

PRESIDENT'S 1967 TAX PROPOSALS

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HEARINGS BEFORE THE COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES NINETIETH CONGRESS

FIRST SESSION

ON

THE TAX PROPOSALS OF THE PRESIDENT
CONTAINED IN HIS MESSAGE TRANSMITTED
TO THE CONGRESS AUGUST 3, 1967

AUGUST 14, 15, 21, 22, 23, 24, 25, 28;
SEPTEMBER 12, 13, AND 14, 1967

PART 1

Contains August 14, 15, 21, 22, 23, 24, and 25

Printed for the use of the Committee on Ways and Means



0953885

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1967

83-349

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CONTENTS

PART 1

1967:		
Monday, August 14.....		Page 1
Tuesday, August 15.....		113
Monday, August 21.....		219
Tuesday, August 22.....	.....	257
Wednesday, August 23.....	.....	313
Thursday, August 24.....	.....	341
Friday, August 25.....	.....	377

PART 2

Monday, August 28.....	.....	393
Tuesday, September 12.....	.....	485
Wednesday, September 13.....	.....	639
Thursday, September 14.....	.....	691
Material received for the record.....	.....	723

Message from the President of the United States entitled "Taxes" (H. Doc. 152, 90th Cong., first sess.).....	.....	1
Press release dated Thursday, August 3, 1967, announcing public hearing on President's tax proposals.....	.....	7
Background material on President's tax proposals issued by the Treasury Department:		
Explanation of President's proposal for a tax surcharge of 10 percent.....	.....	8
Tax tables showing effects of 10 percent tax surcharge.....	.....	10
Corporate current tax payment proposals.....	.....	11
Figures on the recommended continuation of excise taxes on automobiles and telephone service.....	.....	13
Draft of bill and technical explanation of "Surcharge Tax Act of 1967".....	.....	32

STATEMENTS BY GOVERNMENT OFFICIALS

Budget, Bureau of the, Hon. Charles L. Schultze, Director.....	.....	40, 113
Council of Economic Advisers, Hon. Gardner Ackley, Chairman.....	.....	48, 113
Federal Reserve System:		
Martin, Hon. William McChesney, Jr., Chairman, Board of Governors.....	.....	691
Hayes, Alfred, president, Federal Reserve Bank of New York.....	.....	717
Treasury, Department of the:		
Fowler, Hon. Henry H., Secretary.....	.....	13, 113
Surrey, Hon. Stanley S., Assistant Secretary for Tax Policy.....	.....	194

PANEL DISCUSSION (ECONOMISTS)

Eckstein, Otto, professor of economics, Harvard University.....	.....	486
McCracken, Paul, Edmund Ezra Day University professor of business administration, the University of Michigan.....	.....	495
O'Leary, James J., chairman of the board and chief economist, Lionel D. Edie & Co., Inc., New York City.....	.....	504
Pechman, Joseph A., director of economic studies, the Brookings Institution.....	.....	518

Reiersen, Roy L., senior vice president and chief economist, Bankers Trust Co., New York, N.Y.-----	Page 525
Saulnier, Raymond J., professor of economics, Barnard College, Columbia University-----	544
Turne, Norman B., National Bureau of Economic Research, Inc.-----	552
Turner, Robert C., professor of business economics and public policy, Indiana University-----	563

PANEL DISCUSSION (BUSINESSMEN)

Dillon, C. Douglas, Dillon, Read & Co., New York, N.Y.-----	658
Roosa, Robert V., partner, Brown Bros., Harriman & Co., New York.---	663
Saunders, Stuart T., chairman of the board, Pennsylvania Railroad.---	639
Weinberg, Sidney J., Goldman, Sachs & Co., (read by Mr. Stuart T. Saunders)-----	656
Wriston, Walter B., president, First National City Bank, New York.---	660

STATEMENTS OF PUBLIC WITNESSES

American Bankers Association, Jack T. Conn, president, and Charls E. Walker, executive vice president.-----	393
American Federation of Labor and Congress of Industrial Organizations, George Meany, president.-----	313
American Life Convention, Arthur S. Fefferman, director, economic analysis, and Kenneth M. Wright, vice president and chief economist, Life Insurance Association of America.-----	327
Andersen, Arthur, & Co., John Mendenhall, partner, and director of taxes.---	370
Bryant, F. Leonard, Manufacturing Chemists Association.-----	359
Bullen, George S., legislative director, National Federation of Independent Business.-----	239
Chamber of Commerce of the United States: Madden, Carl H., chief economist.-----	257
Winter, Walker, vice president, and chairman, taxation committee.---	257
Committee for Economic Development, Frazar B. Wilde, chairman.---	349
Conn, Jack T., president, American Bankers Association, and Charls E. Walker, executive vice president.-----	393
Connolly, John L., chairman, Federal finance committee, Council of State Chambers of Commerce.-----	446
Council of State Chambers of Commerce, John L. Connolly, chairman, Federal finance committee.-----	446
Crehore, John Davenport, Washington, D.C.-----	335
Davidson, John C., president, Tax Council.-----	301
Fefferman, Arthur S., director, economic analysis, American Life Convention, and Kenneth M. Wright, vice president and chief economist, Life Insurance Association of America.-----	327
Ferguson, Courtland D., president, Fighting Taxpayers Association.---	367
Fighting Taxpayers Association, Courtland D. Ferguson, president.---	367
Freedom Inc., E. S. Hall, chief engineer and secretary.-----	332
Graham, Harry, legislative representative, National Grange.-----	476
Gullander, W. P., president, National Association of Manufacturers.---	219
Hall, E. S., chief engineer and secretary, Freedom Inc.-----	332
Heisler, Kenneth G., executive director, National League of Insured Savings Associations.-----	306
Hicks, W. B., Jr., executive secretary, Liberty Lobby.-----	338
Hoffman, Raymond A., Illinois State Chamber of Commerce.-----	309
Illinois State Chamber of Commerce, Raymond A. Hoffman.-----	309
Institute on U.S. Taxation of Foreign Income, Paul D. Seghers, president.---	242
Investors League, Inc., William Jackman, president.-----	384
Jackman, William, president, Investors League, Inc.-----	384
Jackson, Donald W., executive secretary, Tennessee Taxpayers Association, Inc., and member, policy committee, National Taxpayers Conference.-----	380
Kust, Leonard, vice president and general tax counsel, Westinghouse Electric Corp.-----	243
Liberty Lobby, W. B. Hicks, Jr., executive secretary.-----	338

Life Insurance Association of America, Kenneth M. Wright, vice president and chief economist, and Arthur S. Fefferman, director, economic analysis, American Life Convention.....	Page 327
Machinery & Allied Products Institute, Charles W. Stewart, president....	416
Madden, Carl H., chief economist, Chamber of Commerce of the United States.....	257
Manufacturing Chemists Association, F. Leonard Bryant.....	359
Meany, George, president, American Federation of Labor and Congress of Industrial Organizations.....	313
Mendenhall, John, partner, and director of taxes, Arthur Andersen & Co....	370
Mitchell, C. R., chairman, legislative committee, U.S. Savings & Loan League.....	387
Mortgage Bankers Association of America, Robert H. Pease, treasurer and member, executive committee.....	456
National Association of Home Builders:	
Rogg, Nathaniel, executive vice president.....	460
Silverstein, Leonard, tax counsel.....	460
Wiener, Leon N., president.....	219
National Association of Manufacturers, W. P. Gullander, president.....	
National Association of Retired Civil Employees, Clarence M. Tarr, president.....	377
National Federation of Independent Business, George S. Bullen, legislative director.....	239
National Grange:	
Graham, Harry, legislative representative.....	476
Newsom, Herschel D., master (read by Mr. Harry Graham).....	476
National League of Insured Savings Associations, Kenneth G. Heisler, executive director.....	306
National Taxpayers Conference, Donald W. Jackson, member, policy committee, and executive secretary, Tennessee Taxpayers Association, Inc.....	380
Newsom, Herschel D., master, National Grange (read by Mr. Harry Graham).....	476
Patman, Hon. Wright, a Representative in Congress from the State of Texas.....	341
Pease, Robert H., treasurer and member, executive committee, Mortgage Bankers Association of America.....	456
Rogg, Nathaniel, executive vice president, National Association of Home Builders.....	460
Seghers, Paul D., president, Institute on U.S. Taxation of Foreign Income....	242
Silverstein, Leonard, tax counsel, National Association of Home Builders....	460
Stewart, Charles W., president, Machinery & Allied Products Institute....	416
Tarr, Clarence M., president, National Association of Retired Civil Employees.....	377
Tax Council, John C. Davidson, president.....	301
Tennessee Taxpayers Association, Inc., Donald W. Jackson, executive secretary, and member, policy committee, National Taxpayers Conference.....	380
Tenzer, Hon. Herbert, a Representative in Congress from the State of New York.....	287
U.S. Savings & Loan League, C. R. Mitchell, chairman, legislative committee.....	387
Walker, Charis E., executive vice president, American Bankers Association, and Jack T. Conn, president.....	393
Westinghouse Electric Corp., Leonard Kust, vice president and general tax counsel.....	243
Wiener, Leon N., president, National Association of Home Builders....	460
Wilde, Frazar B., chairman, Committee for Economic Development.....	349
Winter, Walker, vice president, Chamber of Commerce of the United States, and chairman, taxation committee.....	257
Wright, Kenneth M., vice president and chief economist, Life Insurance Association of America, and Arthur S. Fefferman, director, economic analysis, American Life Convention.....	327

MATERIAL SUBMITTED FOR THE RECORD

GOVERNMENT OFFICIALS

Ackley, Hon. Gardner, Chairman, Council of Economic Advisers:	Page
Chart 1. Changes in total GNP and final sales.....	52
Chart 2. Relation of nonfarm stocks to total final sales.....	54
Chart 3. Private homebuilding.....	56
Chart 4. Business capital outlays.....	57
Relation of corporate GNP to total and private GNP.....	205
Fowler, Hon. Henry H., Secretary, Department of the Treasury:	
Draft of bill and technical explanation of "Surcharge Tax Act of 1967".....	32
Estimated net administrative budget receipts, present law, in the fiscal year 1968.....	63
Estimated net administrative budget receipts in the fiscal year 1968 (assuming President's tax program).....	32
Repayment of foreign obligations to the U.S. Government.....	114
Table 1.—Comparison of 1963–66 tax liability and 1967–68 tax liability under proposed tax increase for illustrative taxpayers (single individual).....	31
Table 2.—Comparison of 1963–66 tax liability and 1967–68 tax liability under proposed tax increase for illustrative taxpayers (married couple, no dependents).....	31
Table 3.—Comparison of 1963–66 tax liability and 1967–68 tax liability under proposed tax increase for illustrative taxpayers (married couple, 2 dependents).....	32
Technical explanation of "Surcharge Tax Act of 1967," and draft of bill.....	32
U.S. net gold transactions for foreign monetary and domestic industrial and artistic uses (1960–67).....	139
Schultze, Hon. Charles L., Director, Bureau of the Budget:	
Table 1.—Categories of major change in January estimates of 1968 administrative budget expenditures.....	47
Table 2.—Major changes in 1968 administrative budget expenditures by agency.....	47
Table 3.—1968 civilian administrative budget expenditures based on actions and developments to date by type of controllability.....	47
Surrey, Hon. Stanley S., Assistant Secretary for Tax Policy, Treasury Department of the Treasury:	
Derivation of the individual income tax base from Department of Commerce estimates of personal income, 1965.....	196
Detailed breakdown of certain items included in personal income but not in adjusted gross income.....	196
Interest on State and local government bonds, 1962.....	195

PUBLIC

Abel, I. W., president, United Steelworkers of America, telegram dated August 4, 1967, to Chairman Mills.....	755
Adelman, R. P., director of taxation, Celanese Corp., letter dated August 22, 1967, to Chairman Mills.....	753
Air Transport Association, Stuart G. Tipton, president, letter dated August 31, 1967, to Chairman Mills.....	765
Akin, Paul B., president, Laclede Steel Co., letter dated August 23, 1967, to Chairman Mills.....	750
Alan Wood Steel Co., Harleston R. Wood, chairman of the board and president, statement.....	747
Aluminum Co. of America, E. A. Vaughn, vice president and controller, letter dated August 29, 1967, to Chairman Mills.....	746
American Electric Power Co., Inc., Donald C. Cook, president, statement.....	753
American Farm Bureau Federation, John C. Lynn, legislative director, letters dated September 15, 1967, and August 24, 1967, with enclosure, to Chairman Mills.....	760
American Federation of Labor and Congress of Industrial Organizations, George Meany, president:	
Appendix I—AFL-CIO proposal: 6 percent surtax—family of four (income from wages and salaries).....	321

PUBLIC—Continued

American Federation of Labor and Congress of Industrial Organizations, George Meany, president—Continued	Page
Appendix II—AFL-CIO proposal: 8 percent surtax—family of four (income from wages and salaries)-----	321
Appendix III—AFL-CIO proposal: 10 percent surtax—family of four (income from wages and salaries)-----	322
Appendix IV—Approximate amount of additional revenue—Alterna- tive A-----	322
Appendix V—Approximate amount of additional revenue—Alterna- tive B-----	322
Appendix VI—Approximate amount of additional revenue—Alterna- tive C-----	322
Surcharge on family of four-----	318
American Retail Federation, Eugene A. Keeney, executive vice president, letter dated August 29, 1967, to Chairman Mills-----	758
Armco Steel Corp., C. William Verity, Jr., president, statement-----	748
Associated Retail Bakers of America, William A. Quinlan, general counsel and Washington representative, letter dated September 21, 1967, to Chairman Mills, with resolution attached-----	758
Association of American Railroads, Thomas M. Goodfellow, president, letter dated September 13, 1967, to Chairman Mills-----	765
Association of Equipment Lessors, Harvey Granat, president, letter dated September 11, 1967, to Chairman Mills-----	737
Automobile Manufacturers Association, Inc., Thomas C. Mann, president, letter dated August 18, 1967, to Chairman Mills-----	735
Bach, G. L., Stanford University, tax policy statement (signed by 320 economists of various universities)-----	631
Barker, C. Austin, partner-economist, Hornblower & Weeks-Hemphill, Noyes letter dated August 14, 1967, to Chairman Mills-----	792
Barlow, Joel, Covington & Burling, letter dated August 26, 1967, to Chair- man Mills-----	759
Beirne, Joseph A., president, Communications Workers of America, letter dated September 5, 1967, to Chairman Mills, with statement attached-----	755
Boyd, Howard, chairman of the board, El Paso Natural Gas Co., telegram of tax policy dated August 18, 1967, to Chairman Mills signed by 22 American businessmen-----	658
Bratt, Elmer C., director, Business-Economics Center, Lehigh University, letter dated August 29, 1967, to Chairman Mills, with attachment-----	786
Bryant, F. Leonard, Manufacturing Chemists Association, statement concerning proposed amendment to section 6655-----	364
Burns, Arthur F., National Bureau of Economic Research, statement-----	768
Byars, James A., chairman, Governmental Affairs Committee, Columbus, Ga., chamber of commerce, letter dated August 10, 1967, to Chairman Mills-----	742
Calvert, Gordon, executive director and general counsel, Investment Bankers Association of America, letter dated August 18, 1967, to Chair- man Mills-----	734
Celanese Corp., R. P. Adelman, director of taxation, letter dated August 22, 1967, to Chairman Mills-----	753
Collier, Robert P., dean, College of Business and Social Sciences, Utah State University, letter dated August 7, 1967, to Chairman Mills, with attachment-----	782
Columbus, Ga., Chamber of Commerce Governmental Affairs Committee, James A. Byars, chairman, letter dated August 10, 1967, to Chairman Mills-----	742
Communications Workers of America, Joseph A. Beirne, president, letter dated September 5, 1967, to Chairman Mills, with statement attached-----	755
Cook, Donald C., president, American Electric Power Co., Inc., statement-----	753
Crehore, John Davenport, Washington, D.C., National sales tax—a work- able plan, pamphlet-----	795
Dechant, Tony T., president, National Farmers Union, letter dated August 15, 1967, to Chairman Mills, with resolutions attached-----	761
DeWolf, A. J., president, National Machine Tool Builders' Association, letter dated September 13, 1967, to Chairman Mills-----	738

PUBLIC—Continued

Dingell, Hon. John D., a Representative in Congress from the State of Michigan, letter dated August 18, 1967, to Chairman Mills.....	Page 725
Dolan, Terence P., financial and recording secretary, and Gerald A. Ryan, president, Uniformed Firemen's Association of Greater New York, telegram dated September 12, 1967, to Chairman Mills.....	746
Du Boff, R. B., Department of Economics, Bryn Mawr College, letter dated September 12, 1967, to Chairman Mills.....	636
Du Pont, E. I., de Nemours & Co., Inc., Elastomer Chemicals Department, Alastair Rutherford, manager, market analysis, letter dated September 18, 1967, to Chairman Mills.....	785
Duvall, D. C., president, Wheeling Steel Corp., letter dated August 22, 1967, to Chairman Mills.....	752
Eddy, George A., Alexandria, Va., statement.....	830
Eisner, Robert, professor of economics, College of Arts & Sciences, Department of Economics, Northwestern University, letter dated September 12, 1967, to Chairman Mills, with attachment.....	637
Ellis, Otis H., attorney, Society of Independent Gasoline Marketers of America, letter dated September 12, 1967, to Chairman Mills.....	764
Finch, C. C., Washington, D.C., letter dated August 4, 1967, to Chairman Mills.....	832
Foegen, Dr. J. H., professor of business, Winona State College, letter dated August 14, 1967, to Chairman Mills.....	781
Funk, David G., economist, John Hancock Mutual Life Insurance Co., letter dated August 10, 1967, to Chairman Mills.....	789
Gelwick, Allen G., Jr., certified public accountant, letter dated August 23, 1967, to Leo H. Irwin, chief counsel, Committee on Ways and Means.....	826
Gonzalez, Hon. Henry B., a Representative in Congress from the State of Texas, letter dated September 12, 1967, to Chairman Mills.....	730
Goodfellow, Thomas M., president, Association of American Railroads, letter dated September 13, 1967, to Chairman Mills.....	765
Granat, Harvey, president, Association of Equipment Lessors, letter dated September 11, 1967, to Chairman Mills.....	737
Gray, George O., consultant, International Economic Policy Association, letter dated September 12, 1967, to Chairman Mills.....	735
Greenwald, Douglas, chief economist, McGraw-Hill Publications, statement.....	626
Guill, Ben H., congressional liaison, letter dated August 23, 1967, to Chairman Mills, transmitting statement of National Automobile Dealers Association.....	736
Haack, Robert W., president, New York Stock Exchange, statement.....	733
Hailstones, Thomas J., dean, College of Business Administration, Xavier University, letter to Chairman Mills.....	773
Heinkel, Fred V., president, Midcontinent Farmers Association, letter dated August 29, 1967, to Chairman Mills.....	762
Heller, Walter W., University of Minnesota, tax policy statement (signed by 320 economists of various universities).....	631
Huston, Charles L., Jr., president, Lukens Steel Co., statement.....	751
International Economic Policy Association, George O. Gray, consultant, letter dated September 12, 1967, to Chairman Mills.....	735
Investment Bankers Association of America, Gordon Calvert, executive director and general counsel, letter dated August 18, 1967, to Chairman Mills.....	734
Keeney, Eugene A., executive vice president, American Retail Federation, letter dated August 29, 1967, to Chairman Mills.....	758
Kelly, Hon. Edna F., a Representative in Congress from the State of New York, statement.....	723
Kust, Leonard, vice president and general tax counsel, Westinghouse Electric Corp., Thinking Ahead—Tax Speedups and Corporate Liquidity, by Joseph E. Miles, from the Harvard Business Review, July-August 1967.....	247
Laclede Steel Co., Paul B. Akin, president, letter dated August 23, 1967, to Chairman Mills.....	750
Long, H. Owen, Ph. D., head, Business Administration, Division of Social Studies, Pensacola Junior College, letter to Chairman Mills.....	779

PUBLIC—Continued

	Page
Lukens Steel Co., Charles L. Huston, Jr., president, statement.....	751
Lynn, John C., legislative director, American Farm Bureau Federation, letters dated September 15, 1967, and August 24, 1967, with enclosure, to Chairman Mills.....	760
McGraw-Hill Publications, Douglas Greenwald, chief economist, statement.....	626
McKinney, George W., Jr., vice president, Irving Trust Co., letter dated August 14, 1967, to Chairman Mills.....	794
Mann, Thomas C., president, Automobile Manufacturers Association, Inc., letter dated August 18, 1967, to Chairman Mills.....	735
Manufacturers Association of the City of Bridgeport, Conn., Harmon E. Snoke, executive vice president, letter dated August 11, 1967, to Chairman Mills.....	738
Manufacturing Chemists Association, F. Leonard Bryant, statement concerning proposed amendment to section 6655.....	364
Meany, George. (See American Federation of Labor and Congress of Industrial Organizations.)	
Meskill, Hon. Thomas J., a Representative in Congress from the State of Connecticut, statement.....	731
Metro-Goldwyn-Mayer, Inc., statement.....	763
Midcontinent Farmers Association, Fred V. Heinkel, president, letter dated August 29, 1967, to Chairman Mills.....	762
Minish, Hon. Joseph G., a Representative in Congress from the State of New Jersey, letter dated August 10, 1967, to Chairman Mills.....	727
Mott, William C., executive vice president, United States Independent Telephone Association, letter dated September 8, 1967, to Chairman Mills, with attached resolution and editorial.....	742
National Association of Business Economists membership survey on tax increase and economic outlook.....	629
National Automobile Dealers Association, statement, transmitting letter dated August 23, 1967, from Ben H. Guill, congressional liaison, to Chairman Mills.....	736
National Bureau of Economic Research, Arthur F. Burns, statement.....	768
National Farmers Union, Tony T. Dechant, president, letter dated August 15, 1967, to Chairman Mills, with resolutions attached.....	761
National Machine Tool Builders' Association, A. J. DeWolf, president, letter dated September 13, 1967, to Chairman Mills.....	738
National Tax Equality Association, Vernon Scott, president, letter dated September 14, 1967, to Chairman Mills.....	759
Newcomb, Robinson, Robinson Newcomb Associates, to Chairman Mills.....	638
New York Chamber of Commerce Committee on Taxation, statement.....	739
New York Stock Exchange, Robert W. Haack, president, statement.....	733
Patman, Hon. Wright, a Representative in Congress from the State of Texas:	
Text of H.R. 12250, a bill to provide for the issuance of nonnegotiable United States bonds to finance certain defense expenditures for the duration of the hostilities in Vietnam and for other purposes.....	348
Yields on long-term Government bonds, 1939 to present.....	345
Peat, Marwick, Mitchell & Co., certified public accountants, Leon O. Stock, letter to Chairman Mills.....	791
Pechman, Joseph A., director of economic studies, the Brookings Institution, statement on tax policy (signed by 320 economist of various universities).....	631
Peterson, Richard L., assistant professor of economics, Department of Economics, Southern Methodist University, letter dated September 15, 1967, to Chairman Mills.....	772
Quinlan, William A., general counsel and Washington representative, Associated Retail Bakers of America, letter dated September 21, 1967, to Chairman Mills, with resolution attached.....	758
Reid, Hon. Charlotte T., a Representative in Congress from the State of Illinois, statement.....	728
Risch, William H., certified public accountant, letter dated August 18, 1967, to Leo H. Irwin, Committee on Ways and Means.....	827

PUBLIC—Continued

Rutherford, Alastair, manager, market analysis, Elastomer Chemicals Department, E. I. du Pont de Nemours & Co., Inc., letter dated September 18, 1967, to Chairman Mills	Page 785
Ryan, Gerald A., president, and Terence P. Dolan, financial and recording secretary, Uniformed Firemen's Association of Greater New York, telegram dated September 12, 1967, to Chairman Mills	746
Saunders, Stuart T., chairman of the board, Pennsylvania Railroad, statement of principles with 455 signatures of members of the business community	640
Scherr Tumico, Inc., L. T. Smith, financial vice president and treasurer, letter dated September 12, 1967, to Hon. Ancher Nelsen, Member of Congress with covering letter dated September 15, 1967	732
Schwengel, Hon. Fred, a Representative in Congress from the State of Iowa, statement	726
Scott, Vernon, president, National Tax Equality Association, letter dated September 14, 1967, to Chairman Mills	759
Shapiro, Dr. Sherman, professor of economics, College of Business Administration, University of Illinois, letter dated September 8, 1967, to Chairman Mills	782
Shere, Louis, professor of economics, Department of Economics, Indiana University, letter dated September 15, 1967, to Chairman Mills	771
Smith, L. T., financial vice president and treasurer, Scherr Tumico, Inc., letter dated September 12, 1967, to Hon. Ancher Nelsen, Member of Congress with covering letter dated September 15, 1967	732
Snoke, Harmon E., executive vice president, Manufacturers Association of the City of Bridgeport, Conn., letter dated August 11, 1967, to Chairman Mills	738
Society of Independent Gasoline Marketers of America, Otis H. Ellis, attorney, letter dated September 12, 1967, to Chairman Mills	764
Somers, Harold M., dean, Division of Social Sciences, University of California, Los Angeles, letter dated August 26, 1967, to Chairman Mills, with article from Los Angeles Times attached	766
Spangler, Miller B., director, oceanics project, National Planning Association, letter dated August 11, 1967, to Chairman Mills	793
Stahl, Richard W., Forest Hills, N.Y., certified public accountant, statement	828
Stempel, Morton, manager of market planning, Standard Packaging Corp., letter dated August 14, 1967, to Chairman Mills	792
Stock, Leon O., Peat, Marwick, Mitchell & Co., certified public accountants, letter to Chairman Mills	791
Stoner, Henry, Avon Park, Fla., letter dated August 5, 1967, to Chairman Mills	832
Summers, Gary W., letter dated August 15, 1967, to Committee on Ways and Means	826
Tax Foundation—Special report, "Controllability of Fiscal 1968 Expenditures"	177
Tax policy statements:	
Telegram from Howard Boyd, chairman of the board, El Paso Natural Gas Co., dated August 18, 1967, to Chairman Mills, signed by 22 American businessmen	658
Signed by 320 economists of various universities, circulated by G. L. Bach, Stanford University, Walter W. Heller, University of Minnesota, and Joseph A. Pechman, The Brookings Institution	631
Signed by 455 American businessmen, submitted by Stuart T. Saunders, chairman of the board, Pennsylvania Railroad	640
Tenzer, Hon. Herbert, a Representative in Congress from the State of New York:	
Letter dated January 13, 1967, from Paul F. Preston, analyst in public finance, Legislative Reference Service, Library of Congress	292
Letter dated August 22, 1967, from Samuel M. Jones, Deputy Assistant to the Secretary, Office of the Secretary of the Treasury	288
Report from Washington entitled, "H.R. 3803 Seeks To Reduce the Oil Depletion Allowance"	298
Thompson, Hon. Frank, Jr., a Representative in Congress from the State of New Jersey, statement	726

PUBLIC—Continued

Tipton, Stuart G., president, Air Transport Association, letter dated August 31, 1967, to Chairman Mills.....	Page 765
Towle, Lawrence W., Department of Economics, Trinity College, letter dated August 7, 1967, to Chairman Mills.....	780
Turner, Robert C., professor of Business Economics, Graduate School of Business, Indiana University, letter to Chairman Mills.....	638b
Uniformed Firemen's Association of Greater New York, Gerald A. Ryan, president, and Terence P. Dolan, financial and recording secretary, telegram dated September 12, 1967, to Chairman Mills.....	746
United States Independent Telephone Association, William C. Mott, executive vice president, letter dated September 8, 1967, to Chairman Mills, with attached resolution and editorial.....	742
United Steelworkers of America, I. W. Abel, president, telegram dated August 4, 1967, to Chairman Mills.....	755
Vaughn, E. A., vice president and controller, Aluminum Co. of America, letter dated August 29, 1967, to Chairman Mills.....	746
Verity, C. William, Jr., president, Armco Steel Corp., statement.....	748
Westinghouse Electric Corp., Leonard Kust, vice president and general tax counsel, Thinking Ahead—Tax Speedups and Corporate Liquidity, by Joseph E. Miles, from the Harvard Business Review, July–August 1967.....	247
Wheeling Steel Corp., D. C. Duvall, president, letter dated August 22, 1967, to Chairman Mills.....	752
Wojtyla, Henry L., letter dated August 22, 1967, to Chairman Mills, with statement attached.....	789
Wood, Harleston R., chairman of the board and president, Alan Wood Steel Co., statement.....	747

PRESIDENT'S 1967 TAX PROPOSALS

MONDAY, AUGUST 14, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

The purpose of the hearing this morning is to receive testimony from officials of the administration and from the interested public on the President's tax proposals contained in his message to Congress of August 3, 1967.

Without objection a copy of House Document 152, which contains the President's message of August 3 on this subject, will be made a part of the record at this point, along with a copy of the press release which was issued on August 3 announcing the hearings. We will also include at this point a copy of an explanation which was issued by the Department of the Treasury on the tax proposals.

(The information referred to follows:)

[House of Representatives, Doc. No. 152, 90th Cong., first sess.]

TAXES

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING RECOMMENDATIONS FOR TAXES

To the Congress of the United States:

THE HARD AND INESCAPABLE FACTS

Behind the accounts that make up the Nation's budget lies the pursuit of America's responsibility and purpose at home and abroad.

As we enter this new Fiscal Year, the Congress and the American people should have an up-to-date report on the state of the budget, and on the steps that must be taken to protect the national security and to sustain the health and vitality of this Nation.

Last January we submitted our budget for Fiscal 1968. In that budget we estimated:

- Expenditures of \$135 billion.
- Revenue of approximately \$127 billion, including income from a 6% surcharge on corporate and individual taxes effective July 1.
- A resulting deficit of about \$8 billion.

Since then much has happened to change these prospects.

For several weeks, I have reviewed with my advisers the entire economic and budgetary situation. I have consulted with leaders of the labor, farm and business communities. As a result of that review I am submitting today a financial plan for America's continued economic well-being.

No President likes to report a significant revision in the Nation's budget estimates. Treasury, budget and economic experts tried to be as realistic as possible

in the estimates they made late last year. Yet, no task is more formidable than to try to predict—over 18 months in advance—a budget of around \$135 billion and its related revenues for 200 million Americans.

The Nation now faces these hard and inescapable facts for fiscal 1968:

- Expenditures are likely to be between the January budget figure of \$135 billion and \$143.5 billion—as much as \$8.5 billion higher—depending upon the determination and ability of the Congress and the Executive to control expenditures.
- Revenues are now estimated some \$7 billion lower than in January, even with a 6% tax surcharge.
- These changes in the January budget estimates would result in a deficit of \$23.6 billion.
- Without a tax increase and tight expenditure control, the deficit could exceed \$28 billion. And that does not include an estimated \$700 million higher cost of interest on the public debt that such a deficit would involve.

A deficit of that size poses a clear and present danger to America's security and economic health.

If left untended, this deficit could cause:

- A spiral of ruinous inflation which would rob the poor, the elderly, the millions with fixed incomes.
- Brutally higher interest rates and tight money which would cripple the home builder and home buyer, as well as the businessman. Interest rates have already turned up sharply despite the relatively easy money policy of the Federal Reserve System.
- An unequal and unjust distribution of the cost of supporting our men in Vietnam.
- A deterioration in our balance-of-payments by increasing imports and decreasing exports.

This Congress and this Administration must not accept so large a deficit.

Under these circumstances, we must choose between two alternatives:

1. The deficit could be accepted and totally financed by additional borrowing, which itself would drive up interest rates, or
2. The deficit could be reduced by rigidly controlling expenditures, raising as much money as possible through increased taxes, and then borrowing the difference.

The first alternative would be fiscally and financially irresponsible under present conditions. The second alternative is the only way to maintain a strong and healthy economy.

America in its strength and wisdom must choose to travel a responsible fiscal and budgetary course.

That is why I present for your judgment and action a fiscal program that is sensible and sound. There are two essential elements to this program:

- expenditure restraint, to which this Administration is committed and which I urge upon the Congress.
- tax measures to increase our revenues.

FISCAL 1968 EXPENDITURES

The budget for Fiscal 1968, submitted six months ago, estimated expenditures at \$75.5 billion for the Defense Department and Atomic Energy Commission, and \$59.5 billion for our civilian programs.

These estimates may now have to be revised upward by as much as \$8.5 billion:

- \$2.5 billion for civilian programs.
- \$2 billion for reduced sales of participation certificates.
- \$4 billion for defense.

1. Civilian Expenditures

The estimate of non-defense spending for Fiscal 1968 has already increased by \$1.5 billion. This increase stems from two sources:

- First, a number of essential activities were temporarily deferred in fiscal 1967 as part of our fight against inflation. Early this year inflationary pressures had been brought under control. Some of these deferred funds already voted by Congress were released in late February, and again in March and April, particularly to help homebuilding. This added \$600 million to Fiscal 1968 expenditures. These releases included funds for the purchase of low cost home mortgages (\$500 million), construction grants for health and education facilities (\$30 million), and the construction of dams, flood control projects, and other public works (\$20 million).

—Second, the January estimate of expenditures is up by \$900 million primarily because of increases in programs whose payments are *fixed by law and over which the President has no discretion*—such as payments to the States for public assistance and health programs (\$250 million), farm price supports (\$400 million), and Federal contributions to Medicare (\$150 million).

In addition, the Congress is still considering important legislative measures which will vitally affect Fiscal 1968 expenditures. Although we are already a month into the new fiscal year, 10 of the 13 regular appropriation bills have not yet been enacted. No one knows what the total of those appropriations to be voted by Congress for this fiscal year will be.

We do know, however, that the Congress is considering a bill which would raise civilian and military pay by more than \$1 billion above the Administration's 4.5 percent pay proposal. The \$1 billion extra pay raise is equivalent to the yield of a 2 percent tax surcharge and comes directly out of the pockets of American taxpayers.

These items alone would increase civilian expenditures by \$2.5 billion above the budget submitted in January.

Moreover, the Congress, in actions by one or the other House, has reduced by over \$2 billion the authorizations I requested for the sale of participation certificates. Failure to restore these authorizations as appropriations bills move to final passage would add still further to the budget deficit.

Therefore, I urge the Congress to exercise the utmost restraint and responsibility in the legislative decisions which are yet to come and to make every effort not to exceed the January budget estimates.

The Executive Branch pledges to take every proper action within its power to reduce expenditures in the January budget. But our discretion is limited.

Of the \$61 billion now estimated for non-defense expenditures, more than two-thirds is not subject to an Executive reduction.

Consider these facts:

- More than \$30 billion will be spent on programs under which payments are definitely fixed by law or otherwise mandatory—such as interest on the public debt (over \$14 billion), veterans' compensation and insurance pensions (\$5 billion), public assistance (\$4 billion), farm price supports (\$2 billion), medical payments out of the general revenues (over \$1 billion), legislature and judiciary (over \$350 million).
- More than \$15 billion will be spent to complete contracts or obligations entered into in prior years, such as the purchase of mortgages under earlier commitments and the completion of construction begun in 1966 or 1967.
- An additional \$8 billion is spent by the pay of Federal employees in civilian agencies other than the Post Office. Substantial reductions are not possible in these expenditures without bringing to a halt many essential activities such as law enforcement and the Nation's air navigation system. Another \$1 billion will be spent if the 4.5 percent civilian and military pay increase I recommended is enacted.

After taking account of these items, and allowing for a reduction of more than \$5 billion in total expenditures—achieved through the sale of financial assets—this leaves only \$12 billion of outlays over which the President has discretion in the year ahead. Even here, many indispensable programs are involved: for example, medical supplies and equipment for veterans' hospitals, equipment for the U.S. Coast Guard, grants for construction of civilian hospitals.

Reductions in spending will not be easy, for the budget submitted in January was already lean. But I pledge to the Country and the Congress that I will make every possible expenditure reduction—civilian and military—short of jeopardizing the Nation's security and well-being.

As the Congress completes each appropriation bill for Fiscal 1968 expenditures, we will examine at once, *very, very carefully*, the results of those actions, and determine where, how, and by how much expenditures under these appropriations can be reduced.

I am directing each Department and Agency head to review every one of his programs, to identify reductions which can be made and to report to the Director of the Budget in detail on the actions he is taking to put those reductions into effect.

But action by the Executive Branch alone is not enough.

It will achieve nothing if every time the Executive Branch saves a dollar, the Congress adds another dollar—or more—to the expenditures recommended in my January budget.

All actions we take to reduce Federal spending must—and will—be carefully and compassionately weighed. For we cannot turn our backs on the great programs that have been begun, with such promise, in the last three and one-half years. And we cannot now postpone—at a much higher economic and human cost later—the urgent task of making the streets of America safe from crime and chaos and rooting out the underlying causes of unrest and injustice in our land.

Nevertheless, we must move with determination to assure that those for whom these programs were begun are not robbed by the inflation that would accompany an unacceptable deficit.

2. Defense Expenditures

I have concluded, after considering the recommendations of Secretary McNamara, the Joint Chiefs of Staff and General Westmoreland, that I should authorize an increase of at least 45,000 in the number of men to be sent to Vietnam this fiscal year.

This Nation has taken a solemn pledge—that its sons and brothers engaged in the conflict there shall never lack all the help, all the arms, and all the equipment essential for their mission and for their very lives.

America must—and will—honor that pledge. It is for this reason that expenditures for Vietnam—subject as they are to the variable demands of military operations—may now exceed our earlier estimates.

The Department of Defense has been a pace-setter in the Federal Government for efficiency and economy. Still, any organization that has so greatly expanded in so short a time is bound to have some areas in which further economies can be achieved or less essential expenditures stretched out.

I have asked Secretary McNamara, therefore, to conduct a searching review of all defense expenditures and to withhold all such expenditures that are not now essential for national security.

By such action we will try to hold total defense expenditures as near as possible to the level budgeted in January. However, the history of war teaches one clear lesson: the costs of conflict can never be precisely estimated nor fully foreseen. Thus, the possibility remains that defense spending in fiscal 1968, based on present plans, may exceed the January budget by up to \$4 billion.

FISCAL 1968 REVENUES

The Fiscal 1968 budget submitted in January projected revenues of approximately \$127 billion, including income from the tax measure I proposed at that time.

Since January, revenue estimates have been revised downward by a total of about \$7 billion:

- \$800 million as the result of Congressional action in restoring the investment credit and accelerated depreciation earlier than the budget had assumed and more generously than the Administration had requested.
- \$1.3 billion because of lower corporate profits and \$300 million because of lower personal income than projected six months ago.
- \$3 billion because of a decrease in estimated yield from existing income tax rates and \$200 million because of a decrease in the estimated yield of gift and estate taxes and customs.
- \$600 million because of a reduced estimate of miscellaneous receipts such as stockpile sales (\$450 million) and offshore oil revenues (\$80 million).
- \$800 million because of a later effective date for the surcharge on personal income taxes than recommended last January.

A PROGRAM TO INCREASE OUR REVENUES

Just as we must take determined action to control expenditures, so we must take action to increase our revenues if we are to avoid an unsafe and unmanageable deficit in the fiscal year ahead.

The three point tax program here presented is shaped to provide the fairest and least disruptive means of sustaining—without inflation—America's unprecedented period of uninterrupted prosperity, now in its seventy-eighth month.

1. *A speed-up of corporate tax collections, as recommended last January.—Beginning January 1, 1968, corporations would pay their estimated taxes on the basis of 80% of their liability, rather than 70%.*

Over a 5-year period, small corporations, as well as large, would become current in their tax payments, in the same way as individual proprietors already are.

This acceleration in collections should yield \$800 million in additional revenues for Fiscal 1968, somewhat more in subsequent years.

2. *Continuation of excise taxes for the immediate future.*—The 7% manufacturer's excise tax on automobiles is now scheduled to fall to 2% on April 1, 1968, and to 1% on January 1, 1969.

The drop to 2% should be postponed to July 1, 1969, and the drop to 1% should be postponed to January 1, 1970.

The 10% excise tax on telephone service is now scheduled to fall to 1% on April 1, 1968, and to be eliminated on January 1, 1969.

The drop to 1% should be postponed to July 1, 1969, and the tax should be eliminated on January 1, 1970.

Extending these excise taxes would provide additional revenues of \$300 million for Fiscal 1968 and more than \$2 billion for Fiscal 1969.

3. *Surcharges on corporate and personal income taxes.*—

—*A temporary surcharge of 10% should be placed on corporate income tax liabilities, effective July 1, 1967.*

—*A temporary surcharge of 10% should be placed on individual income tax liabilities, effective October 1, 1967.*

These are surcharges on taxes, not on incomes. They would expire on June 30, 1969, or continue for so long as the unusual expenditures associated with our efforts in Vietnam require higher revenues.

These surcharges are four percentage points higher than recommended in January. But they are vitally necessary to provide some of the additional revenues this Nation must have. Altogether, the new surcharges will yield \$6.3 billion in revenues for Fiscal 1968, and somewhat more in Fiscal 1969.

Under this proposal:

—A family of four with an income of \$10,000, now ordinarily paying a tax of about \$1,100 will pay at most an added tax of \$9.25 a month.

—Those American families whose incomes are below \$10,000—3 out of every 4—will pay less than this amount.

—The 16 million taxpayers in the lowest income brackets would be completely exempt from the surcharge. For example, a married couple with 2 children, with an income of less than \$5,000 a year, would pay no surcharge.

—The one out of every four American families who now pay no income tax would be unaffected by the surcharge.

Let us be clear about the significance of this tax surcharge.

If Americans today still paid taxes at the rates in effect when I became President, a little over three and one-half years ago, they would be paying this year over \$23 billion more than they are paying now.

Now your Government is asking for a return of substantially less than half of these tax cuts that I recommended and the Congress overwhelmingly passed in the last three years. This is necessary to give American fighting men the weapons, equipment and the help they need, to hold the budget deficit within limits and to continue our education, health, poverty, urban and other vital programs.

For three out of every four American families, the burden of this increase will be between a few cents and \$9 a month. That is a small burden, a small inconvenience, compared to what is borne by our men in arms who put their lives on the line in Vietnam.

A SOUND AND HEALTHY ECONOMIC ADVANCE

These tax recommendations, taken together, would raise \$7.4 billion in Fiscal 1968. These added revenues—combined with the steps that the Congress and the Executive can and should take to control expenditures—will reduce the deficit to manageable proportions. If, working together, we can avoid an excessive pay increase, and provide the recommended authorization for sale of participation certificates, the deficit could be reduced to a range between \$14 and \$18 billion, depending upon our ability to hold down expenditures.

Last January, we concluded that higher taxes in Fiscal 1968 would safeguard our prosperity. Present economic prospects reaffirm that judgment.

It is the unanimous judgment of the President's advisers that the fiscal program we are recommending is consistent with a sound and healthy economic advance during the year ahead, without tight money and soaring interest rates.

THE COSTS OF INACTION

Failure to act promptly on these tax proposals and to restrain unnecessary spending could have the most serious consequences:

- The Nation could face a return of strong inflationary pressures and an intensified wage-price spiral—which could rob the poor, the elderly, the millions with fixed incomes. We would lose our opportunity to make progress this year toward one of our most urgent objectives: price stability.
- An excessive expansion of domestic markets could again quicken the flow of imports to the United States, while rising costs and prices cut into our exports. The position of the dollar as the key element in the world's financial system could be impaired.
- The resulting distortions in our economy could ultimately endanger the prosperity that generates the jobs and opportunities our men returning from Vietnam have the right to expect.
- Spiraling interest rates and severely tight money would return.

What the Government does not raise through taxes the Government must borrow.

That additional borrowing would be imposed on financial markets already strained by the unprecedented demands of private borrowers and State and local governments. Long term interest rates are already near their peaks of late last summer, and short term rates have begun to climb.

Without a tax increase, I am informed by Chairman Martin that nothing the Federal Reserve System could responsibly do could avoid the spiraling of interest rates.

As interest rates rose, a starvation of mortgage funds would throw housing into a new depression before it had even recovered from the last one. Every other borrower—but most of all the small businessman and farmer—would bear the cost of our fiscal irresponsibility.

A failure to raise taxes would not avoid the burdens of financing a war. For these burdens are inescapable. But, instead of sharing those burdens equitably and responsibly—as an income tax surcharge would do—inflation, tight money, and shortages would tax the American people cruelly and capriciously. The consequences of that irresponsibility would haunt America and its people for years to come.

CONCLUSION

Some may hear in this message a call to sacrifice.

In truth, it is a call to the sense of obligation felt by all Americans.

Americans in Vietnam stand in, and brighten, the light of a proud tradition. They give their service, and some give their lives, for their country—and for us.

To this point, America has served them well by supporting them unstintingly to the last of their needs while building a strong and prosperous Nation at home.

I urge you to remember the following. Last year:

- Real wages were the highest in history—and the unemployment rate reached the lowest point in 13 years;
- Total after-tax real income of American families rose five percent;
- Corporate profits after taxes reached an all-time peak, up nine percent last year;
- Net income per farm increased more than 9 percent, even after adjusting for the higher prices farmers paid;
- Our Gross National Product, valued in constant prices, advanced 5.8 percent.

These gains were achieved without either runaway inflation, or the imposition of the wage and price controls which have been the condition of American life in every conflict of this century.

In significant part, this was the result of responsibility and restraint exercised by the business, farm, and labor communities.

The current situation summons those groups as never before to maintain that responsibility in their wage and price decisions.

It summons all Americans to respond with that same responsibility in the challenge of their own lives.

The inconveniences this demand imposes are small when measured against the contribution of a Marine on patrol in a sweltering jungle, or an airman flying through perilous skies, or a soldier ten thousand miles from home, waiting to join his outfit on the line.

There are times in a Nation's life when its armies must be equipped and fielded, and the Nation's business must still go on. For America that time is now.

The Nation's unfinished agenda here at home must be pursued as well. The poor must be lifted from the prisons of poverty, cities must be made safe and livable, sick and undernourished bodies must be restored, our air and water must be kept clean, and every hour of our future must see new opportunities unfold.

This, then, is the story behind the facts and forecasts, and the recommendations I submit today.

Last January I told the Nation:

"I wish I could report to you that the conflict in Vietnam is almost over. This I cannot do. We face more cost, more loss, and more agony. For the end is not yet. I cannot promise that it will come this year—or come next year. Our adversary still believes, I think tonight, that he can go on fighting longer than we can, and longer than we and our allies will be prepared to stand up and resist.

"Our men in that area—there are nearly 500,000 now—have borne well the 'burden and the heat of the day.' Their efforts have deprived the Communist enemy of the victory that he sought and that he expected a year ago. We have steadily frustrated his main forces. General Westmoreland reports that the enemy can no longer succeed on the battlefield.

"I must say to you that our pressure must be sustained—and will be sustained—until he realizes that the war he started is costing him more than he can ever gain.

"I know of no strategy more likely to attain that end than the strategy of 'accumulating slowly, but inexorably, every kind of material resource'—of 'laboriously teaching troops the very elements of their trade.' That, and patience—and I mean a great deal of patience."

Those words are even more true today.

The test before us as a people is not whether our commitments match our will and our courage; but whether we have the will and the courage to match our commitments.

I urge the Congress to respond to the fiscal challenge that faces the Nation. I hope that in the National interest you will act promptly and favorably upon these recommendations.

LYNDON B. JOHNSON.

THE WHITE HOUSE, August 3, 1967.

[PRESS RELEASE, THURSDAY, AUGUST 3, 1967]

CHAIRMAN WILBUR D. MILLS (D., ARK.), COMMITTEE ON WAYS AND MEANS, ANNOUNCES PUBLIC HEARINGS ON PRESIDENT'S TAX PROPOSALS

Chairman Wilbur D. Mills (D., Ark.), Committee on Ways and Means, today announced that public hearings on the President's tax proposals would begin on Monday, August 14, 1967. The details of the President's proposals are contained in his Message which he transmitted to the Congress today. Copies of this Message will be available in print at the Committee Office, Room 1102 Longworth House Office Building, Friday morning, August 4, and will be mailed to all persons requesting to be heard.

Lead-Off Witnesses.—Chairman Mills stated that the first witnesses to appear at the hearings, which will begin on Monday, August 14, will be Secretary of the Treasury Henry H. Fowler and Budget Director Charles L. Schultze, and possibly other Government witnesses. The hearings will continue on Tuesday, August 15, and then will be suspended for two days, Wednesday and Thursday August 16 and 17. The hearing will resume on Friday, August 18. It is hoped the Government testimony will be completed by that date and that public witnesses can begin on Monday, August 21.

Cut-Off Date for Requests to be Heard.—The cut-off date for requests to be heard is not later than the close of business Tuesday, August 15. The requests should be submitted to Leo H. Irwin, Chief Counsel, Committee on Ways and Means, 1102 Longworth House Office Building, Washington, D.C. 20515. Witnesses will be advised as promptly as possible after the cut-off date as to when they have been scheduled to appear.

Time Allotted for Hearing.—The limited time available requires that all persons and organizations with the same general interest designate one spokesman to represent them so as to conserve the time of the Committee and the other

witnesses, prevent repetition and assure that all aspects of the proposals can be given appropriate attention.

The Committee will be pleased to receive from any interested organization or persons a written statement for inclusion in the printed record of the hearing in lieu of a personal appearance. These statements will be given the same full consideration as though the statements had been presented in person. In such cases, a minimum of three (3) copies of the statement should be submitted by the close of business, Wednesday, August 23, 1967.

Contents of Requests to be Heard.—In order to eliminate repetitious testimony and to properly schedule witnesses, it will be necessary for the request to be heard to specify:

- (1) the name, address, and capacity in which the witness will appear;
- (2) the list of persons or organizations the witness represents and in the case of associations or organizations, their total membership and where possible a membership list;
- (3) the amount of time the witness desires in which to present his *direct oral* testimony (*not* including answers to questions of Committee Members);
- (4) an indication of whether or not the witness is supporting or opposing the proposal or proposals on which he desires to testify; and
- (5) a *topical outline* or *summary* of the comments and recommendations which the witness proposes to make.

If a prospective witness has already submitted a request to be heard on any of the subjects covered by this hearing, the request should be re-submitted furnishing the above information and otherwise conforming to the rules set forth for conducting this hearing.

Written Statements.—In the case of those persons who are scheduled to appear and testify, it is requested that 60 copies of their written statements be submitted 24 hours in advance of their scheduled appearance. If it is desired, an additional 60 copies may be submitted for distribution to the press and the interested public on the witness' date of appearance.

Persons submitting a minimum of 3 written statements in lieu of a personal appearance may also, if they desire, submit an additional 60 copies of their statements for distribution to the Committee Members and the interested departmental and legislative staffs, pending the printing of the public hearings, which will include such statements along with the oral testimony of those persons who appear in person. An additional 60 copies may be submitted for the press and the interested public, if it is desired.

Format of All Written Statements.—To more usefully serve their purpose, *all* written statements (those for the purpose of personal appearance and those submitted in lieu of a personal appearance) should contain—

- (1) a *summary of comments and recommendations*, and
- (2) *subject headings* in their main body.

TREASURY DEPARTMENT, WASHINGTON, AUGUST 4, 1967

BACKGROUND MATERIAL IN PRESIDENT'S TAX PROPOSAL

The attached material constitutes background on the tax proposals in President Johnson's message on the State of the Budget and the Economy, delivered to the Congress August 3, 1967.

Included in the attachments are:

- Material on the 10 percent surcharge proposal as it affects individuals and corporations;
- Tax tables, showing the effects of the surcharge on individuals and on corporations;
- A description of the acceleration of corporation tax collections;
- Details of the continuation of excise taxes on automobiles and telephone service.

EXPLANATION OF PRESIDENT'S PROPOSAL FOR A TAX SURCHARGE OF TEN PERCENT

The President's recommendation to increase taxes is a temporary surcharge of 10 percent on personal income tax liability and 10 percent on corporate income tax liability. The surcharge provides an exemption for low income individuals and families. It is a 10 percent increase in the tax liability otherwise due, not 10 percent of the taxable income.

The proposal would make the surcharge effective October 1, 1967 for individuals and effective July 1, 1967 for corporations. The President has recommended that the surcharge remain in effect until June 30, 1969, or continue so long as the unusual expenditures associated with our efforts in Vietnam require higher revenues.

Under this proposal:

- A family of four with an income of \$10,000, now ordinarily paying a tax of about \$1,100, will pay at most an added tax of \$9.25 a month.
- Those American families whose incomes are below \$10,000—3 out of every 4—will pay less than this amount.
- The 16 million taxpayers in the two lowest income brackets would be completely exempt from the surcharge. For example, a married couple with 2 children, with an income of less than \$5,000 a year, would pay no surcharge.
- The one out of every four American families who now pay no income tax would be unaffected by the surcharge.

INDIVIDUALS

This is how the surcharge would apply to individuals:

- Since the surcharge would be effective on October 1, 1967 and thus be effective for only one-fourth of the year 1967, the rate of the surcharge for that year would be 2.5 percent of the tax for the entire year. If the tax on an individual for 1967 would be \$1,000 under present law, for the income of the entire year the surcharge would raise this tax by \$25, to \$1,025.
- Since the surcharge would be in effect for all of the calendar year 1968, the surcharge due on calendar 1968 tax liability would be the full 10 percent. On a tax of \$1,000 which the individual would otherwise owe, the surcharge would come to \$100 or 10 percent.

Exemption

The exemption from the surcharge covers taxpayers whose *taxable income* falls entirely within the first two brackets of the individual income tax. Generally speaking this exemption would exclude from the surcharge all single persons with taxable incomes of \$1,000 or less after deductions and exemptions and all married persons with taxable incomes of \$2,000 or less after deductions and exemptions.

In terms of specific tax liabilities, single returns having \$145 or less tax, joint returns having \$290 or less tax, and head of household returns having \$220 or less tax would be exempt.

As an example, married couples with two children with *earnings* of less than \$5,000 per year and single people with *earnings* of less than \$1,900 per year would not be subject to the surcharge, assuming the use of the minimum standard deduction.

The exemption will cover about 16 million taxpayers, or approximately one-sixth of the 98 million total of all taxpayers. Of the 16 million who will not be subject to the surcharge, approximately 5 million are single individuals and 11 million are married taxpayers.

CORPORATIONS

This is how the surcharge would apply to corporations:

- For calendar year 1967, the surcharge for corporations would be higher than for individuals because of the earlier effective date, July 1—for corporations.
- For corporations whose taxable year coincides with the calendar year, the surcharge for calendar year 1967 will be 5 percent of the tax for the entire year (as against 2½ percent for individuals) since the surcharge would be effective as of July 1 and thus would apply for half of the calendar year.
- The full 10 percent surcharge would apply for 1968.
- For corporations whose taxable year does not coincide with a calendar year, the rate of the surcharge would be determined on the basis of the number of days in the corporations' fiscal years that fall within the period during which the surcharge is in effect (July 1, 1967 to June 30, 1969).

The liability to which the surcharge applies is the tax liability before allowance of the investment credit and the foreign tax credit.

A calendar year corporation with profits before tax of \$100,000 will pay an additional \$2,075 in 1967, and an additional \$4,150 in 1968.

Revenue Effect

The revenue effect of the surcharge is to increase fiscal year 1968 receipts by \$6.3 billion:

- The increase in receipts from individuals would amount to \$4.0 billion.
- The increase in receipts from corporations would amount to \$2.3 billion.

* * *

TREASURY DEPARTMENT, WASHINGTON, AUGUST 4, 1967

TAX TABLES SHOWING EFFECTS OF 10 PERCENT TAX SURCHARGE

The following tables indicate, for 1967 and 1968, effects of the surcharge recommended by the President on various levels of wage income and various family situations.

