4 billion by 1975. The best way to reduce the travel gap is to encourage increased foreign travel to the United States. An adequately financed promotional program is, however, a *sine qua non* for achieving this.

VIII. Adjustment Responses Expected of Trading Partners

During 1968 the international payments pattern has been subject to large and, to some extent, unusual capital movements. During the first quarter these were associated with the large-scale speculation in gold. During the second and third quarters the French franc felt the impact of large-scale capital outflow, following the labor and student disturbances in May. The United States was the recipient of substantial inflows of capital for the purchase of portfolio stocks, and from large-scale borrowing from the Euro-dollar market by the American commercial banking system.

At the same time, the combined current balance of payments surplus of the European Community countries as a group appears to have increased even above the extremely high level of 1967, when it amounted to $4¼ billion. Italy's current account surplus rose to nearly $2½ billion, and Germany's to perhaps $2¾ billion. The German trade surplus was again particularly striking, at about $4 billion a year with imports figured to include insurance and freight, or over $5 billion a year on a basis comparable to that used in United States trade figures.

These figures are cited to give some indication both of the importance of these large trade surpluses in sustaining the domestic economies in these two countries, and at the same time making it much more difficult for the United Kingdom and the United States to achieve an improvement in their trade and current accounts.

These developments in the current and capital accounts have led to questioning as to whether an adjustment pattern can be based over a longer period of time on an extremely high trade and current account surplus in the European Community, offset by a very large outflow of capital in the form of banking funds and portfolio investments. Partly because of the substantial reserve losses of the French, the European Community countries actually recorded a decline in reserves of $1.1 billion in the first half of 1968, following a number of years in which these countries regularly added to their reserves at the rate of nearly $1½ billion a year. This very substantial swing indicates the very large size of capital movements that can occur in a relatively short time when a currency comes under pressure.

Because of these capital movements, the dollar has been strong in the exchange market, and the United States has had a substantial official transactions surplus in 1968, as against a deficit measured on this basis of $3.4 billion for the entire year 1967. However, this structure of international payments may be vulnerable in the future. For example, if the German economy should begin to show signs of inflation, a tighter monetary policy would be likely to exert an especially strong restraining effect upon the purchases of foreign bonds, which have been quite large in 1968, and on investments in foreign money markets by the German commercial banking system. The equilibrating capital outflow would then decline much more rapidly, in the event of a German boom, than the corresponding reduction in the German trade surplus as domestic consumption of imported goods increased.

The ideal situation would be for the German and Italian economies to expand while avoiding a resumption of inflationary pressures are to base the expansion upon domestic demand factors, relying less upon the impetus to the domestic economy of the extremely large current and trade surpluses. The Italian economy could make effective use at home of the substantial amounts of real goods that are now being shipped abroad and financed by the export of capital. In fact the Italian authorities recognize that an equilibrium on current account as well as capital account is a desirable objective for Italy. The German authorities took steps in November to reduce the large current account surplus, although they still rely heavily on capital exports to avoid a rise in German reserves.

In sum, the first three quarters of the year 1968 have been marked by capital movements that have tended to strengthen the position of the dollar, as against earlier periods, although this has been partly associated with strain on the Franch franc. More attention is beginning to be devoted to the more deep-seated and difficult problem of achieving a pattern of trade surpluses and deficits that will be regarded internationally as more satisfactory than the present concentration of strong current account positions in the European Community countries, apart from France.

It is therefore to be hoped that the Continental surplus countries will find ways of relying to a larger extent upon domestic demand, rather than on foreign demand for their products, in maintaining the strength of their economies. Greater reliance on domestic demand would represent an important contribution by the surplus countries to the balance of payments adjustment process.

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