COMPARISON OF 1963-66 TAX LIABILITY AND 1967-68 TAX LIABILITY UNDER PROPOSED TAX INCREASE FOR ILLUSTRATIVE TAXPAYERS¹ (SINGLE INDIVIDUAL)

Wage income	1963 tax ²	1964 Tax Act decrease	1966 tax ²	1967 tax ²	Tax increase over 1966 tax ³	1968 tax ²	Tax increase over 1966 tax ⁴
\$1,000.....	\$62	\$46	\$16	\$16	(⁵)	\$16	(⁵)
\$1,900.....	224	77	147	151	\$4	162	\$15
\$2,000.....	242	79	163	167	4	179	16
\$3,000.....	427	94	333	341	8	366	33
\$5,000.....	818	147	671	688	17	738	67
\$7,500.....	1,405	237	1,168	1,197	29	1,285	117
\$10,000.....	2,096	354	1,742	1,786	44	1,916	174
\$12,500.....	2,887	489	2,398	2,458	60	2,638	240
\$15,000.....	3,787	633	3,154	3,233	79	3,469	315
\$20,000.....	5,900	982	4,918	5,041	123	5,410	492
\$25,000.....	8,324	1,342	6,982	7,157	175	7,680	698
\$35,000.....	13,778	2,151	11,627	11,918	291	12,790	1,163

¹ Proposed tax increase of 2.5 percent of the tax in 1967 and 10 percent in 1968 which does not apply to single returns with taxable income of \$1,000 or less and joint returns with taxable income of \$2,000 or less.

² Tax liability computations assume minimum standard deduction or deductions equal to 10 percent of income whichever is greater. Tax liability from optional tax table where income is under \$5,000.

³ 1967 tax minus 1966 tax.

⁴ 1968 tax minus 1966 tax.

⁵ There is no increase in 1967 or 1968 for a single person whose tax at 1966 rates is \$145 or less.

TABLE 2.—COMPARISON OF 1963-66 TAX LIABILITY AND 1967-68 TAX LIABILITY UNDER PROPOSED TAX INCREASE FOR ILLUSTRATIVE TAXPAYERS¹ (MARRIED COUPLE, NO DEPENDENTS)

Wage income	1963 tax ²	1964 Tax Act decrease	1966 tax ²	1967 tax ²	Tax increase over 1966 tax ³	1968 tax ²	Tax in- crease over 1966 tax ⁴
\$2,000.....	\$122	\$64	\$58	\$58	(⁵)	\$58	(⁵)
\$3,000.....	305	101	204	204	(⁵)	204	(⁵)
\$3,600.....	413	119	294	301	\$7	323	\$29
\$5,000.....	660	159	501	514	13	551	50
\$7,500.....	1,141	227	914	937	23	1,005	91
\$10,000.....	1,636	294	1,342	1,376	34	1,476	134
\$12,500.....	2,213	382	1,831	1,877	46	2,014	183
\$15,000.....	2,810	475	2,335	2,393	58	2,569	234
\$20,000.....	4,192	708	3,484	3,571	87	3,832	348
\$25,000.....	5,774	978	4,796	4,916	120	5,276	480
\$35,000.....	9,601	1,604	7,997	8,197	200	8,797	800

¹ Proposed tax increase of 2.5 percent of the tax in 1967 and 10 percent in 1968 which does not apply to single returns with taxable income of \$1,000 or less and joint returns with taxable income of \$2,000 or less.

² Tax liability computations assume minimum standard deduction or deductions equal to 10 percent of income whichever is greater. Tax liability from optional tax table where income is under \$5,000.

³ 1967 tax minus 1966 tax.

⁴ 1968 tax minus 1966 tax.

⁵ There is no increase in 1967 or 1968 for a married couple whose tax at 1966 rates is \$290 or less.

TABLE 3.—COMPARISON OF 1963-66 TAX LIABILITY AND 1967-68 TAX LIABILITY UNDER PROPOSED TAX INCREASE FOR ILLUSTRATIVE TAXPAYERS¹ (MARRIED COUPLE, 2 DEPENDENTS)

Wage income	1963 tax ²	1964 Tax Act decrease	1966 tax ²	1967 tax ²	Tax increase over 1966 tax ²	1968 tax ²	Tax increase over 1966 tax ²
\$3,000.....	\$65	\$61	\$4	\$4	(9)	\$4	(9)
\$5,000.....	420	130	290	290	(9)	290	(9)
\$7,500.....	877	191	686	703	\$17	755	\$69
\$10,000.....	1,372	258	1,114	1,142	28	1,225	111
\$12,500.....	1,901	334	1,567	1,606	39	1,724	157
\$15,000.....	2,486	424	2,062	2,114	52	2,268	206
\$20,000.....	3,800	640	3,160	3,239	79	3,476	316
\$25,000.....	5,318	906	4,412	4,522	110	4,853	441
\$35,000.....	9,037	1,508	7,529	7,717	188	8,282	753

¹ Proposed tax increase of 2.5 percent of the tax in 1967 and 10 percent in 1968 which does not apply to single returns with taxable income of \$1,000 or less and joint returns with taxable income of \$2,000 or less.

² Tax liability computations assume minimum standard deduction or deductions equal to 10 percent of income whichever is greater. Tax liability from optional tax table where income is under \$5,000.

³ 1967 tax minus 1966 tax.

⁴ 1968 tax minus 1966 tax.

⁵ There is no increase in 1967 or 1968 for a married couple whose tax at 1966 rates is \$290 or less.

* * *

TREASURY DEPARTMENT, WASHINGTON, AUGUST 4, 1967

CORPORATE CURRENT TAX PAYMENT PROPOSALS

In his August 3 Message on the Budget and the Economy, the President recommended two proposals relating to corporate current payments of tax, effective for 1968 tax years. Under the proposals there would be:

- Elimination over a 5-year period of the present exemption of the first \$100,000 of corporate tax liability from the requirement of payment on a quarterly estimated basis. This change would put corporations on the same current tax basis as an unincorporated proprietor, who must now make estimated tax payments based on his entire liability.
- An increase from 70 to 80 percent that a corporation's estimated tax for any given taxable year must bear to its final tax liability. The 80 percent requirement is now applicable to those individuals who are required to estimate their tax liabilities.

Revenue resulting from both proposals would be \$800 million in fiscal year 1968 and \$400 million in each of the succeeding fiscal years. The proposals do not increase the actual tax liabilities of any corporation.

EFFECTS OF PROPOSALS

Under present law, corporate taxpayers are required to make estimated tax payments only with respect to their estimated tax liability in excess of \$100,000. They are not required to make any estimated tax payments on their first \$100,000 of estimated tax liability, and if their annual estimated tax liability is \$100,000 or less, they are not required to file a declaration of estimated tax.

The first proposal places all corporate taxpayers on a current tax payment basis with respect to their entire tax liability. This result would be achieved under the proposal by providing for a gradual elimination of the \$100,000 exclusion over a five-year period, beginning with taxable years 1968.

The provision gears tax payments more closely to accruals of tax liability and to current developments in the economy.

The second proposal raises from 70 to 80 percent the percent of the tax liability that a corporation may pay in estimated tax by installments without incurring a penalty. The 70 percent rule was instituted in the 1954 Revenue Act, and has not been revised since as respects corporations. The proposed change to 80 percent conforms to the percentage now required to be paid by individual taxpayers, as established by legislation enacted in 1966.

HOW THE PROPOSALS WORK

Payment of First \$100,000 of Estimated Tax

The proposed change would require a corporation to file a declaration of estimated tax for a taxable year if it can reasonably be expected that its tax liability for the year (after taking into account credits) will exceed \$40, the figure presently applicable to individuals. As indicated above, the present exemption for all corporations is \$100,000.

The proposal would involve a new definition of "estimated tax" (which is the basic amount subject to payment by installment) reflecting the removal of the existing \$100,000 exemption over a five year period. During the transition period, a corporation, in determining the amount of its estimated tax liability, would be permitted to exclude an amount equal to the applicable "exclusion percentage" multiplied by the lesser of (1) \$100,000, or (2) the amount which the corporation estimates as its income tax for the year less the estimated amount of its credits.

The "exclusion percentage" would be defined as follows:

If the declaration is for a year beginning in—	The "exclusion percentage" is—
1968 -----	80
1969 -----	60
1970 -----	40
1971 -----	20

In the case of taxable years beginning after 1971, there would be no special exemption.

As an example, a corporation which estimates its income tax less credits for 1968 to be \$80,000 would be entitled to an estimated tax exclusion of \$64,000 for 1968—80 percent (its exclusion percentage) times \$80,000. Its estimated tax liability would, therefore, be \$16,000. If the corporation estimates its income tax less credits for 1968 to be \$120,000, its estimated tax exclusion would be \$80,000 (80 percent times \$100,000) and its estimated tax liability would be \$40,000.

Increase from 70 to 80 Percent Respecting Amount of Estimated Tax which Corporations Must Pay in Installments

Under present law, a corporation is not subject to penalty for an under-payment of estimated tax if its payments equal or exceed those which would be required on the basis of estimated tax liability of 70 percent of actual tax liability. The proposal amends the current law to raise the 70 percent figure to 80 percent. This conforms the percentage for corporations to that now applicable to individuals.

HISTORIC BACKGROUND

Prior to 1950, corporations were permitted to pay income taxes, in four quarterly installments, in the year following the taxable year. Thus, for a calendar year corporation, the tax for 1948 was payable in four equal installments during 1949.

The first legislation designed to accelerate corporate tax payments (the Mills plan) gradually advanced payments, beginning in 1950, to two 50 percent payments in the third and sixth months following the taxable year (i.e., March 15 and June 15 for calendar year corporations).

In 1954, a five-year transition plan spread over the years 1955-1959 was adopted to effect a partially current payment of the estimated tax. When fully effective, a calendar year corporation paid 25 percent of its estimated tax in excess of \$100,000 on September 15 and 25 percent on December 15 of the current taxable year. The balance was payable in two installments the following March 15 and June 15.

The Revenue Act of 1964 provided for a further gradual acceleration of estimated corporate tax payments which, by 1970, would have required corporations to be on a totally current payment basis as to tax liabilities in excess of \$100,000; that is, payments equal to 25 percent of the estimated tax (over \$100,000) would have been due on April 15, June 15, September 15, and December 15 of the taxable year. (Fiscal year corporations must make estimated payments by the fifteenth day of the fourth, sixth, ninth and twelfth month of their fiscal years.)

The Tax Adjustment Act of 1966 accelerated the 1964 plan by requiring that the transition to current status (for tax liability in excess of \$100,000) be achieved with taxable years beginning in 1967. Thus, for taxable years beginning in 1966, the April 15 and June 15 installments were increased to 12 percent of the esti-

mated tax. For taxable years beginning in 1967, 25 percent payments were required on the April and June payments. For all taxable years beginning in 1967, therefore, full current payment of estimated corporate taxes, to the extent in excess of \$100,000, will have been achieved.

* * *

TREASURY DEPARTMENT, WASHINGTON, AUGUST 4, 1967

FIGURES ON THE RECOMMENDED CONTINUATION OF EXCISE TAXES ON AUTOMOBILES
AND TELEPHONE SERVICE

The President today recommended postponements of reductions in the 7 percent manufacturer's excise tax on automobiles, and the 10 percent excise tax on telephone service, for the period covered by the temporary surcharge.

For manufacturer's excise tax on automobiles, the President recommended that:

- The scheduled drop to 2 percent on April 1, 1968 be postponed to July 1, 1969;
- The scheduled drop to 1 percent on January 1, 1969 be postponed to January 1, 1970.

For excise tax on telephone service, the President recommended:

- The scheduled drop to 1 percent on April 1, 1968 be postponed to July 1, 1969;
- The scheduled elimination, now set for January 1, 1969, be postponed until January 1, 1970.

(See also proposed language and technical explanation of proposal at p. 32.)

The CHAIRMAN. Our first witnesses will be officials of the administration. We have with us today the Secretary of the Treasury, the Honorable Henry H. Fowler; the Director of the Bureau of the Budget, the Honorable Charles L. Schultze; and the Chairman of the Council of Economic Advisers, the Honorable Gardner Ackley.

Let the Chair say at this point that it is generally recognized that members of the White House staff and the Council of Economic Advisers do not normally appear at hearings before legislative committees, but the Chair specifically requested that in this instance an exception be made so that Mr. Ackley could be with us this morning.

If it is agreeable with the committee, and in order that the administration may have the opportunity of presenting its direct case to the committee in full without interruption, I would suggest that each of the gentlemen at the witness table be permitted to present his full statement before we members of the committee ask questions. Is there objection? None is heard.

I will ask the Secretary of the Treasury to be our first witness this morning, Director Schultze our second witness, and Mr. Ackley to speak third.

Mr. Secretary, we are always pleased to have you before the committee. We regret exceedingly the circumstances that bring you here on this occasion. It is not a very popular subject matter, but we do appreciate having you, anyway. You are recognized, sir.

**STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE
TREASURY**

Secretary FOWLER. Thank you, Mr. Chairman and members of the committee. Thank you for the opportunity to appear before you in support of the fiscal program recently announced in the President's message. This program includes both tax measures to increase our revenues and action by the Congress and the executive branch to restrain,

cut, and control expenditures so as to reduce the prospective deficit in fiscal 1968 and thereafter to manageable levels.

Mr. Chairman, I will not read the entire statement before you. I will particularly cut short the detailed discussion of the details of the tax program because I think they are widely known and perhaps they would come up for more technical discussion later.

The CHAIRMAN. However, your statement in that regard will be included in the record, Mr. Secretary.

Secretary FOWLER. Thank you. I appeared before this committee in May to ask for borrowing authority needed to finance a war. In order to keep the use of that borrowing authority to proportions compatible with our national economic and financial health, I appear today to ask for taxing authority for the same purpose and to plead through this committee to the Congress that it join with the President in making every possible expenditure reduction—civilian and military—short of jeopardizing the Nation's security and well-being.

We are engaged in a costly conflict in Southeast Asia with no clear prospect of any early ending. But it is a temporary cost and surely one day will terminate when the enemies of freedom conclude that the price of aggression is too high.

This unusual and temporary cost must be financed in a manner consistent with preserving sound, balanced, economic growth without inflation at home.

Fiscal responsibility means differing things in differing circumstances. In a wartime context it must include the courage and willingness to raise the money that is as necessary as the guns, planes, and material needs of our forces in Southeast Asia.

In current circumstances fiscal responsibility means that in financing the special and temporary costs of Vietnam we should obtain as much from temporary tax revenues as economic conditions permit.

However, it does not mean, under present circumstances, that we should try to eliminate the entire deficit by a tax increase—by a surcharge not of 10 percent, but by one of nearly 50 percent.

Fiscal responsibility also means that we should hold down and restrain expenditures that can be canceled or postponed without damage to our national interest. It does not mean attempting the impossible—the elimination of the deficit solely by reducing expenditures.

The course of fiscal responsibility is the program outlined by the President; namely, reducing the deficit “by rigidly controlling expenditures, raising as much money as possible through increased taxes, and then borrowing the difference.”

After an intensive examination of all the facts available to us, my colleagues here and others in the Cabinet have advised and recommended to the President that the prompt temporary imposition of a 10-percent surcharge on both corporate and individual income taxes, except for individuals in the lower income brackets, is a necessary and equitable financial measure.

We have concluded that this proposal, supplemented by a speedup of corporate tax collections and a temporary deferral of scheduled excise tax deductions, is not only consistent with the objectives of sustained growth, high employment, and price stability, but necessary if these objectives are to be successfully pursued.

Let me now set forth the basic overall reasoning that led us to the conviction that the President's program represents the best choice of fiscal measures that the present circumstances permit.

The Director of the Budget, Mr. Schultze, will cover the budgetary and expenditure aspects of the President's program in depth, and the Chairman of the Council of Economic Advisers, Mr. Ackley, will deal in some detail with the economic aspects of the program. I will also discuss some of the financial reasons for the program and explain how the tax measures would be implemented and how they would affect taxpayers.

I want to emphasize that we have arrived at these views on the basis of what the President termed "the hard and inescapable facts." What are these hard facts?

First, our special Vietnam costs are now being incurred at a rate in excess of \$22 billion per year. These costs are at levels that call for more financing from current tax revenues—by a temporary surcharge of as much as economic conditions permit.

Second, without this temporary surcharge, our budget deficit in the current fiscal year would increase to unacceptable levels. This statement is based on the original January budgetary levels of revenues and the expenditures for Vietnam and all the other defense and civilian programs, and on the developments outlined in the President's message which make it necessary and realistic to revise the expenditure estimates upward and the revenue estimates downward.

Third, despite the Federal Reserve System's continued application of a policy of monetary ease, resulting in a substantial expansion of the Nation's money supply and credit, we are witnessing a return of long-term interest rates to levels near their peaks of late last summer.

Recently, short-term rates which had moved steadily downward since last fall, have reversed their direction and have begun to move back up. This temporary surcharge is therefore necessary to avoid the risk of excessively high interest rates and limited credit in particular sectors, such as housing.

To the extent that the Federal Government must finance its growing deficit by borrowings on the credit markets rather than pay for its additional expenditures by additional revenue raised through the surcharge, Government borrowing will increase the pressure on these markets and contribute to high interest rates and the risk of inequitable and damaging imbalances in credit availability—even assuming a continuation of the recent high rates of growth of money supply and bank reserves.

The imposition of the tax surcharge is prompted by these hard facts of the current cost levels of the hostilities in Vietnam, the current level of the budgetary deficit that is being incurred, and the current levels of interest rates and credit conditions in both the long- and short-term areas. This conclusion does not involve guesswork.

Given these facts, the only valid reason for failing to impose this temporary surcharge would be a solid conviction that it would be inconsistent with preserving sound, balanced economic growth.

Although a temporary surcharge was included in the fiscal 1968 budget program to be effective July 1, it is wise for both the Presi-

dent and the Congress to take this final decision when the course of economic developments accompanying the inventory readjustment in progress indicated that the impact of a tax increase would be beneficial rather than harmful.

We are now of the unanimous view, and that view is confirmed by the overwhelming preponderance of economic fact and opinion, that any real danger of an economic downturn is past. Indeed, the outlook, given the scale of Federal, State, and local public expenditures and private demand, is for a substantial rate of growth in the period ahead—with the debate being confined to exactly how rapid the growth will be.

This provides the fourth and final reasons for a temporary surcharge. We view the surcharge as a measure of insurance against the risk that, without this program of combining a temporary tax increase with expenditure restraint, the levels of growth would give rise to unacceptable inflationary pressures.

This development would take a toll of our economic balance and stability or be curbed by excessively high interest rates and tight money that would provide an unhealthy unbalanced economy, ill adapted to a smooth transition to peace with prosperity.

I. WHY WE NEED THE TAX INCREASE

1. To meet the special cost of Vietnam

Now let me develop some of these reasons. We need the tax increase, first, to meet the special costs of Vietnam.

I am sure that so long as hostilities are continuing in Vietnam no member of the committee would want or has wanted to deny the finances necessary to permit our fighting men to do an effective job.

In the fiscal year 1966, the special Vietnam outlays that followed upon our national decision of late July 1965 added \$6.1 billion to our administrative budget expenditures.

However, due mainly to the accelerated growth of our economy, revenues climbed by \$11.6 billion, so that we were able to close out the fiscal year 1966 with an administrative budget deficit of only \$2.3 billion, which was \$3 billion below the \$5.3 billion forecast in the original submission of the budget in January 1965.

The original estimate for special Vietnam costs in fiscal 1967 as submitted in the January 1966 budget, was \$10.5 billion, more than a \$4 billion increase over fiscal 1966 costs for that purpose.

Accordingly, the Tax Adjustment Act of 1966 was recommended and shortly enacted. It provided an additional \$1.2 billion of revenues in fiscal 1966 and an additional \$4.6 billion in fiscal 1967, by accelerating collections and deferring scheduled excise tax reductions. That act did not involve any increase in individual or corporate liabilities.

In the latter part of the calendar year 1966 it was apparent that the special costs of Vietnam in fiscal 1967 would be nearly double those originally estimated in the January budget. This reflected the rapidly increasing scale of hostilities and the fact that, with these hostilities likely to continue, it had become necessary to plan and budget for the continued conduct of hostilities on a substantially increased scale through fiscal 1968.

A special supplemental appropriation for defense in the amount of \$12.9 billion was, therefore, requested in last January's budget message. A surcharge of 6 percent on both corporate and individual income taxes to last for 2 years, or for so long as the unusual expenditures associated with our efforts in Vietnam require higher revenues, was recommended to become effective at the beginning of fiscal year 1968.

Immediate imposition last January of this surcharge was not requested because of the temporary period of slack in the economy resulting from fiscal and monetary restraints previously imposed and the inventory readjustment. Now, however, inventories have been substantially readjusted, and the course of the economy is heading upward.

I thus come to the hard, inescapable fact that the special costs of Vietnam are now being incurred at a rate—in excess of \$22 billion—that calls for a temporary increase in the tax liabilities of individuals and corporations to meet a portion of those costs.

2. To hold down the deficit

We need also this tax increase to hold down the deficit.

We could, of course, turn away from the course of responsible actions and attempt to meet our financial obligations without resort to a tax increase. Consider for a moment what this would mean in terms of the size of the deficit that would result.

The budget for fiscal 1968 submitted last January estimated expenditures at \$135 billion—\$75.5 billion for the Defense Department and Atomic Energy Commission, and \$59.5 billion for civilian programs. As the Director of the Budget will detail, these estimates may be exceeded by as much as \$8.5 billion—\$2.5 billion for civilian programs, \$2 billion for a possible denial by Congress of the authority to sell participation certificates in the amount included in the January budget, and \$4 billion for defense.

In addition, with no tax increase and with expenditure at the higher end of these contingencies, outlays for interest on the public debt would also rise, by up to perhaps as much as \$700 million.

The President has pledged to take every proper action to avoid an increase of this magnitude. But as he pointed out in his message to Congress, action by the executive branch alone is not sufficient. The outcome will also depend on congressional action with respect to appropriations and mandatory spending requirements.

Turning to the receipts side, since last January revenue estimates have been revised downward by approximately \$7 billion:

\$800 million as the result of congressional action in restoring the investment credit and accelerated depreciation earlier than the budget had assumed.

\$1.3 billion because of lower corporate profits.

\$300 million because of lower personal income than projected 6 months ago.

\$3 billion because of a decrease in estimated yield from existing income tax rates and \$200 million because of a decrease in the estimated yield of gift and estate taxes and customs.

\$600 million because of a reduced estimate of miscellaneous receipts such as stockpile sales (\$450 million) and offshore oil revenues (\$80 million).

\$800 million because of a later effective date for the surcharge on personal income taxes than recommended last January.

The budgetary consequences of these revised estimates of revenues and the expenditure contingencies outlined would imply a deficit of \$23.6 billion. In the event no tax increase was enacted, and in the absence of tight expenditure control, the deficit could rise to \$29 billion (including \$700 million for the higher interest cost on the public debt that such a deficit would involve).

On the other hand, with tight expenditure control and with the tax increase programs, the deficit can be kept within a range of \$14 to \$18 billion.

Chairman Ackley will develop in detail the broad economic consequences that are presented by a choice between these two alternative courses of action.

3. To avoid excessively high interest rates and tight money

We also need this tax increase to avoid excessively high interest rates and tight money.

I cannot stress too strongly my deep concern about the pressures that would be exerted on the money and credit markets by the borrowing requirements associated with a deficit in excess of a \$14- to \$18-billion range.

The credit markets can accommodate a Federal deficit of considerable size. But, given present private demands for credit, an outsized Federal deficit, such as would result without the proposed tax rise and expenditure restraints, cannot be accommodated without severe disruption to the credit markets, sending interest rates sky high and shutting off the flow of credit to sectors such as the home mortgage market and small business.

Some people may ask why we have to raise taxes and hold back spending. Why can't we borrow more? Isn't the U.S. Government's credit good? These questions come naturally because none of us likes to raise taxes or reduce or deny funds for many worthwhile programs. The fact is that we must choose among alternatives: one is to raise taxes and reduce expenditures to the maximum extent possible, and then borrow the rest; the other is to go much deeper into debt through very heavy borrowing.

It is my particular assignment today to explain why unlimited recourse to borrowing would be risky and unfortunate in the present financial situation.

Some may also ask: "What about World War II; wasn't there very heavy recourse to borrowing then?" The answer is that there was such recourse then, but it was undertaken only in conjunction with widespread direct controls (complete allocation of materials and facilities; price, wage, and salary controls; direct credit controls) that limited activities not directly related to the war effort.

Even with these measures there was a substantial inflationary cost. In the current situation we have avoided those rigid controls, and also avoided the milder controls of the Korean period. We propose in the present situation to follow general fiscal and monetary policies that continue to make it possible to avoid rigid direct controls.

Now let us consider our financial markets and the demands on those markets. To see how the pieces fit together, we need to look at the whole range of demand and supply factors.

Concentration on just one part of the whole picture will not do. This rundown, Mr. Chairman, may be a bit elementary and even

tedious, but I think it is so important to keep the whole credit market picture in mind that it is worth going over this with some care.

On the demand side, the major components are the business sector, the consumer sector, and government.

Businesses borrow to expand their facilities and for working capital, such as to finance inventories.

Consumers borrow chiefly to finance home purchases and for an increasing variety of consumer goods and services—such as cars, vacations, college expenses.

Governments borrow to finance their cash deficits, which arise when the net outpayments from spending and lending programs are not covered by tax and other revenues.

On the supply side, the main sources of credit are the banking system, other financial institutions, and savings generated in the business and consumer sectors. Two of these sources deserve special mention because of their strategic importance.

The banking sector, including the central bank, is a kind of balance wheel which can be permitted or encouraged to supply increasing amounts of credit, or discouraged from so doing by the availability of reserves provided through the central bank.

The other highly strategic sector is the direct supply of credit from individuals. It is strategic because its variations up or down are closely related to net pressures on the markets and on interest rates. Normally, the volume of credit supplied directly by individuals is small. Most individuals place their savings with thrift institutions which, in turn, lend these funds to borrowers. This is known as financial intermediation.

When this individual sector is called on to supply a substantial amount of credit directly, rather than through savings institutions or other intermediaries, it is usually a sign of market pressure. This normally occurs when demand is rising very strongly and borrowers are more interested in getting their money than in the rates that they have to pay for it.

That is what happened in 1966. With credit demands running strong, and supplies limited, interest rates on open market paper kept rising until willing investors could be found—which in many cases involved the withdrawal of funds from thrift institutions and direct investment by individuals in high-rate market paper.

The halt in bank credit growth thrust further demands on individuals. Credit demands had no place else to go, once the banks and other financial intermediaries could not handle any more. Either the demands could be met by the residual sector—individuals—or they could go unmet.

In the process of sorting out the demands that would be met and those that would not be met, interest rates last summer reached the highest levels in several decades.

Starting a little less than a year ago, there was a dramatic turn for the better in the credit markets, reversing some of the forces that had produced earlier strains, but leaving some scars and vivid recollections.

The factors making for a change included the temporary suspension of the investment tax credit, a reduction and rearrangement of Federal demands on the credit markets, holdbacks in Federal spending pro-

grams, legislation and administrative action to restrain the fierce competition for consumer savings, and a Federal Reserve move toward easier Reserve availability.

By early 1967, credit market pressures relaxed further, as economic growth abated, monetary policy eased some more, and the President's fiscal program announced in January proposed a tax surcharge to begin in fiscal year 1968.

Easier credit was evident in terms of both availability and cost. The Nation's money supply expanded at a 6 percent annual rate in the first half of this year, while total bank credit has grown at an annual rate of about 11 percent. The discount rate was reduced from 4½ percent to 4 percent, and the prime bank lending rate from 6 percent to 5½ percent.

Yet, in the face of this expansionary monetary policy, long-term interest rates, which had turned down from their peaks of last August and September to substantially lower levels through March, have more recently moved back up and reached levels uncomfortably close to last summer's peaks. Indeed, for some types of government and corporate bonds, current rates are as high as those of a year ago.

The decline in short-term rates from last year's peak levels proceeded into June, and extended to more than two full percentage points on some types of securities. In recent weeks those rates have also bottomed out, however, and moved back up as much as a percentage point—although they remain well below last year's peaks.

A major cause of the rise in long-term rates since March is the huge volume of borrowing by corporations and by State and local governments. New capital issues by corporations in the first 7 months of 1967 were a record \$13.5 billion, up 23 percent from the similar period in 1966—which had been a recordbreaking year.

If one excludes private placements by corporations and looks just at public offerings, which have a greater immediate market impact, the volume of new issues was \$7.2 billion in the first half of this year, against \$8 billion in all of 1966 and \$5.6 billion for all of 1965.

To a considerable extent, this heavy pace of offerings has reflected a desire of corporations to take advantage of the greater credit availability to rebuild their liquidity and reduce their dependence on the banking system. Last summer, even some of the largest corporations found their access to bank credit limited, and this experience is still quite memorable to corporate treasurers.

States and municipalities have also borrowed very heavily, and for somewhat similar reasons—making up for some postponements of borrowings last year and seeking to obtain some money needed now or in the future while it is currently available. New tax-exempt issues by State and local authorities came to \$8.8 billion in the first 7 months of this year, up about 28 percent from a year earlier.

There is an additional market factor that seems to be impelling this headlong rush to borrow, even at current high rates. Many of these corporations and governmental authorities are said to be pushing their borrowings because they fear that a greatly increased Federal Government deficit will produce still higher interest rates and tighter conditions of credit availability in the months ahead.

And they are apparently concerned that big Federal Government demands might coincide with an increasing buildup in private de-

mands that would revive inflationary pressures, in turn boosting spending and income and eventually stimulating still greater credit demands.

The fact that this can happen against a background of expansionary monetary policy has been demonstrated clearly in recent weeks and months. So it is no answer for those who inveigh against high interest rates to call for easy money unless they are ready to see higher taxes or unless they are willing to take the risk of a serious inflation.

A special reason for prompt action to cut the prospective Federal deficit is the desirability of encouraging the current uptrend in homebuilding and the increased availability of money in the mortgage market.

Last year the mortgage market was starved for funds and homebuilding went through the wringer—particularly as thrift institutions lost funds to higher paying open market paper and bank deposits.

This year, traditional mortgage lenders have experienced record inflows of funds. Some of this inflow has been used to rebuild depleted liquidity, but the availability of mortgage funds has also improved greatly.

Yet there can be no complacency about this improvement, for since this spring, rising interest rates on corporate securities have tended to attract some funds from thrift institutions into these securities rather than into mortgages. The recent rise in short-term rates, if it goes much further, could pull savings funds directly out of the thrift institutions. These developments raise the possibility of a new stringency in housing credit.

We do not present the proposed tax surcharge as something that will cut interest rates immediately and sharply, or eliminate all the problems that have faced the financial markets, the mortgage market, or homebuilding in the past 2 years since the Vietnam escalation began.

Even with a tax increase, there will be a sizable Federal deficit, and sizable competing demands from the private sector.

But a tax surcharge will reduce the size of the Federal deficit and the size of Federal borrowing needs. It will help assure a continuation of expansionary monetary policy, and it will reassure borrowers and lenders that there is no need for a renewed scramble for funds or runup of interest rates.

It could well turn the tide in the credit markets, calm down the precautionary borrowing and produce freer flows of funds at more reasonable rates of interest.

We have discussed the recent role of certain key private sector demands on the credit markets, but it is particularly important, in weighing the need for fiscal action, to look at the Federal Government demands.

Consider these facts relative to Federal credit demands on the private sector in the fiscal year ended June 30, 1967:

The total outstanding volume of Treasury securities, Federal agency securities, and participation certificates increased by slightly under \$10 billion.

But Government investment accounts increased their holdings of these issues by \$11.6 billion, and the Federal Reserve added \$4.5 billion to its holdings.

Thus instead of exerting a net credit demand on the private sector, Federal credit market operations actually supplied over \$6 billion to the private credit markets through net repayment of debt.

Even after making an adjustment for the \$5 billion decline in the Treasury's cash balance over the fiscal year, there was still a net repayment of credit from the Federal sector to the private sector.

The picture in this current fiscal year will be different. It will not be a question of net repayment of credit by the Federal Government to the private market, but of how large a net demand might be made on those markets.

Illustrative of the possible Federal credit demands, suppose that the administrative budget deficit in fiscal year 1968, with the proposed tax measures enacted, is \$14 billion.

Adding together the increases in Treasury debt, Federal agency debt, and participation certificates, there would be an increase in outstanding obligations of some \$20-\$21 billion. Making rough allowance for purchases by the Government investment accounts and Federal Reserve, the net demand on the private sector might be around \$10-\$12 billion. (This \$10-\$12 billion net demand for the full fiscal year should not be confused with the estimates recently reported for prospective Treasury borrowing in the July-December 1967 period; the latter estimates, which anticipated market borrowing of \$15 billion in Treasury issues and possibly \$2 billion in participation sales, included a seasonal component which would be reversed later in the fiscal year when a seasonal surplus of revenues over expenditures is anticipated.)

Without the proposed tax measures, the Federal sector's net demands on the private credit market in the fiscal year 1968 would be \$7.4 billion greater. Moreover, added financial requirements could raise, as they did in 1966, from further demands on Federal credit agencies, because of tightened credit conditions in the private sector.

The total of Federal credit demands on the private sector, without tax action, could thus reach \$20 billion, or exceed it if expenditures ran to the higher side of the range of contingencies now contemplated.

Moreover, the difference between net Federal credit demands on the private sector on the order of \$10-\$12 billion, or on the order of \$20 billion or somewhat more, depending mainly on the presence or absence of tax action, does not tell the full story.

For along with swollen Federal credit demands, the failure to hold down the budget deficit would create an inflationary environment in which private credit demand could soar, and in which it would be more difficult to continue an expansionary monetary policy, and that would cut down on total available supplies of credit.

Thus private credit demands, in the absence of a tax surcharge, would be hit in three ways—by the enlargement of Federal credit demands, by a swelling of the private demands themselves, and by the curtailment of total credit supplies.

The net result would be a vastly different set of credit market conditions, imposing a very substantially heavier net demand for funds that could not be met by institutional lenders, and that could be met only in part by the residual sector made up mainly of individuals.

One can only conjecture about the precise pattern and sequence of events through which tightened credit conditions would envelop the market in the absence of a tax increase, but last year's experience might provide some guidance.

One could expect, for example, that as the Treasury and Federal agencies came to market in greater and greater volume, higher rates would have to be paid to draw in additional investors. Increasingly, the funds might be drawn from the thrift institutions that are the mainstay of the mortgage market.

In the meantime, corporate borrowers would bid rates up, and attract investment from institutional lenders that have the flexibility to shift among government securities, corporate issues, and mortgages. Banks might well face insistent business demands to draw on credit lines, while lessened reserve availability kept a tighter lid on the banks' total portfolio, so that less could be put into Federal Government securities or tax-exempt issues even at steeply higher interest rates.

Along with the mortgage market, and State and local government borrowers, other borrowers with relatively limited bargaining power and limited flexibility of alternative credit resources would also be likely to suffer disproportionately at the hands of tightened credit conditions—including small business and farmers.

It would be a case of "pay up or do without," and perhaps a case of "doing without" even for those willing to "pay up" to a considerable extent.

It would be sheer hypothesis to guess what heights interest rates might have to scale in the grim process of sorting out the credit demands that would be met, and those that would not be met, but the pressures would clearly be there, in the absence of tax action and tight expenditures control action, to push rates substantially higher than they are now.

One need look only around the world, even at highly industrialized countries, to see government bond yields of 7 percent or more—and indeed of more than 8 percent during much of last year in Germany. Rates on prime industrial bonds in the United Kingdom have ranged as high as 8 percent as recently as a year ago, and these yields touched 9 percent in Germany.

These, I submit, are not tolerable conditions for the United States.

I have dwelt at some length on the importance of the proposed tax increase for the performance of financial markets and interest rates, because to my mind that is a key reason for its enactment. With the proposed tax increases, and tight expenditure control, the net demand can be held to tolerable proportions that the credit markets can handle, given a reasonably supportive monetary policy climate.

Without the tax increase, we are convinced that the credit markets could not finance the resulting deficit—except at the cost of sharply reduced availability of credit to meet private demands, and sharply increased interest rates.

Since Chairman Ackley is going to cover, Mr. Chairman, in detail the problem surfaced in the next pages dealing with "To protect healthy economic growth and price stability," I will omit their treatment here.

(The material, referred to here, deleted from Secretary Fowler's prepared statement follows:)

4. To protect healthy economic growth and price stability

As I have already indicated, my judgment as to the necessity for the tax increase program is based on hard fact. I believe the hard evidence we have at hand clearly indicates that the economy is now on an upward course and that an economic recession is not in the picture.

Let me cite just a few of the factors I have in mind:

The growth in final sales (to consumers, to government, and to business for investment other than in inventories) in the first six months of this year exceeded the growth in the corresponding period of 1966—\$31 billion compared to \$24 billion.

The growth of total GNP has been held down, of course, by the inventory readjustment. Considerable readjustment has taken place. Business inventories grew at an annual rate of only one half billion dollars in the second quarter of this year, which is the lowest inventory growth in six years. A return to normal inventory growth will contribute to a faster rise in GNP.

Personal income rose \$3.7 billion in June, the largest rise in the past five months. As personal income has risen, retail sales have become more buoyant. Also the personal savings ratio which has been abnormally high in recent quarters is showing signs of returning to a more normal level.

New construction generally has strengthened and residential housing starts have been rising strongly from the low point reached late last year.

Total manufacturers' new orders for June rose for the fifth consecutive month, to \$46 billion, the highest since the record level of September 1966. Order backlogs are again beginning to rise, and in June reached the highest level so far this year.

The unemployment rate dropped back to 3.9 percent in July after rising to 4 percent in June; the unemployment rate in all categories of workers either declined or remained unchanged. The unemployment rate for married men dropped from 2 percent in June to 1.8 percent in July.

From these and many other related facts which Chairman Ackley will develop in detail in his statement, we conclude that from an economic viewpoint a tax increase is an appropriate and desirable measure. Moreover, it is the best insurance we have against the possible development of an inflationary spiral. I do not argue that excessive growth of demand is the only factor causing prices to rise. But it has been and could again be a major factor, and the one factor that could produce a rapid upward spiral. The restraining influence of the tax increase will thus contribute to stabilizing the level of prices.

5. To protect our balance of payments

Mr. FOWLER. A fifth reason for this tax increase is to protect our balance of payments.

The tax increase will encourage the sound, balanced economic growth that is most favorable to our balance-of-payments positions. Over the period 1961-64 when GNP rose on the average by about 6 percent per annum (money terms), the U.S. trade surplus increased almost \$2 billion, from \$4.8 billion in 1960 to \$6.7 billion in 1964.

Without the tax increase, we run the risk of faster, less well-balanced growth, and increased inflationary pressure. As events of the last 2 years have demonstrated, this can lead to a substantial increase in imports.

In 1965 and 1966, when the gross national product rose at annual rates of between 8 and 9 percent, imports rose by about 15 percent and 18 percent, respectively—far more than exports—with the result that our trade surplus deteriorated steadily from \$6.7 billion in 1964 to \$4.8 billion in 1965 and to \$3.7 billion in 1966.

Expressed as a percentage of the gross national product, imports rose from 2.9 percent, on average, in 1961-64 to 3.1 percent in 1965, and 3.4 percent in 1966.

Exports over the 2 years 1965 and 1966, taken together, continued to grow reasonably well despite higher cost and price increases than in the preceding period. How much better they would have done in the absence of excessive demand here, we do not know. We do know that in order to increase our trade surplus we must not only hold imports to a reasonable level but we must keep our exports competitive over the longer run. The tax increase contributes to this by reducing upward pressures on our costs and prices.

In the first half of this year, our trade surplus has, in fact, improved from the low annual rate of \$2.9 billion in the fourth quarter of 1966 to an annual rate of \$4.5 billion in the second quarter of 1967. We must not permit a new outburst of excessive demand to interrupt this trend.

The recently strengthened interest equalization tax and our voluntary Federal Reserve and Commerce programs will help hold capital outflows within reasonable limits.

To summarize then, on why we need a tax increase:

It is necessary to fulfill our obligation to finance the special cost of Vietnam in a responsible way.

It is needed to hold down the size of the deficit to acceptable limits. It is needed to avoid the return of monetary stringency and high interest rates with their distorting and unfair impact on the economy, particularly in the homebuilding sector.

It is appropriate in relation to our current and prospective economic situation and insures against the danger of a spiralling of prices. Without the tax increase our balance-of-payments position will suffer.

II. THE TAX INCREASE PROGRAM

To produce the needed revenues the President has proposed a three point program:

I will omit the detail of those proposals since they are familiar to members of the committee.

(The material, referred to here, deleted from Secretary Fowler's prepared statement follows:)

A *temporary* surcharge of 10 percent of tax liability (not 10 percent of taxable income) to be placed on corporations and on those individuals with tax liability above an exemption level.

To be effective October 1, 1967 for individuals, and July 1, 1967 for corporations.

To remain in effect until June 30, 1969, or continue so long as the unusual expenditures associated with our efforts in Vietnam require higher revenues.

A speedup in corporate income tax collections.

A postponement of the scheduled excise tax reductions on automobiles and telephone service during the period of the temporary surcharge.

1. *The surcharge form of tax increase*

MR. FOWLER. I will make a comment about the surcharge form of the tax increase. In recent years there has been considerable expert discussion about the form that a temporary tax increase should take. We have concluded from that discussion that an across-the-board surcharge is generally the most appropriate method.

A surcharge is simple to administer and easy for the taxpayer to understand. It is relatively prompt and predictable in its impact. It causes minimal disturbance to the existing pattern of relationships

among taxpayers, and this seems fair and sensible for a moderate, temporary, emergency increase.

A surcharge is in line with the recommendations of the Subcommittee on Fiscal Policy of the Joint Economic Committee. In the spring of 1966 the subcommittee held hearings on the subject of tax changes for short-run stabilization, which were a thorough and comprehensive investigation of the subject.

The committee agreed that a uniform percentage addition to, or subtraction from, corporate and personal income tax liabilities, to be effective for a stated period, best satisfied the criteria for short-run stabilizing revenue changes.

It was in the light of these compelling considerations that a general surcharge—modified to avoid imposing additional tax burdens on individuals in the very lowest income brackets—was decided upon as the major measure in the President's program.

I want to make quite clear that the choice of the surcharge form to meet a temporary need by no means implies a turning away from the need for achieving important permanent structural changes in the tax system.

Indeed, as the President stated in his economic message, he will be sending a message proposing comprehensive tax reform later in this session.

Both in timing and objectives, however, tax reform should be distinguished from the present temporary surcharge recommendation. The surcharge is needed now for revenue. Expeditious action is essential if it is to achieve its purpose. It is a temporary measure and not a permanent part of our revenue structure. The central issues for congressional concern are the size of the needed increase and its timing.

The tax reform message will require more deliberate consideration since it involves proposals for permanent structural changes and some redistribution of tax burdens in the interest of a fairer sharing of the load. Its basic objective is not to raise revenue but to correct a number of inequities and abuses in our tax system.

Tax reform is a job that very much needs to be done. I hope your committee will be giving its consideration to the President's reform recommendations in the months ahead.

I move now, Mr. Chairman, over to page 46 in my statement in the middle of the page.

(The material deleted from Secretary Fowler's prepared statement follows:)

2. Effect of the surcharge on individuals

The 10 percent surcharge would be effective for individuals as of October 1, 1967. There has been some confusion about what the 10 percent applies to. For clarity, let me repeat that the surcharge percentage applies to the tax liability of the individual—not to the individual's income. A surcharge equal to 10 percent of the tax liability the individual would otherwise incur under present law would, of course, equal a much smaller percent of the individual's income. Thus, a married couple with two dependents with a wage income of \$10,000 and taking typical deductions, would have a tax of \$1,114 under present tax rates, and a 10 percent surcharge would amount to \$111. But this \$111 is only slightly more than 1 percent of the family's income.

The selection of the October 1 date—3 months later than the recommended starting date for corporations—reflects certain practical considerations involved in changing the current payments required to be made by individuals. Increased withholding rates for wages and salaries could not feasibly be put into effect at

a much earlier date because of the time required both by the Internal Revenue Service and employers to prepare and implement new withholding schedules. It is generally desirable to keep down the slippage of time between the effective date for a tax increase and the date on which increased withholding becomes effective, in order to avoid necessitating large payments by individuals when they file their final returns.

Concretely, the surcharge would apply to individuals as follows:

Since the surcharge would be effective October 1, 1967, and thus be in effect for only one-quarter of the year 1967, the rate of the surcharge for that year would be 2½ percent of the tax for the entire year 1967.¹ If the tax on an individual for 1967 would be \$1,000 under present law, the surcharge would raise this tax by \$25 to \$1,025. Increased withholding rates incorporating the surcharge would go into effect October 1, 1967, so that individuals with wages or salaries would remain on a current payment basis.

Since the surcharge would be in effect for all of the calendar year 1968, the surcharge due on calendar year 1968 tax liability would be the full 10 percent. On a tax of \$1,000 which an individual would otherwise incur, the surcharge would come to \$100 or 10 percent.²

Persons of restricted means should not be required, even in times of emergency, to sacrifice already minimal standards of living. Consequently, the proposal provides an exemption for such persons.

The exemption from the surcharge covers taxpayers whose taxable income falls entirely within the first two brackets of the individual income tax.³ Generally, this exemption would exclude from the surcharge:

All single persons with taxable incomes of \$1,000 or less after deductions and exemptions; all married persons with taxable incomes of \$2,000 or less after deductions and exemptions; and all heads of households with taxable incomes of \$1,500 or less after deductions and exemptions.

In terms of specific tax liabilities, single returns having \$145 or less tax, joint returns having \$290 or less tax, and head-of-household returns having \$220 or less tax would be exempt.

In terms of total earnings, married couples with two children with earnings of \$5,000 or less per year and single people with earnings of less than \$1,900 per year would not be subject to the surcharge, assuming the use of the minimum standard deduction.

The exemption will cover about 16 million taxpayers, or approximately one-sixth of the 98 million total of all taxpayers. Of the 16 million who will not be subject to the surcharge, approximately 5 million are single individuals and 11 million are married taxpayers.

The effects of the proposal may be illustrated by applying the proposed surcharge to a married couple with two dependents using typical (10 percent of income or minimum standard deduction) deductions:

With \$5,000 earnings, their tax will be unchanged (and still \$130 lower than they would have paid in 1963).

With \$10,000 earnings, their tax will rise \$28 in 1967 and \$111—or \$9.25 a month—in 1968 (their 1968 tax will still be \$147 less than they would have paid in 1963).

With \$20,000 earnings, their tax will rise \$79 in 1967 and \$316—\$26.34 a month—in 1968 (their 1968 tax will still be \$324 less than they would have paid in 1963).

Since the bulk of American families—three out of every four—have an income below \$10,000, they will be paying less than \$9.25 a month, down to only about \$2.50 a month.

3. Effects of the surcharge on corporations

The 10 percent surcharge would apply to corporations, effective July 1, 1967. Thus, for calendar 1967 the surcharge would be higher than for individuals because of the earlier starting date. For corporations whose taxable year coincides with the calendar year, the surcharge for calendar year 1967 would

¹ The surcharge applies to the present law tax including the tax on capital gains.

² A special provision will also insure that persons receiving retirement income qualifying for the retirement income credit will maintain their present parity for income tax purposes with recipients of social security benefits.

be 5 percent (compared to 2½ percent for individuals) since it applies for one-half the year. The full 10 percent surcharge would apply for 1968.

For corporations whose taxable year does not coincide with a calendar year, the rate of the surcharge would be determined on the basis of the number of days in the corporation's fiscal years that fall within the period during which the surcharge is in effect (July 1, 1967-June 30, 1969).¹

A calendar year corporation with profits before tax of \$100,000 will pay an extra \$2,075 in 1967 and 1969, and an extra \$4,150 in 1968.

4. *Revenue effect of the surcharge*

The revenue effect of the surcharge will be to:

Increase fiscal year 1968 receipts in the Administrative Budget by \$6.3 billion.
The increase in receipts from individuals amounting to \$4 billion.
The increase in receipts from corporations amounting to \$2.3 billion.

5. *The speedup in corporate tax collections*

Two steps are recommended to place corporations on the same current tax payment basis as individuals. Beginning January 1, 1968, corporations would pay their estimated tax liability on the basis of 80 percent of estimated tax liability, rather than 70 percent as under present law. Corporations would then be on the same percentage basis that individuals, sole proprietorships, and partnerships have been on since the beginning of this year.

The second proposal to bring corporations to a current estimated tax payment basis is to eliminate, over a five-year period commencing January 1, 1968, the \$100,000 of tax exemption from estimated tax payment requirements. By this measure, all corporations, small, medium and large, will gradually be placed on the same current tax payment basis as individual proprietors and partnerships. The five-year transition period assures that the change to a current tax payment basis will be accomplished in an orderly and balanced manner. All corporations, regardless of size, can plan for steady implementation of the system, and will not have to catch up to a totally current basis in any one year.

The 80 percent requirement would add about \$400 million revenue in fiscal year 1968.

The transition to current payment for the first \$100,000 of corporate tax would add about another \$400 million revenue in fiscal year 1968 and equivalent amounts in each of the ensuing four fiscal years.

These proposals are logical extensions of the transition to a current payment basis for corporations reflected most recently by the Tax Adjustment Act of 1966, and are appropriate responses to the obvious need to align corporate payment rules with those applicable to noncorporate taxpayers.

6. *The postponement of the scheduled excise tax reductions*

Under present law the excise tax on passenger automobiles is scheduled to drop from 7 percent to 2 percent April 1, 1968, and then to 1 percent January 1, 1969. The excise tax on telephone service is scheduled to drop from 10 percent to 1 percent April, 1968, and then to zero January 1, 1969.

It is appropriate in the light of our revenue needs that these scheduled reductions be deferred for the period during which the proposed surcharge is in effect. Since these excises are currently in effect, deferment of their reduction is a relatively simple matter administratively for business firms and the government. Moreover, the burden of these taxes is widely dispersed over the population and does not rest disproportionately on a narrow segment of the community. The proposal suspends the above scheduled reductions until July 1, 1969, and January 1, 1970, respectively. The additional revenue derived would be approximately \$300 million for fiscal year 1968 and approximately \$2.5 billion for fiscal year 1969.

Mr. FOWLER. The revenue effect for fiscal 1968 of the President's three-point tax program as a whole, then is to increase receipts by \$7.4 billion:

\$6.3 billion from the surcharge.

\$800 million from the speedup of corporate collections.

\$300 million from the deferral of scheduled excise tax reductions.

¹ Thus, a corporation with a November 30 fiscal year would apply a proportionate surcharge rate to its 1967 fiscal year determined as follows: 10 percent multiplied by a fraction the numerator of which is 153 (the number of days in the taxable year after June 30, 1967) and the denominator of which is 365, or approximately 4.2 percent.

Assuming the President's tax program is enacted, total receipts for the administrative budget for the fiscal year 1968 are estimated at \$122.5 billion. A breakdown of this revenue estimate is attached to the statement.

The size of the deficit would depend upon the final level of expenditures. Higher expenditures affect the deficit directly, of course, but also indirectly through their impact on private incomes and thereby on Federal revenues. Were expenditures to fall in the high end of the range, for example, revenues would rise by perhaps as much as a billion dollars.

In summary, the President's proposal provides needed revenues by balanced and equitable means:

The speedup in estimated tax payments for corporations brings this sector of business into parity with unincorporated businesses.

The effect of postponing the scheduled excise tax reductions is dispersed widely over the population.

The surcharge is a temporary measure designed for relatively simple implementation and termination, which applies progressively in the same manner as our basic income tax liability, but appropriately exempts those who, because of low incomes, should not be required to shoulder this additional responsibility.

CONCLUSION

Mr. Chairman and members of the committee, in conclusion I end on a point with which I began.

Based on the hard facts we all face, the President's program for combining a tax increase with expenditure reduction to diminish the deficit and the extent of Government borrowing represents a sound, fair, and fiscally responsible choice of the alternatives open to this committee, the Congress, and the American people.

Admittedly, no one likes to pay additional taxes even for a temporary period. The President does not like to recommend an increase in taxes; the Secretary of the Treasury and his colleagues do not like to plead for an increase in taxes; we know this committee does not like to ask the House of Representatives to vote an increase in taxes.

All of us—President, administration officials, this committee, and the House—have proven alert and anxious to reduce the Federal tax burden on the American people.

We have done so, and in recent years this policy of Federal tax reduction has meant substantial savings for the American taxpayer. In 1962 the investment tax credit was passed. In 1964 the most significant reductions in personal and corporate income taxes in history were voted.

In 1965 excise taxes were removed on over 200 items. It has been my privilege to espouse all of these measures before this committee.

As a result of these reductions initiated in the Congress by this committee despite, constantly rising State and local taxes, Americans enjoy a lower tax burden than any major industrial country in Western Europe—and this includes taxes levied at all levels of government, Federal, State, and local.

Figures collected by the Organization for Economic Cooperation and Development show that as a proportion of total national produc-

tion, French citizens paid 38.5 percent in taxes; Germany 34.4 percent, Italy, 29.6 percent; United Kingdom, 28.6 percent; and the United States 27.3 percent.

As the President said in his message:

If Americans today still paid taxes at the rates in effect when I became President, a little over three years ago, they would be paying this year over \$23 billion more than they are paying now.

The enactment of the proposed surcharge would temporarily take individual tax rates less than one-half way up to the 1963 levels.

Attached to my statement are tables showing precisely how much better off taxwise each individual taxpayer will be in 1967 and 1968 even with the temporary surcharge, compared to his income tax liability in 1963.

For a little more perspective on what the surcharge means for the individual taxpayer, let me point out that the surcharge:

In the aggregate, would amount to only 1 percent of individual income before all taxes.

Would place a far lesser burden than the tax increase of the Korean war, when the average increase in tax rates was the equivalent of about a 28-percent surcharge.

Would be in no way comparable to the increase in tax burden in World War II when the ratio of income tax to total personal income rose from 1.3 percent to 10.8 percent, resulting from increased rates, reduced exemptions, and rising incomes. This was a 730 percent increase, starting from a very small base.

For the corporation, the surcharge will be an increase of 10 percent compared to an average rise of 52 percent during the Korean war. In World War II the effective rate on corporations due to a combination of rate increases and the excess profits tax resulted in effective rates that were higher by 174 percent.

Now once again armed conflict involves our security. As the President said:

There are times in a nation's life when its armies must be equipped and fielded, and the nation's business must still go on. For America that time is now.

The time has come when we must levy a temporary tax to defray a portion of the cost of the conflict in Southeast Asia and thereby forward the Nation's business.

The Nation is determined to see those hostilities terminated, but only under conditions consonant with a future for peace and freedom that offers no reward for Communist aggression or its cult of violence and subversion.

This is an occasion to recall the statement of a great American of another day, Justice Oliver Wendell Holmes, who said, "Taxes are what we pay for civilized society."

We cannot share the sacrifices our brave men are making in the field. But we can meet the fiscal challenge at home. We can provide the additional taxes that will help hold the budget deficit within limits conducive to the maintenance of a healthy, balanced economy, well fitted for the eventual transition to a peace with prosperity.

It is my firm conviction that, however unwelcome to Americans as taxpayers, the President's program is in the best interest of those same Americans—

As consumers who want price stability.

As wage and salary earners who have or seek jobs in an economy characterized by sustained and steady growth rather than boom and bust.

As businessmen whose lifeblood is credit and steady expanding demand from confident customers.

As homebuyers and farmers to whom ever higher interest rates, tight money, and increased costs are far more cruel than taxes.

As poor, elderly, or living on a fixed income to whom a spiral of inflation is ruinous.

As fightingmen who dream of returning someday to a job, an education, and a home.

Members of this committee share with the Secretary of the Treasury the special responsibility of seeing to it that the bills of the Government are paid—whether out of borrowed money or revenues.

I hope you will share with me the conclusion that the prompt enactment of the President's tax proposals is a necessary and indispensable part of a program of fiscal responsibility.

(The tables referred to follow:)

TABLE 1.—COMPARISON OF 1963-66 TAX LIABILITY AND 1967-68 TAX LIABILITY UNDER PROPOSED TAX INCREASE FOR ILLUSTRATIVE TAXPAYERS¹ (SINGLE INDIVIDUAL)

Wage income	1963 tax ²	1964 Tax Act decrease	1966 tax ²	1967 tax ²	Tax increase over 1966 tax ³	1968 tax ²	Tax increase over 1966 tax ⁴
\$1,000.....	\$62	\$46	\$16	\$16	(⁵)	\$16	(⁵)
\$1,900.....	224	77	147	151	\$4	162	\$15
\$2,000.....	242	79	163	167	4	179	16
\$3,000.....	427	94	333	341	8	366	33
\$5,000.....	818	147	671	688	17	738	67
\$7,500.....	1,405	237	1,168	1,197	29	1,285	117
\$10,000.....	2,096	354	1,742	1,786	44	1,916	174
\$12,500.....	2,887	489	2,398	2,458	60	2,638	240
\$15,000.....	3,787	633	3,154	3,233	79	3,469	315
\$20,000.....	5,900	982	4,918	5,041	123	5,410	492
\$25,000.....	8,324	1,342	6,982	7,157	175	7,680	698
\$35,000.....	13,778	2,151	11,627	11,918	291	12,790	1,163

¹ Proposed tax increase of 2.5 percent of the tax in 1967 and 10 percent in 1968 which does not apply to single returns with taxable income of \$1,000 or less and joint returns with taxable income of \$2,000 or less.

² Tax liability computations assume minimum standard deduction or deductions equal to 10 percent of income whichever is greater. Tax liability from optional tax table where income is under \$5,000.

³ 1967 tax minus 1966 tax.

⁴ 1968 tax minus 1966 tax.

⁵ There is no increase in 1967 or 1968 for a single person whose tax at 1966 rates is \$145 or less.

TABLE 2.—COMPARISON OF 1963-66 TAX LIABILITY AND 1967-68 TAX LIABILITY UNDER PROPOSED TAX INCREASE FOR ILLUSTRATIVE TAXPAYERS¹ (MARRIED COUPLE, NO DEPENDENTS)

Wage income	1963 tax ²	1964 Tax Act decrease	1966 tax ²	1967 tax ²	Tax increase over 1966 tax ³	1968 tax ²	Tax in- crease over 1966 tax ⁴
\$2,000.....	\$122	\$64	\$58	\$58	(⁵)	\$58	(⁵)
\$3,000.....	305	101	204	204	(⁵)	204	(⁵)
\$3,600.....	413	119	294	301	\$7	323	\$29
\$5,000.....	660	159	501	514	13	551	50
\$7,500.....	1,141	227	914	937	23	1,005	91
\$10,000.....	1,636	294	1,342	1,376	34	1,476	134
\$12,500.....	2,213	382	1,831	1,877	46	2,014	183
\$15,000.....	2,810	475	2,335	2,393	58	2,569	234
\$20,000.....	4,192	708	3,484	3,571	87	3,832	348
\$25,000.....	5,774	978	4,796	4,916	120	5,276	480
\$35,000.....	9,601	1,604	7,997	8,197	200	8,797	800

¹ Proposed tax increase of 2.5 percent of the tax in 1967 and 10 percent in 1968 which does not apply to single returns with taxable income of \$1,000 or less and joint returns with taxable income of \$2,000 or less.

² Tax liability computations assume minimum standard deduction or deductions equal to 10 percent of income whichever is greater. Tax liability from optional tax table where income is under \$5,000.

³ 1967 tax minus 1966 tax.

⁴ 1968 tax minus 1966 tax.

⁵ There is no increase in 1967 or 1968 for a married couple whose tax at 1966 rates is \$290 or less.

TABLE 3.—COMPARISON OF 1963-66 TAX LIABILITY AND 1967-68 TAX LIABILITY UNDER PROPOSED TAX INCREASE FOR ILLUSTRATIVE TAXPAYERS¹ (MARRIED COUPLE, 2 DEPENDENTS)

Wage income	1963 tax ²	1964 Tax Act decrease	1966 tax ²	1967 tax ²	Tax increase over 1966 tax ³	1968 tax ²	Tax increase over 1966 tax ⁴
\$3,000.....	\$65	\$61	\$4	\$4	(9)	\$4	(9)
\$5,000.....	420	130	290	290	(9)	290	(9)
\$7,500.....	877	191	686	703	\$17	755	\$69
\$10,000.....	1,372	258	1,114	1,142	28	1,225	111
\$12,500.....	1,901	334	1,567	1,606	39	1,724	157
\$15,000.....	2,486	424	2,062	2,114	52	2,268	206
\$20,000.....	3,800	640	3,160	3,239	79	3,476	316
\$25,000.....	5,318	906	4,412	4,522	110	4,853	441
\$35,000.....	9,037	1,508	7,529	7,717	188	8,282	753

¹ Proposed tax increase of 2.5 percent of the tax in 1967 and 10 percent in 1968 which does not apply to single returns with taxable income of \$1,000 or less and joint returns with taxable income of \$2,000 or less.

² Tax liability computations assume minimum standard deduction or deductions equal to 10 percent of income which-ever is greater. Tax liability from optional tax table where income is under \$5,000.

³ 1967 tax minus 1966 tax.

⁴ 1968 tax minus 1966 tax.

⁵ There is no increase in 1967 or 1968 for a married couple whose tax at 1966 rates is \$290 or less.

Estimated net administrative budget receipts in the fiscal year 1968 (assuming President's tax program)

	Billions
Individual income taxes.....	\$70.5
Corporation income taxes.....	32.7
Excise taxes.....	9.1
Estate and gift taxes.....	3.0
Customs.....	2.0
Miscellaneous receipts.....	5.2

Net administrative budget receipts..... 122.5

UNDERLYING INCOME ASSUMPTIONS, CALENDAR YEAR 1967

Gross national product.....	783.0
Personal income.....	625.0
Corporate profits.....	80.0

Mr. FOWLER. Thank you.

The CHAIRMAN. Mr. Secretary, we thank you.

(The draft of the bill and technical explanation, prepared by the Department of the Treasury, requested to be placed in the record by Chairman Mills follows:)

A BILL To amend the Internal Revenue Code of 1954 to impose a temporary surcharge tax, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

(a) Short Title.—This Act may be cited as the "Surcharge Tax Act of 1967."

(b) Amendment of 1954 Code.—Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision, the reference shall be considered to be made to a section other provision of the Internal Revenue Code of 1954.

SEC. 2. IMPOSITION OF TAX SURCHARGE

(a) In General.—Subchapter A of chapter 1 (relating to determination of tax liability) is amended by inserting at the end thereof the following new part:

"PART V—TAX SURCHARGE**"Sec. 51. Tax surcharge.****"SEC. 51. TAX SURCHARGE****"(a) Imposition of Tax.—**

"(1) Calendar year taxpayers.—In addition to the other taxes imposed by this chapter and except as provided in subsection (b), there is hereby imposed on the income of every person whose taxable year is the calendar year, a tax equal to the percent of the adjusted tax (as defined in subsection (c)) for the taxable year specified in the following table:

Calendar year	Percent	
	Individuals	Corporations
1967.....	2.5	5
1968.....	10.0	10
1969.....	5.0	5

"(2) Fiscal year taxpayers.—In addition to the other taxes imposed by this chapter and except as provided in subsection (b), in the case of taxable years ending on or after the effective date of the surcharge and beginning before July 1, 1969, there is hereby imposed on the income of every person whose taxable year is other than the calendar year, a tax equal to—

"(A) Ten percent of the adjusted tax for the taxable year, multiplied by

"(B) A fraction, the numerator of which is the number of days in the taxable year occurring on and after the effective date of the surcharge and before July 1, 1969, and the denominator of which is the number of days in the entire taxable year,

"(3) Effective date defined.—For purposes of paragraph (2), the 'effective date of the surcharge' means—

"(A) July 1, 1967, in the case of a corporation, and

"(B) October 1, 1967, in the case of an individual.

"(b) Low Income Exemption.—Subsection (a) shall not apply if the adjusted tax for the taxable year does not exceed—

"(1) \$290, in the case of a joint return of a husband and wife under section 6013,

"(2) \$220, in the case of an individual who is a head of household to whom section 1(b) applies, or

"(3) \$145, in the case of any other individual (other than an estate or trust).

"(c) Adjusted Tax Defined.—For purposes of this section, the adjusted tax for a taxable year means the tax imposed by this chapter (other than by this section, section 871(a) or section 881) for such taxable year, reduced by any credit allowable for such year under section 37 (relating to retirement income) computed without regard to this section.

"(d) Authority to Prescribe Composite Tax Rates and Tables.—The Secretary or his delegate may determine, and require the use of, composite tax rates incorporating the tax imposed by this section and prescribed regulations setting forth modified optional tax tables computed upon the basis of such composite rates. The composite rates so determined may be rounded to the nearest whole percentage point as determined under regulations prescribed by the Secretary or his delegate. If, pursuant to this subsection, the Secretary or his delegate prescribes regulations setting forth modified optional tax tables for a taxable year, then, notwithstanding section 144(a), in the case of a taxpayer to whom a credit is allowable for such taxable year under section 37, the standard deduction may be elected regardless of whether the taxpayer elects to pay the tax imposed by section 3.

"(e) Estimated Tax.—For purposes of applying the provisions of this title with respect to declarations and payments of estimated income tax due more than 45 days (15 days in the case of a corporation) after the enactment of this section—

"(1) In the case of a corporation, so much of any tax imposed by this section as is attributable to the tax imposed by section 11 or 1201(a) or subchapter L shall be treated as a tax imposed by such section 11 or 1201(a) or subchapter L;

"(2) The term 'tax shown on the return of the individual for the preceding taxable year', as used in section 6654(d) (1), shall mean the tax which would have been shown on such return if the tax imposed by this section were applicable to taxable years ending after September 30, 1966, and beginning before July 1, 1968; and

"(3) The term 'tax shown on the return of the corporation for the preceding taxable year', as used in section 6655(d) (1), shall mean the tax which would have been shown on such return if the tax imposed by this section were applicable to taxable years ending after June 30, 1966, and beginning before July 1, 1968.

"(f) Western Hemisphere Trade Corporations and Dividends on Certain Preferred Stock.—In computing, for a taxable year of a corporation, the fraction described in—

"(1) Section 244(a) (2), relating to deduction with respect to dividends received on the preferred stock of a public utility,

"(2) Section 247(a) (2), relating to deduction with respect to certain dividends paid by a public utility, or

"(3) Section 922(2), relating to special deduction for Western Hemisphere trade corporations,

the denominator shall, under regulations prescribed by the Secretary or his delegate, be increased to reflect the rate at which tax is imposed under subsection (a) for such taxable year.

"(g) Withholding on Wages.—In the case of wages paid after September 30, 1967, and before July 1, 1969, the amount required to be deducted and withheld under section 3402 shall be determined in accordance with the following tables in lieu of the tables set forth in section 3402 (a) or (c) (1).—

Tables To Be Used in Lieu of Tables in Section 3402(a)

[Insert Tables 1-6, 8]

TABLE 7.—If the payroll period with respect to an employee is annual

(a) Single Person—Including Head of Household:

If the amount of wages is—	The amount of income tax to be withheld shall be—
Not over \$200.....	0
\$200 to \$1,200.....	14%
\$1,200 to \$1,300.....	\$160+17%
\$1,300 to \$4,400.....	\$177+19%
\$4,400 to \$8,800.....	\$766+22%
\$8,800 to \$11,000.....	\$1,734+28%
Over \$11,000.....	\$2,350+33%

(b) Married Person:

Not over \$200.....	0
\$200 to \$2,200.....	14%
\$2,200 to \$4,400.....	\$320+17%
\$4,400 to \$8,800.....	\$694+19%
\$8,800 to \$17,700.....	\$1,530+22%
\$17,700 to \$22,000.....	\$3,488+28%
Over \$22,000.....	\$4,692+33%

Tables To Be Used in Lieu of Tables in Section 3402(c) (1)

(b) Minimum Distributions.—Section 963(b) (relating to receipt of minimum distributions by domestic corporations) is amended—

(1) by striking out the heading of paragraph (1) and inserting in lieu thereof the following:

"(1) Taxable years beginning in 1963, 1967, and 1968.—", and

(2) by striking out the heading of paragraph (3) and inserting in lieu thereof the following:

"(3) Taxable years beginning in 1965, 1966, and after December 31, 1968.—".

(c) Clerical Amendment.—The table of parts of subchapter A of chapter 1 is amended by adding at the end thereof the following:

"Part V. Tax Surcharge"

(d) **Effective Date.**—The amendments made by this section shall apply—

(1) Insofar as they relate to individuals, with respect to taxable years ending after September 30, 1967, and beginning before July 1, 1969.

(2) Insofar as they relate to corporations, with respect to taxable years ending after June 30, 1967, and beginning before July 1, 1969.

SEC. 3. RAISING FROM 70 PERCENT TO 80 PERCENT THE ESTIMATED TAX WHICH MUST BE PAID IN INSTALLMENTS BY CORPORATIONS

(a) **In General.**—Section 6655(b) (relating to amount of underpayment), and section 6655 (d) (relating to exception), are amended by striking out "70 percent" each place it appears therein and inserting in lieu thereof "80 percent".

(b) **Effective Date.**—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1967.

SEC. 4. PAYMENT OF FIRST \$100,000 OF ESTIMATED TAX

(a) **Requirement of Declaration.**—Section 6016(a) (relating to requirement of declaration of estimated tax in case of corporations) is amended by striking out "\$100,000" and inserting in lieu thereof "\$40".

(b) **Reduction of Exclusion from Estimated Tax.**—Section 6016(b) (relating to the definition of estimated tax in the case of a corporation) is amended to read as follows:

"(b) **Estimated Tax.**—

"(1) **Definition.**—For purposes of this title, in the case of a corporation, the term 'estimated tax' means the excess of—

"(A) the amount which the corporation estimates as the amount of the income tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever is applicable, reduced by the amount which the corporation estimates as the sum of any credits against tax provided by part IV of subchapter A of chapter 1, over

"(B) an amount equal to the applicable exclusion percentage (determined under paragraph (2)) multiplied by the lesser of—

"(i) \$100,000, or

"(ii) the amount determined under subparagraph (A).

"(2) **Exclusion percentage.**—The term 'exclusion percentage' means—

If the declaration is for a taxable year beginning in—

The exclusion percentage is—

1968	80
1969	60
1970	40
1971	20
1972 or later	0

(c) **Exception from Addition to Tax.**—Section 6655 (d) (1) is amended by striking out the phrase "reduced by \$100,000" and inserting in lieu thereof "reduced by an amount equal to the applicable exclusion percentage, determined under section 6016 (b) (2), multiplied by the lesser of \$100,000 or the amount of such tax".

(d) **Addition to Tax for Underpayment of Estimated Tax.**—Section 6655 (e) (relating to the definition of tax) is amended to read as follows:

"(e) **Definition of Tax.**—For purposes of subsection (b), (d) (2), and (d) (3), the term 'tax' means the excess of—

"(1) the amount of tax imposed by section 11 or 1201 (a), or subchapter L of chapter 1, whichever is applicable, reduced by the sum of any credits against tax provided by part IV of subchapter A of chapter 1, over

"(2) an amount equal to the applicable exclusion percentage, (determined under section 6016 (b) (2)), multiplied by the lesser of—

"(A) \$100,000, or

"(B) the amount determined in paragraph (1)."

(e) **Technical Amendment.**—Clause (v) of section 243 (b) (3) (C) is amended by striking out "100,000".

(f) **Effective Date.**—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1967.

SEC. 5. POSTPONEMENT OF CERTAIN EXCISE TAX RATE REDUCTIONS

(a) Passenger Automobiles.—

(1) In general.—Subparagraph (A) of section 4061 (a) (2) (relating to imposition of tax) is amended to read as follows:

“(A) Article enumerated in subparagraph (B) are taxable at whichever of the following rates is applicable:

“7 percent for the period beginning with the day after the date of the enactment of the Tax Adjustment Act of 1966 through June 30, 1969.

“2 percent for the period July 1, 1969, through Dec. 31, 1969

“1 percent for the period after Dec. 31, 1969.”

(2) Conforming amendments.—Section 6412 (a) (1) (relating to floor stocks refunds on passenger automobiles, etc.) is amended by striking out “April 1, 1968, or January 1, 1969” and inserting in lieu thereof “July 1, 1969, or January 1, 1970”.

(b) Communication Services.—Section 4251 (relating to tax on communications) is amended—

(1) By striking out subsection (a) (2) and inserting in lieu thereof:

“(2) The rate of tax referred to in paragraph (1) is as follows:

Amounts paid pursuant to bills first rendered—	Percent
“Before July 1, 1969.....	10
“After June 30, 1969, and before January 1, 1970.....	1”

(2) By striking out subsection (b) and inserting in lieu thereof:

“(b) *Termination of Tax.*—The tax imposed by subsection (a) shall not apply to amounts paid pursuant to bills first rendered on or after January 1, 1970.”

(3) By striking out subsection (c) and inserting in lieu thereof:

“(c) *Special Rule.*—For purposes of subsection (a), in the case of communications services rendered before May 1, 1969, for which a bill has not been rendered before July 1, 1969, a bill shall be treated as having been first rendered on June 30, 1969. For purposes of subsections (a) and (b), in the case of communications services rendered after April 30, 1969, and before November 1, 1969, for which a bill has not been rendered before January 1, 1970, a bill shall be treated as having been first rendered on December 31, 1969.”

(c) Effective Date.—The amendments made by this section shall be effective on the date of enactment of this Act.

TECHNICAL EXPLANATION OF SURCHARGE TAX ACT OF 1967

This bill, which is entitled the “Surcharge Tax Act of 1967”, has four substantive sections:

(1) Section 2 imposes a temporary surcharge on both individual and corporate income tax liability at an annual rate of 10 percent.

(2) Section 3 raises from 70 percent to 80 percent, the percent of its estimated tax which a corporation may pay by installments without incurring a penalty.

(3) Section 4 eliminates, over a five-year period, the \$100,000 estimated tax exemption presently granted corporations.

(4) Section 5 suspends the schedule for the reduction of the excise taxes on passenger automobiles and telephone services during the period of the temporary surcharge.

There follows a more detailed description of each of these provisions.

Section 1 of the bill sets forth its title.

Section 2. *Tax Surcharge.*

(a) *Imposition of tax.*—Subsection (a) of section 2 of the bill adds a new part to subchapter A of chapter 1 of the Internal Revenue Code which consists of a new section 51 imposing a temporary tax surcharge on corporations and individuals.

General Provisions.—Subsection (a) of the new section 51 provides for the imposition of the surcharge. The tax is at an annual rate of 10 percent of tax liability (adjusted as provided in section 51(c)) and is effective from July 1, 1967, through June 30, 1969, for corporations and from October 1, 1967, through June 30, 1969, for individuals. For taxpayers who report their income on a calendar year basis, the rate of the surcharge for the calendar years involved is as follows:

Calendar year	Rate of tax (percent)	
	Individuals	Corporations
1967.....	3.5	5.
1968.....	10.0	10.
1969.....	5.0	5.

In the case of taxpayers who report their income on a fiscal year basis, the rate will be 10 percent for years falling entirely within the effective dates, whereas, in the case of taxable years that straddle either the commencement or termination date, the tax will be prorated depending on the number of days in the taxable year falling within the period the tax is in effect.

Low income exemption.—Subsection (b) of the new section 51 provides an exemption from the surcharge for individuals (other than estates and trusts) whose tax does not exceed that generally applicable to the first two brackets of taxable income. More specifically, the surcharge will not apply to a husband and wife filing a joint return if their tax does not exceed \$290. It will not apply to a head of household whose tax does not exceed \$220, or to a single individual (or a married individual filing a separate return) whose tax does not exceed \$145. In the case of a head of household, the exemption level is determined on the basis of the tax applicable to \$1,500 of taxable income which is midway between the first two tax brackets of a single individual and the first two tax brackets of a married couple filing a joint return.

Tax base on which surcharge is computed.—Subsection (c) of the new section 51 provides that the surcharge shall be computed as a percentage of the tax otherwise imposed by chapter 1 of the Internal Revenue Code, with the exception that it shall not be imposed with respect to the 30 percent tax under section 871 (a) and 881 on nonresident alien individuals and foreign corporations receiving income not effectively connected with a business in the United States. In the case of an elderly person who is eligible for the retirement income credit, the surcharge will be computed as a percentage of his tax liability after subtracting his retirement income credit. Similarly, tax liability shall be reduced by the retirement income credit in determining whether such an individual is eligible for the low-income exemption. This treatment is afforded the retirement income credit in order to give it the same effect on the surcharge as the exclusion for social security benefits. Tax liability would not be reduced by any other credits in computing the amount of the surcharge. On the other hand, once the surcharge has been computed, it may be offset by credits to which the taxpayer is entitled and which are not absorbed by his regular tax liability.

Authority to prescribe composite tax rates and tables.—Subsection (d) of the new section 51 provides that the Secretary of the Treasury or his delegate may compute composite income tax rates incorporating the surcharge and prescribe regulations setting forth modified optional tax tables computed on the basis of such composite rates. The composite rates may be rounded to the nearest whole percentage point. If the Secretary or his delegate exercises his authority under this subsection, he may require taxpayers to use the rates and/or tables he has prescribed.

Moreover, if he prescribes optional tax tables incorporating the surcharge, the usual rule that a taxpayer with less than \$5,000 of income may take the standard deduction only if he uses the optional tax tables will be waived in the case of a taxpayer who is eligible for the retirement income credit. This special rule is to reflect the fact that the effect of the retirement income credit on the surcharge cannot be accurately incorporated into the optional tax tables, with the result that those claiming the retirement income credit will almost universally use the regular tax computation. Under these circumstances, without the special rule, most taxpayers claiming the retirement income credit would be precluded from using the standard deduction.

Estimated tax.—Subsection (e) of the new section 51 contains provisions conforming the estimated tax provisions to the new surcharge tax. Under present law, corporations are required to pay estimated tax only with respect to taxes imposed by section 11 or 1201(a) or subchapter L (relating to insurance companies). The new subsection (e)(1) provides that any surcharge that is attributable to a tax imposed under these sections or subchapter shall, for estimated tax purposes, be treated as a tax imposed under these sections or subchapter and, therefore, subject to estimated tax payments. Paragraphs (2) and (3) of the

new subsection (e) provide that, in the case of the option under which individuals and corporations may pay their estimated tax on the basis of their prior year's tax liability, this prior year's liability shall be adjusted to reflect the surcharge tax.

Under the provisions of the new subsection (e), corporations would be required to reflect the surcharge in their first estimated tax payment due more than 15 days after the bill is enacted. For individuals, the surcharge would have to be reflected in the first estimated tax payment due more than 45 days after the enactment of the bill.

Western Hemisphere Trade Corporations and dividends on certain Preferred stock.—The following two provisions of the Internal Revenue Code provide a special deduction with respect to certain income which has the effect of reducing the corporate tax rate applicable to that income by 14 percentage points. These provisions are:

- (1) Section 922, relating to the taxable income of Western Hemisphere Trade Corporations; and
- (2) Section 247, relating to dividends paid by a public utility on its preferred stock.

Section 244 provides a reciprocal deduction with respect to amounts received as dividends on certain preferred stock of a public utility. In order to maintain the 14 percentage point differential under these sections, subsection (f) of the new section 51 provides that the computation shall be adjusted, under regulations prescribed by the Secretary of the Treasury or his delegate, to reflect in the regular corporate tax rate the surcharge imposed under the new section 51.

New withholding tables.—Subsection (g) of the new section 51 sets forth new tables for computing the amount of income taxes to be withheld from wages paid on or after October 1, 1967, and before July 1, 1969. These tables reflect an increase in the withholding rates of 10 percent.

(b) *Minimum distributions by foreign subsidiaries.*—Subsection (b) of section 2 of the bill amends section 963 (b) (relating to receipt of minimum distributions by domestic corporations from their foreign subsidiaries) to provide for the use of a minimum distribution table reflecting the surcharge. The new table is to be used for taxable years beginning 1967 and 1968. It is the same table that was applicable for taxable years beginning in 1963 when the corporate tax rate was 52 percent (the present corporate tax rate including the additional surcharge is 52.8 percent).

(c) *Clerical amendment.*—Subsection (c) of the new section 51 makes a clerical amendment to reflect the addition of the new Part V imposing the surcharge.

(d) *Effective date.*—Subsection (d) of the new section 51 provides the effective dates for the surcharge. These dates are explained in the discussion under subsection (a) of the bill.

Section 3. Increase From 70–80 Percent the Amount of Estimated Tax Which Corporations Must Pay in Installments.

Under present law, a corporation is not penalized for an underpayment of estimated tax if its payments equal or exceed those which would be required on the basis of estimated tax liability of 70 percent of actual tax liability (less \$100,000). Section 3 of the bill amends section 6655 to raise the 70-percent figure to 80 percent. This conforms the percentage for corporations to that made applicable to individuals beginning in 1967. This change would be effective for taxable years beginning after December 31, 1967.

Section 4. Payment of First \$100,000 of Estimated Tax.

Under present law, corporations are required to make estimated tax payments only with respect to their estimated tax liability in excess of \$100,000. They are not required to make any estimated tax payments on their first \$100,000 of estimated tax liability and, if their annual estimated tax liability is \$100,000 or less, they are not required to file a declaration. Under section 4 of the bill, the \$100,000 exclusion would be repealed over a five-year period.

More specifically, subsection (a) of section 4 of the bill would amend section 6016(a) to require a corporation to file a declaration of estimated tax for a taxable year if it can reasonably be expected that its tax liability for the year (after taking into account credits) will exceed \$40. As indicated above, the present exemption level is \$100,000.

Subsection (b) of section 4 of the bill amends section 6016 (b) to provide a new definition of "estimated tax" (which is the basic amount subject to payment by installment) reflecting the removal of the existing \$100,000 exemption over a five year period. During the transition period, a corporation, in determining the

amount of its estimated tax liability, would be permitted to exclude an amount equal to the applicable "exclusion percentage" multiplied by the lesser of (1) \$100,000, or (2) the amount which the corporation estimates as its income tax for the year less the estimated amount of its credits. The revised subsection (b) of section 6016 would be define the term "exclusion percentage" as follows:

If the declaration is for a year beginning in—		The "exclusion percentage" is—
1968	-----	80
1969	-----	60
1970	-----	40
1971	-----	20

In the case of taxable years beginning after 1971, there would be no special exemption.

As an example of the transition rule, a corporation which estimates its income tax less credits for 1968 to be \$80,000 would be entitled to an estimated tax exclusion of \$64,000 for 1968; 80 percent (its exclusion percentage) times \$80,000. Its estimated tax liability would, therefore, be \$16,000. If the corporation estimates its income tax less credits for 1968 to be \$120,000, its estimated tax exclusion would be \$80,000 (80 percent times \$100,000) and its estimated tax liability would be \$40,000.

Subsection (d) of section 4 of the bill amends section 6655 (e) to reflect the repeal of the \$100,000 exemption in the provisions for determining whether, and if so, to what extent, an addition to the tax should be imposed for underpayment of estimated tax. The same transitional rules apply. Thus, for example, assume a corporation's tax return for the taxable year ending December 31, 1968, indicates an income tax liability of \$150,000. To utilize the exception provided in section 6655 (d) (1) permitting estimated tax payments to be based on the prior year's tax, such corporation would be required to pay for 1969 an estimated tax of \$90,000, computed as follows:

1968 Income Tax Liability	-----	\$150,000
Less: \$60,000; 60 percent (the exclusion percentage for 1969) times		
\$100,000	-----	60,000
Total	-----	90,000

Subsection (3) of section 4 of the bill amends section 243(b) (3) (C) (relating to estimated tax exemption for members of an affiliated group) to reflect the repeal of the \$100,000 exemption.

Subsection (f) of section 4 of the bill provides that the amendments made by this section shall apply to estimated tax payments for taxable years beginning after December 31, 1967.

Section 5. *Postponement of Certain Excise Tax Rate Reductions.*

(a) *Passenger Automobiles.*—Under present law an excise tax of 7 percent of the selling price is imposed on the sale by the manufacturer, producer, or importer of passenger automobiles. This rate is scheduled to be reduced to 2 percent on April 1, 1968, then to 1 percent after December 31, 1968.

Subsection (a) of Section 5 of the bill suspends this schedule of reductions for the period during which the temporary surcharge will be in effect. Thus, the present 7 percent rate will remain in effect until July 1, 1969. A rate of 2 percent will apply to sales between July 1, 1969, and December 31, 1969, with a 1 percent rate applying to all sales after December 31, 1969. Conforming amendments are made so that floor stocks refunds will apply on the corresponding date of each reduction.

(b) *Communication Services.*—Under present law, an excise tax of 10 percent is imposed on amounts paid for local and long distance telephone service (including teletypewriter service). A reduction of the rate to 1 percent is scheduled to apply to amounts paid pursuant to bills rendered on or after April 1, 1968, with the tax scheduled to terminate entirely as to bills rendered on or after January 1, 1969.

Subsection (b) of Section 5 of the bill suspends this schedule of reductions for the period during which the temporary surcharge will be in effect. Thus, the present 10 percent rate will continue to apply until July 1, 1969, at which time the scheduled reduction to 1 percent will take effect. The tax will terminate on January 1, 1970. A conforming amendment makes corresponding changes in the dates applicable under the special rules established under present law to adjust for billing practices.

(c) *Effective Date.*—Subsection (c) of section 5 of the bill provides that the amendments made by this section shall apply as of the date of enactment of the bill.

The CHAIRMAN. Mr. Schultze, we will hear you next.

STATEMENT OF HON. CHARLES L. SCHULTZE, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman and members of the committee. In his August 3 message, the President proposed a series of measures which call for difficult decisions on the part of both the executive and the Congress. But while they are difficult, they represent the exercise of responsibility—a responsibility which cannot be avoided if the economic and social health of the Nation is to be maintained.

As the President pointed out, failure to take action to raise taxes and reduce expenditures would produce a fiscal 1968 budget deficit which is clearly unacceptable—unacceptable for four basic reasons:

1. A deficit of \$25 to \$30 billion, with its implications for both Federal and private borrowing, would place such a burden on the Nation's money and capital markets that sharply rising and record-high interest rates would swiftly follow. Even at these high prices, credit—and particularly credit for home buyers—would become less and less available. The recovery in homebuilding from last year's setback would surely be choked off, and indeed, reversed. Over a period of a year we could well lose half a million sorely needed new houses. From the standpoint of economics, social need, and equity, there is no excuse for laying on one selected sector of the economy such a disproportionate burden of financing our efforts in Vietnam.

2. An administrative budget deficit of \$25 to \$30 billion—with its corresponding national income accounts deficit of \$15 to \$18 billion—on top of an economy which is already in the neighborhood of full employment could hardly fail to generate substantial inflationary pressures. No one can forecast the precise wage and price consequences of such a deficit, or the specific sectors of the economy where it would be most severe. But inflationary consequences there would surely be. And once the interaction of rising prices on wage demands and of wage increases on prices is started, it simply cannot be stopped quickly by fiscal action which comes too late.

3. A \$25 to \$30 billion deficit would adversely affect our balance of payments, encouraging a rise in imports and discouraging our exports. Again, no one can give an accurate estimate of the magnitude of this effect. But its direction is clear.

4. Finally, failure to act responsibly would worsen the major social problems of our cities and for many of our poorer citizens. While the very poor are not the primary buyers of new homes, they are affected by a slowdown in new home construction. A slackened pace of new home construction tends to reduce vacancy rates, raise rents, and block the upward movement of the poor into better houses. Many of the poor live on fixed incomes—welfare payments or small pensions—whose purchasing power is eroded by rising prices. The investments of State and local governments in much-needed public facilities are retarded when interest rates rise sharply and credit becomes scarce.

These are indirect, but nevertheless real consequences which could well follow from failure to adopt responsible fiscal action.

The President's program of action calls for both tax increases and expenditures restraint. There have been, and will, I am sure, continue to be a number of voices raised to demand that the necessary action be concentrated solely on the expenditure side. Action by both the Congress and the executive to reduce and restrain expenditures is indeed called for. I shall discuss this in more detail at a later point. But it should be—and as a matter of fact I think it really is—clear to all, that expenditure reductions alone simply cannot accomplish the needed fiscal restraint.

In fiscal 1968 there are some \$21 billion of immediately controllable civilian expenditures, of which \$8 billion represents payrolls and \$1 billion, the proposed military and civilian pay raise. To suggest that, in addition to the cuts which will have to be made in this total under the President's proposals, a further \$7½ billion could be found in lieu of the requested tax increase does not, I submit, constitute a responsible or realistic approach to the problems we face.

In short, I believe the President's proposals, which offer a combination of expenditure restraint and tax increases, represent a desirable and meaningful solution to the situation which confronts us.

Let me turn now to a more detailed analysis of 1968 budget expenditures.

CURRENT 1968 BUDGET ESTIMATES

Before getting to the figures themselves, I would like to explain briefly the basis for the current estimates.

Basis for current estimates

First of all, since final action on appropriations and legislation in this session of the Congress is far from complete, the present estimates can take specific account of congressional action only in a few instances—those where both Houses have acted on a measure. Where neither body or one body alone has taken action to date, we are continuing to use the January estimate. However, where it is no longer possible for a measure to become effective on the date proposed in last January's budget, we do assume slippage in the effective dates of relevant legislation; this is the case, for instance, with respect to the President's recommendation for postal rate increases, for which we are now estimating effective dates beginning October 1, 1967, rather than July 1, 1967.

Second, the estimates take account of the latest actual experience with respect to agency spending rates and uncontrollable factors affecting the expenditure estimates.

Third, the current revisions reflect amendments to the original appropriation recommendations and legislative proposals included in the budget last January.

Administrative budget expenditures

The January budget estimated administrative budget expenditures for fiscal 1968 at \$135 billion. Since then, actions by the executive branch and the Congress plus certain changes in uncontrollable program workload have occurred which will raise expenditures by \$1.5

billion. In addition, a number of contingencies have appeared which could cause further substantial changes in expenditures.

I. Actions and developments to date.—Changes in administrative budget expenditures from actions and developments since January are now estimated, as I said, at \$1.5 billion. These changes are shown in table I, the next page in your testimony. They fall into four major categories:

First, there is an addition of \$600 million for programs previously deferred in accordance with the President's anti-inflation message of September 8, 1966. In late February, and again in March and April, as inflationary pressures eased, and after extensive discussions with Members of Congress, some of the funds which had been withheld were released.

The earlier-than-anticipated releases were mainly for the new program for purchases of low-cost housing mortgages, which had been specifically provided by the Congress last year.

Second, we are now faced with an estimated increase of \$900 million for programs in which payments to individuals or groups are set by law and are, therefore, relatively uncontrollable. Of this amount \$400 million is for higher farm price support payments by the Commodity Credit Corporation. This increase is due primarily to revised estimates to crop yields for feed grains and soybean consumption. We also anticipate an increase of \$300 million above the January budget estimate in grants to States for public assistance—reflecting changes in State laws and a more rapid acceptance of medicaid than had been anticipated. As this committee well knows, the Federal Government provides, under the law, a specified proportion of State cash and medical assistance payments. As States liberalize their eligibility standards and as they begin to participate in the medicaid program, Federal expenditures for public assistance are automatically increased. Another \$200 million increase is due to Federal contributions to medicare, as the number of participants in the supplementary medical program have exceeded expectations.

Third, congressional actions completed or almost completed are estimated to result in an increase of \$100 million in 1968 expenditures. More costly legislation for veterans' benefits has been passed by both Houses of the Congress than was proposed in the January budget. This raises estimated outlays by \$100 million. In addition, the later effective date now assumed for postal rate legislation will add another \$100 million to net budgetary costs. These actions are partially offset, however, by a reduction of \$100 million based on appropriation actions completed or nearly completed to date.

As you know, appropriation reductions in a given fiscal year do not usually lead to expenditure reductions of the same amount in that same fiscal year. Part of the appropriation changes affect expenditures in subsequent years. And some appropriation reductions are purely accounting changes which have no effect on expenditures. For example, in the three appropriation bills enacted to date, appropriations were reduced by \$145 million which will lead to a fiscal 1968 expenditure reduction of \$103 million on our best estimates. Or again in all of the civilian appropriations bills passed by the House to date, appropriations were reduced by \$1,650 million with a fiscal 1968 expenditure effect of \$660 million.

Fourth, a net decline of \$100 million will result from lower expenditures on international financial transactions, partially offset by a rise in outlays for domestic loan programs.

Table 2, attached to this statement, shows by agency the major changes I have just described.

II. *Contingencies.*—Let me turn now to some contingency elements. In considering the expenditure outlook for 1968, there are a number of contingencies which must be explicitly recognized, but whose precise outcome cannot be forecast at the present time.

1. *Defense expenditures.*—In a war situation, military requirements tend to change, and accurate prediction of those changes long in advance is virtually impossible. As a consequence, we must be prepared for additional defense expenditures in support of our combat forces. One illustration of changing requirements was the President's recent decision to authorize an increase of 45,000 in American troops deployed in Vietnam, over and above the number incorporated in the January budget estimates.

At the same time, however, the President has directed Secretary McNamara to review all defense expenditures and to reduce or defer those not now essential for national security. The Secretary is conducting this review, and all efforts will be made to offset to the greatest extent possible the potential increase in Vietnam outlays over the amounts budgeted in January.

Neither the magnitude of the increases for Vietnam or the amount of offsetting savings can be accurately predicted at this time. The net change in defense expenditures, however, should range from zero to an increase of \$4 billion, taking into account both the increases and the offsetting savings.

2. *Federal employee pay raises.*—As you know, the President proposed a 4½-percent pay raise for Federal civilian and military employees, effective October 1, 1967. The \$1 billion cost of this proposal was incorporated in the January estimate of budget expenditures. The pay bill now being considered by the House Committee on Post Office and Civil Service would provide a larger percentage increase, an earlier effective date, and other changes which, when extended to military as well as civilian employees, would add an additional unbudgeted \$1 billion to fiscal 1968 expenditures.

3. *Participation certificates.*—The Congress in the Participation Sales Act of 1966 authorized an expansion of the existing participation sales program to cover additional types of Federal programs.

As part of that act, it was provided that the volume of participation sales made each year by the Federal National Mortgage Association would be authorized in appropriations acts. The January budget proposed total sales of \$5 billion of participation certificates and requested the necessary authorizations.

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

Proceeds from participation sales are credited to the revolving funds of various Federal credit programs and reduce net budget expenditures for these programs. Consequently, if participation sales are \$2

billion below the January estimates, by reason of failure to enact the necessary authorizations, total budget expenditures will exceed the January budget by \$2 billion.

4. Interest on the public debt may increase over the January budget estimate, to the extent that expenditures rise toward the high end of the range of possible contingencies or revenues fall below those now estimated. The resulting increase in the deficit would lead to increased Federal borrowing requirements and higher market rates of interest—both of which would increase interest costs on the public debt.

If these contingencies should turn out on the high side, expenditures would exceed the January budget by \$8.5 billion:

\$4 billion for defense; \$2 billion for lower participation sales; \$1.5 billion for increase in uncontrollable expenditures, that I discussed earlier; and \$1 billion for the additional pay rise.

In turn, these higher expenditures, coupled with failure to enact the proposed tax measures, would cause interest costs on the public debt to rise substantially, by perhaps \$700 million above the January budget estimates.

Decisive action on the part of the Executive and the Congress, however, can hold these contingencies well below the \$8½-billion total. In the case of both military and civilian expenditures, we are launching a program to identify and put into effect major expenditure reductions designed to offset, to the maximum extent possible, those unavoidable increases which do occur. I will describe that program at a later point in my testimony. By its actions on pay and participations certificates, the Congress can also contribute to this effort. Expenditure restraint is an essential part of the fiscal program which the President has recommended to the Congress.

ADMINISTRATIVE BUDGET REVENUES AND THE DEFICIT

Turning now to administrative budget revenues and the deficit, Secretary Fowler has presented to the committee revised estimates of revenues for fiscal 1968, and discussed the revenue yield of the tax proposals.

With no tax increase, without action to reduce expenditures, with military spending rising the full \$4 billion discussed earlier, and with the revised revenue estimates presented by the Secretary, the budget deficit could range up to \$29 billion.

On the other hand, adoption of the President's tax proposals, combined with expenditure restraint on the part of both the Congress and the Executive could reduce that deficit to a range of \$14 to \$18 billion.

If, as one example, the Congress holds the civilian and military pay raise to the level proposed by the President, and authorizes the full amount of participation certificates requested in the January budget; and if reductions in civilian expenditures are made sufficient to offset fully the \$1.5 billion increase now in prospect; and if military outlays should rise by the \$4 billion I mentioned earlier, total administrative budget expenditures in fiscal 1968 would be \$139 billion—\$135 billion as forecast in the January budget plus \$4 billion of added defense spending. Under these circumstances, and with the enactment of the President's tax proposals, revenues are estimated at \$123 billion—slightly higher than the \$122.5 billion noted by the Secretary in his

testimony, since this estimate takes into account the impact on private incomes, and therefore on tax revenues, of the added military expenditures. The deficit under these conditions would be \$16 billion, \$139 billion expenditure, \$123 billion revenue.

We believe a range of \$2 billion on either side of this deficit estimate represents a reasonable allowance for contingencies. On the one hand, military expenditures may not rise by the full \$4 billion. The \$4 billion is not a forecast but the higher end of a range which prudent planning must take into account in view of the uncertainties of a war situation. Moreover, the executive branch will bend every effort to make the civilian expenditure reductions larger than the \$1.5 billion necessary to offset increases now in prospect. On the other hand, additional pay increases or lower participation in sales authorizations could force expenditures above the \$139 billion level, leading to a deficit higher than \$16 billion. The \$14 to \$18 billion range, therefore, reflects a realistic appraisal of the situation as we now see it.

EXPENDITURE REDUCTIONS

We have begun a concerted effort to achieve every reduction and deferral which can reasonably be made in order to lower nondefense expenditures. We are determined to cut more than the \$1.5 billion, which would offset the release of 1967 withheld funds and the uncontrollable increases in CCC, public assistance, and other outlays. Such a cut would bring civilian expenditures—exclusive of changes in participation sales and in the President's pay proposals—back to the \$59.5 billion level estimated in the January budget. Our actual reduction target is larger than that—we are aiming at a cut of over \$2 billion—as a means of holding civilian expenditure below the January estimate.

Such an expenditure reduction would require cuts in obligational authority and program levels of some \$4 billion. Whether we will be able to achieve our target fully, I cannot predict at this time. But we are setting our sights high in order to insure significant reductions, when the actual results are all in. The outcome will, of course, depend in part upon congressional action on the budget, as well as upon our own efforts.

We have already set machinery in motion so that as each appropriation bill is enacted, it will be carefully reviewed by the agency involved to see what can be done to contribute to this interim goal. We believe this is the most effective way to accomplish this first step toward our objectives.

Until the Congress acts, it is impossible to determine the base from which reductions can be achieved. The final result will come from a combination of congressional action on appropriation bills and other legislation and executive branch action to economize, defer, cut back, and stretch out expenditures from the amounts that would be feasible under the appropriations enacted. An intensive review is already underway in the major agencies for which appropriations have thus far been enacted; namely, Treasury, Post Office, and Interior.

The job will not be easy. As the President pointed out in his tax message, and as the members of this committee know, the opportunity for significant discretion in the level of budgetary outlays in the year ahead is very small; only \$21 billion lies outside the areas of national

defense and relatively uncontrollable programs or commitments. As I said earlier, about \$8 billion of this represents the Federal payroll at present pay rates and an additional \$1 billion is the cost of the military and civilian pay raise recommended by the President.

Most of the reductions must come in the remaining \$12 billion. As you can see, this means that the reductions would have to amount to well over 10 percent of controllable programs. Nevertheless, we will identify and carry out such reductions. A breakdown of the budget into controllable and uncontrollable expenditures is attached to my statement as table 3.

Compared to 4 years ago, Federal expenditures, apart from Vietnam, have indeed risen. But they constitute a smaller, not a larger, share of the Nation's economic activity. In 1968, even if we realize only \$1.5 billion in civilian expenditure reductions out of our \$2 billion plus target, non-Vietnam expenditures will constitute only 14 percent of the nation's gross national product. This compares with 16 percent in fiscal 1964 and 16½ percent in the last half of the 1950's. I realize on the basis of past experience, that some members of this committee are not sympathetic to the participation sales program. If I exclude those from the calculations, non-Vietnam expenditures in 1968 would still be only 14½ percent of our national economy in fiscal 1968 compared to the 16 percent in 1964 and 16½ percent in the late 1950's.

Even if we add Vietnam outlays to the total—at the level budgeted in January—the 1968 share of Federal expenditures in the national economy would be about 16⅔ percent, only a shade above the ratio in the latter half of the 1950's when, of course, there were no Vietnam expenditures. Finally, if military expenditures should rise the full \$4 billion discussed earlier, the Federal share of the national economy would increase to 17.2 percent of GNP—about the same as in 1955 and 1959, and far below the 21 percent reached during the Korean war.

In short, Federal expenditures outside of Vietnam have indeed risen over the past 4 years—risen to meet the growing workload generated by an expanding population and to help meet some of the Nation's major problems in health, education, urban development, and poverty. But the rise has been held within reasonable bounds. As a share of our national economy, Federal outlays outside of Vietnam have been reduced over the past 4 years.

During fiscal 1968, as a part of the President's overall fiscal program, we shall be applying still further restraint to Federal expenditures. This can and must be done, in view of the situation which faces us.

In summary, Mr. Chairman, I believe the President has proposed a responsible combination of measures to prevent an excessive budgetary deficit. Both expenditure restraint and tax increases are called for. Neither will be easy. But the pain of both is far less than the consequences, for all Americans, of failure to act.

Thank you.

(The tables referred to follow:)

TABLE 1.—*Categories of major change in January estimates of 1968 administrative budget expenditures*

[In billions]	
Effect of earlier release of some 1967 deferred activities.....	+\$0.6
Low-cost housing program.....	+ .5
Other, including construction by the Corps of Engineers and the Department of Health, Education, and Welfare.....	+ .1
Relatively uncontrollable changes under existing law.....	+ .9
Farm price supports.....	+ .4
Public assistance grants to States.....	+ .3
Medicare trust fund payments.....	+ .2
Effect of completed or almost completed congressional action.....	+ .1
Veterans' benefit legislation.....	+ .1
Slippage of postal rate increase by 1 quarter.....	+ .1
Appropriation actions completed.....	- .1
Other	- .1
Reestimates of rates of outlay in some programs, mainly loan ac- tivities of the Departments of Housing and Urban Development and Agriculture.....	+ .4
Reestimates of financial transactions for Export-Import Bank and international financial institutions.....	- .5

TABLE 2.—*Major changes in 1968 administrative budget expenditures by agency*

[In billions]	
January budget estimate, total.....	\$135.0
I. Major changes from actions and developments to date:	
Housing and Urban Development—Mainly effects of tightening money market on mortgage purchases, and earlier release of amounts deferred in fiscal 1967 for low-cost housing.....	+ .7
Health, Education, and Welfare—Mainly additional payments to medicare trust funds and public as- sistance grants (cash payments and medical assist- ance).....	+ .5
Agriculture—Mainly Commodity Credit Corporation, caused by higher farm price support payments for feed grains and soybeans.....	+ .4
Transportation—Mainly for the supersonic transport (covered by contingency allowance in January).....	+ .1
Veterans' Administration—Mainly more liberal leg- islation for readjustment benefits, pensions, and death gratuity payments.....	+ .1
Post Office—Mainly slippage of effective date of pro- posed postal rate increase from July 1, 1967, to Oct. 1, 1967.....	+ .1
Office of Economic Opportunity—1967 budget amend- ment for expanded summer programs.....	+ .1
Corps of Engineers—Mainly effect of earlier resump- tion of work on construction deferred in fiscal 1967.....	+ .1
International financial institutions—Conversion of maturing IMF notes (which were recorded as ex- penditures when issued) to letters of credit (under which expenditures are recorded only when funds are actually paid out).....	- .4
Export-Import Bank—Lower level of loan disburse- ments, net.....	- .1
All other.....	- .1
Subtotal	136.5

II. Range of possible contingencies:

Defense expenditures—increase up to-----	4, 000, 000, 000
Excess Federal pay raise—increase up to-----	1, 000, 000, 000
Participation sales—increase up to-----	2, 000, 000, 000
Interest on the public debt—increase up to-----	700, 000, 000

TABLE 3.—1968 civilian administrative budget expenditures based on actions and developments to date by type of controllability

[In billions]

Relatively uncontrollable civilian expenditures:

Major programs:

Interest -----	\$14.2
Veterans' pensions, compensation, and insurance-----	5.0
Public assistance grants-----	4.4
Farm price support (CCC)-----	1.9
Postal public service costs and revenue deficit (existing law)---	1.0
Health insurance payments to trust funds-----	1.1
Legislative and judiciary-----	.4
Other -----	2.3

Total, major programs-----	30.2
Payments on prior contracts and obligations-----	15.3

Relatively controllable civilian expenditures:

Sale of financial assets-----	-5.3
Proposed pay increases-----	1.0
Personnel compensation-----	8.0
Other -----	11.7

Total -----	61.0
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The CHAIRMAN. Thank you, Mr. Schultze. Mr. Ackley, you are recognized, sir.

STATEMENT OF HON. GARDNER ACKLEY, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. ACKLEY. Mr. Chairman and members of the committee, although tradition has generally restricted congressional testimony by the Council of Economic Advisers to appearances before the Joint Economic Committee, the importance of the proposals before you justifies an exception to that practice.

I am here, on behalf of my two colleagues as well, to register our strong support for the President's tax proposals.

Secretary Fowler and Director Schultze have covered well the budgetary and financial aspects of the situation. I do not intend to repeat their discussion. Rather, since great interest has been expressed in the economic impact of the proposed program, I shall expand on what they have said about the economic outlook with and without the President's program.

Let me summarize at the outset the points I shall make.

1. Federal budgetary policy has been highly stimulative so far in 1967. It would remain highly stimulative if no action is taken to increase tax rates and to restrain expenditures.

2. Fiscal stimulus was appropriate and constructive in the first half of this year. Along with an easing of monetary policy, it helped generate a rapid growth of final sales—the combined spending of consumers, governments, and of business for fixed investment—in the face of an unprecedented drop in inventory investment.

3. Continuation of this strong stimulus, however, would be appropriate only if inventory investment were likely to plunge into a sharp and prolonged liquidation, or if final sales were likely to level off abruptly.

4. Recent economic developments are inconsistent with either of these bearish possibilities. Current evidence clearly indicates that most of the drag of the inventory adjustment is behind us and that final sales are continuing to advance briskly. Economic growth has resumed and the economy is picking up speed.

5. The time has arrived for a movement of fiscal policy toward restraint in order to safeguard prosperity. Prompt enactment of the President's tax proposals would assure healthy economic growth, guarding against a new disruption of financial markets, preserving our opportunities for an improved price performance, protecting our international trade surplus, while permitting a solid advance of more than \$50 billion in our gross national product over the next year.

THE STATE AND FUTURE OF BUDGETARY POLICY

Most economists regard the national income accounts budget as the best measure of the impact of Federal fiscal transactions on the flow of private incomes, spending, and production.

As so measured, the Federal budget has moved dramatically in a stimulative direction during the past year. In the first half of calendar 1966, it was in surplus at an annual rate of nearly \$3 billion.

In that period, the Federal Government was subtracting more from private incomes through tax receipts than it was injecting into the stream of private purchasing power through income-creating expenditures.

In the first half of this year, however, the budget was deeply in deficit at an annual rate of \$13 billion, registering a swing of \$16 billion over the 1-year period. The annual rate of expenditures rose \$25 billion over the year. Defense purchases dominated the picture, growing nearly \$15 billion.

Social insurance benefits, reflecting the initiation of medicare, accounted for more than half the nondefense advance. Meanwhile revenues grew by a little more than \$9 billion, reflecting changes both in tax rates and in the economy. In particular, the drop in corporate profits put a dent of \$2 billion to \$3 billion in tax revenues.

The current rate of deficit, and the recent swing in the deficit, represent a potent fiscal stimulus, by any standard of comparison. At no time previously since the Korean war has the Federal budget on national income account been actually—or even potentially—in deficit under high-employment economic conditions.

During the Korean war, the peak deficit rate for any half-year period was \$5½ billion—about the same as the recent \$13 billion rate when viewed in relation to GNP.

In the absence of tax action, we could not count on a decrease in the national income accounts deficit over the year ahead. Indeed, at the upper end of the range of expenditure contingencies, the deficit would actually increase to a rate well above \$15 billion.

On the other hand, with the tax increase and the efforts to cut back expenditures recommended by the President, and with the healthy

growth of revenues that will accompany a solid economic advance, the annual rate of deficit should be around \$3 to \$5 billion by the end of fiscal 1968.

There are times when a large imbalance of Federal spending over Federal income helps to balance the total economy, by offsetting a large imbalance of private income over private spending.

If private investment is especially weak or significantly weakening, if private desires to save are unusually strong or rising sharply, if credit-financed expenditures are depressed as the result of a highly restrictive monetary policy, then total demand will need the support of a Federal deficit in order to reach prosperity levels.

But history certainly tells us that, most of the time, a large and maintained Federal deficit under conditions of high employment will strain the capacity of the economy and generate inflationary pressure.

The wisdom of a tax increase as economic policy can be rejected only if one is confident that private demand is and will remain unusually sluggish. Only in that event could the economy take a persistent massive fiscal stimulus over the year ahead without becoming over heated.

THE STATE AND FUTURE OF ECONOMIC ACTIVITY

Demand was indeed sluggish in the early months of 1967, and the stimulus of fiscal policy helped to right the balance and to maintain the forward motion of our unprecedented 6½-year period of prosperity. But demand has already gained in vigor, and the evidence overwhelmingly rejects a forecast of sluggishness for the year ahead.

The economic conditions of 1967 are rooted in the developments of the past several years. In 1964 and the first half of 1965, we enjoyed a rapid and healthy advance fueled by the large fiscal stimulus stemming from the Revenue Act of 1964.

The tax cut added mightily to consumer and business purchasing power. And this extra purchasing power flowed into markets for goods and services, creating jobs and adding to wage and profit incomes.

With the excise tax reduction of mid-1965, fiscal policy continued to be moderately stimulative, appropriately aiming for further progress toward the target of full employment.

In the summer of 1965, however, the decision to increase our military forces in Southeast Asia began to place a marked and unforeseen fiscal stimulus on top of our previous budgetary plans.

As a result of the extra defense expenditures and orders, and of the sharp psychological reaction of private spenders to the prospect of a continuing defense buildup, we experienced a period of hectic economic advance in late 1965 and early 1966. The economy was exceeding reasonable speed limits and the brakes had to be applied.

They were applied—both through monetary policy and through the tax measures recommended by the President in January 1966 and promptly enacted by the Congress in March. The overall pace of economic advance was brought down to a reasonable rate by the spring and summer of last year.

But business investment demand forged ahead, seemingly immune to the restraining policy actions. The capital boom called forth ever-larger doses of restrictive monetary policy, placed intolerable burdens on financial markets, generated strong upward pressures on wages and prices in capital goods industries, and contributed to a huge upsurge in imports.

The Presidents fiscal program of last September 8 turned the tide of interest rates and financial pressures. The capital boom was finally brought to a halt by a combination of forces—the suspension of tax incentives which Congress enacted last October, the direct and indirect impact of tight money, the more moderate pace of overall economic activity, and the related relaxation of inflationary psychology.

The brakes worked. Inflationary pressures were brought under control. But the natural consequence of the restraining policy measures was a period of economic advance at a slower-than-ideal speed.

In the fourth quarter of last year, demand leveled off but production continued to increase. In particular, many manufacturing firms stepped up their output, looking for a further growth of their markets which did not materialize.

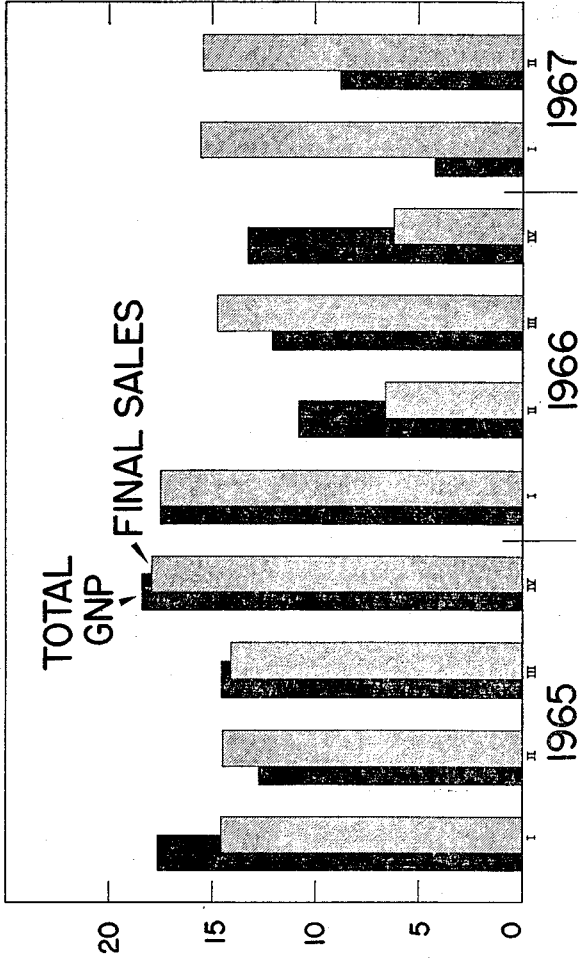
As a result, there was a massive accumulation of inventories of unsold goods in the closing months of 1966, which led to cutbacks in industrial output early this year.

The inventory adjustment dominated our economic performance in the first half of 1967. This is illustrated in chart 1, which shows recent quarterly movement of total gross national product, and of “final sales”—that is to say, gross national product excluding inventory investment.

Chart I.

CHANGES IN TOTAL GNP & FINAL SALES

\$BILLIONS, CHANGE*



* CHANGE FROM PREVIOUS QUARTER, SEASONALLY ADJUSTED ANNUAL RATES.
SOURCE: DEPARTMENT OF COMMERCE.

Over the past two quarters, the total production sold to final users—consumers, homebuyers, government at all levels, business for fixed investment, and net sales abroad—rose by a rapid \$15½ billion a quarter, as shown by the lighter bars on the right.

Incidentally, Mr. Chairman, these figures are based on revisions of the second quarter gross national product estimates which the Department of Commerce is releasing this morning. This rate of advance exceeds the increase in buying by final users in any single year in our history. In only two previous quarters since 1951 has the growth of final sales been greater. Both of those are quarters which appear on the chart.

However, during the first two quarters of 1967, the production that went into additions to inventories fell by \$18 billion, giving us a net gross national product gain of only \$13 billion for the first half of the year.

The recordbreaking swing in inventory investment did not send the economy into reverse only because final sales were advancing so vigorously. And the strength of final sales, in turn, owed much to the stimulus of fiscal policy and the easing of monetary policy.

The rapid increases in Federal outlays showed up directly in an \$8 billion gain in the annual rate of Government purchases over these two quarters, nearly all for defense; these expenditures and higher social insurance benefits supported consumer incomes and thereby indirectly contributed to the \$16 billion annual-rate rise in consumer spending over the half year. The relaxation of monetary policy permitted a \$2 billion gain in homebuilding. Thus, the large stimulative swing of the Federal budget (and of monetary policy) helped to minimize the swing in economic activity.

PROSPECTS FOR THE MONTHS AHEAD

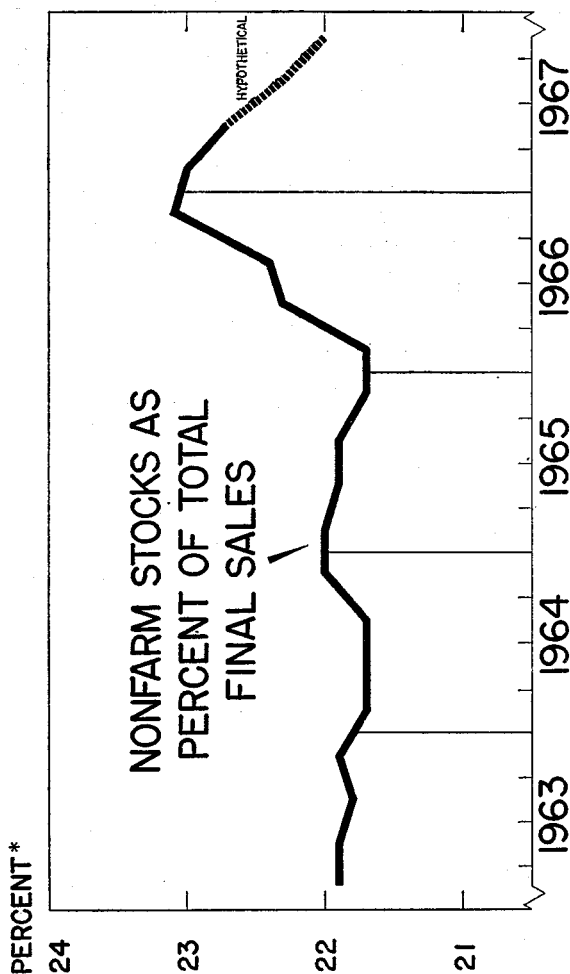
On any reasonable assessment of the evidence, one must conclude that the drag of the inventory adjustment is largely behind us. If inventory investment simply remains at the second-quarter level, it will stop retarding the growth of total production. Gains in gross national product would then fully match the increases in final sales—a marked change from the situation in the first two quarters of the year.

Moreover, if inventory investment remains close to zero—as it was in the second quarter—and if the growth of final sales is maintained at the same rate as in the first half of the year, the relation between inventories and final sales would be completely back to normal for the economy as a whole at the end of 1967.

This hypothetical calculation is shown by the broken line in chart 2.

Chart 2.

RELATION OF NONFARM STOCKS TO TOTAL FINAL SALES



* BASED ON SEASONALLY ADJUSTED DATA IN 1958 PRICES.
SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

The ratio of total nonfarm inventories to total final sales (expressed in constant prices), rose sharply in the latter half of 1966, after having remained virtually unchanged for some years. But the ratio has been moving down in the first half of 1967, as shown on the right. Although the ratio remains high, balance can readily be restored through the growth of sales rather than through any significant actual decline of stocks.

The latest figures for the month of June show that firms were actually, on balance, reducing stocks in June. That liquidation has now fully restored a normal balance between stocks and sales in retail and wholesale trade. There are a number of areas in manufacturing where inventories remain very high relative to sales.

This is especially true where the customers of manufacturing firms have themselves been adjusting inventories and, hence, curtailing their purchases from manufacturers.

Now that retailers and wholesalers have made their adjustment, manufacturers should experience strengthened demands. With improved markets, manufacturing output should resume its advance and manufacturers' inventory-sales ratios should decline.

Some net liquidation of inventories could continue for another month or two. But it cannot be reasonably projected for very long into the future.

Inventory investment will bottom out in the second half of the year. And, after touching bottom, inventory investment should begin a gradual climb toward its normal prosperity rate of about \$7 billion. In the first half of 1968, an inventory rebound should be an important stimulative force.

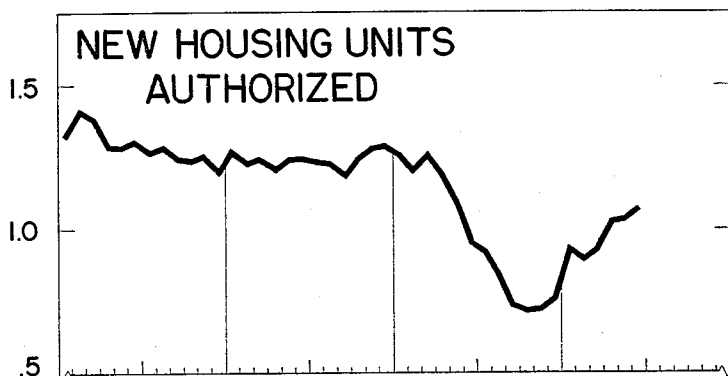
There is every reason to expect further good gains in consumer spending. After reaching an abnormally high peak in the first quarter of 1967, the consumer saving rate has begun to decline, although it is still well above its normal level. Over the past 5 months, retail sales have advanced an average of 1 percent a month.

Evidence of a housing rebound has been similarly convincing and encouraging. As chart 3 indicates, both expenditures on new residential construction on the bottom page and permits for new dwelling units have been rising steadily this year.

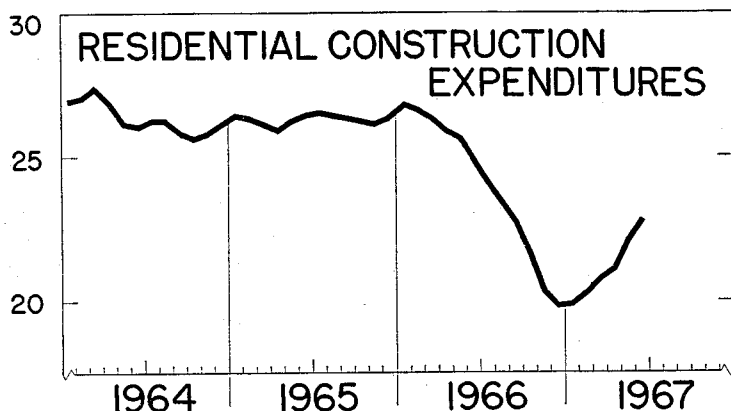
Chart 3.

PRIVATE HOMEBUILDING

MILLIONS OF UNITS*



\$ BILLIONS*



* SEASONALLY ADJUSTED ANNUAL RATES; NONFARM ONLY.
SOURCE: DEPARTMENT OF COMMERCE.

They still have a long way to go, merely to return to levels that were normal prior to the mortgage famine of 1966. Growing consumer incomes and rapid family formation should generate sufficiently strong housing demand in 1968 to bring homebuilding up to—and beyond—its 1964-65 pace.

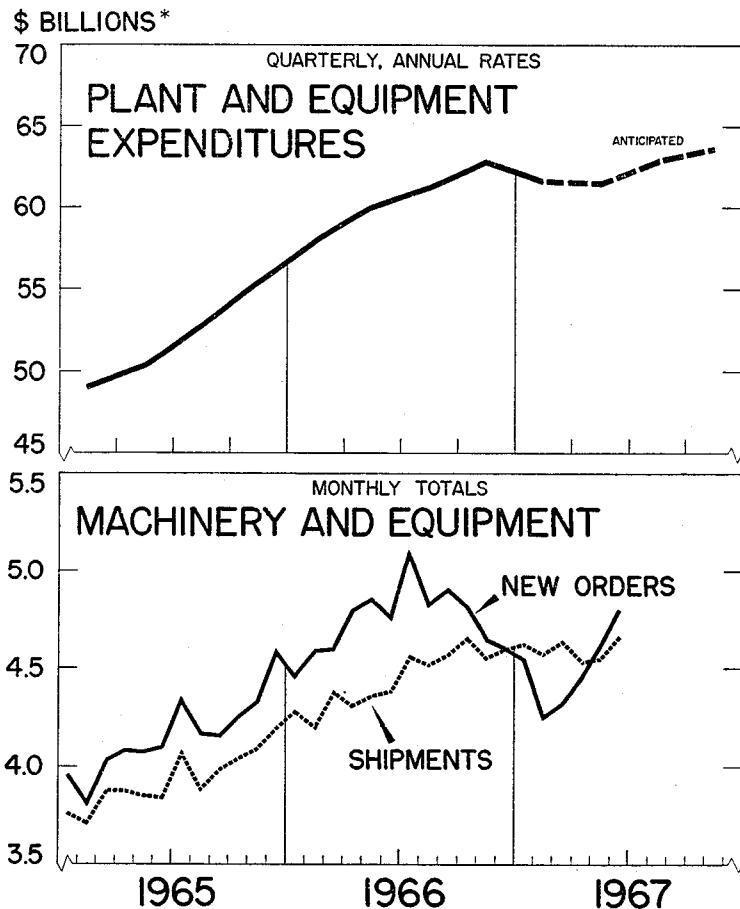
So long as mortgage funds remain available, homebuilding should be a key propelling force in the economy's advance over the coming year.

The other major sector of private demand, business fixed investment, is not likely to be a particularly stimulative force. But neither should it be a drag on overall production.

As chart 4 shows, businessmen have planned a gradual upturn in their investment for the second half of the year.

Chart 4.

BUSINESS CAPITAL OUTLAYS



*SEASONALLY ADJUSTED.
SOURCES: DEPARTMENT OF COMMERCE AND SECURITIES
AND EXCHANGE COMMISSION.

These are based on the Commerce-SEC survey of May of this year. In interpreting this evidence, it should be recognized that firms have scaled down somewhat their earlier plans for investment, and this scaling down could continue.

On the other hand, the restoration of the investment tax incentives may have some upward impact on plans. The chart also shows on the bottom panel the recent sustained recovery in new orders for machin-

ery and equipment, which have now advanced for 4 straight months and are now running ahead of shipments.

All of this adds up to the verdict of a buoyant economy in which the pursuit of a highly stimulative fiscal policy would be inappropriate—indeed, perilous.

I have far more confidence in this overall judgment than in any quantification I can offer of just how fast the economy is likely to advance and just where the gains will take place. Nevertheless, this committee may be interested in a sketch of our current numerical projections. Assuming no major disruptions from strikes or developments abroad, our estimates for the next two quarters show the following, if Congress were to reject the President's tax proposals.

1. Spending by State and local governments should rise about \$4½ billion, maintaining its steady and stable upward trend.

2. Spending by the Federal Government should rise between \$3 and \$6 billion, depending on defense contingencies and on congressional decisions regarding the Federal pay bill and other key civilian issues.

3. Housing should rise about \$3½ billion provided funds remain available.

4. Plant and equipment spending should essentially remain on its high plateau. But, in the absence of a tax increase, it could rise by \$1 billion.

5. Given these gains and the growth of incomes they would generate, consumer spending would rise by between \$16 and \$18 billion.

6. Inventory investment should begin its recovery, rising by \$1 to \$2 billion.

Even at the lower end of this range of these estimates, the increase in gross national product would be \$29 billion. At the upper end the \$35 billion advance would nearly match the hectic pace of gain between the third quarter of 1965 and the first quarter of 1966.

If unchecked, the pace of advance would accelerate in the first half of 1968, as investment in plant and equipment and inventories responded to booming sales.

This would be too rapid a pace of growth, inconsistent with the stability of interest rates. It would give renewed momentum to the wage-price spiral and eliminate any hope for a return to price stability.

A growth in gross national product of about \$50 billion over the next year would approximately keep pace with the growth of our productive capacity, enabling us to add to real output at a rate of about 4 percent a year, after correction for the built-in price increase that we must expect. Since we have a small margin of excess capacity today, we could welcome a rate of growth slightly above that pace.

But we certainly could not welcome—indeed, we cannot safely tolerate—a growth of as much as \$60 billion or more.

With the President's tax program, our projections show good prospects for realizing a growth in the neighborhood of \$55 billion over the next year. Prompt enactment of a tax increase will both moderate the growth of purchasing power in the fourth quarter, and prevent the development of inflationary expectations. It would assure that the recovery of homebuilding is not aborted by tight money, and that recent welcome gains in our international trade surplus will continue.

The assessment of the outlook I have presented is broadly in accord with the judgment of most expert forecasters today. We have

tested and challenged our own views against the bearish opinions held by a small minority of the profession.

Frankly, I find it hard to make sense of a diagnosis of persistent sluggishness over the coming year. To accept it, one has to believe either that inventory investment will plunge into sustained and massive liquidation or that growth of final sales will slow down abruptly in the months ahead.

Such a forecast seems clearly at odds with the evidence I have presented on inventories, retail sales, homebuilding, investment plans, and orders. It also flies in the face of a number of facts I have omitted—such as the recent pickup in employment, the acceleration of personal income gains, and the advance of construction contracts.

In short, there is nothing to suggest that a powerful fiscal stimulus is called for in order to support healthy economic growth. On the contrary, the maintenance of such a stimulus is most likely to undermine our prospects for balanced prosperity.

THE PROSPECT FOR PRICES

With a tax increase, growth of production in the coming months would not place serious strain on our productive resources. But even under these conditions the general price level will continue to rise in response to inflationary forces which were set in motion during the rapid expansion of late 1965 and early 1966.

Wage demands of both organized and unorganized workers have been spurred by the cost-of-living increases of the past 2 years. And while labor markets are not as tight as last year, there are still shortages of well qualified workers in many occupations.

These are particularly marked in medical care and other professional services, construction, and repair and maintenance services. The recent temporary decline in manufacturing employment has been more than offset by the continued rapid expansion of employment in trade, services, finance, and government—especially State and local.

Under these pressures average hourly compensation in the private nonfarm economy rose at an annual rate of over 6 percent in the first 6 months of 1967—far exceeding the normal increase in labor productivity. The recent pattern of union settlements has been around 5 percent a year.

Even with unemployment rates remaining around the 3¾-percent level of the past year and a half, we can expect a gradual relaxation of wage pressures. The mobility of our labor force and the expanded public and private training programs are better adapting the effective supply of labor to the demand.

Productivity gains will be larger as the rate of production accelerates.

Nevertheless, unit labor costs will surely increase during the coming year. With expanding demand, most employers will find it possible to raise prices to compensate for higher costs. The price level will continue to rise, though somewhat more slowly than last year.

But the more rapid rise in demand that would occur without a tax increase would sharply accelerate the rate of price increase. New pressures on raw materials supplies, new shortages of labor, and renewed tightness in capacity utilization would add a new surge of price increases on top of those already in prospect. Responsible public policy cannot permit this to happen.

FEDERAL REVENUES AND TAX CHANGES

The current economic situation and the prospective economic developments, just reviewed, make it clear that the economy can "take" a tax increase without endangering prosperity—indeed, that a tax increase is necessary to restrain an otherwise excessive economic advance which could generate strong inflationary pressures.

Under these circumstances the tax increase would clearly yield more revenues—not less, as some have contended. It could yield less only if it threw the economy into a recession, so that the effect of the higher tax rates was more than offset by a reduction in the tax base.

There surely have been times when that could be the effect of a tax increase. The proposition that—in a weak economy—higher tax rates can produce less revenues rather than more is, of course, the counterpart of the proposition that—in such an economy—a tax reduction can increase Federal revenues by stimulating a strong economic advance.

If our economic situation today were that of 1962 and 1963—or of the 5 or 6 previous years—we should indeed again be considering a tax cut rather than a tax increase. In late 1962 and 1963, unemployment was high, utilization of plant capacity was low even though new investment was adding only very slowly to capacity, prices were under no pressure, and the prevailing business sentiment was that the weak economic expansion that had begun in early 1961 had about run its course. Under those conditions a tax cut could and did put idle resources to work and expand the revenue base dramatically.

But that is not the situation of the economy in 1967 or its outlook for 1968. We are operating at or below 4 percent unemployment and, with a tax increase, we will continue to make full use of our resources.

Under these circumstances, fiscal restraint will slow down the growth of demand, to keep it within the growth of our ability to produce. This is precisely why we want it. But it will only slow it down not turn it around.

Under today's conditions, a tax increase will yield substantially larger, not smaller, revenues. The higher tax rates will be applicable to an expanding tax base. The revenue estimates which the Secretary of the Treasury has given you take account of that prospect.

Without a tax increase, the tax base would, of course, expand even more rapidly. But the extra expansion would consist mainly of higher prices for the same volume of production. Federal revenues would rise, but the real purchasing power of those revenues would not. The extra revenues would be paid in inflated currency, its value impaired by rising prices for what the Federal Government buys.

Without a tax increase, the cruel and unequal bite of tight money and high interest rates would impose some restraint on the growth of demand and the inflation of money incomes. But the additional revenues generated by that kind of restraint would not flow to the Government. Rather, they would flow to those who have money to lend.

We must not forget that—whenever the economy is operating at or close to full use of its productive resources—increased Government expenditures cannot fail to be paid for by a slower growth of real income in the private economy. Extra production to meet the needs of the Government must necessarily be matched by lower production to meet private needs.

The question is only whose needs will be left unsatisfied, and by what mechanism the resources will be diverted from private to Government use. I think we would all agree that it is better that the resources be diverted to the Government through taxation rather than through inflation or monetary stringency.

As the President's message pointed out: "A failure to raise taxes would not avoid the burdens of financing a war. For these burdens are inescapable. But, instead of sharing those burdens equitably and responsibly—as an income tax surcharge would do—inflation, tight money, and shortages would tax the American people cruelly and capriciously. The consequences of that irresponsibility would haunt America and its people for years to come."

The President has proposed a responsible course of action to meet the needs of the period immediately ahead. I am sure we all wish it were not necessary to raise taxes, even temporarily. And I know there will be bitter complaints about the specific expenditure reductions that the Congress and the President will find it necessary to make.

But we must not lose our perspective. Over the past few years we have been able simultaneously to reduce taxes by far more than they are now being raised, and at the same time to undertake major new programs to meet the needs of the American people; and I am convinced that we can continue on this course in the years ahead.

There are two reasons why it has been possible to combine lower taxes with the initiation of important new programs in the areas of education, health, cities, pollution, and the attack on poverty and distress.

The first reason is that a major and continuing effort has been made to control Government costs, increase efficiency, and to prune down older programs where needs are now less urgent.

The second and more important reason lies in the unequalled power of our essentially free and private economic system to enlist the energies, the skills, the imagination, the enterprise, and the ingenuity of American workers, businessmen, farmers, investors, scientists and engineers, inventors, promoters, lenders, and all who participate in this incredible complex of activities we so casually refer to as "the American economy."

The growth of our ability to produce goods, services, and incomes continues apace, and shows no limits. In that perspective, I am confident that we can look forward again to a trend of lower, not higher, tax rates—which will still produce the growing revenues needed to finance the farsighted public programs the American people want and need.

The time will again come when a responsible fiscal policy presents the welcome opportunity for tax reduction. We will hasten that time if we now take the responsible fiscal action of temporarily raising taxes, as the President has proposed.

Thank you.

The CHAIRMAN. Thank you, Mr. Ackley, and without objection those charts and tables attached to your statement will appear in the record at the points indicated in your statement.

Gentlemen, I have a few questions that I would like to propound to all three of you.

First, Mr. Secretary, do you have a chart that we can include in the record of what your estimates of revenue will be on the basis of your

best judgment at the present if none of the proposals presently before the Congress for additional revenue is enacted?

Secretary FOWLER. Mr. Chairman, I can give it to you orally as follows.

The CHAIRMAN. All right, sir.

Secretary FOWLER. We have calculated, as my statement indicates and as the table which is attached to it indicates under the heading "Estimated Net Administrative Budget Receipts in the Fiscal Year 1968 (assuming the President's tax program)"—that is the very last sheet in the statement—that under the proposed legislation revenues would be \$122.5 billion.

The CHAIRMAN. That is with the tax bill?

Secretary FOWLER. That is with the tax bill as proposed. Now, if you deduct the tax package you would subtract \$7.4 billion from that total giving you receipts without the tax package of \$115.1 billion.

Now, that is without taking into account, Mr. Chairman, the fact that there would be some increase in receipts under present law because income levels would be higher with no increase in taxes.

As Chairman Ackley has indicated, we think most of this would be in the form of price increases, but, nonetheless, taking into account that feedback factor from no taxation you would add \$1.3 billion to the \$115.1 billion, which would give you \$116.4 billion, taking into account the element of feedback. Further the January budget proposed other legislation, principally the diversion of part of the excise tax on automobiles to the Beauty-Safety Trust Fund, which would decrease administrative budget receipts by \$0.5 billion. If this were not enacted, budget receipts would be \$116.9 billion.

The CHAIRMAN. All right. Refresh my recollection, Mr. Secretary, on what the estimates of revenue were in the budget estimated in January for the 1968 fiscal year.

Secretary FOWLER. Mr. Chairman, I can take you through, if you want to at this point, a reconciliation of the current estimates which are in the table attached to my statement and those we had in the January budget.

The CHAIRMAN. All right. First of all give me the figures, will you, which included a 6-percent surcharge effective Just 1 last.

Secretary FOWLER. \$126.9 billion.

The CHAIRMAN. The net effect then is a difference of around \$10 billion on the basis of what you gave me just prior to this question, \$116.9 billion versus the \$126.9 billion?

Secretary FOWLER. Yes, sir.

The CHAIRMAN. Will you break that down, because that is a rather sizable difference. I understand of course it included in part tax increases which amounted to what? \$5.4 or \$5.5 billion?

Secretary FOWLER. \$5.5 billion in the January budget.

The CHAIRMAN. For the fiscal year, and that would leave then about a \$4.5 billion variation in our estimates?

Secretary FOWLER. I would take each individual item in the January budget revenue estimates and give you a reconciliation of it in this context.

The CHAIRMAN. If you will do that I think it will be helpful for the record.

Secretary FOWLER. As I said, our current estimate for the fiscal year 1968 receipts is \$122.5 billion assuming a 10-percent income tax surcharge effective July 1, 1967, for corporations and October 1 for individuals. This current estimate is \$4.4 billion below the January budget estimate of \$126.9 billion, which assumed a 6-percent surcharge effective July 1 for both corporations and individuals and a reconciliation of these two estimates using the figures consistent with the estimates given in the President's tax message will follow: First, on individual income tax the January estimate, which is contained in the budget on page 58 of the January budget book, was \$73.2 billion. Revisions have been made in that estimate because of (a) a reduction in the marginal rate because of calendar 1966 experience amounting to \$3 billion.

Since that is a sizable item I know you will want me to detail the reasons for it.

The CHAIRMAN. That would be \$3 billion off of the \$73.2 billion?

Secretary FOWLER. That is right. The marginal rate experience of calendar 1966, in our judgment, now justifies a recalculation of the yield.

The current estimate of personal income assuming the January budget expenditure level for the period affecting the fiscal 1968 receipts is approximately \$2 billion less than the January estimate.

The CHAIRMAN. What does that make it now? \$71.2 billion or \$70.2 billion?

Mr. SCHNEEBELI. \$70.5 billion.

The CHAIRMAN. What I am trying to get to, Mr. Secretary, is what is your estimate now compared to your \$73.2 billion of revenue from individuals.

Secretary FOWLER. There are five factors and I come out with a \$70.5 billion figure, which is the figure contained in the attachment to the statement.

The CHAIRMAN. \$70.5 billion. Oh, yes, I'm sorry I interrupted you.

Secretary FOWLER. \$70.5 billion. Now, first you deduct from the \$73.2 billion the \$3 billion which is a reduction in the marginal rate because of the calendar 1966 experience.

The CHAIRMAN. Mr. Secretary, that \$70.5 billion includes, does it not, the enactment of the 10-percent surcharge effective October?

Secretary FOWLER. Yes, sir.

The CHAIRMAN. What are your estimates now of individual taxes to be paid in this fiscal year without considering a tax increase?

Secretary FOWLER. I would have to supply that for you.

(The following table was received by the committee:)

<i>Estimated net administrative budget receipts, present law, in the fiscal year 1968</i>	
	<i>Billions</i>
Individual income taxes.....	\$67.0
Corporation income taxes.....	30.3
Excise taxes.....	9.3
Estate and gift taxes.....	3.0
Customs.....	2.0
Miscellaneous receipts.....	5.3
Net budget receipts, present law.....	116.9
Effect of proposed legislation other than tax program.....	— .5
Net administrative budget receipts with no tax action.....	116.4

The CHAIRMAN. If you will, supply it for the record at this point.

Secretary FOWLER. Yes, sir. Suppose I take you through the calculations and get us from the \$73.2 billion to the \$70.5 billion and then I will comment on each individual one.

You would deduct from the \$73.2 billion \$3 billion because of the change in the estimate of the yield by reason of our marginal rate experience in calendar 1966 which I will explain later; second, a reduction in the personal income assumption.

The January budget assumed personal income for calendar year 1967 of \$624 billion. For comparability this must be adjusted upward by approximately \$3 billion to \$627 billion because of the July 1967 revisions in the national income accounts by the Department of Commerce. The current estimate of personal income under those revised adjusted accounts of \$625 billion is \$2 billion below the revised January estimate of \$627 billion which at the marginal rate we are now using of 15½ percent would reduce the receipts by a further \$300 million, so in addition to the \$3 billion of reduction you would add an additional \$300 million of reduction because of lower incomes than we previously estimated.

The CHAIRMAN. Let me see if I follow you. In January we estimated personal income subject to the income tax of \$624 billion? Is that what you are saying?

Secretary FOWLER. That is right.

The CHAIRMAN. What do you estimate now that income to be for purposes of the 1968 fiscal year?

Secretary FOWLER. Well, you have two adjustments up, one, the Department of Commerce adjustment up to \$627 billion. We think the income is less because incomes have been less in the first 6 months than originally estimated and we would deduct \$300 million from our revenue estimates to take into account that lower level of income.

The CHAIRMAN. You would end up in your own estimates with, say, \$623.7 billion?

Secretary FOWLER. Mr. Chairman, I am going to ask Mr. Schultze to see if he can try this.

Mr. SCHULTZE. Let me try, Mr. Chairman.

The CHAIRMAN. I know it is hard to get over to me.

Mr. SCHULTZE. We started in January with \$624 billion as the estimate of personal income on which individual income tax receipts were based. However, in the intervening period the Department of Commerce has revised the previous statistics. The result is that our figure of \$624 billion, if it were put on the basis of the current GNP statistics, would be \$627 billion. So, in effect, we are saying that our January estimate was based on calendar 1967 personal income of \$627 billion, even though that isn't the number you will see printed in the budget, the difference being recent revisions in the background statistics.

We are now estimating \$625 billion in personal income. That is a \$2 billion reduction in the estimate used to calculate the 1968 revenues. If you apply a 15½-percent marginal tax rate against that \$2 billion you will find it comes out to \$300 million. This is the \$300 million the Secretary referred to as the reduction in estimated personal income tax collections on account of a revision in our estimates of personal income.

The CHAIRMAN. Now, in January when we had an estimate of \$624 billion what percentage did we apply there?

Secretary FOWLER. We applied a 19-percent marginal rate. I will come to that in a moment.

The CHAIRMAN. And 19 against the \$627 billion or \$625 billion?

Secretary FOWLER. This is the revision of that marginal rate, Mr. Chairman, that provides the substantial reduction in the revenue estimates on individual income.

The CHAIRMAN. So it is now 15½ percent you think?

Secretary FOWLER. That is right.

The CHAIRMAN. Fifteen and a half in place of 19. That makes a difference then in your revenue estimates of what amount?

Secretary FOWLER. The factor for reduced yield is \$3 billion and because of the lower personal income with the new marginal rate we add \$300 million to the figure.

The CHAIRMAN. So it is \$3.3 billion then that we would take off of the \$73.2 billion.

Secretary FOWLER. That is right. Now, then, you have two more factors. The delay in the enactment of the 6-percent surcharge on individuals from July 1, 1967, to October 1 reduces receipts by another \$1 billion. However, as a fourth figure the increase in the surcharge from 6 percent effective October 1, 1967, to a 10 percent effective on that date would increase receipts by \$1.6 billion.

The CHAIRMAN. You then add back to the subtotal that \$1.6 billion?

Secretary FOWLER. Right, and the total reduction in fiscal 1968 receipts in this individual income account is \$2.7 billion, which subtracted from the \$73.2 billion figure in the January budget gives you the \$70.5 billion in the new estimate.

The CHAIRMAN. Let's look to the area from which we get our next largest return.

Secretary FOWLER. The corporate side.

The CHAIRMAN. Corporate income.

Secretary FOWLER. The January estimate in the budget was revenue from corporate income tax of \$33.9 billion.

The CHAIRMAN. Let's start out, if you will, on what prediction was of corporate profits in calendar 1967 from which we were to get revenue?

Secretary FOWLER. \$83 billion.

The CHAIRMAN. \$83 billion.

Secretary FOWLER. Yes, sir.

The CHAIRMAN. With a return of \$33.9 billion in revenue.

Secretary FOWLER. That is correct.

The CHAIRMAN. All right.

Secretary FOWLER. Now certain revisions have been made. First, a restoration of the investment credit before January 1, 1968, reduces receipts by \$800 million. Second, there has been a decline in corporate profits from the estimated levels in the January budget.

The CHAIRMAN. What are those figures now, Mr. Secretary?

Secretary FOWLER. We are now using, as indicated in the attachment to my statement, an estimate of \$80 billion.

The CHAIRMAN. \$80 billion.

Secretary FOWLER. Yes, sir.

The CHAIRMAN. You think that is a pretty good estimate?

Secretary FOWLER. Yes, sir.

The CHAIRMAN. I have been using a little lower figure.

Secretary FOWLER. Well, you get differences of opinion about this.

The CHAIRMAN. Most of the opinion that I have heard is anywhere from 75 to 79.

Mr. ACKLEY. Could I make a point there, Mr. Chairman?

The CHAIRMAN. Yes, Mr. Ackley.

Mr. ACKLEY. This morning the Department of Commerce released the second quarter figures for corporate profits. The first quarter figure, which we previously had, was \$79 billion. The preliminary estimate for the second quarter shows an increase—a modest one—\$79.2 billion. And our economic projections do call, as the Secretary said, for further increases over the year ahead.

The CHAIRMAN. You better get that information out pretty quickly because it is a little more optimistic than some of the statements made to me by corporate executives.

Secretary FOWLER. Because of this increase in the estimates the decrease in revenues from corporate income is \$1.3 billion.

The CHAIRMAN. Is that in addition to that \$800 million?

Secretary FOWLER. Yes; it is additional to the \$800 million?

The CHAIRMAN. That means then that you have present corporate revenues estimated at \$31.8 billion?

Secretary FOWLER. No, sir. There are some more factors that have to be figured in to be complete.

The CHAIRMAN. All right. What are they?

Secretary FOWLER. A decrease in the basic yield of the surcharge due to profit declines. We estimated in the January budget that the 6-percent surcharge would increase receipts by \$200 million in fiscal 1967 and \$1.3 billion in fiscal 1968.

Late enactment of the surcharge means that \$200 million that we estimated we would collect in fiscal 1967 will now be collected in fiscal 1968 and the total 1968 effect estimated in January then with the present timing would be \$1.5 billion rather than the \$1.3 billion I have given.

At the current estimated levels of corporate profits the 6-percent surcharge is estimated to yield \$1.4 billion. Compared with the January estimate this is a reduction of \$100 million.

The CHAIRMAN. That is to come off then.

Secretary FOWLER. That is to come off. Now, the delay in the enactment of the surcharge noted, however, will increase, as I have said, the fiscal 1968 receipts as compared with the January allocations between 1967 and 1968 by \$200 million, so you put a plus \$200 million.

Now, the increase in the surcharge from 6 to 10 percent results in an increase in receipts of \$900 million.

Now, I come to the factor of rounding. The above figures computed in millions of dollars when totaled necessitate a rounding adjustment reducing receipts by \$0.1 billion. We would put that adjustment in by reducing another \$100 million, so that the total reduction in fiscal 1968 receipts on this corporate side is \$1.2 billion, and you take that \$1.2 billion from the January estimate of \$33.9 billion and you get the total contained in the table on the statement of \$32.7 billion, which is the now current corporate revenue estimate.

The CHAIRMAN. Now, again, I am trying to find out, Mr. Secretary, in the corporate area as well, what the amount would be of corporate

taxes paid based upon corporate profits in 1967 if there is no tax increase enacted.

Secretary FOWLER. I will supply that for you, Mr. Chairman. (The information referred to appears on p. 63.)

The CHAIRMAN. All right, we would want this information just as we asked for it with respect to individual income taxes.

Secretary FOWLER. Now, on the excise tax, the January estimate was \$8.8 billion. That estimate has been revised because of the proposed extension of present rates on automobiles and telephone excises by \$300 million, so you find the figure \$9.1 billion which is the current estimate contained in the table attached to the statement.

The CHAIRMAN. Do you have a division there? What part of that goes into the general fund?

Secretary FOWLER. All of it, sir.

The CHAIRMAN. This is the general fund you are talking about.

Secretary FOWLER. Yes, sir.

The CHAIRMAN. Is this exclusive of the highway trust fund?

Secretary FOWLER. Yes.

The CHAIRMAN. This is exclusive of that?

Secretary FOWLER. Yes, sir.

The CHAIRMAN. We are talking here solely about the general fund.

Secretary FOWLER. About the general fund.

The CHAIRMAN. All right.

Secretary FOWLER. Now, on estate and gift taxes the January estimate was \$3.1 billion and the actual figures in fiscal 1967 turned out to be \$100 million less than estimated, so we revised the fiscal 1968 estimate downward by the same amount; namely, \$100 million. That gives you your current estimate of \$3 billion, which is the figure now contained in the table.

On customs the January estimate was \$2.1 billion. The actual receipts in fiscal 1967 proved to be \$100 million less than estimated so we revised the fiscal 1968 estimate downward by the same amount, \$100 million, and that gives us a current estimate in the table attached to the statement of \$2 billion.

Finally, miscellaneous receipts, the January estimate was \$5.8 billion and that estimate has been revised downward by \$600 million principally because of an estimate of reduced receipts from stockpile sales of \$450 million and on offshore oil of \$80 million. The total reduction in the January estimate of \$600 million gives us our current estimate of \$5.2 billion.

The total of those items is \$4.4 billion which deducted from the January estimate of \$126.9 billion gives our current estimate of \$122.5 billion.

Mr. Chairman, I would like to explain this marginal rate matter, which is complicated but has such an important bearing on the major factor of reestimating that has come into the picture since our last discussion.

I now address myself to the \$3 billion item which is important in this reduced estimate of receipts. The actual fiscal year 1967 receipts when finally totaled up and released, as you will recall, in July indicate that the calendar 1966 individual income tax liability was about \$2.2 billion below the January estimate.

The difference in these estimates arises principally because of the marginal rate. Now, the marginal rate, as you are familiar with, is the year-to-year change in the individual income tax liability as a percent of the change in individual income. It appears to have been about 14.1 percent for calendar 1966 rather than the 19.2 percent marginal rate that we used in making that calculation last January.

Now, since the calendar 1966 tax liabilities are a principal benchmark for computing the calendar 1967 tax liabilities and the consequent fiscal 1968 individual income tax receipts, this \$2.2 billion reduction lowers the fiscal 1968 receipts by the same amount. Then there is the fact that it becomes necessary in the light of the analysis of the returns that finally came in in April, May, and June to revise the marginal rate used in the estimate for the calendar year 1967. We are now assuming a marginal rate for calendar year 1967 of 15.5 percent, which gives a decrease in the marginal rate below that used in January for calendar 1967 (as well as for calendar 1966) of 3.7 percentage points.

Now, with the change in the personal income adjusted to a tax basis from calendar 1966 to 1967 we have estimated this decrease of 3.7 percentage points in the marginal rate would reduce the added yield in 1967 from the rise in personal income under the individual income tax by \$1.3 billion. This \$1.3 billion due to the reduction in the marginal rate for 1967 added to the \$2.2 billion reduction in the calendar year 1966 liability, which is the base for our 1967 estimate, means a total reduction in the level of fiscal year receipts of \$3½ billion.

The current stock market performance gives some reason, however, to increase the yield of the tax on capital gains by \$500 million, so the net effect of these various adjustments gives you the decrease of receipts of \$3 billion for the fiscal year 1968. We think this is the proper estimate to use now in the light of the experience we have had with the 1966 calendar receipts, and with the derivation of a more accurate marginal rate on the basis of those proved figures.

What has happened is that since 1963 this marginal rate had been moving upward. It is the crucial factor in our estimating process on individual income, and after being stable at around 10 to 11 percent for a period of years it commenced to rise, from 10.8 percent in 1963, to 14.3 percent in 1964, and to 17.2 percent in 1965.

So last December in arriving at our January estimates for the fiscal year 1967 we used a projection of what had been that very steady trend of an increase in the marginal rate and used 19.2 percent for the calendar year in question.

The committee will recall, I think, that in the estimates of individual income tax yield for 1964, 1965, and 1966 we had been regularly underestimating by very substantial amounts, and one of the factors in the underestimates for these previous years was that we were using a marginal yield which was always lagging behind what in fact proved to be the case. So having seen this trend moving upward from the 10.8 percent figure in 1963 to the 14.3 percent in 1964 and the 17.2 percent in 1965 we followed that trend line conservatively and used a 19.2-percent rate.

Now, with the 1966 calendar year figures coming in and our ability to derive an accurate determination of what the actual marginal rate was in 1966, which was well below the estimate of it, we have now

made an adjustment and used a 15½-percent figure which is about in between the 17.2 percent for 1965 and the 14.1 percent which proved to be the case in 1966.

The CHAIRMAN. Mr. Secretary, all of this adds up to the fact that your estimates for fiscal year 1968 were developed with the feedback you referred to. What was that figure, \$116.9 billion?

Secretary FOWLER. 116.9; yes, sir.

The CHAIRMAN. And in the fiscal year just ended our revenues actually were \$115.8 billion.

Secretary FOWLER. That is correct, sir.

The CHAIRMAN. We have an increase there of \$1.1 billion in revenues without any adjustments in the tax structure.

Secretary FOWLER. That is right.

The CHAIRMAN. We recognize that in the 1967 fiscal year as a result of the speedup of corporate taxpayments we really borrowed money for 1967 that would have been paid in 1968 without that action.

Secretary FOWLER. That is right, sir.

The CHAIRMAN. Normally, however, our revenues have risen at a higher pace in the past few years than is indicated here by this \$1.1 billion difference, plus the allowance for the amount that we took from 1968 into 1967 fiscal year.

How do we explain that?

Secretary FOWLER. Because, as Chairman Ackley has outlined and as we have discussed, the very, very rapid rate in increase in corporate profits which marked the previous years and the resulting yield in revenues will not characterize calendar year 1967. We have already agreed that the \$83 billion is no longer an appropriate estimate and in the light of the downturn in corporate profits in the first quarter we are revising our corporate profit figures accordingly. So we have two very substantial factors reducing the rapid movement of increasing revenues from the corporate side—one, the loss of the impact of the acceleration that I think is in excess of \$4 billion, and the reduction in corporate profits before taxes.

Instead of an increase in corporate profits before taxes which has characterized the previous years we are now confronted by a reduction in corporate profits before taxes.

The CHAIRMAN. And in spite of that fact you think it advisable that taxes be increased?

Secretary FOWLER. Yes, sir; because of the general economic outlook that we have ahead in the terms that Chairman Ackley has indicated, and because the alternative that I see of not doing this and of depending entirely on borrowed funds to meet this deficit would entail risks for the economy and the financial affairs of the country that would be unacceptable.

The CHAIRMAN. Mr. Director, let me address a question to you if I may. As I understood your presentation, the outer limits of your estimates of expenditures out of the general fund of the Treasury would now be \$143.5 billion?

Mr. SCHULTZE. Correct, sir, plus—if that occurred—some additional allowance for interest.

The CHAIRMAN. I understand. There would have to be added to that figure the \$700 million.

Mr. SCHULTZE. Correct; yes, sir.

The CHAIRMAN. So that it would be \$144.2 billion as I hurriedly added here if all of the contingencies you referred to come into existence.

Now, revenues then \$116.9 billion would have to be subtracted from that to arrive at the deficit and that would be \$27.3 billion?

Mr. SCHULTZE. Correct, sir.

The CHAIRMAN. How do we get this \$29 or \$28 billion?

Mr. SCHULTZE. The Secretary may want to speak to your question, but I think the major part of the difference is that the revenue figure the Secretary first gave you of \$115.1 billion did not allow for the effect of a feedback.

The CHAIRMAN. I see.

Mr. SCHULTZE. In order to explain the figures simply, the effect of a feedback on revenues was left out.

The CHAIRMAN. I see. Those who write most about the proposition of increasing taxes and express their opposition to it, Mr. Director, would have us first cut back on the expenditure side if I properly read their letters.

We started in 1965 fiscal year I believe it was or maybe it was 1966—correct me—with a January estimate of \$97.5 billion.

Mr. SCHULTZE. I believe you are referring to the first estimate of fiscal 1965 expenditures which were \$97.9 billion.

The CHAIRMAN. This was the estimate brought to us I believe in January.

Mr. SCHULTZE. January of 1964.

The CHAIRMAN. Which would have been for the 1965 fiscal year, would it not?

Mr. SCHULTZE. Correct, sir.

The CHAIRMAN. And the actual spending was under that I believe, as I recall, about \$96½ billion.

Mr. SCHULTZE. That is correct, sir.

The CHAIRMAN. All right. Now I want you to take your time and tell me how a rate of spending of \$96.5 billion in 1965 has reached an outer limit of \$144.2 billion in 1968. Take me through the programs, if you will, and let me know where this increase has occurred.

Mr. SCHULTZE. Yes, sir. May I do that in the following way?

The CHAIRMAN. You do it in your own way so I can understand it.

Mr. SCHULTZE. What I would like to do for ease in presentation is to assume the additional \$4 billion in military expenditures.

The CHAIRMAN. Oh, yes, I want you to get to the figure of \$144.2 billion which we said was your estimate of the outer limit.

Mr. SCHULTZE. And, additionally, the \$1½ billion increase that I outlined in various civilian programs.

The CHAIRMAN. Right.

Mr. SCHULTZE. Not allowing, for the moment, for expenditure cuts, or additional pay, no PC's, to go through the items, and then we can adjust the final result.

The CHAIRMAN. Right.

Mr. SCHULTZE. If I do that, I would be starting with \$140.5 billion. That is the number I will go to and then adjust up to the higher figure if that is all right with you, Mr. Chairman.

The CHAIRMAN. That is fine.

Mr. SCHULTZE. That means there is an increase of \$44 billion between fiscal 1965 and fiscal 1968.

The CHAIRMAN. Yes, sir.

Mr. SCHULTZE. Of that \$44 billion, assuming the additional \$4 billion military spending, there would be an increased \$29.7 billion for the Department of Defense—of the total rise of \$44 billion, \$29.7 billion is for the Department of Defense, including military assistance.

The CHAIRMAN. That is the difference between what we had in 1965 and what we may have in 1968.

Mr. SCHULTZE. The difference between 1965 and 1968, plus the \$4 billion.

The CHAIRMAN. Which we may have in 1968?

Mr. SCHULTZE. Correct. In turn, of that \$29.7 billion, \$3.8 billion would be exclusive of Vietnam. The remainder is for Vietnam—allocating the extra \$4 billion to Vietnam—leaving us \$14.3 billion for all other expenditures outside of the Defense Department and military assistance which, as I said, is included with the Defense Department.

The CHAIRMAN. Incidentally, does that include the Atomic Energy Commission?

Mr. SCHULTZE. It does not. I am doing AEC separately because you may wish it separately.

The CHAIRMAN. All right.

Mr. SCHULTZE. Turning now to the \$14.3 billion, let me first go through some of the major items and then come down to individual programs.

The CHAIRMAN. All right.

Mr. SCHULTZE. Of the \$14.3 billion, economic assistance to Vietnam accounts for \$0.5 billion, and interest on the public debt for another \$2.7 billion.

The CHAIRMAN. \$2.7 billion.

Mr. SCHULTZE. Correct. Pay increases during the intervening years, except for those already included for the Department of Defense, account for \$1.9 billion. Public assistance, including both cash and medicaid, increases by \$1.4 billion—cash assistance is about \$300 million of that and medical assistance is the remaining \$1.1 billion.

Then there is veterans' compensation and pensions, \$500 million; payments to trust funds for medicare—this is for the supplementary medical insurance and for the uncovered who are paid for by general revenue—\$1.1 billion.

Now, combining interest, pay in civilian agencies, public assistance, veterans, payments to the medicare trust fund, and economic assistance in Vietnam, the total increase for these items comes to \$8.1 billion if I have done my addition correctly.

Mr. CONABLE. How much is the economic assistance to Vietnam?

Mr. SCHULTZE. There is an addition of \$500 million on account of economic aid to Vietnam. Apart from the \$8.1 billion, then, there is \$6.2 billion for all other programs and I will now break that down—

The CHAIRMAN. All right.

Mr. SCHULTZE (continuing). In terms of its major components. First, the Department of Health, Education, and Welfare, exclusive of public assistance which I have already talked about, is up by \$4.3

billion. Let me give you some of the components of this \$4.3 billion: Elementary and secondary education, \$1.4 billion; higher education, \$1 billion; other educational outlays—adult literacy and the like—\$300 million; so the increase since 1965 in education is \$2.7 billion out of the \$4.3 billion. In health it is \$1 billion. That brings us to a total of \$3.7 billion for education and health and leaves other HEW programs at \$600 million.

That exhausts the \$4.3 billion.

The CHAIRMAN. What are these others, Mr. Schultze?

Mr. SCHULTZE. Mr. Chairman, I would have to supply that for the record.

The CHAIRMAN. Put it in the record at this point, if you will.

Mr. SCHULTZE. Yes, sir.

(The information referred to follows:)

The major changes in expenditures between fiscal year 1965 and the current estimate for 1968 for the Department of Health, Education, and Welfare, other than those listed by Mr. Schultze above, are:

	<i>Amounts (billions of dollars)</i>
Vocational Rehabilitation Administration (largely grants to the States) --	+0.2
Grants for maternal and child welfare-----	+0.2
Payments to trust funds for military service credits-----	+0.1
All other (Food and Drug Administration, etc.)-----	+0.1
Total increase, 1965 to 1968-----	+0.6

Mr. SCHULTZE. Next, outside of HEW, for the Office of Economic Opportunity there is a \$1.6 billion increase in expenditures between fiscal 1965 to fiscal 1968.

The CHAIRMAN. \$1.8 billion?

Mr. SCHULTZE. A \$1.6 billion increase from fiscal 1965 to fiscal 1968 for the Office of Economic Opportunity.

For Housing and Urban Development, the increases are essentially in three categories: First, there is \$600 million for public housing, urban renewal, and community facilities combined. Another \$600 million is the expenditure estimate for fiscal 1968 of the low cost housing mortgage purchase program enacted last year by the Congress. This is \$600 million for expenditures from the \$1 billion of special funds which, you will recall, were made available for the Department of Housing and Urban Development. FNMA purchases of mortgages, primarily for low- to moderate-income housing, and outlays for college housing, are the primary elements of the remaining \$1 billion.

These three categories give us a total for HUD of \$2.2 billion—gross of participation certificates, which I will come back to.

The CHAIRMAN. The total of this is in excess of \$6.2 billion.

Mr. SCHULTZE. That is correct, because I have some reductions.

The CHAIRMAN. I see.

Mr. SCHULTZE. I am giving you these figures gross of participation certificates and then I will come back and deduct the impact of participation certificates.

Next, the Veterans' Administration, apart from compensation and pensions, shows an increase between 1965 and 1968 of \$700 million largely for two major items, the GI bill of rights and medical care, covering expansion of hospital beds and upgrading of medical services in the veterans hospitals.

Next, all of our natural resource programs, which would include water resource investment, the Corps of Engineers and the Bureau of Reclamation, the Park Service—primarily for recreation, the Forest Service, and water pollution control, all of these natural resource programs together add up to about a \$700-million increase over 1968.

I can furnish a breakdown for the record. I don't have it handy.

The CHAIRMAN. All right. We will ask you to do that, too.

(The information referred to follows:)

The major changes in expenditures between fiscal year 1965 and the current estimate for 1968 for Natural Resources programs are as follows:

	<i>Amounts (billions of dollars)</i>
Department of the Interior (land and water programs): Bureau of Reclamation; Bonneville, Southeastern and Southwestern Power associations; Office of Saline Water; Federal Water Pollution Control Administration and Bureau of Land Management-----	+0.2
Corps of Engineers-----	+0.2
Department of the Interior (recreation programs): Bureau of Outdoor Recreation and National Park Service-----	+0.1
Department of Agriculture: Forest Service-----	+0.1
Tennessee Valley Authority-----	+0.1
All other (largely Department of the Interior)-----	+0.1
Total increase, 1965 to 1968-----	+0.7

NOTE.—Detail does not add to total due to rounding.

Mr. SCHULTZE. Finally we have the Export-Import Bank, up \$400 million and the space program, up \$200 million. Now, from that I deduct the following: an increase of \$3.7 billion from 1965 to 1968 in the sale of financial assets, primarily, but not solely, participation certificates. This assumes the full authorization and sale of the participation certificates assumed in the January budget.

Finally, all other agencies taken together come to minus \$300 million. Now, that includes a number of increases and decreases, all or most of which are small, but they net out to a \$300 million decrease.

Now, within the figures I have given you, there are in individual programs a number of ups and downs. Clearly the ups outnumber the downs, but there are buried in all of these agency totals some decreases as well as the increases I have mentioned. I have netted them out in large amounts.

The CHAIRMAN. How does the estimate for the Department of Agriculture compare with 1965?

Mr. SCHULTZE. I will talk in terms of expenditures, actually, since all these figures are expenditures.

The CHAIRMAN. That is right.

Mr. SCHULTZE. Commodity Credit Corporation expenditures are reduced between the 2 years by about \$400 million and other agriculture programs are up—

The CHAIRMAN. Does that result from sale of assets or from actual cuts in the rate of spending?

Mr. SCHULTZE. Let me check. May I?

The CHAIRMAN. Oh, certainly.

Mr. SCHULTZE. Gross of asset sales, the Commodity Credit Corporation is down \$400 million and other programs are up \$500 million.

The CHAIRMAN. That is what I thought.

Mr. SCHULTZE. Gross of asset sales.

The CHAIRMAN. What can you say, Mr. Schultze, about reductions?

Mr. SCHULTZE. Let me mention one I forgot, if I might. The Atomic Energy Commission is down \$240 million.

The CHAIRMAN. What can you say about reductions in existing programs accompanying increases that the Congress has voted through establishing the new programs that you have enumerated?

Mr. SCHULTZE. May I list about eight or nine items?

The CHAIRMAN. All right.

Mr. SCHULTZE. First, in the Department of Agriculture within the Commodity Credit Corporation, quite apart from changes in crop yields, there is a reduction in the transportation and storage costs of commodities, both because of a reduction in unit cost through rationalization of the program and because of lower stocks, particularly with the voluntary programs we have had. This has reduced expenditures by approximately \$400 million over the period.

Secondly, again in the case of the Department of Agriculture, approximately \$150 million was saved by converting the direct farm housing loan program to a guarantee program.

Next, in the public facilities program of HUD, because of the increase in new programs, that public facility loan program has been reduced from \$73 million to \$30 million. Again, because of additional funds available for metropolitan planning, the public works planning advances of the Department of Housing and Urban Development have been reduced from \$20 million to \$9 million. We have reduced, particularly during the period of Vietnam, the ship construction program in the maritime agency from 17 ships to 13 ships. The expenditure implications of that action are spread out over 3 or 4 years, but they amount to somewhere between \$6 and \$10 million per ship and we reduced the level from 17 to 13.

Next, the Coast Guard, another case in point, has reduced its requirements by some \$15 million because of changes in search and rescue operations. The Atomic Energy Commission, as I noted, has some increases but these are more than offset by decreases, so that the AEC is down in total by \$240 million over the period.

In addition, there were about eight other items that we proposed reductions on last year and we were not successful in convincing the Congress to give them to us. I list in particular the impacted school-aid program, amounting to some \$200 million; the agricultural conservation program, involving some \$130 million; and a reduction for agricultural research stations of a small amount for construction. We also proposed reductions of \$70-some million through user charges which come into the budget to finance meat inspection and other agriculture programs, and some \$70 million for the special milk program, some \$30 million for the school lunch program, and some \$11 million for the land-grant colleges.

These we proposed. None of them did we get, but they are in addition to the items I have mentioned.

And, finally, these figures do not include explicitly the cost reduction efforts in the Department of Defense, nor in the civilian agencies, which essentially simply reduce budgetary requirements as you go along through the years.

What I am saying is that all of the figures are basically netted out. Expenditures would have been a good bit higher had it not been—

both in defense and civilian agencies—for specific cost reduction efforts, improving productivity, and the like, which are simply buried in all the figures as we have gone through the last 3 years.

There are a number of examples. In terms of moving toward competitive as opposed to negotiated contracts, both in NASA and DOD, hundreds of millions of dollars of savings are involved in that. To give another example, the Social Security Administration, states that use of an automated system for computing adjustments in benefits under social security has reduced expenditure requirements by some \$20 million. Savings like these are scattered all the way through the budget, but they are not identified separately since they are built into the budget.

The CHAIRMAN. You have gotten over into the trust funds there; have you not?

Mr. SCHULTZE. That is correct; yes, sir.

The CHAIRMAN. There have been a number of increases, of course, in the payments from the trust funds.

Mr. SCHULTZE. Would you like those, Mr. Chairman?

The CHAIRMAN. I want to talk about those, but we do have a quorum call. Could you gentlemen be back here at 2 o'clock?

Secretary FOWLER. Yes, sir; Mr. Chairman.

The CHAIRMAN. Without objection then we will recess until 2 o'clock.

(Whereupon, at 12:52 p.m., the committee recessed to reconvene at 2 p.m., the same day.)

AFTER RECESS

The committee reconvened at 2 p.m., Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order. Mr. Schultze, while Mr. Ackley is getting to the table, pick up where you were before and tell us about the increases in the trust funds as well, which also are supported by taxation.

Mr. SCHULTZE. Yes, sir. Let me start with two global numbers, and then break them down. From fiscal 1965 through fiscal 1968, on the basis of current estimates, trust fund receipts have increased by \$17.5 billion and trust fund expenditures by \$16.3 billion.

Let me give, then, the major components of the \$16.3 billion. First OASI—old-age and survivors insurance—has an increase of \$6.5 billion. Let me explain the basis for that. For purposes of making the estimate, this includes the administration's social security bill, but with a January 1, 1968, effective date, rather than the July 1, 1967, date originally projected.

For disability insurance, the increase is \$900 million. The hospital insurance trust fund which did not exist in 1965, has estimated expenditures of \$3.7 billion in 1968. Expenditures for supplementary medical insurance trust fund, which of course, also did not exist in 1965, are estimated at \$1.6 billion in 1968.

The unemployment trust fund shows a decline of \$500 million, since unemployment is, of course, lower than it was in fiscal 1965.

Railroad retirement is up \$255 million, and I think rather than read all the rest of them, I will give just the remaining major items.

The CHAIRMAN. All right.

Mr. SCHULTZE. Federal Employees Retirement Fund, \$650 million; secondary market operations of the FNMA Trust Fund, \$744 million;

the Highway Trust Fund, \$90 million. Then with all the rest the total adds up to \$16.3 billion.

The CHAIRMAN. All right. Let me direct your attention now a little beyond 1968, if I may. On the basis of the breakdown which you gave us, Mr. Schultze, with respect to the items of increase and the total of our spending in 1968, would you say with the Vietnam war still going on it would be safe to assume that our rate of spending in the fiscal year 1969 would not be less than it is in 1968?

Mr. SCHULTZE. That is right. It would be safe to assume that.

The CHAIRMAN. Yes. If we have no tax bill, we are not, therefore, faced with the temporary situation insofar as our deficit is concerned. If we have a deficit of some 25 to 29 billion this year, and still have no tax bill in fiscal 1969, we might have as much deficit then, or more?

Mr. SCHULTZE. You could very easily; yes, sir, that is right.

I obviously don't want to be in a position to try to forecast 1969 expenditures now, but clearly, you are correct in terms of the general magnitude.

The CHAIRMAN. There are some built-in increases in all of these programs.

Mr. SCHULTZE. That is right.

The CHAIRMAN. And if the Vietnam situation continues, it might result in us having a deficit without a tax bill of an even greater amount than we anticipate now for fiscal 1968.

Mr. SCHULTZE. Well, I would say that there are two things you have to take into account. There is the normal growth of revenues, on the one hand and there are the built-in increases in expenditures, including what might be necessary in Vietnam, on the other.

I see no reason to think that, without a tax bill, there would be any major reason to reduce that estimate.

The CHAIRMAN. What disturbs me so much is this—that if we are not very careful, these built-in increases, these things that go with the program as it proceeds from year to year, may well increase by an amount equal to or greater than the amount that we get from the increase in the base of the tax, the tax revenue.

Now we have not allowed that to happen, and I am sure you will point that out. But with the Vietnam situation on our hands, nobody can predict what that may lead to. Certainly, we know there are some built-in increase in our domestic programs.

Mr. SCHULTZE. That is right. But I would not want to leave the impression that the built-in increase in domestic programs is equal to the normal rate of growth in revenues from an increasing tax base. Nevertheless, it is there and would take up a part of it.

The CHAIRMAN. That is right and if the Vietnam situation costs more, why the combination of the two could take it all up.

Mr. SCHULTZE. That is right.

The CHAIRMAN. And we still end up with a very sizable deficit.

Mr. SCHULTZE. Yes, sir.

The CHAIRMAN. Now I have had considerable reservation about this proposition as all three of you know from our conversations.

In the light of all the demands that are being made by people for additional Federal services—problems within our cities, this drive presently underway for Federal sharing of revenue, and things of that kind—I don't think we should hold out to the American people that our condition is such at this time that a tax increase can be temporary.

Mr. SCHULTZE. Might I comment?

The CHAIRMAN. Oh, I want you to.

Mr. SCHULTZE. It seems to me that in the context of Vietnam being temporary—and I obviously am not in a position to put a period of time on the word “temporary”—but it seems to me, Mr. Chairman, that in that sense, this tax increase is temporary. You would recall in the figures that I cited this morning, the increase in defense expenditures including the \$4 billion, if I remember the figures correctly, was something like \$29 billion over the past 4 years—3 years, excuse me—of which Vietnam accounted for all but about \$3 to \$4 billion.

If you look at the tax increases that we are asking for over and against that increase, you will notice that the tax increases are substantially less than the size of the Vietnam expenditures.

This is neither, at this point, to justify or not justify the tax increases, but to provide some idea of the magnitudes involved. Conversely, therefore, when Vietnam, as ultimately it will, does conclude, there will be substantial expenditure reductions which can be applied against removing the temporary tax increase.

It is not as if, in other words, we were asking for a tax increase equal to Vietnam. If we had asked over the period for a tax increase equal to the size of Vietnam spending, when Vietnam ended, we would then have no room, in a sense, to allow for any other expenditures to grow. But, rather, the size of this temporary tax increase is substantially less than the magnitude of the Vietnam costs that we are facing, so I don't think I would want to draw as pessimistic a conclusion as you do about the temporary nature of the tax increase.

Again, remembering also, I am not trying to predict any kind of timing on Vietnam. I obviously can't do that.

The CHAIRMAN. Maybe it is because we sit in different positions—

Mr. SCHULTZE. It may be, sir.

The CHAIRMAN. —that I would be a little bit more pessimistic about the temporary nature of the proposed surcharge than you, but I remember that we had some tax increases in connection with the Korean war. I remember, too, how long it was before we got rid of them, and that was not your fault. You were not the Director of the Bureau of the Budget then, and I am not by any means criticizing you. I am just stating a fact.

Mr. SCHULTZE. No, sir; but again, if I might, I would like to make two points with respect to that. You will recall that in fiscal 1954 there were significant tax decreases as Korean expenditures were reduced.

The CHAIRMAN. Oh, yes. We did reduce some of them. We did not take off all the excises, however.

Mr. SCHULTZE. And as I said, what we have here is an increment of \$25 to \$30 billion on account of Vietnam, and taking all of these tax proposals together, amounting to \$7.4 billion, it seems to me, putting these two in context, that when Vietnam is over, and those kind of expenditures are over, even allowing for some rebuilding of defense inventories, there would be substantial room, so that this tax increase clearly could be labeled “temporary,” in the context of Vietnam being temporary.

Secretary FOWLER. Mr. Chairman, I would just like to add one comment to that. I think the force of what the Director has said is supplemented by the form that this particular tax increase takes.

I would agree that there are always risks involved with taxes being carried on. But one of the very purposes of the fiscal subcommittee, of the Joint Economic Committee, was to arrive at a form of a tax which would be clearly directed for temporary purposes, and it is the form suggested by that committee which we are now proposing. The references that the President has made in both his state of the Union message and in the current message, indicate that, both in substance, in the figures Mr. Schultze has described, and in the form of the tax itself, that there is less danger of its being continued as a permanent feature of our system.

The CHAIRMAN. I am not arguing with you about what your intention is. I know that is your intention, Mr. Secretary, but I was stating that when we increased some of the taxes for the Korean war, we kept them on, and I remember very well having made the argument, time after time, as a member of the committee and later as chairman of the committee, that we could not allow these to expire because our deficit situation was such that we needed the revenues.

I can't avoid the feeling as I look to the future, even with peace in Vietnam, that we may well find ourselves not developing revenues as fast in the future under our present system as requests will be made for additional services from Washington.

That was our problem immediately following the Korean war, as I remember the figures. But anyway, perhaps that is too philosophical, and perhaps what we are saying today will be wrong as we look back on it later.

Mr. SCHULTZE. May I make one other point, I think, to put that in perspective, and I am sorry I don't have the exact numbers to give you on this, but there is a difference between the buildup of military expenditures this time and for Korea.

If my memory serves me, prior to Korea, we had defense expenditures on the order of, I think, about \$13 to \$15 billion a year, and the increase for Korea was not just to fight in Korea, but because of what it taught us about what we had to do with our defense posture.

As a consequence of that we built up in the war period and ever since, a substantially higher defense budget, so that the amount that you could come down after Korea, it seems to me, looked at in general terms, was significantly less than would be available if we came down the whole \$25 to \$30 billion now, because we have a much bigger defense base in a sense.

So one of the reasons, I suspect, for the continuation of some of the Korean taxes for a long period of time, would not really be relevant, I think, for the period after Vietnam, where you are facing quite a different situation.

The CHAIRMAN. Mr. Ackley, let me turn to you and direct a few questions, if I may. My concern, as I talk to you, is about the long range implications of what we are asked to do.

There is no question if one looks merely at a fiscal year that one would say that a deficit of the size that you and others at the table have stated is not in the best interests of our economy now. What economic effect, in the long run, do you envision as a result of the action that is suggested today?

How much do we reduce the ability of the private sector to go forward? How is that translated on down the road into gross national

product and profits, expansion, utilization of equipment, and employment?

Mr. ACKLEY. Mr. Chairman, I gather you are directing your question not to the immediate situation, but to the longer run situation.

The CHAIRMAN. That is right.

Mr. ACKLEY. And it seems to me that the principal impact of the program that the President suggested, on both the side of taxes and expenditures, must then be evaluated in terms of its impact on the basic growth rate of the American economy.

Mr. Chairman, I do not see this program as having a serious and lasting impact on the growth rate of the American economy.

The tax increase that is requested is one which does not restore tax rates, on the average, close to the levels which prevailed prior to 1963, and the increases are temporary in character.

At the end of my statement, Mr. Chairman, I indicated my own confidence in the growth potential of the American economy, and in the possibility that we can count on a renewal of the trend toward lower tax rates.

The impact of this tax increase on our long term growth rate would be found, I suppose, first in its possible impact on the level of investment expenditures. We have had, of course, a very high level of investment expenditures, a rapidly increasing level, for the past 3 years, and we don't anticipate that investment expenditures would under any circumstances expand substantially further in the next year or two.

We have some catching up to do with the growth of our capital stock which has been put in place, that is currently being put in place. So I don't see that the action that is proposed has a significant impact on our basic ability to produce, in the short run or in the long run, Mr. Chairman.

We have an expanding labor force, a rapidly expanding one. We have initiated in recent years important programs to improve the quality of our labor force, through expanded programs of training, health and basic education. Even though the further expansion of those programs may have to be curtailed, because of the current fiscal emergency, their existing levels are such that they will continue to contribute importantly to the increasing productivity of our labor force, and to our ability to produce in the years ahead.

The CHAIRMAN. Mr. Ackley, let me ask you, too, for the moment, just to forget the budgetary situation, and look to the present economic situation. Not what you expect will happen, but what our present situation is. If that were to not change, if it were not to improve, would it then still be wise to have a tax bill?

Mr. ACKLEY. I find that a difficult question to answer because I am so convinced that we have already evidence of the factors which will, which have begun to, lead to a greatly improved and strengthened economic situation.

The CHAIRMAN. I want to discuss those factors with you as we go on here but I sometimes wonder if we do not impose upon you and others when we expect you to tell us what is going to happen. Let us try to divorce from our discussions momentarily what we think will happen 3 months, 6 months from now, and look to see what we know the situation is today—face up to these known facts, and then decide whether or not it would be best on the basis of what is known to have a

tax increase or not have it. Then we could, of course, argue among ourselves and make our judgments about what will happen as we look to the future. On the basis of the existing situation, however, is it so exuberant, so buoyant now that we could with a great deal of confidence expect to do no harm to the economy if the situation remained for a period of some 6 to 12 months as it is today?

Mr. ACKLEY. It seems to me the facts of today include all those factors which will inevitably create a rising level of output and incomes in the year ahead.

I certainly agree with you that the task of trying to forecast economic conditions for a period ahead is a difficult and dangerous one, and one which none of us has fully perfected.

I submit, however, Mr. Chairman, that it is impossible in any case to have an intelligent economic and fiscal policy without some kind of a forecast.

If we had the conditions of a boom today, which would appear to make a tax increase appropriate, we still would have to be acting with at least the implicit assumption that those boom conditions would be continuing and one can never be confident that boom conditions will automatically continue by themselves. They have disappeared in the past. Thus a forecast is always necessary in evaluating a fiscal program.

It seems to me the key known fact about the present and recent economic situation is the one I stressed in my testimony this morning: namely, that the level of demand by final users—consumers, governments, business for plant and equipment, and home buyers—has been advancing rapidly in each of the past two quarters, by \$15 billion, and that all of the evidence we have suggests the continuation of that kind of an advance.

So that it would be a dangerous step to raise taxes today only if one had some reason to suppose that the inventory adjustment which has so greatly held down the advance of production in the first half year, would continue.

Now that is the forecast which it seems to me is the speculative forecast. It is one that I would find it very hard to support. I think, in other words, that the facts of today include all of the forces that have been and are operating in the economy, and that those factors of today do support the view that the economy will be able to take the tax increase without danger to its health.

Secretary FOWLER. Mr. Chairman, could I add one word to that? Turning from the general economic picture to the strictly financial picture, the picture in the financial markets, one can say, without too much fear of contradiction from those familiar with those markets, that those markets will tend a lot more to stability and to the kind of a balanced picture that we all want if we raised more of the money out of current revenues than if we borrowed the total in the market.

So looked at from the specialized, but highly important, aspect of the situation in the financial markets, even though the economic factors that you and the chairman have been discussing might not be decisive one way or another, from where I sit, it is preferable, greatly preferable, to meet a substantial part of this borrowing demand out of increased taxes rather than to borrow the entire amount.

The CHAIRMAN. Mr. Ackley, let me get back to the details, if I may, of the factors that determine where we go and to what extent. Let's look at the plant and equipment expenditures first, and check and see if my figures are right.

In 1965 to 1966 these expenditures increased from about \$52 billion to \$60.6 billion. That was an increase of about 16½ percent. I remember last fall a survey that indicated in 1966 they might increase by at this point as much as 17 percent, but it actually turned out, I think, to be about 16½.

I understand that based upon anticipation surveys plant and equipment expenditure figures for 1967 is estimated at \$62.4 billion.

Mr. ACKLEY. That is right.

The CHAIRMAN. Now that would be an increase of 67 over 1966 of 2.9 percent.

Mr. ACKLEY. Roughly 3 percent.

The CHAIRMAN. Yes. The percentage increase the next quarter over the corresponding quarter last year appears to be decreasing, 6.3 percent in the first quarter to 1.3 percent in the fourth quarter. Is that about right?

Mr. ACKLEY. It looks about right, Mr. Chairman.

The CHAIRMAN. All right; does this substantial drop in percentage increase of plant and equipment expenditures suggest any concern as to inflationary pressures from this sector of the economy?

Mr. ACKLEY. No, sir; I don't think it does.

I think we are happy that the plant and equipment boom which went so far and so fast in the past 2 years has come to an end. Indeed, that was the objective of the measures which the President proposed and Congress supported last fall. As I reviewed this morning, our expectation is for essentially a plateau in plant and equipment expenditures in the next half year, and only moderate advance thereafter. This is an expectation with which we should take satisfaction rather than otherwise.

The CHAIRMAN. If we do the combination of things which are suggested in this tax proposal, insofar as the effect on profits and moneys retained after taxes are concerned, are we likely now to turn this small percentage increase in the fourth quarter into a negative figure, bearing in mind that the tax is to go into effect as of the 1st of July of this year?

Mr. ACKLEY. Mr. Chairman, the plant and equipment survey to which you referred anticipates an increase in the level of expenditures on plant and equipment between the second and fourth quarters of \$2 billion. Our own view is that we should be more conservative than that, and in the analysis I gave you this morning suggested that we were not counting on that much of an increase. If it did not occur, the gain from 1966 to 1967 would be somewhat less than the 3 percent which is now predicted.

Your question was whether the enactment of the tax increase would further reduce the growth of plant and equipment expenditures.

The CHAIRMAN. In the fourth quarter?

Mr. ACKLEY. In the fourth quarter.

The CHAIRMAN. It was in the fourth quarter that I noticed the rate of growth of about 13/10 percent.

Mr. ACKLEY. My answer to that, Mr. Chairman, would be that undoubtedly this would be one of the large number of factors that might have some impact on investment spending. I would point out, however, that the President proposed in January a 6-percent surcharge on corporate profit, effective at midyear. So the only new piece of information is the proposed 10 percent rather than the 6 percent. It was with this recommendation already on the books that manufacturers, and other businessmen, when surveyed last May, reported the investment plans which we have been discussing.

I would point out also that the string of advances in new orders for machinery and equipment, shown in the chart which I referred to this morning, indicate that the advance in new orders for machinery and equipment has continued, along with the heating up of the discussion of the tax increase. And I would point out that in June, the Dodge Index of Construction Contracts again shows very strong intentions by businessmen to build new plant.

With the background of the proposed tax program, with the background of lower operating rates, reduced industrial production, and so on, that we have had in the early part of this year, I think the record reflects the confidence by businessmen—demonstrated in a number of other ways, too—that indeed the economy is strong, and will remain strong, and that the tax increase, when enacted, will not throw it into a recession which would make new capital expenditures redundant.

The CHAIRMAN. Let me turn next to the index of industrial production. I believe it stood at 159 last December. I believe it was 158.1 in January of this year.

Mr. ACKLEY. Right.

The CHAIRMAN. 156.4 in February, 155.5 in May, 155.2 in June.

Now this had been declining. Will you have any expectations that this will show a sharp increase soon, and if you do, how much?

Mr. ACKLEY. Mr. Chairman, the decline in the index of industrial production is the best reflection of the drag of the inventory adjustment on our economy.

The inventory adjustment is concentrated in manufacturing—in the goods area of our economy. You can't build up inventories of services, and the drag of the inventory adjustment is clearly visible in what has happened to manufacturing production.

Even with that inventory adjustment, the decline in the industrial production index has been fairly modest. It seems to me that all the evidence suggests the fact that the inventory adjustment is substantially completed. Moreover, the evidence we already have on employment and hours, and production of specific products, also strongly suggests to me that the July index of industrial production will show an appreciable upturn.

The CHAIRMAN. What do you think it will be?

Mr. ACKLEY. I would not want to predict, Mr. Chairman, but I could easily guess on the basis of what we have seen happening to total man-hours, and to production of specific commodities, that it could be up half a point, or even a point.

The CHAIRMAN. It would not be then even back to what it was last December?

Mr. ACKLEY. Oh, no.

The CHAIRMAN. When do you anticipate that we will get back to the 159 of last December?

Mr. ACKLEY. We are getting down into a degree of detail into which I would prefer not to get. But I would certainly think that, by the end of the year, the industrial production index would be above the level of the end of last year.

The CHAIRMAN. In other words, we can be certain now that we can enact this tax increase without further depressing this production index?

Mr. ACKLEY. As you yourself have suggested, Mr. Chairman, we can never be certain. But it is surely the overwhelming probability, based on all the evidence that we have.

The CHAIRMAN. A closely related item is the utilization of plant capacity in manufacturing industries. It is my understanding that the percentage of capacity utilization was close to 90 percent, in all of the quarters last year.

Is that about right?

Mr. ACKLEY. Yes, Mr. Chairman. It reached a peak in the second quarter of almost 91 percent.

The CHAIRMAN. Yes. Now this year, however, I understand the plant capacity utilization was 87 percent in the first quarter, and 84.7 percent in the second quarter. Does this unused capacity suggest further room for utilization without fear of inflationary pressures?

Mr. ACKLEY. Yes; I think it does, Mr. Chairman. There is room for an increase in the rate of utilization of plant capacity without putting excessive pressures on our plant and equipment resources.

I think we do have to recall that this index is a manufacturing index, and therefore, subject to the same limitations as were relevant to the index of manufacturing production.

This is where the inventory adjustment has occurred—in manufacturing industries. For our whole economy, while the industrial production index declined about 2 percent from the fourth quarter of last year to the second quarter of this year, total production of all kinds, in constant prices, actually grew. Not much, but by about a half percent. And in fields other than manufacturing, output has been growing substantially. We don't have any index of utilization of capacity in these other areas, but it must have been holding up very well.

The CHAIRMAN. You don't have a fear, then, that the tax increase might further decrease plant utilization?

Mr. ACKLEY. The kind of economic outlook that I was describing this morning, even with the tax increase, would be consistent instead with some rise in the utilization rate in manufacturing.

Just as manufacturing has suffered the brunt of the inventory adjustment, so will it benefit most from the recovery. With the recent trend of new orders for manufacturing production going up each month of the past five, and already almost back to its alltime peak of last September, with manufacturing shipment rising in the last 2 months, it seems to me that the outlook is for a moderate and gradual pickup in the operating rate. I would not preclude the possibility of some further immediate decline in the rate of utilization in manufacturing. But certainly for the longer pull, an upturn is coming.

However, we certainly do not expect nor would we want the operating rate to get back to the almost 91 percent level of the second quarter of last year. This is too high an operating rate—an operating rate at which our resources were under pressure, and with which we had sharply rising prices. But I would expect that a year from now the operating rate will be higher than it is today, and at a level consistent with a healthy balance between demand and production.

The CHAIRMAN. Let me shift now to another area, new construction. I know that this is an area where we have all been speaking in terms of improvements. Let me ask you, however, if these higher levels are not more or less directly connected with Government construction and expenditures?

Mr. ACKLEY. I don't think so, Mr. Chairman. Public construction as I recall the number, has been essentially on a plateau all of this year, so far, and the substantial recovery in construction has been basically in private construction.

First of all, residential construction. As my chart 3 this morning indicated, it has been recovering steadily at a rather promising rate during the first half of the year.

Industrial and commercial construction did decline into the first half of this year, but that decline has been stopped, and industrial and commercial construction is now stable or rising.

The CHAIRMAN. I have some figures that commercial, industrial, and other construction in June of this year was down about \$2 billion below the figure for June of 1966, \$24.2, compared to \$26.6.

Mr. ACKLEY. Commercial, industrial construction, Mr. Chairman, as I have it here, at seasonally adjusted annual rates, June of last year was \$13.7 billion, and in June of this year, \$12.8 billion.

The CHAIRMAN. You don't have a table before you then that has commercial, industrial, and other construction?

Mr. ACKLEY. And other?

The CHAIRMAN. Yes.

Mr. ACKLEY. I have a column for "other," which we can add together.

The CHAIRMAN. Please add them together.

Mr. ACKLEY. The "all other" was \$12.9 billion in June of 1966, and \$12.9 billion in June of 1967.

The CHAIRMAN. What I am getting at then is this—we had a level this year in April, did we not, of 25.7, for the total?

Mr. ACKLEY. Yes, that is the figure both for May and for June.

The CHAIRMAN. Why is this slippage between April and May? I mean, between April and June?

Mr. ACKLEY. Actually, Mr. Chairman, total private nonresidential construction was up slightly from April to June—from \$24.9 billion to \$25.7 billion.

The CHAIRMAN. That is right.

Mr. ACKLEY. Industrial and commercial construction reached a peak of \$15.1 billion annual rate in January, an alltime peak, dropped to \$12.5 billion in April, and since then, seems to have again been moving up, which I think would be expected to continue. Restoration of accelerated depreciation could be an important factor in this area.

The CHAIRMAN. All right, now we did have some problem then of slippage in commercial and industrial. When we look on the other hand

at Federal, State, and local construction, you note that in June of 1967, the figure is 26.3 billion, and in June of 1966, it is 23.1.

So what I am getting at is this. That most of the increase, as I viewed the statistics, is in the area of Federal, State, and local construction, and we don't see the improvement in the commercial and industrial areas.

MR. ACKLEY. I am not sure I caught your numbers, Mr. Chairman. The ones I have for Federal, State, and local for last June of \$23.1 billion for Federal, State, and local.

THE CHAIRMAN. That is what I said.

MR. ACKLEY. It rose to a peak of \$27 billion in February of this year, and then declined to \$26.4 billion.

It has been essentially on a plateau for the first half of this year.

THE CHAIRMAN. 26.4, is that about right?

MR. ACKLEY. I believe the revised figure for June is \$26.4 billion.

THE CHAIRMAN. Now is there any indication, however, that we need fear inflationary pressures in the area of private construction?

MR. ACKLEY. Mr. Chairman, unfortunately this is one of the most inflationary segments of our economy. For a combination of reasons, as you know.

THE CHAIRMAN. It looks to me like it is, when you look at Federal, State, and local construction, but when you get out of that part of construction—

MR. ACKLEY. I was speaking in terms of inflationary pressures as they are reflected in the cost of construction, which has indeed been rising rapidly due to a combination of factors.

I hope there is no great inflationary pressure in the outlook for the construction industry. We do expect a very healthy continuing recovery in residential construction, if we avoid cutting off the funds by renewed tight money crunch, which indeed, as the Secretary suggested this morning, could very effectively cut off the recovery of housing construction.

With the improved level of residential construction that we expect and I think we have every reason to count on, we still should be able to maintain reasonably healthy conditions in the construction industry.

THE CHAIRMAN. Now let us turn, Mr. Ackley, to business inventories. The net accumulation, as I understand it, reached its peak in the fourth quarter of 1966. At that time, we had a net accumulation of \$18.5 billion on annual basis.

The first two quarters of this year, while accumulations continued, the accumulations were at lower rates, being \$7.1 billion in the first quarter, \$2.1 billion in the second quarter. And I understand that for the month of July, maybe it was about a zero rate of accumulation in inventories.

MR. ACKLEY. Mr. Chairman, the figure—

THE CHAIRMAN. June, I am sorry.

MR. ACKLEY. The figure for the second quarter has been revised downward from \$2.1 to \$0.5 billion. That is part of the revision that was announced this morning.

In other words, in the second quarter, inventory accumulation was very close to zero. Included in that revision are the new data for June, which show a net decumulation of almost half a billion dollars.

The CHAIRMAN. Now that being the case, what does this substantial decrease in inventory accumulation suggest that business is thinking?

Does it mean that business is not yet anticipating inflationary price rises in inventory stocks? Why would business allow this situation of decumulation to almost liquidation in the field of inventory to happen, if the business community was convinced that it was faced with an inflationary price spiral?

Or is there an explanation?

Mr. ACKLEY. Mr. Chairman, I think the explanation lies as I tried to suggest this morning, in the fact that in the latter months of last year, as you yourself pointed out, accumulation was very excessive. Businesses have been adjusting to this excessive accumulation of last year by reducing their rate of production relative to their rate of sales, and engaging in very little further accumulation, particularly in the second quarter.

I don't think business is—I hope business is not expecting an acutely inflationary situation, which will make them scramble for goods.

I do expect that with the continued uptrend in final sales, business will grow into its inventories, which in manufacturing are still somewhat excessive.

As my second chart this morning suggested, if the rate of increase of final sales merely continues in the second half at the same rate as in the first half, and no further accumulation occurs, to say nothing of no decumulation, the ratio between stocks and final sales would be restored to normal by the end of the year.

The CHAIRMAN. What effect does a tax increase have, in your opinion, on this present pattern?

If we enact a tax increase, would it have the effect of again causing business to accumulate, or would it have the effect of causing business to liquidate? Do we know?

Mr. ACKLEY. I don't think the tax increase by itself, Mr. Chairman, is a decisive factor at all. I think the actual advance in the economy and the expected future advance, along with the existing inventory situation, are the important factors that will determine whether business accumulates inventories or merely leaves them where they are for awhile.

The prospective continuing advance in final sales suggest that business will be wishing, before long, to resume inventory accumulation. Sales will have grown in relationship to the existing stock, and they will then be in a position to want to rebuild inventories.

The CHAIRMAN. Will you pardon us? I understand that this is a vote rather than a quorum call, and if we may suspend for about 10 or 15 minutes, we shall be back.

(Whereupon, a brief recess was taken.)

The CHAIRMAN. The committee will please be in order.

Let there be order in the room, please.

Mr. Ackley, this past Saturday's business and financial section of the New York Times carries a piece stating that total manufacturing and trade inventories declined in June, as you pointed out, the first month they declined in something like 6 years.

The total drop was, according to this, \$468 million seasonally adjusted, divided almost equally among manufacturing, wholesale, and retail.

Now, to me, this indicates a continuation of the negative side of the trend I referred to earlier. To you, is it negative or positive? How do you view this?

Mr. ACKLEY. For the past period, when it was occurring, the drop in rate of inventory accumulation was obviously negative in its impact. It was a drag on production.

It reduced current output and employment and income. But for the future, it seems to me that this rapid drop is indeed the most healthy aspect of the whole situation.

The fact that the inventory adjustment has gone so rapidly and so smoothly means that we have eliminated a very large part of the problem of the excess inventories that accumulated last year. We have set the stage for the kind of recovery we want.

Th CHAIRMAN. Which really were excessive to not only normal circumstances, but our own best economic results.

Mr. ACKLEY. Yes indeed.

The CHAIRMAN. Those enormous accumulations of last year?

Mr. ACKLEY. Yes, sir.

The CHAIRMAN. The sales this year have been relatively low, and it might well be that there still is a substantial excess of inventory to work off. Do we know about that?

Whether or not there still is the need to work off additional excess inventories? Sales in some areas have been lower.

Mr. ACKLEY. Yes, Mr. Chairman, sales have been themselves depressed by the inventory adjustment. If we take the ratios of inventories to current sales for wholesalers and retailers, they are now back to essentially a normal level. For manufacturers, the ratio of inventories to sales is still high, although it has been declining for the last couple months. That ratio, which is really the crucial point, is affected both by the change in stock and by the change in sales.

The CHAIRMAN. Well, this article states that there might be some further liquidation of inventories during the remainder of the year.

Mr. ACKLEY. I suggested in my testimony, Mr. Chairman, that it would certainly not be impossible that we might have another couple of months of inventory liquidation. But I certainly do not expect liquidation through the rest of this year.

Indeed, we should be having accumulation again by the end of the year.

The CHAIRMAN. And the imposition of the additional tax, you say, would have no effect.

Mr. ACKLEY. Only as it has an effect on the general economic environment.

The CHAIRMAN. Now, let's go to retail sales. Here you point to retail sales as an area of the economy showing improvement; do you not?

Mr. ACKLEY. I am sorry?

The CHAIRMAN. I say you point to the rise in retail sales now as an area of improvement in our economy; do you not?

Mr. ACKLEY. Yes, indeed. The last 5 months have shown very striking improvement in retail sales.

The CHAIRMAN. May was over May of 1966, June was over June of 1966, and so on. I have not seen anything on July, yet. Do you have figures on July?

Mr. ACKLEY. Yes, sir; the preliminary figures for July were released, I believe, last Thursday; they showed an increase, a preliminary figure, of 1 percent over the very large increase which had been shown in June.

Over the past 5 months retail sales are up 5 percent.

The CHAIRMAN. Let me ask you about that, though, in some detail. In May of 1967 our sales were over May of last year by 5.8 percent. Then in June of this year, they were only 4.3 percent over June of 1966. Now you say July sales in 1967 are over July of 1966 by what percent?

Mr. ACKLEY. Over July of 1966 by 5.4 percent.

The CHAIRMAN. By 5.4 percent. Back more nearly to what they were for May over May.

Mr. ACKLEY. I don't have the year over year comparisons for each month before me, Mr. Chairman.

The CHAIRMAN. What I am getting at there was this decline in the percentage increase in June, over June of 1966, compared to the percentage increase in May of 1967 over 1966. And I just wondered if that is the situation, wherein we find any buildup of inflationary pressures on the basis of no greater percentage increase than we seem to be having in sales?

A whole lot of that difference between 1967 and 1966 is reflected, is it not, in price changes, not in units?

Mr. ACKLEY. If we look at retail sales in July, which were up 5.4 percent over July a year ago, we must recall that 5 percent of that gain was just within the past 5 months. However, I agree we have to recognize that retail sales adjusted for price change would be up by less than that.

Now, in making that adjustment we have to remember that we can't use the Consumer Price Index, which includes services, because service prices have risen more rapidly than goods.

The rise in July of prices of goods sold in retail stores was about 2 percent overall above a year ago. So that roughly $3\frac{1}{2}$ percent of the increase over a year ago in retail sales is real, and perhaps 2 percent of it would be price increase.

I may add that if one examines the composition of the change in retail sales over the past year, it strengthens the view that we have seen a strong performance in the last few months.

For most categories of retail sales, the increases over a year ago are quite striking, and they are particularly striking in the areas which might be thought to reflect consumer confidence.

Take for example, durable goods—furniture, appliances, automobiles. Compared with a year ago, automotive sales in July were up almost 10 percent, the sales of retail automotive group. Furniture and appliances, almost 7 percent. The small gains; on the other hand, are in such things as food. Food store sales in July were only 1.7 percent above a year earlier.

There are clearly some special factors there that I am not sure I understand. But certainly where consumer confidence might seem to be at stake, as reflected in these figures, certainly gives evidence of strong consumer buying patterns.

In considering the performance of retail sales, I think we have to recall that the consumer saving rate so far this year has been abnormally high, although it has begun to drift down. Certainly we are not

likely to face a further increase in the saving rate. Rather, one would expect that the saving rate would return to its normal level, which is rather consistently lower than currently.

The CHAIRMAN. It has gone—it is going on a level of better than 7 percent all of this year, as a percent of personal income.

Mr. ACKLEY. The saving rate in the first quarter was 7.3 percent. With the revisions which were made this morning, the second quarter was 6.7 percent.

The CHAIRMAN. But ordinarily, it is less than 6 percent; is it not?

Mr. ACKLEY. I would think for the last 3 years, it has averaged just below 6 percent.

The CHAIRMAN. Just below 6. Now let us go to the unemployment rate. In the forepart of 1966, we were at about 3.9. During the latter part the rate increased gradually until we got down to about three and a half, did we not?

Mr. ACKLEY. It dipped to three and a half in November, although that was sort of a freak.

The CHAIRMAN. Maybe so, but we did actually get down to a very low rate in November.

Mr. ACKLEY. Yes, sir.

The CHAIRMAN. Now from that time until June of this year, the unemployment rate has gradually gone up, has it not?

Mr. ACKLEY. It was 3.7 in January and February, 3.6 in March, 3.7 in April, 3.8 in May 4.0 percent in June, and then dipped to 3.9 in July.

The CHAIRMAN. Is this a big enough change anywhere along the line to indicate any shift in the direction of the unemployment rate—that we would expect it to go back down—or does this indicate that it may continue to fluctuate and go up one month a little higher than the month before?

What can we predict with respect to the direction of it, on the basis of what we know about it now?

Mr. ACKLEY. The unemployment rate is a product of two things, both of which are somewhat difficult to predict.

One is, of course, employment and the other is the labor force. The labor force has been growing rapidly and undoubtedly will continue to grow, but so has been employment, and so will it.

Our judgment would be that the unemployment rate ought to be moving at least slightly downward in the year ahead, even with the tax recommendations. Without the tax recommendations, it probably would move down slightly further.

The CHAIRMAN. Mr. Ackley, is there any possibility now that the converse of what took place in 1964 might take place in 1967? With respect to employment rates and unemployment rates, if we enact this proposal? Now I remember one of the arguments made for reducing taxes in 1963 and 1964 was the rate of unemployment then in existence.

I think it has been clearly demonstrated that the tax reduction at that time played a part, at least, in bringing up our rate of employment and reducing our rate of unemployment. Now is there any fear that if we should adjust taxes upward, our unemployment rate might also go up during the remainder of this year, and in 1968?

Mr. ACKLEY. Given the expectation that one has about the growth of the labor force, which although it is erratic from month to month or even over a 6-month period, and the expectation of the employment gains that would be associated with the production gains we anticipate, I would not expect that there is danger of a rising unemployment rate over the next year.

Now it may fluctuate and it could go back up to 4, next month. It is erratic from month to month. We had anticipated that the unemployment rate would rise to 4 percent by the middle of the year, and said so.

And in fact, it did. The inventory adjustment cut back manufacturing employment, and this obviously had to be reflected in the unemployment rate. Our expectation for the year ahead is an unemployment rate in the range that we have had for the last year and a half, somewhere around $3\frac{3}{4}$ percent, and that is the expectation with the adoption of the proposed tax.

The CHAIRMAN. One of the arguments advanced in favor of increasing taxes is the rise in prices. We frequently have heard that pointed to as an area of justifying its requiring an additional tax increase.

Now it is true, is it not, that the consumer price index of 115.6 in May of 1967 is above the 112.6 in May of 1966? There was an increase of about 3 percent?

Mr. ACKLEY. Yes, sir.

The CHAIRMAN. In that period of time?

Mr. ACKLEY. Yes and the figures for June show a further increase, although the same year-over-year advance as in May.

The CHAIRMAN. Now let's look at the figures. How much of this increase, total of this increase between May and May that we just referred to occurred between May and December of 1966?

And then how much of it has occurred this year?

Mr. ACKLEY. I am not sure that I can give you percentages between May and December. I can give it to you June to December or December to June.

The CHAIRMAN. I think the increase from May to December was from 112.6 to 114.7. An increase of 2.1 points, while the increase this year, at least through May, to 115.6, was an increase of nine-tenths of a point.

Mr. ACKLEY. Well; yes, sir, and in June it increased another four-tenths to 116.

The CHAIRMAN. Have you any figures on July?

Mr. ACKLEY. No, no figures yet for July, Mr. Chairman.

The CHAIRMAN. This next area is an area I know less about, but I want to get into it, and that is the argument that is made that if we don't have a tax increase, our money supply will be such and the impact of our borrowings upon the money markets will be such as to bring about a very inflationary situation.

Now I know full well the problems the Secretary of the Treasury has. I have been trying to help him for a long, long time to better manage his payments of Government obligations and public debt—with some degree of difficulty I might add in getting my colleagues in the House to go along.

I still am not at a point where I feel I could convincingly explain to anybody the connection between tax rates and interest rates.

I have more difficulty understanding that than any part of this whole argument. I am thinking of what I consider to be—I am glad I am not running it—some pretty bad management of the affairs of the Federal Reserve last year, when the Federal Reserve was proceeding to make money and credit available at an annual rate of increase of almost 7 percent over 1965 up until May of 1966; then very suddenly, the Federal Reserve just cut off all increases, and almost caused a money panic sometime late last year. Now this year, with our economy going at less than an exuberant pace, the Federal Reserve makes available increased money and credit again, at an annual rate of something between 9 and 10 percent, say, whatever the figure is for the first 6 months of this year. Then, I am told that there is a direct connection between what happened last year with respect to interest rates on money and a deficit that the Government was incurring and the lack of a tax rate increase—it is a little hard for me to believe.

Mr. Martin is going to be before the committee sometime before we get through. I am going to be interested in learning exactly why there was, for a period of months, a great percentage rise in money and credit, and suddenly, it was cut off and equally suddenly turned on again, in February or January of 1967.

It seems to me, just applying commonsense to it, that the supply of money and credit should be regulated a little bit more evenly than that.

Now you can say whatever you please, but get me straight on this. How was it that monetary controls did not have any affect for a while, and then when the effect was felt, the responsibility for adjusting to it was passed to the Congress? How are Members of Congress to judge the need for tax restraint against last year's pattern of monetary controls? Sometimes I think that we get the buck passed to us unduly. I know that when it is passed to us we can't pass it to anybody else.

Mr. ACKLEY. Mr. Chairman, may I begin by saying that I have not at all times agreed precisely with the actions that the Federal Reserve has taken with respect to the management of our monetary policy. Yet I think we must recognize that monetary policy is designed to play a stabilizing role, one in which it does try to moderate movements that are in the wrong direction and support those that are in the right direction for the economy as a whole. The Federal Reserve, as early as December 1965, moved—prematurely, in the administration's judgment—to a policy of restriction, and yet it is a remarkable fact that in the first half of 1966, the money supply, narrowly defined, did grow at 4½ percent annual rate, followed by a decline at about a 1-percent rate in the second half of 1966.

In other words, it took a while from the time that the Federal Reserve decided that restrictive measures were appropriate before they had any impact on this particular measure; namely, the supply of money.

This, of course, is only one evidence of monetary policy and the effects of monetary policy. The most significant impact from the standpoint of the economy is the availability of bank credit and the level of interest rates.

And again, bank credit was not effectively restricted in the first half of 1966, although the Federal Reserve was attempting to pursue a restrictive policy.

But the restriction on the growth of bank credit also began to bite severely in the second half. So the return to the easy money policy, which the Federal Reserve began to make last fall, as early as October or November, has been significant and important. Indeed it is one of the factors which has permitted the very substantial revitalization of our housing industry which we have seen since the low point of last October. As I said, I don't claim nor, I am sure, will the Federal Reserve claim, that its record on timing or on the extent to which its instruments of control have taken hold of the situation is perfect. Yet I do believe that they have attempted to use monetary policy—as I think it was intended to be used—as an instrument of stabilization—leaning against the wind and trying to curtail inflationary pressures by restricting the availability of credit to the economy, and trying to support an advance when advance is appropriate.

I think it must be recognized that the easy money policy which the Fed moved to late last fall has been an important factor in maintaining momentum during the first half year while we were going through the inventory adjustment.

Secretary FOWLER. Mr. Chairman, I would like to add one word to that.

The CHAIRMAN. I wish you would, Mr. Secretary, because I want to get straight on this connection, the connection, if you will, between interest rates and tax rates.

Secretary FOWLER. Well, this focuses on the always difficult but always necessary problem of effecting the right kind of mix between fiscal and monetary policy because these are two arms that attach to a single body and the movement of one as related to the other affects the whole. First, let me say that I will not attempt to speak for Chairman Martin of the Federal Reserve Board. He will be here to speak for himself. But I think it is no secret in the light of the announcement that was made last week when the President's message went up that at this particular time the entire Federal Reserve Board, and the Secretary of the Treasury, and the Director of the Budget, and the Council of Economic Advisers are all unanimous in the view that the best mix for the economy in the period ahead is a mix that would include some additional measure of fiscal restraint that would come from an increase in taxes and a reduction in expenditures rather than, if this expansion needs to be restrained in the period ahead, a dependence on monetary restraint. That is why in my statement on page 25 I stressed that—

For along with Federal credit demands, the failure to hold down the budget deficit would create an inflationary environment in which private credit demand could soar, and in which it would be more difficult to continue an expansionary monetary policy, and that would cut down on total available supplies of credit.

So as we see this in the period ahead, to the degree that the additional restraint is necessary, and we think it will be in the light of Chairman Ackley's presentation this morning, we believe that it is desirable to press down on the fiscal side, as it were, leaving the monetary side relatively, not perhaps entirely, free. I can't speak for what action they would find it necessary to take, but the more action we take

on this side, the less you would have to turn to the efforts to hold down the expansion of credit and to turn the money supply, you might say, in a different direction. Whatever may have been our differences in the past, I think, frankly, as I have indicated before this committee, they had primarily to do with timing.

I think we were all agreed at the beginning of 1966 that a combination of both fiscal and monetary restraint would be necessary in that period. Now, in this period ahead as the economy is emerging from the period of the inventory readjustment that Chairman Ackley has outlined, and all the signs are toward a period of expansion, we are as one in our view that the right mix of fiscal and monetary policy is one that includes the tax increase, which, therefore, diminishes to that degree the necessity for the Federal Reserve System to move to a restrictionist policy or a degree of restrictionist policy in the monetary field.

The CHAIRMAN. Mr. Secretary, as I say, I don't know much about this relationship because I have not made any real study of monetary policy, but I think anyone, whether he has studied it or not, would agree completely with your observation that we are better off if we have the proper mix of the two policies than if we don't have it. What I am trying to get to is how do we know that we can have the proper mix of monetary policy if the difference in our deficit is only reduced by \$7.4 billion, which is the amount of tax revenue effect of this bill in the 1968 fiscal year? Are we certain that the Federal Reserve, on the other hand, would not do again in this year or in 1968 what they did in the year 1966, and if they do it again, might we not expect about the same consequences to occur?

Secretary FOWLER. I think that is the question, Mr. Chairman, I will have to defer and leave for the Chairman of the Federal Reserve Board.

The CHAIRMAN. I am going to question him when he gets here.

Secretary FOWLER. I can't speak for them on that.

The CHAIRMAN. I am going to ask him some questions when he gets here because I just don't know whether or not to try to sell the tax bill on the basis that the Federal Reserve is going to do what you and I might think to be the right thing on their policy. I am a little concerned about it.

Mr. ACKLEY. I have asked you all these questions—and I am now a step in tax policy on the basis of what we think may happen and to find out where the inflationary pressures may be as we look to the future. Certainly I hope that as we look ahead this time we are doing it with a higher degree of accuracy than on other occasions. I am not talking about you in the past, but of occasions in previous years when some of our projections have missed the market pretty badly, going back as far as 1948. I am always a little concerned about taking through—for the reason that I have wanted to get to the components that is why I have asked you so many questions about it. This is one of the things, however, that is being used apparently as justification for this action.

When one looks at the situation that the Secretary of the Treasury describes and the Director of the Bureau of the Budget, naturally I end up with the conclusion that something should be done.

Now, Mr. Director, you remember when we did what I think now was a mistake and suspended the 7-percent investment credit. You

think we restored it in the wrong way, so maybe we are even in that respect. The President undertook to suspend certain governmental spending programs, and I suppose that from the minute he made the announcement until the matters were restored he had somebody visiting him every day asking for the restoration of some part of that spending program.

Is there any thought that, regardless of what the Congress can do—since the Congress apparently is overly authorizing again, we are going to repeat the process. Congress authorizes a project, and then we authorize certain expenditures. In a sense, we really don't appropriate any more. Is there any real possibility that if taxes are increased that we can expect the rate of spending for the fiscal year 1968 not to be greater than that initial \$135 billion estimate in the January budget.

Mr. SCHULTZE. I would have to break my answer to that into two parts, Mr. Mills. First with respect to civilian expenditures, I would say there is first a good possibility and, in fact, we are aiming at reduction of civilian expenditures below the level estimated in January. By that I mean there is a good chance for making cuts sufficient not only to offset the increases from the releases we made earlier this year and from the public assistance and other uncontrollable increases, but trying to cut somewhat below. That is No. 1.

No. 2, in turn, I can't at this stage indicate how the entire defense picture will come out, balancing both the potential increases and the decreases. But if I leave out the defense picture, and I look to the actions which the executive will take, then I can say there is a good possibility—I can't guarantee it 100 percent—that civilian expenditures can be reduced below the January estimate, because that is what we are setting our target at. Clearly, Mr. Chairman, this has to be taken in the context of the two other items that I spoke of: one, the pay bill, the extent to which that is passed and takes effect with amounts over and above the President's recommendations, and, secondly, the authorizations for sales of participation certificates. But those apart, on the civilian side we will be shooting for reductions of more than \$2 billion. In turn, you will recall, I indicated we had expenditure increases facing us of \$1½ billion. The reductions we are aiming at are greater than \$1½ billion. That is what our target is, that is what we are shooting for, Mr. Chairman. I can't, of course, speak on the pay question or the participation certificates in terms of what the Congress will ultimately do.

The CHAIRMAN. Mr. Director, how soon do you think there will be some positive information about what might be done in this area?

Mr. SCHULTZE. Mr. Chairman, we are, as I indicated in my testimony, sending instructions to each agency giving them a cut target, as soon as their appropriations bills are passed. At that time we will ask them to review their expenditures to see how they could come down to that target. I can't predict when the appropriation bills are going to come through or exactly how rapidly we will get responses from the agencies, but we will be moving as fast as we can in terms of getting the bills, looking at them, and getting instructions out to agencies, getting their submissions back to us, and coming to agreement on a specific cut. I cannot give you a date on that. We are doing it as soon as we can.

The CHAIRMAN. These things I am talking about would have to be other than merely suspensions or delays because if that was all we would do we might compound our situation in 1969 just as we have compounded it in 1968 to the extent that expenditures were delayed in 1967. It just seems to me like we are going to have to find some way to bring about reductions on the spending side to coincide and go along with increases in revenues if we are to make any impression here—

Mr. SCHULTZE. I agree, Mr. Chairman.

The CHAIRMAN (continuing). And get any acceptance by the American people of a tax increase.

Mr. SCHULTZE. I agree, Mr. Chairman. I might point out that in the effort we are going through and will be going through we are doing two kinds of things, both straight reductions and deferrals. Let me point out that, with respect to the deferrals, it does not automatically mean when you defer something you add to expenditures in the succeeding year. For example, if you defer a start of a public works project from fiscal 1968 until fiscal 1969 you reduce expenditures in both of those years, because the second year of spending on a public works project tends to be relatively large and so you move that into 1970. So we are looking both at reductions and deferrals. What happened this year is not that the deferrals in fiscal 1967 themselves are adding to 1968 expenditures, but rather that when we made up the budget in January we did not have in mind the release of those deferrals, and that is what now causes increases, not the deferrals themselves.

The CHAIRMAN. I see. Gentlemen, I want to thank you. You have been very helpful in responding to my questions.

Mr. Byrnes.

Mr. BYRNES. First, Mr. Secretary, let me ask a procedural question: Has a bill been presented to the committee as yet?

Secretary FOWLER. Mr. Byrnes, I don't think the bill has been presented to the committee, but our staff has been engaged in preparation of one and would have it available for the committee whenever it is your wish.

Mr. BYRNES. The primary reason I ask is that not only are we confronted with a decision on increasing taxes, but also what form any proposal will take. We have sent out invitations to public witnesses to appear beginning next Monday. They will find it difficult to talk about particular details if a bill is unavailable, and we may be deprived of their views on technical problems that may be involved.

Secretary FOWLER. Mr. Byrnes, I will be glad to submit a bill with the technical explanation for the record at any time that you would like to have it.

The CHAIRMAN. Any time you are ready, Mr. Secretary. I think today or tomorrow will be fine.

Secretary FOWLER. I tried to cover in my statement the broad outline of the nature of the bill, but you do need the bill.

Mr. BYRNES. In broad outline it is a proposal for a tax increase. Due to the time the committee will devote to the technical aspects and the complications that develop, the bill should be made public if we are to have the views of all interested individuals before we get into executive sessions.

Secretary FOWLER. Yes, indeed.

Mr. BYRNES. While they are still welcome to appear.

Secretary FOWLER. I will supply copies this afternoon.

The CHAIRMAN. Without objection, depending upon what further disposition is made of it, we will include it in the record, Mr. Secretary, in connection with your remarks.

(The information referred to is on p. 32.)

Mr. BYRNES. I think, Mr. Chairman, that copies should be made available for the public—

The CHAIRMAN. They will be available.

Secretary FOWLER. Right.

The CHAIRMAN. Mr. Secretary, why don't you, if you have your bill ready, just release it and send us a copy of it. We will have available additional copies for release here for the public so the public may have the opportunity of going over it.

Secretary FOWLER. All right, sir.

Mr. BYRNES. Fundamentally, we are here because we have either a \$29 billion deficit or a \$27.3 billion deficit. It is fundamentally the deficit that brings you here, isn't it?

Secretary FOWLER. Yes, sir.

Mr. BYRNES. Let me clarify a point. You have discussed two figures—\$29 billion and \$27.3 billion. What causes the difference in these figures, Mr. Director?

Mr. SCHULTZE. The basic difference is that the \$29 billion is arrived at by totaling up the potential expenditure increases and the potential losses in revenue from revised estimates that the Secretary went through. If you do that, you get to the \$29 billion.

Mr. BYRNES. What is left out when you get the \$27.3 billion?

Mr. SCHULTZE. That is what I am coming to. At the same time if you have expenditures that high, there would be an impact back on the economy in the form of higher profits and incomes which would raise tax revenues slightly. Most of the \$1.8 billion represents that feedback effect.

Mr. BYRNES. In other words, an expenditure level under the present estimates of revenue which would produce a \$29 billion deficit would have a feedback producing more revenue than you are presently contemplating?

Mr. SCHULTZE. That is correct, by an amount which we roughly calculate as \$1.3 billion. This is partly a presentation problem admittedly, Mr. Byrnes, in totaling up expenditures and revenues which could add to the \$29 billion deficit. It is simpler to present figures on each side without talking about the interaction between the two, but there would be some relatively slight interaction between them.

Mr. BYRNES. We are really talking about a \$29 billion deficit, because you can't crank in a feedback unless you have the expenditure.

Mr. SCHULTZE. I agree, sir.

Mr. BYRNES. You are faced with an expenditure that produces a \$29 billion deficit based on current revenues.

Mr. SCHULTZE. That is, if just expenditures went up, on the basis of current estimates of expenditures plus contingencies, that is what you would get.

Mr. BYRNES. That is, assuming expenditures increase according to your current projections.

Mr. SCHULTZE. In terms of the problem we are looking at.

Mr. BYRNES. All right. I haven't heard of feedbacks used in quite this way before. The idea apparently is that we should be careful not to cut too much or we will have a bigger deficit because we will eliminate the feedback.

Mr. SCHULTZE. The feedback is a relatively small proportion of the gross increases.

Mr. BYRNES. It seems to me that is the fundamental point. I am not going to be worrying about cutting back on expenditures just because it might eliminate some feedback.

Mr. SCHULTZE. I fully agree. Nobody was arguing that.

Mr. BYRNES. We better achieve the cuts in expenditures that produce a \$29 billion deficit first and then worry about the feedback later.

Mr. SCHULTZE. I fully agree with that.

Secretary FOWLER. I think we ought to talk in terms of \$29 billion. It is easier conceptually.

Mr. BYRNES. Then I think we can all discuss the problem on the same basis.

Secretary FOWLER. That is right.

Mr. BYRNES. Now, at what level do you consider a deficit significant enough to require concern about cutting back expenditures? Earlier this year some of us stated that the projected budget deficit presented a serious situation. We talked about it again in May and June when we had the debt ceiling increase.

As I gather, Mr. Secretary, your request for a tax increase is predicated on three general categories or areas. One is the Vietnam situation. I assume that the Vietnam aspect is more of a moral issue than it is anything else—the sharing of sacrifices.

Secretary FOWLER. I think it is that and more.

Mr. BYRNES. You are certainly going to provide every assistance to the boys in Vietnam regardless of whether or not you get a tax increase, aren't you?

We are going to provide this assistance regardless of the method or combination of methods we use to provide the necessary financing.

Secretary FOWLER. That is right.

Mr. BYRNES. It seems to me that it isn't a matter of the boys in Vietnam saying, "Boy, I hope Congress votes a tax increase or we may not have any ammunition tomorrow."

Secretary FOWLER. No, I don't think that is the case. I think it is more than that, however. It is trying to handle the financing of this special, and we hope temporary, expense in a manner that is consistent with the maintenance of a healthy economy.

Mr. BYRNES. The war effort isn't the only item that is figured in the \$29 billion deficit projection, but it is one of the expense items that goes in?

Secretary FOWLER. Yes.

Mr. BYRNES. You are not going to change that expenditure by the tax increase, so I am assuming that the Vietnam rationale used here is for moral and historical reasons. We have always increased taxes in times of war. Our fiscal needs required this, but we also did it on the basis, it seems to me, of all of our citizens sharing in the sacrifice. This rationale had a moral basis, and I assume that is what you are advancing here.

Secretary FOWLER. No; in addition to the moral problem that you have properly referred to, there is the conventional wisdom that when you have a special temporary expenditure of the magnitude that this expenditure has now come to be it seems wise to pass special tax measures to fund at least a portion of that special temporary expense out of current revenues. It is a sensible way of dealing with a special and temporary expense.

Mr. BYRNES. Then last year, when you knew that Vietnam expenses were accelerating by some \$10 billion—practically doubling—would have been the time to propose a tax increase if you wanted the increase to coincide with the additional temporary expense.

Secretary FOWLER. Mr. Byrnes, I tried in my statement in discussing the special costs of Vietnam to indicate that we did in early 1966 relate the additional \$4 billion-plus increase over the fiscal 1965 cost to the Tax Adjustment Act and that when it appeared, as my statement indicates, later on in the year that the expenses in Vietnam would be double the \$10 billion, we did decide that it would be necessary to try to fund some additional portion of that.

That was the genesis of the 6-percent surcharge request, but given the condition of the economy, the inventory readjustment Chairman Ackley has described, which was then facing us, the additional tax increase to meet that part of the cost to that degree was scheduled for a July 1 date rather than a January 1 date.

Mr. BYRNES. So you can have some increase in temporary costs without asking for a tax increase. But I don't think this rationale leads either one of us down the right road.

Another item you mentioned as the basis of the tax increase is the inflationary pressures that will result if we don't have a tax increase and cut back expenditures.

I am glad to see that you have generally tied the tax increase to expenditure reductions in your statement.

Secretary FOWLER. Oh, much more than that, Mr. Byrnes. Conceptually, they are wedded.

Mr. BYRNES. I want to go into that and see how closely they are tied together. One of the reasons for this tax increase is inflationary pressures that this kind of a deficit produces; is that correct?

Secretary FOWLER. The pressures that running this kind of a deficit could produce given the kind of an economy that we have today.

Mr. BYRNES. All right. The Chairman has explored the economic indexes in some detail in order to determine whether a tax increase is appropriate to the state of the economy. I would like to read from a letter I received from a Member of the other body and get your general comments on it. It says:

If we leave out the food component of the Consumer Price Index (on the ground that it is subject to its own particular cycle and not general demand) then prices have risen more this year than they did in the same period last year in spite of the fact that the demand is not nearly as strong as it was in 1966. The basic reason for this phenomenon is that services constitute the major element of the price increase in both years, especially medical care. Medical care has been going up for many years, and most other services tend to rise with wage rates. I can see very little relationship between price increase and general demand, at least in the short run. Yet it is widely cited as one of the principal reasons for tax action. Actually our economy is not operating at or near capacity. Capacity utilization is down to 85 percent. Unemployment is at four percent and the work week is the lowest in six years. Our economy could withstand a substantial increase in demand without overextending itself.

If these assertions are correct, and I gather they are because they coincide with the indexes that the Chairman cited, why can't the economy withstand a substantial increase in demand without over-extending itself?

Secretary FOWLER. I have the same letter, Congressman Byrnes, and I can just shorten this by telling you how I replied to it.

Mr. BYRNES. Yes; that would be fine.

Secretary FOWLER. I certainly agree with your point that there is not a perfect relationship between demand growth and price movement, as evidenced by the fact that consumer prices, other than food, have increased more this year than in the first half of 1966 despite a slowing down in the growth of demand. At the same time, however, we must recognize that the influence of demand does work in part with a lag effect, so that price developments this year are partially a reflection of rapid demand growth in 1966. Moreover, the transmission to retail prices of the higher level of wholesale prices which developed during 1966 has certainly been facilitated by the continued basic strength of demand forces. Indeed, the growth of final sales during the first half of 1967 has been greater than in the corresponding period in 1966.

It seems to me, therefore, that the greater part of wisdom lies not in downplaying the importance of demand factors, but in remaining aware that the problem of price stability may be seriously aggravated by a renewed upsurge of demand and by shaping our fiscal measures accordingly. The temporary tax increase program recommended in the President's message will, I believe, contribute to price level stability and be quite compatible with a generally strong economy.

I want to emphasize that I consider the temporary tax increase as a necessary measure to finance the special costs of Vietnam, to keep our Federal deficit to within tolerable emergency limits, and to hold down interest rates and prevent a recurrence of monetary stringency. Incidentally, by averting a sharp rise in interest rates, the tax increase will make a specific and direct contribution to keeping down the cost of mortgage financing which you cite as a major element in the price increase of 1966 and 1967.

Mr. BYRNES. Maybe the individual who wrote the letter will be more satisfied with that reply than I am.

Secretary FOWLER. I doubt it, Mr. Byrnes.

Mr. BYRNES. How much of a demand can the economy take? If you do everything that you talk about in your statement, we are apparently going to have a \$14 to \$18 billion deficit. The pressure of a \$29 billion deficit is certainly greater than a \$14 or \$18 billion deficit, but if we are on the verge of great price pressures, why are you dealing with partial measures?

Secretary FOWLER. No; I think you underscore, Mr. Byrnes, by that question the importance of having the full 10 percent on the time schedule indicated because—

Mr. BYRNES. But why is what I am asking you.

Secretary FOWLER. I think it is what is needed. Of course, there could be some debate about whether or not a 12-percent or a 14-percent tax could be more appropriate. We recognize that there is a range here of uncertainty about expenditure estimates, but we think that the 10-percent increase is the appropriate one, certainly if the expendi-

tures come out at the lower end of the range. If there are changes in expenditures, they will affect the economy, but we believe that, given this range, 10 percent represents a realistic appraisal of the range with which we are dealing and that it is the appropriate percentage of surcharge to ask for.

I am not happy that there may still be pressures on the money market, as a result of our borrowing in the market that I described, but we believe that \$7,400 million reduction in those pressures is a very meaningful and desirable measure.

Mr. BYRNES. This is the other aspect of your rationale underlying this recommendation. This argument is based on moneary policy and the effect on interest rates of having to go into the market and borrow. I want to get into that also.

But what I am trying to bring out now is that in January, when we were faced with a \$10 billion projected deficit, you talked about a 6-percent surtax effective July 1. Very little effort was made by the administration to meet that deadline, and I don't know that Dr. Ackley can have much confidence that the tax increase recommended by the administration was coloring their judgment.

It would seem to me that the business community ignored it, just as almost everyone else did. Certainly the administration forgot about it after they put it in the budget message. In May, Mr. Secretary, you were telling us you didn't know when you were going to have the bill or when you were going to ask us to act on it.

So I can see the business community saying, "Well, we at least don't have to worry about a tax effective on July 1."

Secretary FOWLER. I think I said at the time, too, that I liked to argue my case when I thought the facts and the evidence would be more strongly accumulated in support of it, and I believe that time is now.

Mr. BYRNES. So you are here now.

Secretary FOWLER. With reference to your comment about the difference between 6 percent in January and 10 percent now and the fact that we still have a substantial deficit—

Mr. BYRNES. I am talking in terms of something definite. In January you were faced with an \$8.1 billion deficit—even with a 6-percent surtax effective July 1.

Now you are looking at a budget picture showing a projected \$29 billion deficit. What is the relationship?

Secretary FOWLER. We are now trying to put together a tax increase and a series of measures that Mr. Schultze has described that would bring this deficit down to a range of between \$14 and \$18 billion depending upon the outcome of some of the imponderables that are described in the President's message.

Now, I think your question really goes to why, having proposed a 6-percent tax increase in order to hold the deficit down to \$8 billion in January, we are willing to accept a deficit of \$14 billion now, and I have several comments on that.

First, I would say that the first half calendar year 1967 economic slowdown was somewhat greater than we had earlier estimated and because of what has happened in the first half of this year, we estimate a somewhat larger deficit and lesser revenues in fiscal 1968. We don't

think it necessarily follows from that that there has to be a dollar-for-dollar increase in the tax bite.

Secondly, we were contemplating in January a social security program which had a stimulus which, in the light of what I generally understand is the program that this committee would report, would call for somewhat lesser stimulus from the social security side.

Mr. BYRNES. You are talking about last January 1.

Secretary FOWLER. Yes, and also frankly we had hoped that the easy money policy followed by the Federal Reserve Board would result in lower interest rates than have proved to be the case in intervening months, and therefore we haven't gotten as much stimulus from that side as was hoped for in January.

The effective date of the surcharge means some slippage in revenues and increases the deficit, but that does not necessarily change the amount of the fiscal restraint when the tax is in effect. Indeed, in light of the increase from a 6-percent surcharge to 10 percent, taking all these factors into account, we don't welcome but we think we can try and live with a deficit of a higher magnitude.

Let me add that that doesn't mean at all that there is not a very vast difference between trying to live with a \$14 billion deficit and a \$29 billion deficit. It is that other prospect and that other alternative that we think is impossible.

Mr. BYRNES. I think that what probably has some people on this committee worried—and I know it has me worried—is the ability with which you can judge the next 6 months on the basis of looking at the difficulty you had in the 6 months that just passed.

The economic slowdown was, you say, greater than you anticipated. What if the economic upturn is slower than you anticipate? Then what will be the effect of this proposal? Those are the questions, Mr. Secretary, that give us real trouble.

Secretary FOWLER. I think that the direction is reasonably clear. It is going to be up. Whether it is going to be moderately up or whether it is going to be up with heavy inflationary overtones, there is certainly considerable room for discussion.

We think, however, that the safe course and the prudent course is to take the measures recommended and thereby minimize the risks that would be entailed for the general tone of the economy if the course of expansion should prove to be highly expansionary.

The proper objective here, it seems to me, is to try to reach a good cruising speed and avoid the risk of overheating and going at too high a rate.

Mr. BYRNES. One of the reasons underlying this recommendation is the monetary problem created by going to the market to finance this kind of a debt, and the impact it has on interest rates. Is that not correct?

Secretary FOWLER. Yes, sir.

Mr. BYRNES. Let's see how we are going to reduce the \$29 billion deficit so that you only have to go to the market to finance \$14 to \$18 billion. This bill calls for a \$7.4 billion tax increase, is that correct?

Secretary FOWLER. \$7.4 billion.

Mr. BYRNES. \$7.4 billion. So that gets you down to a \$21.6 billion deficit.

Secretary FOWLER. Mr. Byrnes, we can do this with different arithmetic. I think it makes it easier to calculate, if you start from the notion that you are not going to have a deficit of this magnitude and you are going to try to deal with the problem without this heavy increase in the cost of carrying the debt, the \$700 million that is referred to in my testimony and Mr. Schultze's, which is part of the \$29 billion, and start from the \$28.3 billion figure.

Mr. BYRNES. \$28.3 billion. What is the billion dollars you have taken out?

Secretary FOWLER. \$700 million for additional interest cost.

Mr. BYRNES. Is that the difference in the interest cost attributable to a \$29 billion deficit rather than a \$14 billion deficit?

Secretary FOWLER. The computation is based on the fact that there would be a much higher average debt during the year on which you would have to pay interest and the fact that it does involve some assumption about interest costs being somewhat higher than they would be if you didn't have to put that amount of pressure on the market.

We are using in the computation, Mr. Byrnes, a \$14.1 billion as interest cost, if that helps you.

Mr. BYRNES. Let's take the \$28.3 billion figure.

If we take off the \$7.4 billion for the tax increase we have \$20.9 billion. Let's find out where we go from there.

First, though, let me ask whether the budget information that you gave us this morning is the result of the revised budget calculation, Mr. Schultze, that you were undertaking at the direction of the Joint Economic Committee and which we also asked for in May?

Mr. SCHULTZE. Yes, sir; in effect, although clearly in terms of coming up before this committee with a request for a tax increase we would have done it in any event. But you are quite right, it was also called for by Senator Proxmire and the Joint Economic Committee.

Mr. BYRNES. This is the revised budget picture. The basic revision here seems to be on the revenue side rather than containing detailed revisions on the expenditure side.

Mr. SCHULTZE. It seems to me I gave a good bit of detail.

Mr. BYRNES. You gave us the billion and a half expenditure increase, but you gave us that during the debt hearings without any details.

Mr. SCHULTZE. I gave you \$600 million of it, Mr. Byrnes. The other \$900 million is new. In addition, I did detail the specific contingencies that do face us in addition to that \$1½ billion.

Mr. BYRNES. Didn't you indicate a \$700 million increase in defense expenditures in May and a release of \$600 million in funds previously withheld—for a total of \$1.3 billion. Isn't that the same figure you are still talking about?

Mr. SCHULTZE. Correct, except that the \$700 million, you may recall, at that time was simply an indication of some room for estimating error around the January budget figure. That is the way I indicated it. Now I am stating that with respect to defense it could range up to \$4 billion.

Mr. BYRNES. Does that include the \$700 million?

Mr. SCHULTZE. Yes, sir; that would include the \$700 million.

Then, in addition to that, I am saying on the civilian side there would be a \$1½ billion increase, including the \$600 million I gave you

earlier plus \$900 million, primarily in the areas of CCC, public assistance, and payments to the medicare trust fund. Those three items I spelled out in addition today, so I have gone through in detail the \$1½ billion for civilian programs.

I then listed a number of contingencies in other areas, up to \$4 billion on defense, the pay bill, the participation certificates, and, finally, as you will recall, the possibility of higher interest payments on the public debt if all these contingencies turned out unfavorably.

Mr. BYRNES. Yesterday, on a television show called "Issues and Answers," the Secretary suggested, if I understood you correctly, Mr. Secretary, that we were going to sort of handle this deficit, by borrowing half of it, providing 25 percent through reductions in expenditures, and another 25 percent by the tax increase.

How are you going to get the \$7.4 billion reduction in expenditures? What are we going to reduce from? Are we going to be reducing from the pay increase that you are talking about the Congress adding to the budget, or are we starting out with what the budget estimates were?

Secretary FOWLER. In the \$28.3 billion that we started out with there was a billion dollars for an additional civilian pay increase that is under apparently very serious consideration in Congress and discussed in the President's message and in the Director of the Budget's statement. We would hope to avoid that additional billion dollars added on to the deficit. If it is avoided it would bring you down to a deficit of \$19.9 billion.

Then we have expressed the hope and desire, although the House has voted against it, that the Congress would give us the authority to have the additional \$2 billion of PC authorizations.

Mr. BYRNES. All right. Let's stop right there, Mr. Secretary—

Secretary FOWLER. I thought we would stop.

Mr. BYRNES (continuing). For a moment. I don't want to get into this endless circle on the participation certificates.

Secretary FOWLER. I was going to say, then, I was going to turn it over to Mr. Schultze to describe where we go from there.

Mr. BYRNES. You can turn it over now if you want, but let's talk about the PC's.

Secretary FOWLER. He always helps me out on that.

Mr. BYRNES. You are talking about \$2 billion?

Secretary FOWLER. Yes.

Mr. BYRNES. If we repealed the legislation which restricted your use of PC's would that reduce by 1 penny the amount of money you had to go to the market to get?

Secretary FOWLER. No, sir.

Mr. BYRNES. Then how can that ever reduce monetary pressures created by the Federal deficit?

Secretary FOWLER. It doesn't.

Mr. BYRNES. Not one bit, does it? It doesn't reduce your deficit one bit, does it?

Secretary FOWLER. Yes, sir.

Mr. BYRNES. Oh, only in the budget arithmetic that you base on these fiscal gimmicks. The figure that the President puts in a message does not in itself have anything to do with the pressures that led you to come here and ask for a tax increase, does it? Whether that budget

deficit is \$27, \$29, or \$31 billion, the way you handle PC's would not make any difference in the amount of money you must take from the market.

Secretary FOWLER. Yes, sir; Mr. Byrnes, it makes quite a difference because as these figures get bandied about there are psychological reverberations from them and if you talk about the way we have been keeping our books traditionally and have kept them for a long time and if you talk about a \$18 billion deficit rather than a \$20 billion deficit it has some impact. I can't measure it. You can't measure it. No one can measure it, but it is still there.

Mr. BYRNES. You are talking about a psychological impact.

Secretary FOWLER. Yes.

Mr. BYRNES. Look at it from a practical standpoint. A tax increase of \$7.4 billion reduces the deficit from \$28.3 billion to \$29.9 billion. Assume that Congress has refused to enact a pay raise exceeding by a billion dollars what the President budgeted for. That would leave a \$19.9 billion deficit. Congress has either refused to go above the President or the President has vetoed it, and let's not forget about that potential—

Secretary FOWLER. We won't.

Mr. BYRNES (continuing). If you are so concerned about this.

Mr. SCHULTZE. We are concerned.

Mr. BYRNES. Let's not put all of the responsibility up here. There is equal sharing. Anything that becomes law has to have the President's signature unless we override it; isn't that correct?

Secretary FOWLER. That is correct.

Mr. BYRNES. So our calculations have a \$19.9 billion deficit. No matter what we do with PC's, you would have to finance the \$19.9 billion, by which expenses exceed revenues.

Secretary FOWLER. The Government would have to go to the market for an amount that would include either Treasury borrowings or PC sales.

Mr. BYRNES. Right. The amount you have to go to the market for and the resulting monetary problems aren't going to be reduced at all by using PC's to make it look like you are spending \$2 billion less than you actually are.

Secretary FOWLER. That is where we part company a little bit. I think if you use the word "psychological," you say it makes no practical difference. I don't know what practical means. I know what psychological means and I think it would be desirable and I will urge, as I have urged, that we have the authority to market this additional \$2 billion of PC's.

Mr. BYRNES. I thought you were concerned about the additional \$700 million in interest costs that we can reduce by reducing the deficit. But you insist on borrowing money through PC's, which carry the highest rate of interest. That I can't understand. If what we are on is an economy drive, and I hope we are, then I think we ought to save on interest costs by borrowing in the most economical way.

Mr. SCHULTZE. Mr. Byrnes, with that logic we would have taken our guaranteed student loan program and converted it to direct Government lending. It is admittedly cheaper to take our student guaranteed loan program and convert it to direct Government lending because the Treasury can borrow at a cheaper rate than you can borrow from a bank.

Mr. BYRNES. Is that any reason to use PC's to borrow directly at a higher rate of interest?

Mr. SCHULTZE. Mr. Byrnes, the logic is there. If you believe the Federal Government should finance everything it does through the Treasury because the Treasury is cheaper—

Mr. BYRNES. We are trying to reduce this deficit. At this point we are \$19.9 billion in the hole, and the Secretary says, "You would help us reduce this deficit if you will let us borrow money by selling participation certificates"—paying higher rates of interest on them. I say it does not reduce anything.

Mr. SCHULTZE. Mr. Byrnes, we are trying to come down from the \$29 billion or \$28.3 billion deficit to a \$14 or \$18 billion range and you are quite right that \$2 billion of this reduction has a minimal impact on the market, although, as the Secretary says, it should have some psychological impact. So in the total range we are talking about, it is admittedly true that \$2 billion of the difference has a much smaller impact on the market compared to the rest of the difference. That is quite true.

Mr. BYRNES. I must say that shifting from direct borrowing to participating certificates bearing higher interest rates is a great effort to cut back on expenditures.

Secretary FOWLER. This is something we have been over time and time again. I would only say I still see a difference between regular borrowing to finance current expenditures and PC's to finance repayable loans. Now, there is a difference. Maybe we can't quite agree as to what the difference is, but there is a difference. It is a psychological difference and a meaningful difference.

Mr. BYRNES. But regardless of what we do with PC's, you are going to go to the market for \$2 billion, aren't you?

Secretary FOWLER. Either that or through the Treasury.

Mr. BYRNES. Right, so the manner of handling PC's doesn't change the amount you are going to the market for, does it?

Secretary FOWLER. Not a bit.

Mr. BYRNES. It doesn't change any of the problems that are created and which you pointed out to us in your statement at some length, Mr. Secretary, the problems of credit and—

Secretary FOWLER. You can just write off pages 13 through 28 of my statement as far as this \$2 billion is concerned, but they are very, very applicable to the \$7.4 billion involved in this tax increase. They are also very applicable to the billion of additional for the pay bill. They are also very applicable to any expenditures that are reduced beyond that.

Mr. BYRNES. The PC's have some relationship to the pay bill?

Secretary FOWLER. No; I say those pages from 13 to 28, you and I can agree that they have no particular applicability to the PC's.

Mr. BYRNES. All right. That is some progress. Let's see what we are going to do next, then. I don't really know how to record this \$2 billion attributable to PC's in our calculations.

Secretary FOWLER. In the deficit, the way we keep our books, it is down to \$17 billion.

Mr. BYRNES. You are still going to have to borrow \$19.9 billion but you want me to put it down in the table as getting you down to \$17.9 billion. I disagree with that, but for purposes of discussion, let's get together again at \$17.9 billion.

Mr. SCHULTZE. Rather than disturb that I won't make a comment. I was about to comment.

Mr. BYRNES. All right. This is the point at which the Secretary is going to turn it over to you, anyway, so now let's find out what we do with the \$17.9 billion.

Mr. SCHULTZE. He is so generous.

Mr. BYRNES. The Secretary told the public yesterday we were going to cut expenditures by about the same amount as we were going to increase taxes—around \$7.4 billion.

Mr. SCHULTZE. That is correct.

Mr. BYRNES. Was this \$2 billion included in that, Mr. Secretary, that you were going to cut expenses?

Secretary FOWLER. Oh, yes.

Mr. BYRNES. That is real good. Now we see it; now we don't. Let's find out how we are going to get rid of the other \$5 billion of expenditures that are apparently cranked into this \$28.3 billion.

Mr. SCHULTZE. I think the way to put that is the following, Mr. Byrnes. We take the budget and break it into two parts, civilian and defense. Essentially, as I have indicated, we will be setting up reduction targets for civilian expenditures of something over \$2 billion. In addition, Secretary McNamara will be looking at areas in his budget to find ways to postpone, defer, and reduce expenditures to the extent this can be done without getting our defense posture in the wrong situation. It is in that area that we are trying to aim for the \$4 billion additional that Secretary Fowler talked about.

Mr. BYRNES. You don't know where yet?

Mr. SCHULTZE. No. I can give you some indications. Do you want to take, for example, some of the defense areas?

Mr. BYRNES. I would like to ask you about defense expenditures. It is my understanding that the Comptroller of the Defense Department, in testifying before the Appropriations Committee last Thursday, was still holding firmly to a Defense Department budget of \$71.3 billion.

Mr. SCHULTZE. \$73.1 billion, which is what was in the budget.

Mr. BYRNES. Right, \$73.1 billion, which is the figure that was contained in the January budget.

Mr. SCHULTZE. That is correct, \$73.1 billion. What the Comptroller was saying was just what I said in my testimony today and I will detail some of these for you now.

Mr. BYRNES. He was saying something a little different. You said that defense expenditures will be between zero and \$4 billion in excess of the \$73.1 billion in the January budget, didn't you?

Mr. SCHULTZE. That is correct.

Mr. BYRNES. And he was saying no—

Mr. SCHULTZE. I read the transcript, or at least that part of it which had to do with this colloquy, and Mr. Anthony was saying that in terms of making a firm prediction he could not predict any part of the zero to \$4 billion range. He was saying, in terms of a firm prediction, at the moment he would stick with the \$73.1 billion. He indicated, and I have indicated, that there are contingencies involved here—both plus and minus—which could net up to as high as \$4 billion. This is what he said and I said.

Mr. BYRNES. You are suggesting that you will have as much as \$4 billion in additional defense expenditures, but that this will be offset to an extent by savings you are going to make. This figure of \$4 billion that you cranked into this \$28.3 billion projected deficit actually turns out to be a cutback?

Mr. SCHULTZE. I think you are putting words in my mouth.

Mr. BYRNES. I am asking you if that is what this \$4 billion is about.

Mr. SCHULTZE. No, sir; I won't say it that way. What I would say is that taking into account both reductions and the possibility of avoiding some of these contingency increases you can get that much out of the \$29 billion. I am not saying we call those changes economies, or savings, or anything else. What I am saying is that if you rack up the contingencies that face you, you have several ways of avoiding them. One, you can reduce expenditures. Two, you can hopefully avoid some of the contingencies which require you to reduce expenditures as an offsetting basis. That is the way I would say it.

Mr. BYRNES. Then, this is simply avoiding a contingency.

Mr. SCHULTZE. And also reductions.

Mr. BYRNES. These contingencies were included in your computations in order to create the \$28.3 billion figure.

Mr. SCHULTZE. No, sir.

Mr. BYRNES. Or to reach the 28.3 billion.

Mr. SCHULTZE. Mr. Byrnes, I just want to make sure the record reads correctly. It wasn't cranked in in order to reach some predetermined \$29 billion. It was put down as an evaluation of what is facing us. I just want to make sure the record reads right on that. We didn't start out with \$29 billion and say how do you get there?

Mr. BYRNES. We better set the record straight. I am trying to find out where you are cutting back on expenditures. The public was told just the other day that there is going to be an expenditure reduction. I want to pinpoint that expenditure reduction so the people can know the nature and size of it. It appears that all you are doing is adding contingencies to the expenditure side and then claiming a savings when you cut back or eliminate the contingency.

Mr. SCHULTZE. Sorry, Mr. Byrnes. Those are your words. I think what the Secretary was saying and what I am saying is that we are facing contingencies on both the revenue and the expenditure side which at the other end could add to a \$29 billion deficit. We are saying by a combination of tax increase and trying to avoid some of those contingencies and reducing expenditures we can bring it down to a range of \$14 to \$18 billion. The upper end of that range would mean we were not very successful in avoiding some of the contingencies. That is essentially what this says.

Mr. BYRNES. All right. We got down to \$20.9 billion by taking off the \$7.4 billion. That is the tax increase.

Mr. SCHULTZE. That is correct.

Mr. BYRNES. That will be reduced to \$19.9 billion if Congress does not enact pay raises exceeding the President's budget by \$1 billion.

Mr. SCHULTZE. Right.

Mr. BYRNES. And for your bookkeeping purposes—and I would underline "bookkeeping purposes"—we take another \$2 billion off for PC's. You are down to \$17.9 billion.

First, how much of a reduction do you hope to get through the PC's? Second, where will you get the next reduction—will you increase and decrease defense by \$4 billion and call that a savings?

Mr. SCHULTZE. I am saying in the civilian area we are going to set up expenditure reduction targets exceeding, this amount, but to be conservative, let's put down \$2 billion.

Mr. BYRNES. They are going to be set up in the future? Why aren't they established now? The Senate Appropriations Committee is currently adding to appropriation bills that have been passed by the House. Why don't you give them the benefit of your advice, and assist them in remaining within the House action on the appropriation bills?

Mr. SCHULTZE. Mr. Byrnes, the Congress has now been in session for 7 months. We have three appropriation bills completed. If we came up to the Congress with a completely new set of appropriations, in terms of a long list of amendments and supplementals, first I am sure the Congress would be here till Christmas. We do not believe that this would be the way to get the cuts made. Secondly, if we came up with that list of cuts during the period in which some bills have passed the House, some have passed the Senate, some are still in committee—in which bills are in all different stages—we are fairly sure that we simply would not get them done. This is the reason we are proceeding as we are—as soon as the appropriations are enacted, we will give each agency a target to hold back within those appropriations.

Mr. BYRNES. Mr. Director, do you really think the Appropriations Committee would get upset if you brought in a rescission bill? You don't hesitate on supplementals, and a rescission bill should be possible.

Mr. SCHULTZE. Mr. Byrnes, you may be right. Far be it for me to put my judgment about what might happen in Congress ahead of yours. All I might do is point out to you the experience of last year when we did send up a number of cuts, about eight or nine of them, many of them involving fairly large amounts of money, and we did not get a single one of them. Now, people said, "You are unrealistic. You should not expect them to get through the Congress," and the like.

Mr. BYRNES. But you also got some you asked for, didn't you?

Mr. SCHULTZE. That is correct, we did, and we held back on most of those, not all of them, but most of them.

Mr. BYRNES. You held back on them?

Mr. SCHULTZE. Yes, sir.

Mr. BYRNES. If you didn't get the money, how could you hold back on them?

Mr. SCHULTZE. I am saying the ones we did.

Mr. BYRNES. I am talking about the cutbacks the Congress did give you.

Mr. SCHULTZE. I misunderstood you. That is correct. In some areas we did not.

Mr. BYRNES. If you balance them together, they may have come out even.

Mr. SCHULTZE. On balance there was a \$2½ billion increase in expenditures last year from congressional action.

Mr. BYRNES. \$2½ billion?

Mr. SCHULTZE. \$2½ billion increase in terms of congressional action last session.

Mr. BYRNES. Is that appropriations or expenditures?

Mr. SCHULTZE. Expenditures. I am talking about expenditure changes in terms of the impact of appropriations and authorizations on expenditures. This I presented to the committee in January when I was up here. We offset a lot of that increase by our cuts.

Mr. BYRNES. God bless you.

Mr. SCHULTZE. All I am saying, Mr. Byrnes, is I realize you disagree with me, but in looking at this thing coldly in terms of how one gets expenditure cuts, our experience has been that if we try to make a lot of revision in the middle of the appropriation process we would end up much worse off than doing as we are planning to do.

Mr. BYRNES. You are going to wait until after the Congress acts?

Mr. SCHULTZE. We are going to take action bill by bill as we get the bills. We will be giving each agency a reduction target as soon as its appropriation bill comes through. We are not going to wait and do nothing until whenever it is that the final last appropriation is in. We are not going to do that, but as each bill comes through, we will give the agency a target. We may have to adjust the targets later, both plus and minus, because of unanticipated events, but that is what we will do.

Mr. BYRNES. You have to wait until you get the appropriation bill before you give them a target.

Mr. SCHULTZE. There are actually two parts to the process. First, those agencies which already have appropriation bills have been given targets, and have been asked to review their expenditures and make recommendations as to how they would reach it. That covers a very small part of expenditures so far this year.

Secondly, to every agency I have sent a memorandum of instructions indicating that we will ask them to make reductions and that between now and the time they get their appropriation bill they should avoid to the maximum extent possible any commitments which will make the reduction difficult.

Mr. BYRNES. What I don't understand is why we are told that the Congress increased appropriations and expenditures this year by—

Mr. SCHULTZE. Last year, 1967.

I wasn't saying this year.

Mr. BYRNES (continuing). By \$2 billion above what last year?

Mr. SCHULTZE. \$2.5 billion more than the budget recommendations.

Mr. BYRNES. By \$2.5 billion above the budget recommendation. Yet we have no less a person than the Vice President pointing out that it is Congress that is responsible for the riots and the unrest because they haven't appropriated enough money. We haven't been spending enough. Now we are told that we spend more than the administration was proposing.

Mr. SCHULTZE. No, sir; I just think you have to distinguish last year from this year. There was a difference in terms of the net end results.

Mr. BYRNES. No, these speeches charged that the conditions would not have existed, that they would have been eliminated, and people could have used them as a justification for the riots. Those conditions would not exist if Congress had only done in the last few years what the administration apparently wanted them to do.

Mr. SCHULTZE. No, sir.

Mr. BYRNES. We were too frugal.

Mr. SCHULTZE. The only thing that I can refer to on that is my understanding that we are talking now about a number of bills this year, not last year, the rat extermination bill, the model cities bill, and others.

Mr. BYRNES. Is that what is causing the riots?

Mr. SCHULTZE. I am not saying anything about causality. I am simply saying the bills in question were the Teachers Corps, and the rat extermination, and model cities bill particularly.

Mr. BYRNES. We didn't give you what you wanted in 1967 for the Teachers Corps if I recall correctly.

Mr. SCHULTZE. That is correct, not completely. All of these are relatively small in terms of money. They do not involve large amounts of money.

Mr. BYRNES. We still spent \$2 billion more than you wanted us to spend, but we didn't spend enough.

Mr. SCHULTZE. That refers to the impact of authorizations and appropriations by the Congress last year on expenditures. A lot of that we didn't spend. I am not saying we spent that much more. I am saying what the situation would have been if we carried out the final result of congressional action.

Mr. BYRNES. I am wondering why you don't seek the help of Congress before these appropriations bills are passed. Why put the entire burden on the Departments?

Mr. SCHULTZE. I am saying, Mr. Byrnes, in a number of areas the Congress can clearly help us. I am not suggesting they can't. All I am suggesting is that it is a matter of judgment—and I admit it is judgment—that if we want to get the cuts, the way to delay and make sure we don't get the cuts, or at least get less of them, is to send up in the middle of the appropriation process a whole new list of appropriations.

Mr. BYRNES. But we have to act on a tax bill. You say, "wait and we will show you some expenditure reductions." So far, I haven't determined where the actual cutting is going to take place. You simply indicate that you hope to do it. After Congress gets through, you are going to tell the department not to spend all the money Congress gave them.

Mr. SCHULTZE. Except it isn't that vague and it isn't that much of simply a hope in that sense. It isn't a question of just telling the departments not to spend so much money. This involves setting specific targets and going through the appropriations, account by account and line by line, and reevaluating and cutting them.

Mr. BYRNES. You are going to cut \$2 billion.

Mr. SCHULTZE. Our target is actually slightly over \$2 billion. I can't guarantee down to the decimal point exactly how much we are going to make of that. We are going to aim for \$2 billion plus. That is our target; yes, sir.

Mr. BYRNES. I checked with some of the members of the appropriation committee this noon, and they are under the impression that the House has not cut the appropriation bills by at least a billion dollars. Now, of course that could be restored in the Senate. I know that.

Mr. SCHULTZE. Let me elaborate on that for you, if I may, Mr. Byrnes. Let me break just the House action for the moment down into two parts and appropriations, civilian and military.

In all of the civilian appropriations bills passed by the House to date—there are 11 appropriations involved for 1968 so far—the appropriation cut was \$1,650-odd million. The expenditure impact of that in fiscal 1968 will be \$650 million—the impact of the House action.

Now in the Senate some small amount of that has been restored in actions taken to date. In addition, on the civilian side, not in the appropriation area, actions or failure to act have added several hundred million dollars to expenditures in terms of an increase in the veterans' bill above the President's recommendation and the delayed date on the postal rate increase, so you might say that, net, in terms of the actions the House has taken on appropriations and authorizations where we know that they will have an impact on expenditures you might come out somewhere in the \$400 million area of decreases.

Secondly, on the military side, the House appropriations bill cut \$1.3 billion from military appropriations, which will have an expenditure impact of \$500 million in 1968. This is one of the items that we think is going to help us, we hope, end up not at the higher end of that \$4 billion range, but maybe we come out better than the \$4 billion. This would be in part because of the Congress. I am not here to say that this year the Congress is generally adding to our budget if we stay away from the participation certificates and the pay raise.

Mr. BYRNES. If we include the civilian expenditures you hope to achieve, the \$28.3 billion figure is down to \$15.9 billion. Is that correct?

Mr. SCHULTZE. Yes, sir, \$15.9 billion, that is correct.

Mr. BYRNES. Where is the next cut? Is defense all that is left?

Mr. SCHULTZE. We are trying to find cuts in defense. I cannot guarantee them, but they involve a combination of avoiding some of the increases and finding offsetting savings. In the defense area all I am saying is that this is the range we are in. This is why we gave you a \$14- to \$18-billion range rather than a specific number because I can't sit here and give you a specific number on defense any more than anybody could at any time during any other war.

Mr. BYRNES. It sounds great. I was really quite enthusiastic when I heard of the Secretary of the Treasury's statement that we would balance the tax increase with corresponding reduction in expenditures. That has certainly gone up in a puff of smoke.

Secretary FOWLER. Let me read what I did say so we will have it all, at any rate. "Well, it was thought on the high side that 10 percent was an appropriate level in the light of the changes that had occurred since we made the original 6-percent recommendation. Of course, there is no magic in any particular combination of figures. The President's rough approach to meeting this deficit, which could run as high as \$29 billion or \$30 billion, is to meet it by about a 25-percent tax increase, which is \$7½ billion, 25-percent reduction in expenditures that might otherwise occur, and borrow the remaining 50 percent.

"Now, those figures could vary. We believe that the best mix as we see it today, the most feasible mix, is the one that is within the reach and within grasp that we could count on, which would imply \$7½ billion of additional revenue in this fiscal year."

Mr. SCHULTZE. To look at this another way, Mr. Byrnes, there is \$2 billion of that which you don't agree with, I realize, but in getting at that figure, you add a \$2-billion-plus civilian expenditures reduction, \$2 billion for PC's, \$1 billion for avoiding a pay increase bigger than

proposed, and if we get the tax increase and avoid these other items, you add \$700 million in interest costs avoided, bringing you up to \$5.7 billion. Now, we are trying to do what we can in the defense area to get more, to get up to that \$7½ billion.

Mr. BYRNES. As I have said many times, a \$29 billion deficit puts us in a fiscal mess. I said this dismal situation needed attention in three ways: expenditure reductions, tax increases, and some borrowing. I thought that a balanced approach was being recommended, that realistic measures were being proposed instead of simply paying lipservice to expenditure reductions. I hoped that we were actually going to do some belt-tightening, but frankly your testimony does not give me any assurance that this is going to happen.

Mr. SCHULTZE. Mr. Byrnes, let me give you an example. On the one hand, the increase in taxes that we are asking for is approximately calculated on incomes and on the average is about a 1-percent take on personal income. If you look on the expenditure side and take the civilian expenditure reduction target of \$2-plus billion, that is going to have to be accomplished in the area where we can make reductions in terms of controllable expenditures—where we don't have payments locked in by law or payments under prior contracts. In that area, the reduction that is going to be over 15 percent, and I don't consider this in most of those programs a minor effort.

Mr. BYRNES. A 15-percent reduction?

Mr. SCHULTZE. Yes, sir. In the first place, you start with about \$21 billion of expenditures that you can get your hands on this fiscal year.

Mr. BYRNES. Yes, you say, "We are only going to deal with 20 percent of the budget, and we are going to cut that part by 15 percent." Sure, this sounds like a large reduction.

Mr. SCHULTZE. No, not only sounds big, Mr. Byrnes.

Mr. BYRNES. I don't know what basis this provides for the Secretary's statement that the taxpayers are going to pay about 25 percent toward cutting down this deficit and the Government will achieve a similar amount through expenditure control.

Mr. SCHULTZE. It is a matter not just of what the executive branch is going to do, but asking the Congress to cooperate.

Mr. BYRNES. I am sure that is the impression that the American people got listening to it.

Mr. SCHULTZE. Not the way the Secretary read it back to me.

Mr. BYRNES. The language is in the hearing.

The CHAIRMAN. Without cutting you off, gentleman, we may resume our questioning in the morning. If there is no objection, the committee will reconvene at 9:30 in the morning. If you gentlemen will, please be with us at that time.

(Whereupon, at 4:50 p.m. the hearing adjourned, to reconvene at 9:30 a.m., Tuesday, July 15, 1967.)

PRESIDENT'S 1967 TAX PROPOSALS

TUESDAY, AUGUST 15, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 9:30 a.m., pursuant to notice, in the committee room, Longworth House Office Building, Hon. Wilbur D. Mills (chairman of the committee) presiding.

The CHAIRMAN. The committee will please be in order.

Mr. Burke?

Mr. BURKE. Mr. Secretary, the American public is quite concerned about the statements of General Charles de Gaulle who is going throughout the world advising all the countries what they should do, and I noted in your statements yesterday that this total tax bill will ask the taxpayers of America to pay approximately \$7.4 billion.

Yesterday I checked the debt outstanding owed by the De Gaulle government to the United States and the total debt as of yesterday was approximately \$7.1 billion. Do you think there could be some effort made on the part of the administration to contact General de Gaulle and ask him to get up some of this money that he owes the United States which would in turn relieve the taxpayers of some of the burdens that they are carrying as a result of the debt owed to us by France?

FURTHER STATEMENTS OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; HON. CHARLES L. SCHULTZE, DIRECTOR OF THE BUREAU OF THE BUDGET; AND HON. GARDNER ACKLEY, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Secretary FOWLER. Congressman Burke, let me deal with that in terms of World War I debts and World War II debts and Marshall plan post-World War II debts.

With regard to the later category, post-World War II debts, the French Government has lived up to the payment schedule that was arranged at the time those loans were made, and, indeed, has prepaid portions of that debt over the last 4 or 5 years in a debt prepayment practice that is mutually advantageous.

With regard to the World War I debts, which make up most of the \$7 billion outstanding that you refer to, a moratorium was entered into in the early 1930's and since that time, although these obligations are in my judgment legal obligations outstanding, debts owed by these respective countries to the United States that are valid and binding, various efforts in the early 1930's and subsequently to explore repay-

ment have been met by the position, as I understand it, of the French Government that they would not repay any of this debt unless the reparation payments that were due France from Germany as a result of World War I were inaugurated at the same time, so that all of those concerned with the moratorium that was entered into in the early 1930's would assume that obligation.

I have an analysis of this situation in much greater detail which I would like to present and enter into the record. I don't happen to have it with me, but I will be glad to bring it down. It will give you and others interested a more complete and detailed picture of the situation involving these World War I debts.

(The following analysis was received by the committee:)

REPAYMENT OF FOREIGN OBLIGATIONS TO THE U.S. GOVERNMENT

In its effort to halt the loss of gold the Administration has given special attention to the potential contribution of debt repayment. Virtually all of the loan agreements and settlements made with foreign countries since the beginning of World War II established fixed amortization schedules which call for regular payments over a period of years. We expect both principal and interest on post-World War II obligations to be paid in accordance with these schedules, and with relatively few exceptions these payments are being made. Our receipts from such payments exceeded \$800 million in 1966. Only in a few cases has it become impossible for debtor nations to meet scheduled payments, making it necessary to negotiate a rescheduling of the obligation. Some of the loan agreements provide for postponing payments under certain circumstances. Where disputes arise resulting in payment delays, efforts are made to reach agreement in order that payments may be resumed. There have been a few instances, notably in the case of the Republic of China and the USSR, where it has not yet been possible to reach agreement involving comprehensive settlement of World War II Lend-Lease and related accounts. (The USSR is making payments on Lend-Lease items which were in production or storage in the United States before V-J Day.)

We have also made clear to the governments of nations in strong financial positions that we welcome repayments in advance of the scheduled due dates. As a result, the United States has received supplemental payments totaling \$2.96 billion since 1959.

The situation is different with respect to World War I debts. Most governments fulfilled their commitments under their World War I debt agreements until the depression. Debtor governments stopped making payments in 1932, following the expiration of the one-year moratorium on debts owed to the United States negotiated by President Hoover in an effort to mitigate the effect of these debt obligations on Europe's economic health. Finland is the only country which is presently meeting its obligations in full. Some of the other countries which still have world War I debts outstanding have made token payments since the early 1930's, but no payments at all have been made since the beginning of World War II.

While the countries which have large World War I obligations to the United States have never denied the juridical validity of their debts, there is a view widely accepted among them that the payment of these debts should be dependent on reparation payments by Germany. Resolutions of the problem of governmental claims against Germany arising out of World War I was deferred "until a final general settlement of this matter" by the London Agreement of 1953, to which the United States is a party.

The Government of the United States has never recognized that there was any connection between the World War I obligations of those countries and their reparations claims on Germany. While the London Agreement would not prevent the United States from raising, on a bilateral basis, the question of payment of any of the debtor countries' World War I obligations (except in the case of Germany), it must be recognized that any effort on the part of the United States to collect these obligations would undoubtedly raise the problem of German World War I reparations. From the practical viewpoint, therefore, there does not seem to be any possibility of reaching an agreement on repayment in the absence of an over-all settlement of the World War I reparations problems, with its wide-ranging political ramifications.

The French hold to the generally prevailing view with regard to their debts to the United States. They not only have been servicing debts incurred after World War II regularly but have paid more than \$880 million in advance of the due date. As of June 30, 1967 France's obligations to the United States, exclusive of World War I debts, were roughly \$300 million.

France's World War I debt derives from cash advances administered by the Treasury Department pursuant to the Liberty Bond Acts from sales of surplus property after the War. On April 29, 1926, the United States and France entered into an agreement to fund these obligations which on that date were fixed at \$3.8 billion plus unpaid interest but this agreement was not ratified until 1929. This agreement was negotiated on the U.S. side by the World War Foreign Debt Commission chaired by the Secretary of the Treasury. The Agreement provided for the issuance of bonds in the principal amount of \$4,025 million repayable over a period beginning June 15, 1926, and ending June 15, 1987. It was further provided that interest on the bonds payable semiannually would be 1 percent beginning June 15, 1930 and that the rate would gradually increase over the amortization period, finally reaching $3\frac{1}{2}$ percent during the last twenty-two years. The rate applicable from June 15, 1965, was to be $3\frac{1}{2}$ percent.

France made payments of principal and interest on these obligations up to June 15, 1931. After the Hoover Moratorium of 1931-32, the French Chamber of Deputies on December 14, 1932, adopted a resolution which "deferred" the interest payment due the next day. The French have made no payments on interest or principal since the moratorium. Statistical bulletins published by the French Ministry of Finance do not now include these obligations in the listing of French external debt.

The World War I indebtedness of the Government of France due and unpaid as of June 30, 1967 was \$5,077 million, including \$2,091 million of the principal sum and \$2,986 million on interest arrearages. Unmatured principal was \$1,773 million. No payments have been made since 1931. The total obligation which might be said to have been outstanding on June 30, 1967, including both matured and unmatured principal and interest arrearages to that date, was \$6,850 million.

Mr. BURKE. As I understand that moratorium, it was granted under the administration I believe of the late and beloved President Herbert Hoover.

Secretary FOWLER. That is correct.

Mr. BURKE. That moratorium was supposed to last for 1 year.

Secretary FOWLER. Yes, sir.

Mr. BURKE. But apparently even under the leadership of General de Gaulle this moratorium is going to last in perpetuity.

Secretary FOWLER. It shows no signs to me of any likely thawing out.

Mr. BURKE. Just one other question, Mr. Chairman.

The CHAIRMAN. Mr. Burke, let me ask the Secretary if he will make that information available to the members as well as for the record. Will you supply such copies?

Secretary FOWLER. Yes.

The CHAIRMAN. Yes.

Mr. BURKE. Mr. Secretary, last year approximately 155 Members filed bills to correct the inequities in the moving expense problem and this had nationwide support. It is an inequity that has to be corrected and I was wondering if you would have any objections to having that included in this tax bill.

Secretary FOWLER. Congressman Burke, we recognize that this moving expense problem is an important issue and pressing for many of those concerned. We have been studying your bill, your proposal, and it has indeed many appealing and interesting aspects.

However, it does not involve some tax policy issues which, in view of previous experience with this problem, will need careful exploration. The President will be submitting some proposals for tax reform later

in the session for more deliberate study, as he stated in his economic message last January. These proposals will deal with the permanent structural features of our tax system which in our judgment need early attention.

In view of the fact that this surcharge proposal, as I have stressed in my statement, is one that calls for prompt action, we believe that it would be more appropriate to consider the substantive revision of the treatment of moving expenses in a series of equally important matters in connection with the changes in the tax structure, changes which will be proposed shortly.

Mr. BURKE. Just looking at it from a practical point, in view of the rough road that I can see for this bill—in fact I doubt if any members of this committee are committed at this time to support it, and many of us have many, many reservations about it—don't you think that the administration might look at this in a little more practical way and put some improvements in this tax bill that might gain a little bit of support for it.

Right now I can see a very rough road ahead and I am merely bringing this to your attention and to the attention of the administration because there are many things that will have to be done with this tax bill before it can go through and this is just one of the ways I am trying to lighten your load, Mr. Secretary.

Secretary FOWLER. I don't think you would be lightening the load by adding to it. In this particular case instead of picking up revenue, the end result would be to lose revenue and I am much more interested in seeing the members of this committee and the Members of Congress face up to the present proposals that are in front of them. As the President has stated, they should be voted up or they should be voted down.

The uncertainty that is hanging over the financial markets and the economy as a result of this present situation is one that should be disposed of and I don't think it would be wise to compound that uncertainty by involving these hearings and this bill with a number of permanent changes in the structure of our tax system which experience has always proven are going to take many, many months to consider and dispose of.

Mr. BURKE. I don't think there is any member of this committee that won't face up to his responsibilities and I think it is about time that the Treasury faced up to its responsibilities as far as moving expenses are concerned. This is one of the most unfair parts of our tax structure and it has received a great deal of attention all around the country, and they have been ignoring it for the last 4 years and I think we might have the administration face up to some of its responsibilities and correct some of the glaring inequities that are in the law and possibly this might be the place to do it rather than the promise of something that is going to happen in the land of never-never.

We are getting late in the session and there are some of us who are concerned about this moving expense bill that feel that, while we might get it before the committee and might have a hearing on it, time will run out, and this being a tax bill, and of course you people can do what you want to do about my suggestion, but I think if you want to help the road and lighten the load all the way through you

will put in something here that will show the taxpayers that you are not only concerned about reaching down into their pockets and taking their money out of them, but also by putting in something there that will correct the inequities and the unfairness in the law as far as the moving expenses are concerned.

Secretary FOWLER. Mr. Burke, let me just say that, and I don't want to let your statement go without comment, I don't enjoy or take any pleasure in reaching down in the pockets of the taxpayer and extracting more money. I have other more pleasurable things I would like to be doing.

As I said to the committee yesterday, I have been a strong proponent of the policy of tax reduction whenever the circumstances permit it, and there have been in the last few years instance after instance of the readiness of the Treasury and this administration to espouse a policy of tax reduction which has resulted in the most significant series of cases of lightening the load of the American taxpayer in the history of the income tax system since it was inaugurated.

However, we all have our responsibilities to think not only about the American taxpayer as a taxpayer, but also in his other roles, as I indicated yesterday, as a consumer, as a farmer, as an employee, as a retired person living on income, as a businessman whose life blood is availability of credit.

We have to think of our citizenry in all these other capacities and, we believe, that looked at in that aspect for the reasons indicated yesterday, there is a great deal more involved in this particular bill or proposal than simply reaching down into the pockets of the taxpayer.

We think it is a very necessary measure to assure economic stability and growth and prosperity which have now lasted for about 78 months, and unprecedented period of time, and we want to continue that period of prosperity and growth and we believe that it would be seriously menaced if the proposals before this committee were not promptly considered and enacted.

Mr. BURKE. I agree with a great many of the statements you have made and I might point out that some of the arguments that have been used here yesterday were the same arguments we used to reduce the taxes, and they seemed to be presented yesterday, almost in toto as the arguments, when you look back at the hearings, to reduce taxes.

Apparently some of the people in these statements here included the same statement and the same reasons for reducing the rates as they are now for increasing them.

In other words, they were to correct the recurring deficits in the Federal budget. They were going to correct the problem of obsolete plant and unused plant and equipment capacity. They were going to correct the problem of the balance-of-payments deficit, and there were many reasons given here at that time in 1963 and the same reasons were given yesterday.

I am a little bit confused about just what the real reason is for this tax increase and whether it is necessary because in reading over the statements made on advocating the reduction in taxes and then reading the statements made by the three of you yesterday they almost concurred.

On one hand they said, "Well, this is going to help the economy. This is going to get us on the right road. This is going to correct the deficits."

This was going to do all this when you were advocating a reduction in taxes and now we find that the same arguments are being used for an increase. We are sitting here as ordinary men, and not being an economist I am concerned about some of the statements that have been made here.

In fact, I recall one of the economists that appeared here and I asked him the question what would happen if we reduced the taxes and increased Federal spending and the economy continued on a decline, "What would you do then?"

He said, "Well, I would come in again and recommend a further cut in taxes and increase the spending."

That seemed to be the theme at that time. Now, this isn't the theme that was presented to us yesterday and I would like to know where the change is and why.

Secretary FOWLER. I think it is a very good question, it is a very pertinent one, and one that we receive frequently. I would like to try my hand at it. Chairman Ackley covered it in some depth in his statement yesterday. But as I look at it—I was here in 1963 before this committee advocating the tax reduction bill as an answer to the economic problems of the time and I felt very strongly then and feel very strongly now that the reduction of overly high tax rates at that time was a desirable, and proper, and necessary measure to move the U.S. economy out of the state of relatively sluggish growth which had characterized the economy for the previous 5 years or so. Now, since 1963 the situation has changed markedly.

For the last three and a half years the underlying economic and financial picture has been quite different. In late 1963 when this committee was considering that tax reduction program, although there had been, I would call it, a very moderate expansion, the economy was still underemployed and the growth in demand which had characterized the early years of the expansion, 1961 and early 1962, was becoming sluggish. Indeed the unemployment rate was about five and a half percent, and business fixed investment was only a little more than 9 percent of the national output, despite the fact that the year before there had been the investment tax credit, and the change in the depreciation practices which was encouraging to investment. The growth in the U.S. economy and output still lagged far behind what was necessary for a full use of our resources and indeed the rates that characterized the economies of other comparable industrialized countries.

Now, three and a half years later we face an entirely different environment. We have had during this period of three and a half years since the enactment of the tax reduction act a very dynamic, fast growing economy in which for the greater part of that time the unemployment rate has been steadily reduced until it reached 4 percent or fractions thereunder.

The range was between three and a half and 4 percent and it has fluctuated in that area for the past year and a half. In some of that period of time there have been some shortages, particularly of skilled

labor. Business fixed investment which had been fairly static during the 5 years up to 1962 and 1963 has surged well up in the intervening years, and despite some recent tapering that we are familiar with by reason of our suspension of the investment credit, is still nearly 10½ percent of national output as against 9 percent 3 years ago and that is a very much more favorable level.

Indeed, every year a large amount of new industrial capacity is coming into the economy and productive capacity is expanding at a rate of between five and a half and six and a half percent a year, whereas prior to 1963 it had been relatively static.

Again we have the problem of interest rates which I referred to yesterday, which at that time were on a much lower scale and which in the past year have reached 40 year highs and after falling back slightly in the winter are now climbing again.

Growth in U.S. output in recent years has been very rapid and at times has pushed hard against our productive potential and created inflationary strains, moving us out of the period of relative price stability that characterized 1959, 1960, 1961, 1962, 1963, and 1964. We think, therefore, that the main danger for the economy as it looks ahead is not the sluggishness or that slack that characterized the years preceding 1963, but the danger of inflationary pressures on prices and of excessive demands in the credit market, and that a temporary tax increase during the period where there is this heavy additional demand on the budget—in excess of \$22 billion a year for the costs of Vietnam—can be in a sense partially compensated for.

Congressman Burke, that in a short way is the difference in the rationale of why a tax cut in 1963 was the right proposal and why a tax increase, indeed a moderate one on a temporary basis, is the appropriate step at this time.

Mr. BURKE. I just have two more questions to ask of you. I am not going to belabor that point and I will accept your statement although I don't agree with it thoroughly.

Actually what the administration is doing is requesting a restoration of some of the cuts that me made in 1963. In other words, looking over this chart of taxes the people will be asked to pay, the individuals will still be paying a lower tax under this tax proposal than they were before the cuts were made in 1963. Is that true?

Secretary FOWLER. They will be paying a lower tax than they were paying before the cuts in the act of 1964, that is right.

Mr. BURKE. In reference to corporations where we reduced the tax from 52 percent to 48 percent, how will this line up there with the 10 percent surtax? Will the corporations be paying less taxes than they were prior to the 1964 act?

Secretary FOWLER. Slightly more. I think about 52.7 or 52.8 percent, between 52 and 53 percent.

Mr. BURKE. Mr. Chairman, that is all I will ask for now.

The CHAIRMAN. Mr. Byrnes had not completed his inquiry at the end of the session yesterday. Mr. Byrnes.

Mr. BYRNES. Mr. Secretary, these questions are without prejudice or prejudgment of what we should do with respect to the overall matter of tax increase. Do I get the impression that you feel that Congress is champing at the bit to increase taxes?

Secretary FOWLER. No; I think Congress is perhaps as reluctant to pass judgment on this tax increase proposal as the Secretary of the Treasury was to propose it. I have been through a long and tortured period of consideration of it and I can well understand that the members of this committee and the Members of Congress want to have a more complete understanding of the reasons for the proposal than can be arrived at in just a few days of consideration.

Mr. BYRNES. I asked that because I wonder how you arrived at a timetable calling for an effective date for individuals of October 1, particularly in view of the withholding tax obligation that we impose on every employer in the country in regard to compensation he pays his employees.

Secretary FOWLER. Well, Congressman Byrnes, it is a very tight timetable that is contemplated by that proposal and we would be certainly the first to recognize that normally the Internal Revenue Service starts printing the forms for the coming year around the first of September. It usually takes a month or some slightly lesser time to reshape the withholding tables that would have to be devised responsive to any decisions of the Congress and place them in the hands of employers for withholding purposes.

We recognize those time factors. That is not the primary reason. The uncertainty that will exist until a decision is taken on this particular question is the matter of primary concern for moving promptly to disposition of this proposal.

A secondary consideration is the hope that, whatever happens here, that it could be geared into not too much of a delay in the normal time schedules that call for the distribution of these forms in the early part of the year.

Mr. BYRNES. Well, it seems to me that the committee, Mr. Secretary, has the obligation not to impose impossible burdens, particularly on people that are acting as tax collecting agents for the Government. It seems to me that the administration has a similar obligation. I am just wondering what is within the range of reasonableness?

Assuming the decision is made to have a tax increase on individuals, what is an appropriate timetable for establishing an effective date.

Frankly, I think that an October 1 date is impractical as it is already August 15 and Congress isn't champing at the bit to pass this bill. Statements I have heard from members of the House and of the Senate Finance Committee don't give me any feeling that Congress will be enthusiastic about passing a tax increase bill before Labor Day.

An effective date of October 1 is just completely impractical. If you have some information to the contrary, I would like to have it because I may be wrong.

Secretary FOWLER. Our information, and I have not personally, but my staff has been very concerned about this problem, is that employers need about 10 to 15 days after the ratification of new rates to make the necessary changes in the mechanical equipment and the machinery that is normally employed in effecting the new withholding.

Mr. BYRNES. I don't want to interrupt. I want you to finish that.

Secretary FOWLER. Just that point, and then a second point is that with the introduction of new withholding, a slippage of some period of time from the effective date of the law and the introduction of the new withholding tables would not make a very great deal of

difference as far as the individual taxpayer is concerned. It would decrease somewhat the amount of overwithholding in the case of some.

It would increase the amount of underwithholding in the case of some. But I don't believe that a slippage of a few weeks between the effective date of the law, presumably October 1, and, let's say, the putting into effect of the new withholding rates on November 1 would be too difficult.

You see, the way this increase would work, Mr. Byrnes, is that the increase for individuals for the calendar year 1967 really amounts to only two and a half percent.

What you are really doing, if the effective date is October 1, is saying that one-quarter of the 10 percent becomes effective on the entire year's taxes, a two and a half percent increase.

Mr. BYRNES. Are you suggesting that if the effective date of the tax increase is October 1, the law might provide that the higher withholding wouldn't begin until November 1? You would just forget about the 1 month of withholding?

Secretary FOWLER. No, that would be made up in the final payment for the individual.

Mr. BYRNES. The individual.

Secretary FOWLER. Yes.

Mr. BYRNES. Well, I am still correct. You are assuming that you would not withhold for the increase attributable to 1 month.

Secretary FOWLER. That is right.

Mr. BYRNES. There would be no withholding on that.

Secretary FOWLER. That is correct.

Mr. BYRNES. So you wouldn't have the two different schedules of withholding.

Secretary FOWLER. No, that is right.

Mr. BYRNES. Let me ask you, Do you know how many employers there are in the country that are withholding? I imagine it is a large figure.

Secretary FOWLER. I don't have that. I can supply it for the record, Mr. Byrnes. I don't have it in mind.

(The following information was received by the committee:)

There are approximately 4 million employers withholding income taxes from employees.

Mr. BYRNES. I wonder how many of those employers have computerized their operations. I think the Treasury and the Government too often assumes everyone is a big operator with computers and that a change in the withholding tables and their obligations in connection with each of their payrolls is a minor inconvenience.

You suggest that employers need only crank the new tables into their machinery. I wonder how many of the employers that are going to have an additional expense because of this proposal have computers that they can crank this information into.

In order for these employers to make the necessary changes in 10 or 15 days they will have to put their entire bookkeeping staff to work.

Secretary FOWLER. I don't think it is that serious. Our information about this, of course, and our experience is primarily based on the changes that occurred in the schedules in connection with the 1964 tax.

Mr. BYRNES. They were given time to make the necessary changes, Mr. Secretary. They weren't confronted with a tax proposal containing an effective date only a month and a half from the time the first hearing was held.

Secretary FOWLER. I don't think there was a very long interval between the final enactment of that bill when it became law and the new tables were issued and their incorporation into a new withholding.

Actually the change in the new withholding can be started just as soon as the Internal Revenue Service is sure what the new rates will be. If it should develop that there is no difference between the House and the Senate, I am being presumptuous here that we would have a bill, the Service could begin the transition to the new rates without waiting for the conference or the enactment.

Now, that transition to the best of our experience runs roughly like this. It takes about 9 days to print up the new folder, the new circular. Actually in 1964 it took 5 days, but the circular was smaller, 32 pages then. The Service now tells us it would take about 9 days. At the same time advance notice can be sent to the employers advising them to start preparing for the new withholding rates.

We would take about 2 days to distribute the circular to the Service centers, about 3 days to label them and put them in the mail, and about 2 days for delivery to employers, and then assume enactment at this point, the remaining time, 10 to 15 days, we think is adequate for the employers to incorporate the new rates and notify the employees. If there were not a different schedule in the Senate action and the House action on rates, then from the time of the Senate action to the effective date of the new withholding, somewhere between 26 and 31 days would be required.

Mr. BYRNES. In order for the new withholding tables to be effective in October, the Senate would have to take action in conformity with the House within the next 2 weeks.

Secretary FOWLER. No; I would say that as a practical matter what we are looking at is action by the Congress in the latter part of September, hopefully the rates change to be effective as of October 1, with the new withholding tables and rates to be in operation as of November 1 or within 25 to 30 days after the date that the rates appear to be fixed as a result of congressional action.

Mr. BYRNES. Dr. Ackley, on page 13 of your statement you list a number of consequences to the economy if Congress were to reject the President's proposal.

I wonder if you could tell us what the situation will be if the tax proposal is adopted. It is going to change State and local government spending?

Mr. ACKLEY. No, sir. I think we would have to go through these one at a time and substitute a somewhat different assumption about the growth of spending by sectors, depending on the passage of the tax bill.

Mr. BYRNES. What about State and local spending? Would that be changed?

Mr. ACKLEY. I should think not.

Mr. BYRNES. What about spending by the Federal Government?

Mr. ACKLEY. I should think again that would not be changed by the action on taxes.

Mr. BYRNES. Housing would rise, you say, about \$31½ billion if we reject the President's tax proposal, provided funds remain available. What will the housing situation be if we pass the tax bill?

Mr. ACKLEY. I would not think it would be changed materially within the second half of 1967.

Mr. BYRNES. You say: "Plant and equipment spending should essentially remain on its high plateau," if we have no tax increase. But you also say that "in the absence of a tax increase, it could rise by \$1 billion."

Mr. ACKLEY. Yes.

Mr. BYRNES. I am not sure that is on a consistent basis with your other predictions.

Mr. ACKLEY. With the tax increase, somewhat less.

Mr. BYRNES. Your prediction assumes no tax increase. You start your various predictions by saying: "If Congress were to reject the tax proposals" those consequences would ensue. Concerning capital spending you say: "Plant and equipment spending should essentially remain on its high plateau. But, in the absence of a tax increase, it could rise by \$1 billion."

Mr. ACKLEY. What I am effectively trying to say is—

Mr. BYRNES. Capital spending will be less if we pass the tax increase, is that it?

Mr. ACKLEY (continuing). That in either case we don't expect much of a boom in plant and equipment. With the tax increase maybe it would be a half billion dollars, maybe nothing, but in any case somewhat lower.

Mr. BYRNES. It will be less if there is a tax increase?

Mr. ACKLEY. Right.

Mr. BYRNES. In No. 5 you predict: "Given these gains and the growth of incomes they would generate, consumer spending would rise between \$16 and \$18 billion."

With a tax increase what would consumer spending be?

Mr. ACKLEY. It would be affected in the fourth quarter by the higher tax liabilities and withholding and would rise perhaps a couple of billion dollars less.

Mr. BYRNES. About \$2 billion less?

Mr. ACKLEY. I am not trying to be precise but in that range; yes, sir.

Mr. BYRNES. Well, the difference would not be too significant, would it?

Mr. ACKLEY. Within the second half of 1967 the tax increase would have only moderate effects on the growth of total spending. The more important effect would be in the first half of 1968.

Mr. BYRNES. In No. 6 you predict, again, on the assumption that Congress rejects the tax proposal, that "Inventory investment should begin its recovery, rising by \$1 billion to \$2 billion."

What if we pass the tax increase? Will that eliminate the rise?

Mr. ACKLEY. This would not depend directly on the tax action, but it would, indirectly. To the extent that expansion of plant and equipment spending and expansion of consumer spending were slowed down you might get somewhat less recovery of inventory investment.

I am not trying to make the case that in the second half of 1967 the difference would be major with or without the tax increase. Ex-

pansion would be reduced somewhat. Instead of expansion in the range of \$29 billion to \$35 billion, perhaps it would be \$25 billion to \$30 billion.

Mr. BYRNES. Do the various figures in these predictions relate only to the last half of calendar year 1967?

Mr. ACKLEY. Mr. Byrnes, as suggested in our testimony there are estimates for the next two quarters. Perhaps that phrase is misleading. I was referring to the change between the second and fourth quarter of 1967.

I then point out that this pace of advance would accelerate in the first half of 1968 in the absence of the tax increase.

Mr. BYRNES. Other than the pace of advance in plant and equipment and in consumer spending—

Mr. ACKLEY. Plant and equipment spending, consumer purchases, and inventory investment would all be higher without a tax increase. In the case of housing, passage of the tax bill would assure easier monetary conditions, and this means stronger housing. On the other hand, passage of the tax bill and the effect on income would tend to reduce somewhat the growth of demand for housing. But this isn't likely to balance the monetary effect.

Mr. BYRNES. Thank you, sir. That is all.

Mr. ULLMAN (presiding). Mr. Secretary, when you were here before the committee early in the spring on the investment tax credit bill I asked you whether we might not be in the same situation this fall with respect to our money and interest rate problem that we were last August and September.

I don't recall what your answer was but you didn't seem to indicate any great degree of concern.

Aren't we about where we were a year ago with respect to the money supply and interest rate problem?

Secretary FOWLER. Certainly not, with regard to the money supply. The money supply and the expansion of bank credit represent a startling contrast to a year ago.

Mr. ULLMAN. Why is it that if we have this money supply situation in hand interest rates haven't come down?

Secretary FOWLER. Because there has been such a tremendous demand for credit, as I tried to outline in my comments yesterday.

Mr. ULLMAN. We are on the horns of a real dilemma and although your testimony and the testimony of Mr. Schultze and Mr. Ackley have been very instructive, I am not satisfied that we have pinned the problem down to the satisfaction of the members of the committee or to the satisfaction of the Members of Congress or the people of the country.

If the economy is not strong enough or if it is not stronger than we think is reasonably safe for the future, then I don't see how we can justify the tax increase in line with the basic philosophy that we laid down 3 years ago when we reduced taxes in order to stimulate growth.

Now, there seems to be some doubt as to where we now are in the economy. My judgment would be that the economy is strong, possibly stronger than it should be in some of its elements and therefore a tax increase might be justified; but I believe I am a minority of this committee in that judgment.

Last year my concern was—and I expressed it to you time and time again—that we were witnessing an overexpansion in the corporate segment of the economy. We were too strong by far on corporate investment. This is what created the financial crisis that caused you to take action in September which should have been taken about 3 months before because all of the flags were up much earlier.

I think that when you took action in September you generally agreed that the problem was overexpansion in the corporate segment of the economy.

Now, in looking at the tables in the back of your statement on business capital outlays I think that, for instance, in shipments of machinery and equipment we saw that rapid rise from early 1965 to late 1966, but with respect to shipments of machinery and equipment there has been very little dropoff. Is that not right?

Mr. ACKLEY. Yes; that is correct. It has been more or less on a plateau since September.

Mr. ULLMAN. And that is at a relatively high basis, is it not?

Mr. ACKLEY. It is on a historically high basis, yes.

Mr. ULLMAN. The problem in establishing this balanced economy is that we have to keep a balance between the purchasing power of the people and the productive capacity of our plant, in order to keep a healthy growth; is that not right?

Mr. ACKLEY. Yes. There is room for some fluctuation in the relative emphasis as among consumer goods, housing, plant and equipment, and Government expenditures. But essentially that is correct. We can't have large imbalances between the growth of purchasing power and growth of industrial capacity.

Mr. ULLMAN. And one of the danger signals in any economy would be an overexpansion of plant capacity; is that not right?

Mr. ACKLEY. It could under some circumstances; yes, and we were worried about that last year.

Mr. ULLMAN. And that was a great problem, was it not?

Mr. ACKLEY. It was, indeed.

Mr. ULLMAN. In looking at both of these charts on business capital outlays in plant and equipment expenditures we saw a very slight dropoff. But, according to this chart, the plant and equipment expenditures today are higher than they were at the peak last September or last October.

Mr. ACKLEY. You are referring to the shipments of machinery and equipment?

Mr. ULLMAN. I am referring to your chart on business capital outlays and you don't have it numbered.

Secretary FOWLER. I think the broken line is "anticipated."

Mr. ULLMAN. The broken line is "anticipated," but the releases of the Commerce Department as of yesterday certainly would tend to confirm that anticipated broken line, would it not?

Mr. ACKLEY. I am not sure that we have better information today on total plant and equipment expenditures. I would point out that there is a difference between the top and the lower panel. The top one includes plant expenditures. The lower one refers only to machinery and equipment, and plant expenditures have been down somewhat more in recent months than machinery expenditures.

Mr. ULLMAN. But even on plant expenditures according to this chart your judgment is that they are approximately at the same level today that they were at the peak last summer?

Mr. ACKLEY. Essentially, yes.

Mr. ULLMAN. And insofar as machinery and equipment are concerned your chart would indicate that they are even higher today with respect to shipments than they were last September.

Mr. ACKLEY. Yes, sir. Shipments were slightly higher in June than they were last September.

Mr. ULLMAN. The basis of our problem of course was the new orders. When we suspended the investment tax credit new machine tool orders dropped off rapidly. When you came before us early this year to restore the investment tax credit I questioned the wisdom of doing it and I think the only justification was the serious threat of recession in the country.

You did not prognosticate that that was the situation. You had other reasons for presenting the bill.

Secretary FOWLER. Congressman Ullman, what we were concerned with last fall and what we were concerned with this spring is a greater degree of stability in the growth of plant and equipment capacity. The cause of concern was the pace at which plant and equipment expenditures had proceeded last year up to the time of the September program, not the fact that it was increasing. It was the very rapid pace of the increase of, as I recall, about 16 or 17 percent in the year 1966 that was the cause for concern.

It wasn't, at least in my view, the level of plant and equipment expenditures that had been reached. It was the gradient or the rate of the very rapid expansion, the boom in that particular sector, that was creating an imbalance in the economy.

I think that is no longer the case.

Mr. ACKLEY. I think it is relevant to point out that the capacity of the machinery and equipment industries to produce new machinery and equipment is also expanding.

There has been heavy investment by that industry itself in equipment, so that its ability to produce capital goods has also expanded. Even though total shipments have merely leveled off, the pressures on the capacity of that industry have substantially eased. They have continued to recruit and train labor. They put into effect extensive training programs. They have expanded their own capacity by investing themselves in additional plant and equipment so that we now have the situation of reasonable balance in the machinery industries.

Mr. ULLMAN. Why can't you economists develop a meaningful relationship between proper plant expansion and the purchasing capacity of the public so that we can have meaningful guidelines to follow in exercising our tax policy?

What I am basically getting to, as you well know, is the balance between putting the weight of this tax increase on the corporate economy as against the individual purchasing power.

I don't know why we think it should be across the board. I don't think that it should be weighted heavier on corporations because that might be an easier political thing to do. I think that we should be able to make a judgment according to where the pressures on the economy are and whether corporate expansion is proceeding too rapidly or whether it isn't.

The justification for suspending the investment credit was that corporate expansion was too rapid. We of course put it back into effect much earlier than January 1968 because we were afraid that maybe the dose was too big.

I didn't completely concur in that judgment. But today it seems to me that we have the same situation as last year and are in danger of overexpansion in the corporate economy, whereas real individual income has not gone up correspondingly.

Would you comment?

Secretary FOWLER. I would like first to say that there has been a sharp change in that respect in the last year just in terms of corporate profits. Personal income has gone up steadily and indeed has been on the same steady course it has for some years, but corporate profits have leveled off, have fallen back, as reflected in our revenue estimates.

The concern that you voice that there is a great inducement in the present level or movement of corporate profits to a new investment boom does not seem to me to be a very real danger.

Mr. ULLMAN. Wasn't there a story in this morning's press with respect to much higher corporate profits?

Secretary FOWLER. No, I didn't see anything about their being much higher. It seemed to me the story was that the drop in corporate profits that had been characterizing the recent quarters had now bottomed out and there was a \$200 million increase on a \$79 billion base.

Mr. ULLMAN. But what are you talking about? You are talking about \$80 billion, which is a rather high corporate profit picture historically, is it not?

Secretary FOWLER. Oh, yes, yes. So is personal income. Everything is high.

Mr. ULLMAN. Because there was some decline in corporate profits I think the tendency in these hearings has been to look at the trend for the past 6 months and not to look at the real level that we are operating on.

The level of corporate profits is at an alltime high with the exception of the peak of September of last year, is that not right?

Secretary FOWLER. Yes.

Mr. ACKLEY. Yes, it is, but the flattening of corporate profits that began in the first quarter of last year has materially changed the relative income share since that period.

Let me give you just a couple of numbers that I happen to have before me. If we go back to the second quarter of 1965, and I pick that only because it was a period immediately before the beginning of the defense buildup in Vietnam, from the second quarter of 1965 to the second quarter of 1967 corporate profits before taxes are up less than 5 percent.

Over that same period—from the second quarter of 1965 to the second quarter of 1967—total compensation of employees, all employees, is up 19 percent, and total individual income is up nearly 17 percent.

Mr. ULLMAN. Is this real individual income?

Mr. ACKLEY. No, these are all in terms of money magnitudes rather than real. I don't know how one deflates corporate profits. If we apply the same deflator—the cost of living index, say—to all of them it would reduce them all correspondingly.

If you choose to deflate corporate profits by some different price index than that which you apply to personal income, then you could get some slight relative difference, but it couldn't change the picture materially.

Mr. ULLMAN. Let's look at the money problem and pin the basic responsibility as to the source of the pressures on the money market. Give me some figures with respect to the corporate expansion in the money market, the municipal governments, and so on. Where are the pressures basically coming from?

Mr. ACKLEY. I think Secretary Fowler's statement yesterday contained some of the most important numbers on that.

Secretary FOWLER. The key figures in this area were discussed on page 19 of my statement where I said:

A major cause of the rise in long-term rates since March is the huge volume of borrowing by corporations and by state and local governments. New capital issues by corporations in the first seven months of 1967 were a record of \$13.5 billion, up 23 percent from the similar period in 1966—which has been a record-breaking year. If one excludes private placements by corporations and looks just at public offerings, which have a greater immediate market impact, the volume of new issues was \$7.2 billion in the first half of this year, against \$8 billion in all of 1966 and \$5.6 billion for all of 1965.

If you want some comparable figures on the borrowing by State and local governments, wait just one moment and I will give you our most recent breakdown.

Mr. ULLMAN. This is a very substantial increase in corporate expansion in the money market, is it not?

Mr. ACKLEY. Yes; it certainly is.

Mr. ULLMAN. It is even more startling than last year, is it not?

Secretary FOWLER. Let me give you the State and local now. It is on page 20:

States and municipalities have also borrowed very heavily, and for somewhat similar reasons—making up for some postponements of borrowings last year and seeking to obtain some money needed now or in the future while it is currently available. New tax-exempt issues by state and local authorities came to \$8.8 billion in the first seven months of this year, up about 28 percent from a year earlier.

Mr. ULLMAN. That is up 28 percent.

Secretary FOWLER. Yes; with the other up 23 percent.

Mr. ULLMAN. What is it up in the corporate area?

Secretary FOWLER. I just read that—

New capital issues by corporations in the first seven months of 1967 were a record \$13.5 billion, up 23 percent from the similar period in 1966.

Mr. ULLMAN. Exactly the same amount of increase—

Secretary FOWLER. Twenty-eight percent in State and local governments and 23 percent in corporations.

Mr. ULLMAN. Twenty-three percent in the corporate sector. What part of this expansion in the money market has gone into increased plant capacity and what part has been merely a juggling of financial bookkeeping?

Secretary FOWLER. I don't think we can give you any precise breakdown on what these borrowings have been used for. I did say in my comments yesterday that to a considerable extent, although we can't identify the precise quantity, this heavy pace of borrowings has reflected the desire of the corporations to take advantage of the credit

available to rebuild their liquidity and reduce their dependence on the banking system.

The memory of last summer still remains and I think corporate treasurers have tended to adopt a policy of rebuilding their cash position—certainly in some cases and to some extent in connection with particular issues of securities.

Mr. ULLMAN. What is the trend today? This is important in my mind. Does it seem to be slacking off in either the corporate area or the municipal area?

Secretary FOWLER. I can't say so. There is usually, I think, in the last half of the year some seasonal type of slackening. As far as the basic thrust of it, I see no signs of change. I think a great deal depends upon what happens here.

Mr. ULLMAN. Aren't interest rates actually going up on almost a day-to-day basis in all of these departments?

Secretary FOWLER. No.

Mr. ULLMAN. Municipalities are paying 5 percent for tax-exempt bonds.

Secretary FOWLER. Not on a day-to-day basis but the general trend has certainly been up in the long-term field since early spring, since March, I believe, to pick a given month, and the trend downward in short-term interest rates bottomed out in June and it has since moved up.

I think in the recent period there has been a little bit more of a sense of stability about interest rates. A good deal more questions are being raised as to whether under current conditions they have reached stability, but I must repeat again a great deal depends upon what happens on this particular set of tax proposals and what the outlook is for Federal borrowing in the market.

Mr. ULLMAN. Let's pursue the high-interest-rate problem just a bit further. You have authority to issue 7-year notes, have you not?

Secretary FOWLER. Yes, sir, as of July 1.

Mr. ULLMAN. Have you contemplated doing this?

Secretary FOWLER. We think about it.

Mr. ULLMAN. What interest rates, in your judgment, would you have to put on a 7-year note in order to get it marketed?

Secretary FOWLER. Mr. Ullman, I just don't like to answer a question like that when we have a financing shortly ahead of us.

Mr. ULLMAN. I appreciate that too, but the newspapers are saying it would have to be 5½ percent in order to market a 7-year note.

Secretary FOWLER. I don't believe I would want to comment or conjecture on what the rates would be.

Mr. ULLMAN. I reluctantly agreed to extending the definition of "notes" to 7 years; but if you have to offer them at 5½-percent interest rate you ought not go into the market. I think if interest rates are this high we have to stay out of the long-term market regardless of the problems that it creates. The Federal Reserve Board and others are going to have to take more stringent action than we have in order to make sure that it doesn't happen.

Getting back to the problem of a balance between purchasing power or capacity and corporate profits, we must satisfy the people on two counts. The first is that they are better off now than they were 3 years ago with respect to real individual income.

Translate your figures into real individual income. Also recognizing that the labor force and the number of people are expanding, I would like to get a figure that would be indicative of an individual's situation, with respect to his real income 3 years ago as against today.

Can you give me that kind of a figure?

Mr. ACKLEY. I can give you I think most of what you are seeking. We publish each month in "Economic Indicators" a figure called per capita disposable personal income in 1958 prices; that is, in constant prices. That figure has continued to advance.

For example, in the second quarter last year per capita disposable income—that is after taxes—was \$2,302. In the second quarter of this year it was \$2,388.

I don't have quarterly figures going behind that. But the advance has been steady and uninterrupted except for a brief period of stability in the first part of 1966.

Mr. ULLMAN. If I read the figures correctly back in 1965 third quarter it was \$2,258, is that right?

Mr. ACKLEY. That is right.

Mr. ULLMAN. And it is \$2,388, the second quarter of 1967. What kind of a percentage increase is that?

Mr. ACKLEY. It is again somewhere between 3½ and 4 percent, just roughly, over the past year.

Secretary FOWLER. Mr. Ullman, I could give you some figures here on percentage changes from June 1966 to June 1967 if you wanted to jot them down.

Mr. ULLMAN. Yes.

Secretary FOWLER. In total personal income, plus 7 percent.

Mr. ULLMAN. Is this seasonally adjusted?

Secretary FOWLER. Yes, they are. It is a table I have prepared on real income.

Mr. ULLMAN. Give me the figures then.

Secretary FOWLER. Total personal income, 7 percent. In total wages and salaries, 6.6 percent.

Mr. ULLMAN. This probably is not adjusted to price increases?

Secretary FOWLER. I am going to give you the CPI thing at the end so that the adjustments can be made.

Mr. ULLMAN. All right.

Secretary FOWLER. In wages and salaries in manufacturing, 3.7 percent; in wages and salaries in distribution, 6.9 percent; in wages and salaries in service industries, 9.4 percent; and in wages and salaries in Government, 10.6 percent.

And now the CPI the consumer price index, 2.7 percent, I think applied to those figures I have given you, would give you roughly your picture on real income.

Mr. ULLMAN. You would reduce real income by 2.7 percent?

Secretary FOWLER. Roughly.

Mr. ACKLEY. 2.7 from each.

Mr. ULLMAN. The increase is not substantial in manufacturing wages and salaries which is the big area; it is not?

Mr. ACKLEY. Manufacturing is one that accounts for roughly 25 percent of total nonagricultural employment.

Mr. ULLMAN. Would the total wage and salary increase of 7 percent be adjusted to 5 percent?

Mr. ACKLEY. Substrat 2.7. It would be roughly 4.3 percent.

Mr. ULLMAN. I don't think you people are the best salesmen in the world. Let's turn to table 3 of your testimony, Mr. Secretary, in which you compare tax liabilities in 1963 against these proposals to get at the other side of the coin.

The second thing we have to tell the individual is that they are paying less taxes now than they were 3 years ago because I think there isn't one person in 10 that believes that he is. I haven't talked to anybody yet who has recognized that he has a tax reduction.

Secretary FOWLER. There are other taxing jurisdictions, Mr. Ullman. There are State governments and local governments, and this table is concerned with what this committee and the Finance Committee and the Congress and the administration have been doing in the field of Federal taxes.

Mr. ULLMAN. That is right because their total tax bite probably has increased; has it not? Do you have figures on that?

Secretary FOWLER. I don't have figures on that.

Mr. ULLMAN. I wish we did because the individual doesn't differentiate too much between who he pays the taxes to, but adds up his total tax bill and it is pretty high.

Mr. ACKLEY. I think it should be pointed out that this disposable income that I was using is after all taxes, Federal, State, and local, and it has continued to rise even in constant prices.

Mr. ULLMAN. They are after all. That is very important.

Mr. ACKLEY. I should point out that people's judgment of their tax load is influenced by the fact that at the same time as tax rates have fallen their incomes have been rising, so that the man who is now paying tax at a given income level is comparing his taxes with several years ago when his income was also lower.

Mr. ULLMAN. But these figures you gave me are after all taxes, including property taxes; is that right?

Mr. ACKLEY. Yes, that is right; after all taxes.

Mr. ULLMAN. You are sure of that concerning those figures Mr. Fowler gave us?

Mr. ACKLEY. The figure I quoted are after all taxes. Disposable personal income is after income and payroll taxes, the direct taxes. When you deflate, you take out the effect of the indirect taxes because they are reflected in prices.

Mr. ULLMAN. Is that true of the figures—

Secretary FOWLER. Mine were not in terms of disposable income. It involves that qualification. They were before taxes.

Mr. ULLMAN. Then that leaves me confused because I was relying on the Secretary's figures and I would like to know how to adjust those.

Mr. ACKLEY. We do not have income after taxes by specific groups in the population.

Mr. ULLMAN. We have a 4.3-percent increase. There might very well have been a greater increase than that in taxes, so if we are talking about after taxes there might very well be a reduction in individual income today.

Mr. ACKLEY. No; the figures which the Secretary gave you I think were 7 percent for total personal income before correction for price increase, about 4.3 percent for personal income after price increase, and the figure I gave you earlier for per capita income in constant

prices show an increase of 3.7 percent from second quarter to second quarter, and that is after taxes.

Mr. ULLMAN. Getting back to this table, Mr. Secretary, the other thing that we are going to have to be able to demonstrate to the people is that they are actually paying less taxes. You should have an additional column at the end which indicates the adjusted amount of decrease in taxes between 1963 and now after taking into consideration your tax proposals.

Let's get down this chart very quickly and compute that additional column because I think it is quite important. I want to know about the person who has a \$3,000 income. Let's take the married couple with two dependents, which, I think, is an average American family.

With a \$3,000 income how much less taxes will he be paying after this tax increase that you are proposing than he was in 1963? Let's do that with each one of these columns. How much less will this family with a \$3,000 income be paying after the increase than they were in 1963?

Secretary FOWLER. Well, with the \$3,000 income he would be paying \$65 in 1963 and \$4 now.

Mr. ULLMAN. There is an actual—

Secretary FOWLER. Decline.

Mr. ULLMAN. The difference is \$60 to \$61.

Secretary FOWLER. \$61.

Mr. ULLMAN. After the tax increase he will still be paying \$61 less than he was in 1963. All right for \$5,000 income. How much less is it?

Secretary FOWLER. \$130 less because there is no effect of the surcharge to be calculated in those first two categories.

Mr. ULLMAN. So the person making \$5,000 will not have a tax increase under this proposal and will, in effect, be paying \$130 less on the same income than he was in 1963?

Secretary FOWLER. That is correct.

Mr. ULLMAN. Let's go to the \$7,500 column. How much less?

Secretary FOWLER. Mr. Schultze has been doing some calculating here. Let him give you the figure.

Mr. SCHULTZE. Let me run these down for you. I hope my arithmetic was correct. I did it in a hurry. The \$7,500 man will end up paying \$122 less. The \$10,000 man will be paying \$147 less. The \$12,500 man will be paying \$177 less. The \$15,000 man will be paying \$218 less. The \$20,000 taxpayer will be paying \$324 less. The \$25,000 man will be paying \$465 less, and the \$35,000 taxpayer will be paying \$755 less than he was paying in 1963.

Mr. ULLMAN. After a tax increase of 10-percent surcharge taxpayers will still be paying those amounts less in each category than in 1963?

Mr. SCHULTZE. Yes.

Mr. ULLMAN. This is a very important thing to get across to the people who are being taxed because as of right now I see no favorable sentiment whatsoever among the American people, but a great deal of misunderstanding because they think that their Federal taxes are higher and this is an additional increase.

I am taking too much time and I am going to hurry with just a few questions.

Mr. Director, what will be the increased receipts, on an annual basis, from your proposal? You have told us \$7.4 billion, but this is not

on an annual basis. What are we talking about with respect to an annual increase?

Mr. SCHULTZE. I think the Secretary has that figure.

Secretary FOWLER. You are talking about the full-year effect.

Mr. ULLMAN. Yes; and I would like to have just the 10 percent too. I would like to have the full package and then just the 10 percent.

Secretary FOWLER. Well, I can give it to you for the 10 percent readily. For the full package it would take a little more computing.

Mr. ULLMAN. We don't want the acceleration because that is a one-shot thing. We just want the 10 percent.

Secretary FOWLER. Well, now, in calendar year or liability, or do you want it in collections on a fiscal year basis?

Mr. ULLMAN. Liability, full-year effect?

Secretary FOWLER. Liability, full-year effect?

Mr. ULLMAN. Yes.

Secretary FOWLER. About \$9,270 million, computed at calendar year 1967 income levels.

Mr. ULLMAN. \$9.27 billion will be the—

Secretary FOWLER. That is a rough figure.

Mr. ULLMAN. And that is just limited to the 10 percent, a liability based on a full-year annual basis?

Secretary FOWLER. That is right.

Mr. ULLMAN. Then when you are talking about \$7.4 billion you are only talking about the effect—

Secretary FOWLER. \$6.3 billion is the surcharge component of the \$7.4 billion.

Mr. ULLMAN. You are talking about \$6.3 billion then for the fiscal 1968, and for fiscal 1969 you would be talking about \$9.27 billion, because the acceleration will not be effective in fiscal 1969; is that right?

Secretary FOWLER. No, we are talking about calendar 1968. When you talk about collections, about what comes to us—you see you asked for it in terms of tax liabilities. That means the liability of the taxpayer.

Now, if you turn to the question of how it comes to us in terms of collections I have to give you a different figure.

Mr. ULLMAN. Give us the figure for fiscal 1968 and fiscal 1969.

Secretary FOWLER. About \$6.1 billion for fiscal 1968, again computed at calendar 1967 income levels, and \$8.7 billion for fiscal 1969.

Mr. ULLMAN. That is without acceleration?

Secretary FOWLER. That is right.

Mr. ULLMAN. With acceleration those figures are \$7.4 billion, and what for fiscal 1969?

Secretary FOWLER. Well, you would have a much larger take from the extension of the excises in fiscal 1969 because there is only about \$300 million that would come into the Treasury in fiscal 1968 as a result of the extension of the excises from April 1 on.

In fiscal 1969 from the excise extension there would be about \$2½ billion.

Mr. ULLMAN. In other words, collectionwise it would be a little under \$9 billion for fiscal 1969; is that right?

Secretary FOWLER. No, it would be \$8 billion, a little more than \$8 billion from the surcharge, and \$2.5 billion actually different on the excise.

Mr. ULLMAN. We are talking close to \$11 billion. Leave the excises out and give me the 10 percent and the acceleration because the excise is not a new tax.

Secretary FOWLER. It is just the maintenance at present rates.

Mr. ULLMAN. Give me the figure for fiscal 1969 with respect just to acceleration and the surcharge.

Secretary FOWLER. I have given you the best I have on the surcharge. The acceleration drops down from \$800 million to \$400 million in fiscal 1969.

Mr. ULLMAN. So, in effect, we are just above \$9 billion in actual collections.

Secretary FOWLER. That is right.

Mr. ULLMAN. Mr. Secretary, looking at the economy, and I have registered my concern to you about it as well as the tax package, you indicate that you want the corporate and the individual rate increase to be the same.

You have indicated, however, in your tax package some difference because you have imposed a different date on each one of them. You certainly must recognize that there are some dangers in corporate expansion or you wouldn't have made that part retroactive to July and put at later date on the individual tax.

Secretary FOWLER. No; I think that the application of the retroactive principle to corporate taxes is more compatible with practice and with the administration of the tax. There has been a general expectancy I think on the part of corporations that there would be a surcharge. As far as the administration and collection of the tax as of July 1 with corporations, I don't believe it would impose any undue hardship, whereas with the individual I think it has not been customary in the past and not a welcome suggestion to impose a retroactive tax.

Mr. ULLMAN. Mr. Secretary, I want to get your expression of opinion with respect to the general monetary policy that must be followed even with the tax increase.

Would you not say that even assuming a 10-percent tax increase, that we must maintain a continuing policy of monetary ease, at least at the levels that we have today, if we are to keep the economy in balance and keep from having another financial crisis of the kind we had last September?

Secretary FOWLER. Mr. Ullman, I have tried to indicate in my statement that one of the primary reasons in my judgment for the surcharge proposal, and for the efforts to hold down expenditures and reduce them, is to enable the Federal Reserve System to follow the policy of monetary ease it has been following since last fall.

I think that that is an important objective for us to seek and to achieve. It is one of the primary reasons I think it is important for the Congress and the administration through the taxing arm, and the Congress and the administration on the other side of fiscal policy, the expenditure side, to create and maintain a situation in which the Federal Reserve System can do its job properly and, consistent with its responsibilities, carry forward a policy of monetary ease.

Mr. ULLMAN. You are concerned about the trend toward higher and higher interest rates, are you not?

Secretary FOWLER. I have been. I have been for very long standing. I think that it would do us all good to remember and look back and read the various statements that have been made about high interest rates all last year on the floor of the Congress, the statements that were made in the President's message last September about his concern at that time, the statements that were made in his economic message this year. All of that concern that has been voiced in the past is very relevant to this decision that now confronts you.

Mr. ULLMAN. I appreciate that but I also look at the picture of increasing interest rates and see the possibility of having another financial crisis on our hands in the future.

Secretary FOWLER. Mr. Ullman, I think the significant thing is that here there has not been an increase in interest rates accompanied by a policy of monetary restraint, but, on the contrary, a resumption of an upward trend in interest rates in both the long-term and now the short-term area at a time when, and in conjunction, with a policy of monetary ease which has very, very definite hallmarks.

For example take the amount of money supply that has been created. Actually this year the rate of growth in money supply through July is about at a 7-percent seasonally adjusted annual rate. The rise for all of 1966 was 1.9 percent.

Bank credit has been substantially expanding, and yet despite all that, you have had this upward trend in interest rates which reflects the demand situation for money in the market.

Mr. ULLMAN. I haven't been critical of the Fed because I have been in perfect agreement. I think it would have been disastrous to do anything else. I think their policy, as the chairman has indicated, in 1966 was a disastrous one, but now this is where you come in with your part of the program.

Let me express my opinion. Just the passage of the 10-percent surcharge is not going to be an answer to high interest rates. I hope it will be helpful, but a lot of other things are going to have to be done.

Secretary FOWLER. Holding down Federal expenditures is very important.

Mr. ULLMAN. Yes, and I am sure that you are going to do that to the maximum extent possible, but I think it has been pretty clear here that you can't solve this problem that we have before us by just cutting expenditures.

Secretary FOWLER. Absolutely, you can't. This tax bill is indispensable.

Mr. ULLMAN. This year in the two items of defense costs and interest rates, we have a total expenditure of approximately \$95 billion. That was the amount of the total budget in 1965; wasn't it?

Secretary FOWLER. Pretty close.

Mr. ULLMAN. For only two items, defense and interest rates, we were spending—what was the whole budget 3 years ago? This is a serious situation. I think that we have no alternative but to pass the tax increase. The kind of balance we put on it we have to decide by taking a little closer look at the statistics, but whatever amount of the debt you have to finance on the market, I would hope that to the maximum extent possible you would use the devices that will keep the pressure off the private market.

Secretary FOWLER. I don't know what devices you have in mind.

Mr. ULLMAN. I would hope you would use the trust accounts and that the Fed would expand its holding to the maximum extent possible.

Secretary FOWLER. There are very definite limitations on the extent to which you can use the trust accounts. That depends upon the inflow of cash to those trust accounts and that is something over which we have no control.

Mr. ULLMAN. I would hope you would use them to the maximum extent possible.

Secretary FOWLER. We always have used them to the maximum extent. We have to invest that cash as it comes in interest-bearing securities. There is no limitation there. Whatever comes in we will invest.

Mr. ULLMAN. I would hope that through whatever influence you have on the Fed, you would continue to encourage the policy of increasing the Fed's holdings of Government securities. They should also use whatever devices they have in the discount window with the banks to keep credit growth from becoming inflationary.

It is my judgment that these things can be done, but the interest rate situation is of such a serious nature that it is something that is going to require a great deal of attention by a lot of people to keep from developing into a future money pattern.

Secretary FOWLER. I think when Chairman Martin is before you, you will have, of course, a full opportunity to go over this with him, but just let me say I don't think there is any magic in how we can handle this problem of high interest rates without this tax bill.

There is no magician afoot that can do it without the risks that have been pointed out if we have the kind of expanding economy with all these pressures that are on it in the period ahead.

Mr. ULLMAN. Thank you very much. Mr. Curtis.

Mr. CURTIS. Thank you, Mr. Secretary, I can understand what I regard as some confusion on the part of my colleagues who have been interrogating you regarding the theory that an increase in tax rates will bring in more revenue, when in 1964 we proceeded on a different economic theory; namely, that lower rates would increase revenue.

I think it becomes important to review what was the real economic theory followed in the tax cut of 1964. It was not the theory of new economics, which called for continuing increases in Federal expenditures of about \$5 billion a year (which was occurring) on the theory that aggregate demand had to be increased.

We followed the converse theory—that a cut in tax rates would increase the tax base, that is, economic activity, and that simultaneous expenditure restraint would prevent inflation or high interest rates. The figures are there for anyone to look at. The 1964 expenditure level was \$97.8 billion.

In 1965 it was \$96.5 billion. Actually, we cut a little in Federal spending.

Now, strangely enough, this point has been overlooked. But it bears directly on whether increasing tax rates, which I think are too high right now, will actually increase revenues, cut back on the base, namely, economic activity, so that revenues will be reduced.

I appreciate very much Mr. Ackley's analysis of the economic situation because that is our attempt to measure the tax base. Just as I argued in 1964 that we had to hold Federal expenditures, so I argue

today that the only conceivable way you are going to get an increased revenue from an increased tax rate is by holding down or cutting back on some of these expenditures already in contemplation. I doubt that this would work today, however.

Now, in the three papers presented here I am pleased about one thing—the rhetoric calling attention to the economic damage that can come through high interest rates. But I think it has now been brought out that right now, without the tax increase or anything else, with fiscal 1967 just finished, we are back at interest rates comparable to those in 1966, which were the highest that we had since the end of World War I. We are not just talking about the impact of this coming deficit; we are right in the middle of economic harm resulting from the last deficit, namely, these high interest rates.

The rhetoric is excellent in regard to the economic damage of inflation, but I would point out, as Mr. Ackley did point out, we are talking about something we already have, entirely apart from what this deficit for 1968 might produce. The Consumer Price Index went up by 0.4 last month, and by 0.3 the month before, did it not?

I would pause here a moment to ask whether you do not feel that this inflation is more cost-push—resulting possibly from the inflation of 1966—and not so much demand-pull inflation?

Mr. ACKLEY. Yes, I would certainly agree that the increase in prices of recent months has been largely from the cost side and not because of excessive demand.

Mr. CURTIS. We have further labor-management contracts that are coming up for negotiation. I might say that to a large degree, the impetus behind the Federal pay raise is the impact on Federal employees from the 1966 inflation. Consequently some of this increase that we see on the expenditure side is merely people trying to compensate for the impact of inflation that has already occurred and inflationary forces presently in existence.

In the area of the deficit in our international balance of payments, the rhetoric, in my opinion, was not quite as good. I would like to have seen a better discussion of the dangerous situation we are in in this area.

Now, at this point I would like to pause a moment to discuss a point not yet developed. First, do we now have the second quarter figures for this year on our international balance of payments?

Secretary FOWLER. They have not been announced as yet. They are scheduled to be released by the Department of Commerce tomorrow.

Mr. CURTIS. Because certainly the figures for the first quarter of 1967 were most alarming on the liquidity basis. I am reading from the Economic Indicators on page 25. It was minus \$2.176 billion, which is a considerable rise. What is even more disturbing was the deficit on the official reserve transaction, the measure that the administration had requested us to use in estimating international balance of payments; a whopping minus \$7.288 billion.

No one from the administration, to my knowledge, has ever commented on it. I think there are some explanations for the tremendous size of that. Of course, part of it was the unnatural in a sense or atypical figure for 1966 which was a plus \$225 million, but I wonder if you would comment now.

It seems to me that we have a very serious, if not critical, situation in these figures for the first quarter unless the second quarter—I don't know what they are going to show—balances this off in a very radical way, but would you comment on the problem?

Secretary FOWLER. Mr. Curtis, first, you have hit a number of points. With regard to the other measure of balance of payments, the official settlements basis, as you yourself observed, the surplus in that measure in calendar year 1966 was the result of flows of funds in some measure which were unnatural and not expected to last. You will find that in all the comments that we have made on that particular phenomenon we went on to say we expected to see that reversed during the coming year, and we think that that is actually what has been happening and that when the official settlements figures for 1966 and 1967 average out you will probably find that there is not any greatly different trend over all between that picture and the picture you get on the liquidity deficit.

Mr. CURTIS. The only comment I would make, of course, and I know you realize it, is the figures of \$7 billion, though, is so immense it is going to take all sorts of adjustments even to bring that down, because our previous figure on an annual basis, the highest, just reading from this table was \$3.4 billion and then \$1.3 billion, \$2.7 billion, \$2 billion, \$1.5 billion, and \$1.3 billion. There we have this most unusual one of \$7.2 billion.

Secretary FOWLER. A lot of it was the recovery of the pound in that period. A lot of it was the flowback of funds that had been brought into the United States—

Mr. CURTIS. Short-term.

Secretary FOWLER. In 1966.

Mr. CURTIS. Funds which many warned last year could not be counted on. I don't think you were, but I know that I felt a strange silence on the part of the administration in not joining in the warning.

Secretary FOWLER. I did, Mr. Curtis.

Mr. CURTIS. You did personally. I agree with that. I say the overall picture. But, at any rate, the minus \$7 billion is so large that it is going to take an awful lot of—

Secretary FOWLER. That is an annual rate, Mr. Curtis.

Mr. CURTIS. I understand.

Secretary FOWLER. I don't think you should project a first quarter where there has been a marked flowback of funds from this unusual situation last year.

I don't think you should imply that that is going to go on.

Mr. CURTIS. I am not. I am simply saying that it is so large that you are going to have to do a lot of explanation to bring it back because even on the liquidity basis, the first quarter deficit is running at an annual rate of minus \$2.1 billion, compared to \$1.3 billion in 1966 and 1965.

Secretary FOWLER. On the liquidity basis the figure for the first quarter was up from what we had hoped it would be. We had hoped it would hold and perhaps decline from the \$1.4 billion level of the deficit last year, and the \$1.3 billion in 1965, but the fact of the matter is that the foreign exchange costs of our operations in Southeast Asia have substantially increased and just the direct foreign exchange costs in Southeast Asia account for by far the major portion of that liquidity deficit. So confronted by the financial and physical prob-

lems that we have here today in connection with the regular financing of the Federal Government we do point to the budget expenditures in excess of \$22 billion that are incurred in this year.

We also have to point to the upward of \$1¼ billion of foreign exchange costs as compared to the foreign exchange costs in the early part of 1965.

Mr. CURTIS. No; I appreciate the reasons for it.

Secretary FOWLER. Let me add one other thing to complete this.

Mr. CURTIS. Yes.

Secretary FOWLER. I think we should also note that during this year there has been a very sharp drop in the outflow of gold compared to previous times, even despite the Middle East crisis. Indeed—I will supply these things precisely for the record—but were it not for our sales for domestic use of gold, jewelry, and other purposes, \$62 million worth, we would have virtually complete stabilization in the first half of this year as far as our gold outflow is concerned.

(The following table was received by the committee:)

U.S. NET GOLD TRANSACTIONS FOR FOREIGN MONETARY AND DOMESTIC INDUSTRIAL AND ARTISTIC USES (1960-67)

[In millions of dollars]

	1960	1961	1962	1963	1964	1965	1966	January to June 30, 1967
With foreigners.....	-1,669	-820	-833	-392	-36	-1,547	-431	-3
For domestic uses.....	-35	-55	-57	-69	-89	-118	-141	-62
Totals.....	-1,703	-875	-890	-641	-125	-1,664	-571	-65

Note: Figures may not add due to rounding.

Mr. CURTIS. I certainly hope you are not getting confidence counting on from that figure, because dollar holdings or claims against gold still remain and keep us in a very precarious position.

Secretary FOWLER. I think those increases in dollar holdings, for just one example, are being put to very good use in the Euro dollar market. Central banks and others, private institutions are finding a very good use for those dollar holdings at the current time.

Mr. CURTIS. Mr. Secretary, according to some reports, the increased dollar holdings put you in the position of a beggar when you represent us abroad, because of these holdings against the United States, the fact that our gold holdings are so low, and serious talk of the devaluing of the dollar.

Secretary FOWLER. Not from any responsible source.

Mr. CURTIS. Oh, well, I would say from many responsible sources. I do not happen to agree with them any more than I think you agree with them, but the reports are certainly from responsible sources. In fact, many responsible sources say that we have devalued in devious ways. I share their point of view. Let's not pass off the critics as irresponsible.

Secretary FOWLER. Just on that particular point, let us note once again that the value of the dollar has been maintained over the past 10 years, over the past 5 years, even years when we have been engaged in this extra strain in Vietnam, better than any other country in the

world except Guatemala and El Salvador, and one other country that I can't recall offhand.

Mr. CURTIS. Mr. Secretary, we have to be better because we are the world's banker.

Secretary FOWLER. Of course.

Mr. CURTIS. And if we go down, the whole system of international exchange goes down, so I don't think this is a way of dismissing these criticisms that are directed by responsible, not irresponsible, people.

I again say I hope that we are not in this kind of position. I note that just the other day, and this is news media terminology, responsible people in Great Britain are now talking about devaluing the pound, and certainly the dollar is very closely allied with the pound. But let me come to specifics.

I started my remarks by saying I was sorry we lacked more and better rhetoric on the dangers involved in the deficit in international payments, comparable to the rhetoric on the dangers that come from high interest rates and inflation. But this administration has done nothing about foreign expenditures, governmental expenditures abroad.

Even with the Vietnam war commitment we are spending abroad in the area of foreign aid, in the area of development loan funds, and just the other day the administration reiterated its policy of substantial military commitments in Western Europe.

Secretary FOWLER. Mr. Curtis, I can't accept the statement, and I don't think that we wanted to take the time to go into it—we did it here just a couple of months ago in connection with the interest equalization tax. There has been a great deal done. There has been a great deal of effort exerted in this area with some results, not as much as I would like to see, insofar as our balance of payments is concerned. I will just refer to the statements that were made here in some detail on the interest equalization tax.

Mr. CURTIS. On these things, Mr. Secretary, I am going to get the record on domestic expenditures. We are not interested, or I am not, in words and rhetoric. I can read the figures and the figures demonstrate quite clearly to me the administration has done nothing; quite the contrary, it has continued to increase our commitments in foreign aid, and I am including development loan funds, Public Law 480 funds, and military funds. Although you yourself recognize that our commitments have gone up in Vietnam, yet there has been no compensating cutback by the administration in these other programs.

I am not talking about words. I am talking about dollars.

Secretary FOWLER. Mr. Curtis, perhaps we could leave it this way: That you and I will both agree with all of our hearts and minds that the balance of payments is a serious problem and that is why, among other reasons, we need a tax increase and that is we are here. And I hope that given the emphasis you have been giving to the seriousness of the problem, to the concerns that are voiced in various, as you call them, responsible quarters we can agree on this. I am concerned about the balance-of-payments problem, and one of the primary reasons for this tax increase is to avoid a deterioration in our trade situation and to keep us on the course that we have resumed since last fall of having that trade surplus expand.

You are very familiar, I know from your experience with the Kennedy round—and I followed a number of your writings with great interest in that field—you know that this is a very competitive world we live in insofar as trade is concerned and that the avoidance of excessive demand is a serious element, that the threat of excessive demand to our balance of payments would be a serious threat, and that it is very definitely related to our problem here today.

Mr. CURTIS. There we certainly are in full agreement, but the question before us right now, the tax increase, greatly effects the balance of payments. If your theories are correct when we talk of the tax increase itself, then you are right in my judgment in referring to balance of payments.

Likewise if my theories are correct the tax increase also effects the balance of payments and we would possibly be applying the wrong remedy. I would like to say one thing further on this international balance of payments. Our trade surplus (exports over imports) is our great asset in the international balance of payments but as I have tried to point out, exports depend upon private investment abroad and the administration by restricting private investment abroad is restricting the very area that needs expansion.

I won't pursue that subject further at this point.

Secretary FOWLER. No, because I think the figures on the very rapidly increasing scale of private investment abroad, even in recent years, would show that both in net outflow and in gross plant and equipment investment by American concerns abroad it has grown at a very sharply increased rate. As I recall it, the gross plant and equipment investment level has grown from around \$2 billion a year in the early part of this decade to a level now approaching \$10 billion a year, so there is no paucity of U.S. growth in investment abroad.

Mr. CURTIS. We are always talking in relative terms. I would say there is because the return on this investment abroad is the other plus in our international balance of payments and this is an excellent portfolio as well as being tied with our exports, so it has increased as has everything else.

As you all have observed, this society and economy of ours has continued to increase, so we are always dealing in bigger figures. We must seek the relationship between them. In this area, I think what we do or don't do becomes quite important.

Now, the fourth item of our concern on the economy is the employment figures and unemployment. I grant that 4 percent or 3.8 percent, 3 percent unemployed, looks good for a peacetime economy, but I have been pleading for a number of years to not mix apples with oranges. This is not a peacetime economy.

You have 600,000 additional young men who otherwise would be in the labor force in the armed services. You have at least double that amount in defense plants.

Incidentally, inasmuch as a good portion of those young men are abroad, this bears on the balance of payments, so I think you have to add probably at least 1 or 2 percent to our unemployment figures to relate these figures to a peacetime economy.

I think unemployment is an important factor, particularly structural unemployment, among certain groups, like the Negroes, where the rate is approximately 20 percent.

Mr. Ackley, in your exchange with Mr. Mills yesterday you mentioned about the figure going down to 3.9 from four points last month, but our average hours per week in June continued to decline where it is now 40.2. I don't think we have seen a cessation of this decline yet.

Mr. ACKLEY. Yes, Mr. Curtis, we have.

Mr. CURTIS. You agree this is an important indicator to look at?

Mr. ACKLEY. Yes. In July, however, the average hours did turn up, not only in manufacturing, but in other areas as well.

Mr. CURTIS. What was the total? I don't have that figure. All I have is the July issue of Economic Indicators.

Mr. ACKLEY. In July the average hours in manufacturing increased to 40.3. In contract construction they rose from 37.2 to 37.5, in retail trade from 35.5 to 35.6. So that in the areas in which we have data on average hours it has begun to reverse the downward trend.

Mr. CURTIS. It still is not a strong figure.

Mr. ACKLEY. No, it is well below a year ago, Mr. Curtis.

Mr. CURTIS. And, of course, I am looking at the trend, as I know you are.

Mr. Secretary, the fifth item in our list of objectives—after (1) avoid high interest rates; (2) cope with inflation; (3) unemployment; and (4) deficits in our balance of international payments—is to avoid a recession or a slowdown.

Now, I would use the word "slowdown" to describe the economic situation we are in today. In your revision of revenue estimates for fiscal 1968 you moved down from a January revenue estimate of \$126.9 billion by about \$10 billion, did you not?

Am I right in that?

Secretary FOWLER. No, revised it down by \$7 billion.

Mr. CURTIS. You revised it down to \$7 billion. How did I take off the figure?

Secretary FOWLER. I think the figure that Mr. Mills asked me for was a figure without any tax increase at all.

Mr. CURTIS. That is what I am talking about.

Secretary FOWLER. And \$126.7 billion contemplated a 6-percent increase.

Mr. CURTIS. In other words, without any tax increase you revised the \$126.9 billion downward by how much?

Secretary FOWLER. \$7 billion.

Mr. CURTIS. By \$7 billion. The point I am getting at is that \$7 billion is a reflection of the economic situation which didn't turn out as anticipated. Am I not correct?

Secretary FOWLER. No; only in certain particulars. I give the breakdown of the \$7 billion, as you know, Mr. Curtis, in the statement.

Mr. CURTIS. Yes, I have that. Take corporate revenues.

Secretary FOWLER. The decline in corporate revenues, is one reflection of that and the decline in personal income which we estimate will reduce our revenues by \$300 million is another reflection of a slacker first 6 months, than we had contemplated.

Mr. CURTIS. Yes. Of course, that points up a very key point. In considering a tax rate increase the only reason for its being proposed is on the assumption that it will increase revenues. That is correct, is it not?

Secretary FOWLER. That is right.

Mr. CURTIS. And the other factor is the tax base, which is our economic activity, and we can see just from this little downturn our failure to move forward what can happen to revenue estimates there.

Secretary FOWLER. I think the corporate one is very meaningful. I wouldn't count the \$300 million because of the lower personal income than projected 6 months ago as being significant—I think that was the accompaniment of the inventory readjustment that has gone faster in the first 6 months than we calculated.

Mr. CURTIS. What about estate tax?

Secretary FOWLER. That is \$100 million.

Mr. CURTIS. You listed a group of these items and miscellaneous.

Secretary FOWLER. \$200 million on estate and gift taxes and customs.

Mr. CURTIS. But don't you relate these to the base, the economic activity in the society? I remember we used to—and still do—use a sort of rule of thumb that for every \$4 to \$6 billion GNP increase, we could count on about a billion dollars' additional revenue.

Secretary FOWLER. That is that marginal rate problem.

Mr. CURTIS. I am going to get to that. Nonetheless, it demonstrates the basic point that tax revenues depend upon rate and base and if the rate of any tax is too high you can cut in on the base. This puts us at a point of diminishing returns.

I felt in 1964 we were clearly there. I think we still are there. I think that we could embark upon a program of tax rate reduction, Federal income tax rate reduction, for the next 20 years and probably end up on a gradual basis of cutting back with more revenue by increasing the base, provided—

Secretary FOWLER. I have said the same thing, Mr. Curtis, on recent occasions and I agree with you on that principle.

Mr. CURTIS (continuing). Provided we don't cut a way through the impact of high interest rates and inflation in this process.

Secretary FOWLER. You and I have the same philosophy and point of view on that.

Mr. CURTIS. I know we share a common view on a number of things, as much as we have differed on and probably do on this present economic picture. This is what is worrying a lot of us, as to what we can expect.

I still think that if we could get Federal expenditures down we could get more revenue by increasing or decreasing the tax base rather than the other way around, but certainly believing in that theory we have to study very carefully what the converse would be of increasing these tax rates at this particular time.

This could have a deleterious economic impact.

Secretary FOWLER. Mr. Curtis, we did not recommend that the rate be increased as of January 1 in response to just that feeling that there is a time and a season for everything and we think that the time and the season was not appropriate for a tax increase in January, but that the time and season now in mid-August is appropriate for us to consider it.

Mr. CURTIS. I agree with time and season, but I want to get these other questions first. The area where there is discipline is in expendi-

tures. This for some reason or other doesn't seem to be part of this tax exercise as far as the administration is concerned.

At least they won't say it openly.

Mr. SCHULTZE. They said it as openly as it can be said, Mr. Curtis.

Mr. CURTIS. Let me put it this way. They certainly did not. It was our motion to recommit the 1964 tax bill with instruction to hold expenditures to \$97 and \$98 billion that brought expenditure restraint into the picture.

Mr. SCHULTZE. Because we didn't believe that was a responsible action.

Mr. CURTIS. But you went ahead and talked the other way and pushed the new economic theory of Dr. Heller that it was increased demand that was necessary, that if you cut back Federal spending to compensate for the tax rate increase you would not produce the desired stimulus. Then the administration, and I certainly took the floor of the House and elsewhere to praise the administration in those days, actually held to those levels, but it is important to realize that that is what happened.

It was not increased expenditure. It was holding the level of expenditures that made the tax cut of 1964 successful and therefore is something we have to look to in talking about tax rate increase in 1967 because this is in context not of expenditure restraint but of an expenditure increase of almost \$20 billion last fiscal year and a projection that might go up as much as another—

Mr. SCHULTZE. \$8½ billion.

Mr. CURTIS (continuing). \$18 billion. Well, there is \$126 billion and a possible \$144 billion, another \$18 billion. This is the exercise that I think we have to look at.

Now, the administration said apparently in the budget message of January that the \$8.1 billion deficit was acceptable, according to your rhetoric. That was an acceptable level and could be financed by new bonds.

Now we come along and are told that this \$8.1 billion figure, which, incidentally, ought to have been, for better understanding, \$18.6 billion because in your budget figures were \$5.5 billion in increased revenues from the proposed tax increase—

Mr. SCHULTZE. That is right, and we were instructed to do what we did by the Budget and Accounting Act of 1921.

Mr. CURTIS. I am not talking about—

Mr. SCHULTZE. I realize you don't have to abide by that act, but we do.

Mr. CURTIS. We have had enough public debate on it and I know what has been reported in the news media. The Congress doesn't know this and didn't know it, although people like myself have tried to say it and then we would get no backing. But the answer is in the facts, which are that this was \$5.5 billion built in and \$5 billion for participation certificate sales which also reflect how you finance a deficit, so we had a \$18.6 billion deficit. These are my estimates of what you are recommending, that we finance \$5.5 billion from new taxes, \$5 billion from sale of capital assets, and \$8.1 billion from new debt securities. So now we have moved from \$18.6 billion to where you are saying that you want an additional—what is it—\$2 billion from taxes, \$5.5 billion, and \$7.4 billion. Is that right?

Mr. SCHULTZE. That is not exactly comparable because you lose almost a billion dollars on the later effective date for the personal surcharge than recommended last January, but the net difference between the two is—

Mr. CURTIS. I am talking about financing. I see what you mean.

Mr. SCHULTZE. I am saying the net difference is about \$2 billion; you are correct.

Mr. CURTIS. You were going to get \$5.5 billion from the tax increase as proposed in January.

Mr. SCHULTZE. And now we are estimating \$7.4 billion; you are correct. All I am saying is the net difference isn't entirely on account of the change in rates.

Mr. CURTIS. It is close enough so that we are within \$0.1 or \$0.2 billion. In other words, if I use the \$7.4 billion, I get a \$1.9 billion additional amount that you are going to finance through tax.

Mr. SCHULTZE. Taking everything into account; fine.

Mr. CURTIS. OK. Now, in participation certificates (PC's) you say that if you abandon the \$5 billion—

Mr. SCHULTZE. No; we haven't abandoned it, Mr. Curtis. In listing a number of items that the Congress could add to the deficit this was one of them, that is, the impact of the House action on the PC authorization.

Mr. CURTIS. I am talking about the original budget. You had \$5 billion in it.

Mr. SCHULTZE. Correct.

Mr. CURTIS. I try not to argue with rhetoric.

Mr. SCHULTZE. No; I just wanted to get it clear.

Mr. CURTIS. You have changed that figure. It is no longer \$5 billion.

Mr. SCHULTZE. No, sir.

Mr. CURTIS. It is how much?

Mr. SCHULTZE. May I explain it?

Mr. CURTIS. Yes, sir.

Mr. SCHULTZE. If the Congress gives us the full authorization, we would plan to go ahead and use it.

Mr. CURTIS. You couldn't use \$5 billion, though?

Mr. SCHULTZE. Why not?

Mr. CURTIS. Could you?

Mr. SCHULTZE. If the Congress—

Mr. CURTIS. You have a problem of selling, and so forth.

Mr. SCHULTZE. Oh, I agree. It would depend on what happens during the year, but we see no reason to change our plans at the moment.

Mr. CURTIS. If Congress hasn't given you the authority, you are coming here and asking us for a \$7.4 billion increase. Now tell me, what are your realistic plans for the sale of participation certificates? Are they \$5 billion or what?

Mr. SCHULTZE. I would like to tell you.

Mr. CURTIS. Yes, sir.

Mr. SCHULTZE. Our plans so far as the executive is concerned at the moment are to sell \$5 billion. Now, as you know, these participation certificates have to be authorized in appropriation acts. If we look at what the House has done to appropriation acts so far this year, it has reduced that authority to the point where if its action stands up in the full Congress—through the Senate and in conference—our participation sales would be \$2 billion lower.

Mr. CURTIS. \$2 billion. So it would be \$3 billion.

Mr. SCHULTZE. That is correct but I am not at this time predicting that. We are hopeful of getting the full authorization.

Mr. CURTIS. If you don't have the power to sell these in a way doesn't this cut back on the expenditures that would otherwise be financed by them?

Mr. SCHULTZE. No, sir; this \$2 billion reduction would not result in an expenditure cut.

Mr. CURTIS. Not psychologically?

Mr. SCHULTZE. We have no cases that I know of in which the level we are talking about, the \$2 billion cut, in and of itself would change the level of program activities. There are some programs in which the level of activity depends in part on the level of PC sales; however, this is not the case with respect to the \$2 billion we are talking about here.

Mr. CURTIS. Couldn't it change it because these are increased expenditures?

Mr. SCHULTZE. That is correct, we have estimated some increases in these programs.

Mr. CURTIS. That you are counting on to finance through this sale. You could take this as we take the trust fund and in effect say to the agencies that are counting upon these revenues from these sales to finance it, "Look, our source is diminished," just as we did with the highway trust fund.

Why can't we cut expenditures in this area to make up this difference?

Mr. SCHULTZE. What I am saying, Mr. Curtis, is just taking the level at which the House action, for example, has authorized PC's, there would still be funds available as authorized by the Congress in prior substantive and/or appropriation acts to carry out the lending activity of the programs concerned at the level indicated in the budget even if we didn't get that \$2 billion in PC sales authority.

Mr. CURTIS. I understand that but can't the administration cut back, talking about areas in which you are going to cut back.

Mr. SCHULTZE. Yes, sir. Clearly these programs will be among the areas which we will examine and I am sure they will take their share of cuts. Excuse me. I didn't understand your question.

We would have the authority to make the expenditures for the lending programs. But you are quite right. These will be among the ones that we will look at in our efforts to reduce expenditures.

Mr. CURTIS. I would think this would be a good way. If you cut back \$2 billion from your \$5 billion to \$3 billion in what you are going to sell, cut back \$2 billion, or request agencies to cut back here until we get over this hump, then it wouldn't make any difference.

Mr. SCHULTZE. No, sir; I don't agree with that because what we would do would be to take the total expenditure cut and look at where it ought to be assigned in terms of priorities and technical feasibility, rather than linking it mechanically in some way or other to the PC's.

Mr. CURTIS. I am not talking about that necessarily. There are all sorts of ways of doing it. When you have to cut believe me you can, when there is a will to do it. It means that some of these cuts will be in good programs, but if your rhetoric on the damage that can come to this economy from further inflation—I emphasize "further"—and from further increased interest rates, is meant, then it behooves us to do this.

I think you will all agree that, if inflation does come more than it has, it is a meat ax cut that cuts your welfare program, your defense expenditure, that cuts all programs across the board, right?

Mr. SCHULTZE. Mr. Curtis, that is precisely why in making up this fiscal program the President included expenditure cuts as part of it. Many desirable programs are undoubtedly going to have to be cut. We are going to have to balance off, in other words, the gains on the overall fiscal side against the gains from a particular program.

We agree on that. I think where we disagree is with the magnitude.

Mr. CURTIS. Or the specifics. I remember last year trying to get from the administration where this \$3 billion cut was that you told us and they turned out to be deferments, not cuts at all, and I never could find out even then where they were.

Mr. SCHULTZE. Mr. Curtis, as a matter of fact all through those discussions—and I stress, all through those discussions—we indicated that those would be deferrals and reductions. There is absolutely nothing wrong with deferrals, Mr. Curtis. They simply stretch expenditures out during periods in which there is inflation.

Mr. CURTIS. I am not talking about that being a deferral. I am for deferrals too but when we are talking about cuts and in the context we were talking about, no one thought we were talking in terms of 6-month deferrals. I can assure you of that and the Republicans and the Congress didn't and whether we were right or wrong—

Mr. SCHULTZE. All I can do is use the English language. Right now when I am talking about making reductions—

Mr. CURTIS. I am more interested in figures than the English language, I will tell you right now I am more interested in figures. I am tired of the manner in which the English language has been used by this administration. I want the figures.

Mr. SCHULTZE. Last year we indicated we were going to cut \$3 billion in terms of fiscal 1967 effect, and that is what we did except for about \$100 million that resulted from releases.

In other words, the releases did affect 1967. We made those cuts. I would have urged you to have been with me before the House and Senate Public Works Committee in their hearings on highways to get some idea of how real those cuts were.

Mr. CURTIS. This is an example of this kind of chicanery. That had nothing to do with general revenues. That had to do with the highway trust fund and you know it.

Mr. SCHULTZE. Of course I know it.

Mr. CURTIS. Well, we are talking about the administrative budget.

Mr. SCHULTZE. Fine, let's shift to the administrative budget.

Mr. CURTIS. Let's don't keep shifting from one to another as you did before on trust funds. This whole exercise that we are engaged in here relates to the administrative budget, not trust funds.

Mr. SCHULTZE. This particular exercise does, sir. I thought we were talking about last year's cuts and you didn't think we had cut.

Mr. CURTIS. I am talking about last year's too. That was an exercise on the administrative budget, and did not have anything to do with the trust funds.

Mr. SCHULTZE. Excuse me, Mr. Curtis. I don't like to prolong this argument, but at all stages of this exercise we told you we were considering highways as part of the cutback. We were looking at Federal

programs in terms of cutting off the inflationary pressure in the economy.

If you look at what happened to highway prices, after an increase in construction bid prices of about 13 percent in the period of 2 years before the deferrals, they went down and stayed down. I think this was a very valid part of the 1967 cutback exercises.

I don't see why we have any argument about that. I don't understand that.

Mr. CURTIS. The reason we have an argument is that I have been trying to fight the battle for the administrative budget cuts because we are concerned about general revenues here. The Ways and Means Committee has just put aside what we are going to do about the highway trust fund.

We have a serious imbalance there. We have been spending 5 to 6 months this year on the social security trust fund which has plenty of problems itself. But this exercise and the debt ceiling and the investment credit has to do with our general revenues.

Mr. SCHULTZE. I fully agree and that is what we are talking about this year, the administrative budget. I was simply trying to set the record straight on last year's exercise.

Mr. CURTIS. The rhetoric of this administration is we have exercised expenditure restraint and you say you are doing it, but notably this is in context of an expenditure level of \$77 billion as recently as 1960, and here we are to a projected possible \$144.2 billion in fiscal 1968.

The figures go: 1961, went up to \$82 billion, 1962, \$87 billion; 1963, \$92.6 billion; very interesting, \$5 billion increase; 1964, \$97.7 billion and then we had, thank goodness, a classical theory of taxes and economics prevailed and the expenditures for fiscal 1965 were \$96.5 billion, but then all our efforts went in vain because in fiscal 1966 we went up to \$107 billion.

In other words, you took the \$10 billion jump in 1 year instead of taking it \$5 billion and \$5 billion.

Mr. SCHULTZE. There was a war, Mr. Curtis.

Mr. CURTIS. Oh, go on. Wait a minute. You talked about the war as costing a smaller percentage of GNP in the area before and this is a fair statement, but then when you ever get into one of these things you want to talk the other. I am simply saying these are the figures.

Then the next year it went up \$20 billion just about, to \$125.7 billion. Now this is in context of the language that you used of expenditure reform or restraint and, frankly—

Mr. SCHULTZE. Let's take a look at this.

Mr. CURTIS. The figures are there.

Secretary FOWLER. We never use expenditure restraint in terms of the cost of Vietnam.

Mr. CURTIS. Oh, I didn't say you did and I have been one who, incidentally, feels we well might take a look at that. That shouldn't be a sacred cow, by the way, but certainly we can talk in terms of defense; namely, Western Europe, and why in the name of heaven we don't revise our policy there, but the administration won't even discuss these items with the Congress. They just go ahead and say that they want more money and that they are exercising expenditure restraints and we are supposed to take your language, not your figures.

I won't take your language. I want to know what unacceptable levels are. I want to talk about what we can reduce in some of these areas.

Secretary FOWLER. Why don't you take the figures on the percentage relationships to GNP?

Mr. CURTIS. That is a very interesting one too and the Federal Government is one of the few institutions in our society that hasn't shown a decrease. Take farming, agriculture. Every other sector shows productivity increases.

Mr. SCHULTZE. It has to add to a hundred, Mr. Curtis.

Mr. CURTIS. Well, there are more sectors. You had no television during the Korean war. You had no space. You know the answer to that. As this economy grows you get new sectors that never were in the economy before.

Mr. SCHULTZE. Quite correct; including education and things like that.

Mr. CURTIS. And education is certainly one of the most important and—

Mr. SCHULTZE. You share our belief, Mr. Curtis.

Mr. CURTIS. I wish I could share your figures as well as your belief. Getting over to these areas of expenditures, Mr. Schultze, you simply state without proof that these expenditures are uncontrollable. I don't know a Government contract that doesn't have a termination clause in it; do you?

Mr. SCHULTZE. That is correct; I agree.

Mr. CURTIS. Why are these uncontrollable?

Mr. SCHULTZE. They are uncontrollable because we don't believe, except in very exceptional circumstances—and there are cases where it does happen—we should abrogate the contracts and pay the penalties and thereby increase the cost to the Federal Government.

Mr. CURTIS. This isn't an abrogation. Many times contracts in private enterprise are cut back because—

Mr. SCHULTZE. We don't consider it good public policy. Let me put it that way, then.

Mr. CURTIS. In other words, you don't think it is serious enough to do anything about these things. That is it really.

Mr. SCHULTZE. We think it is serious enough to do things when we think, in term of priorities, they ought to be done.

Mr. CURTIS. Yes, but you won't share your discussion of priorities with the Congress.

Mr. SCHULTZE. Mr. Curtis, I talked to Mr. Byrnes at some length about that.

Mr. CURTIS. You put all of these over here, Mr. Director, and say these are uncontrollable. Now you have admitted that they are controllable, but your argument is, for public policy, we shouldn't do it and that is a fair statement, but then Congress should be involved in this public policy.

They are controllable, aren't they?

Mr. SCHULTZE. Mr. Curtis in the sense that legally we can violate those contracts—

Mr. CURTIS. It isn't a violation.

Mr. SCHULTZE. Yes.

Mr. CURTIS. It is not a violation when you have those clauses.

Mr. SCHULTZE. You are quite correct, Mr. Curtis. I agree that legally we can abrogate the contract, you are quite correct.

Mr. CURTIS. Or you can stretch it out.

Mr. SCHULTZE. Oh, we are doing that.

Mr. CURTIS. You still won't put this in the list of uncontrollables.

Mr. SCHULTZE. What I am saying is that what we do is take the items that are just beginning, for which we have contracts coming up. In other words, if you notice in most of the public works programs, the deferrals occur when the contracts are renewed. What we do is stretch those contracts out. What we don't want to do is take a contract that is only partly completed and cancel it, except under very exceptional circumstances.

Mr. CURTIS. My point is that none of these items should be called uncontrollable. Every one is subject to review and when you present this to this committee and just say, "Well over here is something we have no control over," this is what I am quarreling with.

I can agree on some of these that for good economic and other reasons you might want to cut those back, but I remember that this committee a few years ago decided to cut back even on contracts in-being in the highway program in order to let our revenues catch up with us. I thought that was good.

You say you already are doing some of it but then——

Mr. SCHULTZE. No, all I am talking about is that on contracts in public works where there are renewals we do stretch them out.

Mr. CURTIS. You are not looking over the ones that are in-being now to see where you might——

Mr. SCHULTZE. To cancel them before the end of the contract?

Mr. CURTIS. Why not? In World War II we cut back on practically all public works, didn't we?

Mr. SCHULTZE. We are not in World War II.

Mr. CURTIS. We cut back on practically all public works.

Mr. SCHULTZE. Yes, we did. We cut back this year too.

Mr. CURTIS. Not the way you did in World War II. I am only illustrating the point that to some degree you can easily go to the people involved in public works, Congress. Just as you are going to the taxpayers through us and saying you want more money out of them, you could go to these people in public works because of this tight squeeze of a war and say, "We are going to have to cut back some of these programs," right?

Mr. SCHULTZE. May I explain, Mr. Curtis, how we do it, if I might?

Mr. CURTIS. Sure.

Mr. SCHULTZE. That is precisely what we did in this year's budget on public works. Last year, I think, in the Corps of Engineers, adding what we proposed and what the Congress added on, there were 60 some new starts. In this year's budget we put in nine new starts. In addition, we took all the projects that were ongoing and stretched them out as much as we could. We did not cancel contracts when they were under-way, but we did stretch out where we could.

This is what I am saying.

Mr. CURTIS. Each time, Mr. Schultze, you say, "As much as we could." I respect your judgment, but what I am saying is the Congress has a right to be in on this policymaking. So do the people.

What you think is "as much as we could" may be different from what others think and we may think that inflation and high interest rates are more serious even than the rhetoric in your statement and if it is, then "as much as we could" is either not an accurate phrase or one that is the very bone of contention here.

Mr. SCHULTZE. Mr. Curtis, there are two parts to that. With respect to the public works program, for example, the Congress in the appropriations bill this year did have a chance to cut those nine new starts out. They didn't. They added starts.

Mr. CURTIS. Now I am going to say something about this because I have listened to the rhetoric of the President and the rhetoric here about blaming Congress for these things.

As soon as we had a chance to look back at the budget we urged the President to pull it back and submit a rescission bill and not ask the Congress for all these things.

The President has not done that. He has continued to ask the Congress for it and in many of his messages and his speeches, he has whetted the appetites of the people for these very programs so that then, when Congress may not go along, he still can talk this way.

Furthermore, the President can veto appropriations bills.

Mr. SCHULTZE. He did, Saturday.

Mr. CURTIS. Yes, he did and I was glad he did, although I was very interested in why he picked a pigeon like that one, but he can veto an appropriation bill. They have been vetoed before and they can come back here to Congress.

But instead of that the President tries to create the impression among the people that it is Congress who is responsible for higher spending. I tell you it is the President who has been whetting the appetites of the people for all of these things that have created the pressures on the Congress and I say this as one who votes against these bills as you probably know and has to bear the brunt of going back home to my people who say, "Well, aren't you interested in our welfare," and I say, "Yes, I am and that is why I have voted against them."

But I can't get enough of my colleagues to go along. This President hasn't turned the White House lights off symbolically as he once did. He is going to his farm down in Texas every weekend. That is the symbol today.

Mr. SCHULTZE. Just a minute, Mr. Curtis. There is absolutely no reason for that with respect to what we are talking about here today.

Mr. CURTIS. There certainly is.

Mr. SCHULTZE. If the President occasionally after working 19 hours a day, 7 days a week, decides to go to Texas once, Mr. Curtis, I think it is a pretty ill thing, then, when that is thrown out in the heat of any tax debate as something to do with legislation; we shall all economize.

Mr. CURTIS. You can have your opinion, but I point to your statements here and the various statements by the President blaming the Congress for these things. I was speaking symbolically when I commented that President Johnson seems to have given up turning the lights off in the White House at night.

You try to take it as a personal attack. I am talking symbolically.

Mr. SCHULTZE. I am sorry. Excuse me. It was a symbolic nonpersonal attack.

Mr. CURTIS. You can interpret it any way you choose, but I am trying to get across the thought that the President has done nothing either in exhortation or specifics to encourage the Congress to cut back on expenditure programs and appropriations.

Let's get to some more specifics.

Mr. SCHULTZE. Mr. Curtis, might I have 1 minute to answer your former question?

Mr. CURTIS. Yes.

Mr. SCHULTZE. The President, as a matter of fact, has talked long and vigorously and seen congressional leaders of both sides of the aisle, for example, with respect to the pay bill to try to avoid that \$1 billion add-on going into the budget.

Secondly, the President in all these expenditures—

Mr. CURTIS. Has he said he will veto it?

Mr. SCHULTZE. Mr. Curtis—

Mr. CURTIS. I am being specific. If he would say, "I will veto this" I don't think the bill would come up to him, but has he said it?

Mr. SCHULTZE. Mr. Curtis, the President has indicated pretty clearly how unacceptable this bill is, but you are trying to tell me and the President precisely what kind of tactics ought best to be used.

Your judgment may be right.

Mr. CURTIS. Yes, I would like to suggest that.

Mr. SCHULTZE. Of course you do, but at the same time I don't think we are here to deal with a specific tactic as to how one gets a particular bill. That is your particular evaluation.

Mr. CURTIS. But, Mr. Director, when we deal in generalities we bog down in rhetoric, so let's deal in the details of this pay bill, which the President has said that the Congress shall not pass.

I have already pointed out one of the unfortunate things is that the 1966 inflation has created some of the impetus for this pay increase bill (just as it is behind increased wage demands in the private sector). As I see it, the last place that the Government or anyone should economize is on the living standards of the people.

Mr. SCHULTZE. But we are not economizing on the living standards of the people. We proposed a four and a half percent increase. We are not suggesting that that be withdrawn. What we are simply suggesting is that the additional billion dollars not be enacted.

Mr. CURTIS. I am suggesting that if we want to get through to the Congress on this and other areas the President make it clear that he would veto such a bill. He should also make it clear on some other spending programs that he would veto some of those but, above all, he should come to the Congress with a rescission of some of these proposals he made in the budget we got this January.

Mr. SCHULTZE. I had some discussion yesterday with Mr. Byrnes on that point. The Congress has already been 7 months in session and we have three appropriation bills enacted. To come up now with a whole series of new appropriation bills, it seems to me, would end up keeping the Congress here until Christmas or beyond and we would very likely have far less cuts than if we do it the way we are now planning.

Mr. CURTIS. If this matter is as serious as you three have presented it, and I think it is, then Congress can well be in session until December to do it. If it is this serious and I think it is, and the President

knows how some of us feel about these expenditures, he should and would come in and revise his figures.

We have been asking this for months. The Joint Economic Committee, all 20 members, including 12 Democrats, said in our March joint statement that \$5 billion should be cut out of nondefense expenditure areas at that time. It isn't too late to start cutting. It wasn't too late for you to come in and ask for a tax increase so I am saying it isn't too late for the President not only to cut back, not just in rhetoric, but also come in and share the information with the Members of Congress.

One of the areas you mentioned that was in this uncontrollable area was agriculture.

Mr. SCHULTZE. Just the price support part of it.

Mr. CURTIS. That is pretty good. Regarding the price support program, you said, "We are now faced with an estimated increase of \$900 million for programs in which payments to individuals or groups are set by law and are, therefore, relatively uncontrollable."

Mr. SCHULTZE. Relatively.

Mr. CURTIS. I emphasize "therefore, relatively uncontrollable." "Of this amount, \$400 million is for higher farm price support payments by the Commodity Credit Corporation."

Secretary Freeman by a purely administrative decision on March 31 raised the price support for soybeans from \$2.25 to \$2.50 per bushel. It is clear that this is what caused the soybean acreage to jump and was responsible for the almost 1 million bushel crop just estimated by USDA, the largest on record.

This is within the "relatively uncontrollable" area of expenditure, is it not?

Mr. SCHULTZE. On the March actions you are quite correct that in the price support area you can, to some limited extent, depending on how the law is set up, change those prices. You will recall, for example, at the same time the Secretary reduced the wheat acreage in order to get this down.

Mr. CURTIS. I was coming to that.

Mr. SCHULTZE. May I point out this is the precise reason we used the term "relatively uncontrollable expenditures." There are areas in here in which the basic part of the program is indeed uncontrollable under existing law.

Admittedly, you can manipulate it on the side, but in terms of classifying programs one place or the other this is where we put it and advisedly used the term "relatively uncontrollable."

There is a little one could do, but not very much.

Mr. CURTIS. Certainly you didn't have to increase the \$2.25 to \$2.50, and you probably would have saved \$100 million.

Mr. SCHULTZE. No, sir; not on soybeans.

Mr. CURTIS. Well, Mr. Freeman again by administrative decision permitted the plowup of this year's planted cotton acreage when it looked like it was going to make a good crop, paid Government cotton plants, and then in this land planted soybeans so that our surplus of soybeans would be and has been larger, meaning more cost to the Government, or takeoff time of CCC.

Mr. SCHULTZE. Just about offset by the decrease in cotton, in fact more than offset because cotton is down.

Mr. CURTIS. The point is whether you agree with my criticism, this is surely a controllable item and any administration that is embarked upon an austerity program should certainly have been looking into this particular area.

Mr. SCHULTZE. All I am saying, Mr. Curtis, of that whole list, if you look at it, veterans pensions, public assistance grants, public service cost—

Mr. CURTIS. I looked at them in detail. I will get to them.

Mr. SCHULTZE. What I am saying is that almost all of these expenditures are uncontrollable. You have to classify them one place or the other.

Since they are basically uncontrollable we put them in that category. I can't deny that on the margin in certain of them you can manipulate, but there is a very small amount of room to do that under existing law.

Mr. CURTIS. We will let the record speak for itself. I have a bill in, by the way, to remove the price support on wheat and small grains and I think you probably could save about \$2 billion, not in the immediate fiscal year, but a sizable sum like that. Actually the Secretary of Agriculture increased both the wheat and feed grain allotments before planting time for this year's crop and has produced—

Mr. SCHULTZE. The wheat was decreased, Mr. Curtis.

Mr. CURTIS. I said the amount of grain allotments before planting was increased.

Mr. SCHULTZE. I don't understand that. I'm sorry. That one I don't understand because I do recall the decision which would decrease wheat.

Mr. CURTIS. Wheat and corn production—I have the Agriculture Department's figures here—would be at an alltime high according to the USDA. August crop estimate, 1.5 billion bushels of wheat, 4.7 billion bushels of corn. This is an administrative decisions.

Mr. SCHULTZE. That is a crop figure, yes, sir. What I am saying is that this summer the Secretary of Agriculture in setting the advance acreage decreased the wheat allotment. The yield went up in wheat.

Mr. CURTIS. This is what I once described as the New Frontier waltz, two steps forward in the dark and then one step backward under the spotlights. The net result is one step forward, and this is not expenditure control. If you are doing this kind of a dance it is easy to see how you can go from a \$77 billion expenditure level to \$144 billion, if this is the definition of expenditure restraint.

Mr. SCHULTZE. Mr. Curtis, again what I said before was that basically under present law these payments are uncontrollable. You can, on the margin, change them a little bit, and particularly in the price support area—I can't deny that—but they are classified as relatively uncontrollable, which they are.

Mr. CURTIS. The answer is, and it is a very obvious one, is that we need someone in the administration who thinks they are controllable and will do something about them in this area and in other areas.

Mr. SCHULTZE. For the whole set of farm programs, over the past 5 years we have done precisely that. If you look at CCC price support programs, even there the expenditures this year will be \$400 million less than they were in 1965.

Mr. CURTIS. I am quite familiar with it. On the payroll, you have that in an area that can't be reduced.

I remember several years ago the Jensen amendment, which I thought was an excellent one. It simply said for every four vacancies that occurred in the normal turnover in Federal employment you could only fill one. This perhaps is a crude way of getting total employment down, but it is also possible through productivity increase, if the Government would ever think of it in these terms, to reduce the Federal payroll, but the Federal payroll has continued to expand. Since there is Federal payroll in almost every area, I don't regard this as an uncontrollable item.

Mr. SCHULTZE. Look at the table on the last page of my statement. You will find personnel compensation classified under "relatively controllable." What I did indicate in my text was that it is much more difficult to reduce expenditures in this area than it is in the remaining controllable expenditures, but I have personnel compensation down under "controllable."

Mr. CURTIS. I again point out in defense I don't think the figure cited can be the entire saving, because if we will move in this area, I think probably we will get more military dollars. Foreign aid is a clear area for cutbacks in these times even though I happen to favor the theory of foreign aid. The interest equalization tax is restricting private investment abroad, and this administration has asked for increased soft loans, from the development loan banks, which are not really loans in my judgment. I voted for the Asiatic Bank because I think properly disciplined this is a better way. But the point I am trying to make is that this is not an area where there has been a cutback. It has increased.

Mr. SCHULTZE. Again let's go back to 1965 to compare it and take foreign economic assistance administered by AID. Two things have happened. Expenditures in Vietnam by AID have risen, admittedly, some \$500 million plus.

In all areas other than Vietnam, AID expenditures have decreased by about \$150 million. In addition they are much more closely tied than they were previously to U.S. exports. This is not fully effective, we realize that, but it is as effective as we can make it.

Mr. CURTIS. And also there is a great misconception deliberately perpetrated on the American public by AID that this aid is actually tied, the specific project, to build a school or a road with purchases from the United States.

This is tied to what that country would be buying in the United States whether there were an AID program or not. That doesn't mean I object necessarily to the tying, but I just want to make it clear, it any rate, in foreign aid, AID is only part.

There is the Development Loan Fund, and I again say the soft loans are thinly disguised grants, and Public Law 480 grants, and disposal of military surplus.

Mr. SCHULTZE. May I make two points on that, Mr. Curtis?

Mr. CURTIS. Yes.

Mr. SCHULTZE. The Development Loan Fund is in AID and is included in the numbers I cited.

Mr. CURTIS. On Development Loan Fund bank and the Asiatic Bank.

Mr. SCHULTZE. I know of no Development Loan Fund bank. I think you may be talking about IDB, the Inter-American Development Bank.

Mr. CURTIS. I meant the IDB.

Mr. SCHULTZE. I want to make sure it is clear that the Development Loan Fund is in AID.

Mr. CURTIS. But the point is that we frequently take only one segment of the foreign aid program.

Secretary FOWLER. Mr. Curtis, just to correct that, the interest equalization tax does not apply to less-developed countries. They are exempted under that and it applies only to developed countries so there is a consistency between the interest equalization tax and the AID program in that regard.

Mr. CURTIS. That is a fair point to make. I would go further in my discussion to point out that although that is a valid point to make, I don't think the point will hold up—

Mr. SCHULTZE. Mr. Curtis, may I—

Mr. CURTIS. Yes.

Mr. SCHULTZE. I would like to put this in context. You can go down through some 1,500 appropriations and I guess we could have a debate as to the merits and priorities of each appropriation. I think the most essential element is the fact that, as I pointed out in my statement, first, outside of Vietnam Federal expenditures are taking a smaller and smaller share of our gross national product, having fallen from 16 percent of GNP in 1964 to 14.8 percent of GNP in 1965, the year we started with here, down to 14½ percent now, even when I exclude PC's, since I realize you don't agree with our PC's.

In that context, we have chosen what, I believe, is a middle ground between those who feel the answer to all the problems of this country is just spending more Federal money, and, on the other hand, those who feel that any increase in Federal expenditures is somehow wicked.

We think we have taken a reasonable middle ground and like anyone on middle ground we, of course, get hit by both sides. We can argue about the priorities of each program if you want, but I would like to do it in the context of that overall framework which, I think, is a meaningful measure of what has happened to expenditures.

Mr. CURTIS. I am sure you would like it in that context because you might win it because the context itself overlooks a number of basic points.

No. 1, although this is a criterion, and an important one (expenditure as a ratio of GNP), what really we have to get to is what should the optimum ratio be. We have been dealing in ratios since World War II and, I think, it is about time we started dealing in ratios over a longer period of time or project our minds into the future to see what these optimum ratios should be.

Furthermore, most important, gross national product is only a measure of economic activity. We have forgotten our wealth statistics. Gross national product, if it reflects misguided economic activity, could actually be eating up our wealth.

Mr. SCHULTZE. There is absolutely no indication that I know of from any of our statistics that in some sense our wealth is not appropriately keeping up or is not in line with gross national product.

Mr. Curtis, if I might—

Mr. CURTIS. Well, you made a statement. I just want to correct it.

Mr. SCHULTZE. Go ahead.

Mr. CURTIS. The subcommittee of the Joint Economic Committee on Economic Statistics held hearings in this very area and I hate to inform

you that the Federal Government has declined in its wealth position in relation to its debt.

Mr. SCHULTZE. The Federal Government?

Mr. CURTIS. The Federal Government.

Mr. SCHULTZE. I am sorry, I thought you were talking about the Nation's wealth as a whole.

Mr. CURTIS. No, no. The Nation's wealth has increased very well.

Mr. SCHULTZE. There is a very good reason for that, if it is so, Mr. Curtis.

Mr. CURTIS. But the Federal Government is in trouble.

Mr. SCHULTZE. Let me give you one reason. Over the last 4 or 5 years, the major strategy of this administration, which you might disagree with, has been to shift investment from primarily brick and mortar into investment in human resources. If you look at any chart on Federal spending you will find that public works spending and brick-and-mortar investment, which is the kind of investment that goes into the wealth statistics, has increased very little compared to the increase in investment in education, training, and health, which are not capitalized in the wealth statistics.

Mr. CURTIS. I have been using that argument of yours for years.

Mr. SCHULTZE. I realize that, so any wealth statistic is misleading in that sense because it doesn't take those investments in human resources into account.

Mr. CURTIS. The point is any of those education statistics have to be placed in context with others to understand them.

Mr. SCHULTZE. I fully agree.

Mr. CURTIS. And my criticism of the administration and the presentation of Mr. Ackley on the economic situation is that we have had presented only certain statistics, which are important, valuable, but we have to relate them to other equally valuable and important statistics. What I have said about wealth is only to get it in there. What you have said is a fair comment.

Now I have to go over on the floor. I want to close this discussion on the basic point—at least in my mind—whether or not there has been sufficient, if any, expenditure control that would make a tax increase actually productive of revenue. I don't think there is enough data that has been presented to this committee for us to make any judgment on this question.

If we are going to have a deficit of around \$30 billion, frankly, I don't think it makes any difference what the mix is among the sale of capital assets, increased revenues from taxes, or new debt securities. I think that the very size of the deficit is going to create the damage, whatever happens.

I think this deficit has to be within the range of \$15 billion. I think we might talk in terms of what amount of additional tax revenues could be obtained through possibly increasing rates, but, until we get to that level of deficit, these exercises here don't mean very much.

Mr. SCHULTZE. Mr. Curtis, the whole point of the program is precisely to make sure that that deficit does not reach \$30 billion, but gets to the \$14 to \$18 billion range.

Mr. CURTIS. Yes, according to what you all want to say, but not giving the figures that I think are important to understand this. I think your expenditures have to be revised and cut back radically, even

good programs. The President has to come out and tell the Congress and the people that we are in serious economic trouble and that we have to cut back on even important programs. He has not said that.

Mr. SCHULTZE. He has, and we are going to have to cut back.

Mr. CURTIS. Then give us the detail. Let him start out by announcing that he will veto the Federal pay raise that you complain about, this additional billion. Let him veto an appropriation bill. Let him go up and revise some of his requests. Until that is done, though, Mr. Director, I don't think I could advise any of my colleagues in the House, and certainly not the people, that a tax rate increase would help us to meet these problems.

I think it would aggravate the situation. I think it would hurt it. I think it would damage your situation instead of helping it.

Mr. SCHULTZE. Mr. Curtis, I have gone through, both yesterday with Mr. Byrnes, and today with you the reasons for having presented the expenditure cuts the way we have. I would make one theoretical point about the need for expenditure reduction. There is no question of that need. But it isn't the expenditure reduction in and of itself which makes the tax increase get you more or less revenues. That is the point I wanted to make.

Mr. CURTIS. I think it does. There is our difference possibly. That is what I argued on the 1964 tax cut. I said in order for that tax cut to produce more revenue, which it did, at lower rates we had to hold expenditures down, and that is why I am trying to get the dialog back to where I think the disagreement lies. The new economists keep talking about aggregate demand and I argue that aggregate demand isn't the problem.

Mr. SCHULTZE. The new economists at this table, at least—I am not going to designate which of the three of us are new economists—

Secretary FOWLER. I am not an economist, period.

Mr. CURTIS. No one wants to admit it these days. I am trying to find out who they are now.

Mr. SCHULTZE. In any event, the key point of the new economics is it is symmetrical. The new economics doesn't argue—I don't know whether I should set myself up as a spokesman for the new economics—but the new economics does not argue that under any and all circumstances the answer to our problems is increasing aggregate demand.

Precisely one of the reasons we are here today is to say that without this fiscal program of the President we run the danger of aggregate demand being too high, and more particularly through that, interest rates rising far too high. So here is a set of new economics and I know of no new economist who says the answer to every problem regardless of what it is is increased aggregate demand.

When the patient has a chill there is one medicine for him. When the patient has a fever there is another medicine, even though in both cases you try to keep him healthy and growing.

Mr. CURTIS. And as long as he is growing you give the medicine to apply to chills as well as to apply to a fever. But I think what is wrong has been aggregate demand and deficit financing have been the answer to all these things, and I think now we have come to a point where we realize the answer when new economists ask what is wrong with debt. We must learn to relate the debt to the economic activity (tax base) and wealth holdings of the society.

This is where we are and I think that your presentation here is mainly rhetoric about cutting expenditures. I think that we have to have the hard figures. Otherwise I don't think that this tax increase would produce more revenue. We are already going to have the damage from the previous inflation.

These inflationary forces are still with us, as well as the high interest rates. These are creating real problems and the greatest danger of all in my judgment is the international balance of payments which is aggravated by our domestic picture. I think these are times that call for real frugality and the President has to show us the way.

If he doesn't lead us, if he lets the Congress drift, and then blames the Congress, as I interpret what he is doing, then things are just going to continue to get worse.

Mr. ULLMAN. Mr. Secretary, can you be back at 2 p.m.?

Secretary FOWLER. Yes.

Mr. ULLMAN. And Mr. Director?

Mr. SCHULTZE. Yes.

Mr. ULLMAN. The committee stands recessed until 2 p.m.

(Whereupon, at 12:41 p.m., the committee recessed to reconvene at 2 p.m., the same day.)

AFTER RECESS

(The committee reconvened at 2 p.m., Hon. Al Ullman presiding.)

Mr. ULLMAN. The committee will come order.

Mr. SCHNEEBELI, you may proceed.

Mr. SCHNEEBELI. Mr. Secretary, for my information, will you give me the amount of money in tax income that will be forthcoming in various percentages, from 5 percent to 10 percent in both personal and corporate tax?

Secretary FOWLER. On a 5-percent surtax, 6-percent surtax, and 7 and 8?

Mr. SCHNEEBELI. Yes, for personal and corporate so that we might make up our mind as to what area we might settle on.

Secretary FOWLER. I can give you the figures now on the 10, 8, and 6 scale. I don't have them on 5, 7 and 9.

Mr. SCHNEEBELI. Will you give me on 6, 8 and 10 on personal and corporate?

Secretary FOWLER. I can give it to you in terms of liabilities, that is as it applies to the taxpayer or in terms of collections. Which do you prefer?

Mr. SCHNEEBELI. Treasury income.

Secretary FOWLER. I will take collections. That will be in terms of fiscal years.

Mr. SCHNEEBELI. Yes. I would like to have it for fiscal year 1968, the complete year.

Secretary FOWLER. The fiscal year 1968. Then I will take fiscal year 1969. We don't have economic projections for fiscal 1969 and the figures I will give you are based on calendar year 1967 incomes.

Mr. SCHNEEBELI. Thank you.

Secretary FOWLER. Fiscal year 1968, at 10-percent surcharge, individual tax increase in individual tax collections, \$3,850 million; corporations, \$2,250 million.

Mr. SCHNEEBELI. This is 1968?

Secretary FOWLER. That is right.

Mr. SCHNEEBELI. I thought it was more or less a 2-to-1 ratio.

Secretary FOWLER. You see the effective date on individuals is October 1.

Mr. SCHNEEBELI. Yes, but in 1968 is effective—

Secretary FOWLER. But the fiscal year 1968 we collect on the basis of—

Mr. SCHNEEBELI. I was referring to calendar year. Go ahead.

Secretary FOWLER. For fiscal year 1965 an 8-percent surcharge on individuals would be \$3,080 million. A little over \$3 billion. Corporations, \$1,800 million, or a total of \$4,880 million.

On the 6-percent surcharge, individuals, \$2,310 million; corporations, \$1,350 million.

Mr. SCHNEEBELI. That is fiscal 1968. How about fiscal 1969? That would be for the full year.

Secretary FOWLER. The 10-percent surcharge on individuals, \$6,420 million; corporations, \$2,320 million. A total of \$8,740 million.

Individuals, on the 8-percent surcharge, \$5,130 million; corporations, \$1,860 million. Total of \$6,990 million.

On the 6 percent surcharge, individuals \$3,850 million; corporations, \$1,395 million; or total of \$5,245 million.

Mr. SCHNEEBELI. Now as to corporations, is this tax surcharge figured before or after the investment credit?

Secretary FOWLER. According to the bill that has been drafted and is now available, it will be applied before the investment credit.

Mr. SCHNEEBELI. So the investment credit will be then on 90 percent?

Secretary FOWLER. No. It keeps the investment credit constant at the 7 percent level.

Mr. SCHNEEBELI. Seven percent before the surcharge?

Secretary FOWLER. Yes. If you did it the other way, it would change the effective impact of the investment credit to a 7.7 percent investment credit.

Mr. SCHNEEBELI. Now this total of 10 percent for fiscal 1969, which is about \$8.74 billion, would still be less than one-third of your anticipated deficit for fiscal year 1968, would it not?

Secretary FOWLER. That is correct.

Mr. SCHNEEBELI. In view of the fact that there does not seem to be too much conviction on the part of many people that we are going to have an outstanding rise in our economy in the next 6 to 12 months, is it worth the gamble to put a 10-percent surcharge on corporate taxes and on individuals income, risking a possible downturn in business which is entirely possible, in order to bring in less than one-third of the deficit? Is this considered a good gamble?

Secretary FOWLER. Congressman Schneebeli, two comments: No. 1, we don't find that large a number of people who think this is going to produce a downturn. I realize it is very easy for someone to find a reason not to vote a tax increase. But I do not believe that when the committee has assembled a solid body of economic and financial opinion that is available from those who make a specialty of these things, whether they are in public life or in private life, that you will find that sharp a division of opinion.

There will be those certainly who will be apprehensive and concerned, but I doubt that you will find many who will flatly predict, solidly and with the conviction that we have here, that this is going

to produce a downturn—who will be willing to take the other side of it in a responsible way.

Secondly, I think you have to look at the alternatives. What are going to be the consequences of not voting a tax increase designed to reduce this deficit and bring it into reasonably manageable proportions?

I think you also have to look at the conjunction of the tax increase with the efforts that are made to reduce and hold down expenditures. It is the combination of these two prongs of the program which put an entirely different phase on the magnitude of the extent to which the Federal Government would have to go into the market to borrow, add pressures to the market, and which put an entirely different phase on the future pattern of stimulation to the economy from the deficit on the NIA account that would be steadily trending down during the course of the 12 months ahead, according to Chairman Ackley's testimony yesterday, rather than a constant heat on the boiler from a constant or increasing NIA deficit from the second quarter figures all through the next year or 18 months.

Mr. SCHNEEBELI. I agree with your second statement. With regard to your first statement, I would like to make a comment from some other areas of concern.

The First National City Bank in its August monthly economic letter says, "The administration continues to express optimism about the strengthening of the economy. Business management by and large are not as cheerful as either Washington or Wall Street about economic expansion surging forward. Corporate profits remain depressed in the second quarter."

A July statement by the Bank of America—

Secretary FOWLER. May I comment on that for just a moment, the First National City Bank?

Mr. SCHNEEBELI. Yes. Go ahead.

Secretary FOWLER. I have all of those statements. I will be glad to bring you a compilation if it will be of any interest to you, of the statements of many of these banks.

I think that you will find the solid conviction of the officials of the First National City Bank of New York is that this tax increase should be voted.

Now, whatever side comment may be made in the monthly letter, that is the conviction I think you will find of those people who are in charge.

Mr. SCHNEEBELI. I said I agree with your second premise that from a monetary and fiscal viewpoint that we should probably have a tax increase. But from the point of view of the effects on the business economy I said I don't wholly agree with you.

I don't think Mr. Ackley made a selling statement as far as I am personally concerned. That is why I am reading from this statement saying this tax increase may not have the beneficial effect or may even have a detrimental effect.

Secretary FOWLER. What was said in that letter, and I think the whole letter ought to be read to get the full context, is a perfectly obvious observation. If you are in the steel business which has been going through a substantial inventory adjustment in one of the various lines of manufacture where your customers, rather than buying from you at the pace at which they sell, are using up, reducing their

inventories, if that is all you are looking at—and that is the tendency of people who are in the manufacturing sectors where the inventory adjustment has been most sharply felt—you would have some of the questions that are voiced there, based on your experience of the last 6 months.

Again, if you are looking at the scale of corporate profits and you see corporate profits decline and taking into account what was said this morning, that they seem to have bottomed out and now there is a slight increase at least in the second quarter over the first quarter, which I think puts somewhat of a new—

Mr. SCHNEEBELI. Resulting in \$200 million.

Secretary FOWLER. That is right.

But the fact that they don't keep going down which was the general expectation of a lot of people who were just looking at that side of the picture. If you read the corporate statement reports in any of the publications as they come out one by one over the last 2 or 3 months, you would have gotten, I think, the picture that corporate profits were going to plummet downward again in the second quarter.

Well, they didn't. So what I think you gentlemen have to do is to look, as we have tried to do, not at just one facet of this problem, not just at the past, not just at what happened in January, February, and March and April, but what is happening in May, June, and July, and what seems to be in the cards for the months ahead, and look at all of these particular elements in making a judgment as to whether or not the economy is going to go forward.

All I say is, I guess there are different publications, anybody can read them, but most of those I read which reflect private opinion say that it is behind us.

Mr. SCHNEEBELI. If I may refer to two others, Mr. Secretary.

The man who occupied Mr. Ackley's position 10 years ago says there is a distinct risk that a hike of 8 to 10 percent Federal surtax might bring a downturn in business, according to Raymond Saulnier. Also Mr. Martin Gainsburgh, senior vice president and chief economist of the National Industrial Conference Board, shares that same feeling as to what effect the 10 percent surtax will have on the business economy.

I would say that the letter from the First National City Bank is not localized as to any particular industry or any particular firm. I think it was trying to evaluate the viewpoints of industry in general up to this point.

Secretary FOWLER. Mr. Schneebeli, I neglected to bring—I bring too many black books, but I have one big black book back at the office reflecting the views of some of the gentlemen you mentioned and a number of others on this particular question.

Just let me say that I think when these views are all collected and in the hands of the committee, you will find a fairly overwhelming consensus, which was reflected in an outstanding business publication, Business Week, in its business outlook section as early as July 8, this comment:

By midyear economists usually have a pretty good fix on how the full year will shape up.

But right now there is still a wide spread on expectations for business in the second half of 1967. There is almost universal agreement that there will be no recession. There is also a consensus that business will pick up for the rest of the year and into 1968 also.

But there are sharp differences on the speed of the pickup and how well various areas of the economy will do.

Now that is roughly what I tried to reflect in my statement yesterday as being the general state of outside opinion.

Mr. SCHNEEBELI. As I state, to a lot of the members of our committee there is this question which still may be open in our minds as to exactly what effect on the business economy this proposed tax might have.

I would like to ask you something in another area. Yesterday on the wire this fact was noted:

Union workers in the building trade registered their largest quarterly wage increases in 19 years during the second quarter of 1967, according to Labor Department statistics.

The wage scale average rose 3.9 percent between April and July of this year, bringing average wages to \$4.85 an hour.

This statement, coupled with the unusually high demands being made by the UAW on the auto industry, would indicate that if there is going to be any inflation outside of the fiscal area we are talking about, it certainly is in the matter of wages.

I am wondering what the administration is doing in trying to keep down these huge increases in wages when they are reported to be the largest increase in any quarter in 19 years.

Mr. ACKLEY. Mr. Schneebeli, you are certainly correct that wage increases, particularly in the construction industry, have been exceedingly high and that current demands by other unions are also high, although certainly not as high as in construction.

I think the record of the administration on this is very clear. We have stated repeatedly and as strongly as I know how that this is a serious problem, and that wage increases are exceeding the productivity gains in the economy and are a source of upward pressure on prices.

We have urged repeatedly, the Council, the Secretary, the President, restraint by labor, as well as by business, in wagemaking and price determination. Obviously these appeals are not fully responded to in the private community. We have no legislative authority or other authority to set ceilings. We do not want such authority. We have made our views, I think, very clearly known about the seriousness of this problem and have urged the maximum degree of cooperation be achieved from the private community.

Mr. SCHNEEBELI. Has the administration taken any public position with regard to the UAW demands insofar as it would affect inflation and affect the economy?

Mr. ACKLEY. It has not taken any specific public position on the UAW demands, no. It has taken a public position on the general question of the size of wage increases.

Mr. SCHNEEBELI. In our discussion of the economy and inflation, and the problems we have in trying to raise taxes in this area, do you not think that this huge increase we have had in these wages in many areas is a matter of grave concern and should be dealt with probably a little more forthrightly and publicly?

Mr. ACKLEY. Mr. Schneebeli, the opinions of the administration have been expressed in various ways, both in public statements I have referred to and in private meetings with leaders of the labor and business communities.

One seriously doubts as to the tactical effectiveness of the Government making specific statements about particular pending labor disputes which can often exacerbate rather than help the situation.

Mr. SCHNEEBELI. I would like to say that the White House is doing a good job in making its position clear with regard to Federal pay increases. I think they have done a very excellent job. I hope they stick with it.

Secretary FOWLER. Mr. Schneebeli, I would like to point out that the President in his message sending up this particular measure did comment and say that, "The current situation summons those groups"—referring to business and labor communities—"as never before to maintain that responsibility in their wage and price decisions."

Now, I think, as was said here this morning, to some extent these high wage demands are symptoms of the increasing price levels that have transpired over the last year or so. The tax increase proposals and the program that is before this committee involving the tax increase and an effort on the part of both Congress and the administration to reduce expenditures is designed to hold back and to fight inflation which is one of the causes of these extravagant demands.

If inflationary pressures are allowed to continue to grow, the spiral that we would all be concerned about will become an increasing spiral and our opportunity and our chance to come back to the pattern of relative price stability that characterized the period 1959 through at least 1964 would be delayed—we want to work back to that kind of pattern.

Mr. SCHNEEBELI. I realize this is not your province, Mr. Secretary, this matter of these huge wage increases, but nevertheless they certainly have an impact on what we have been discussing in the last few days on our fight on inflation. It seems to me the administration might be a little more vigorous in trying to keep these inflationary wage increases from coming into being.

Secretary FOWLER. I would agree that there is a direct relationship between these two, as the President's message has indicated. The emphasis on both the avoidance of excessive demands, which is an inflationary force, and the avoidance of wage price changes that are destabilizing are two prongs of the same problem; namely, the drive for price stability.

Mr. ACKLEY. Could I comment briefly on the subject which Mr. Schneebeli raised about the forecasts of economists with respect to the impact of the tax proposal?

I think the views of the economists and others on this are in the process of being revised rather drastically just within the past few days or weeks as additional information becomes available.

For example, at noon today, the Commerce Department released figures in personal income. They are rather striking. Previously published preliminary figures on personal income for June showed a gain of \$3.7 billion in personal income from June over May. This was the largest personal income gain since January.

That has now been revised upward substantially to a \$4.4 billion gain for June. Preliminary figures for July show a further increase of \$4.5 billion for July. The total increase in those 2 months alone of \$8.9 billion, practically \$9 billion. At an annual rate that would be almost a \$54 billion gain.

This compares with the gain in the 4 months from January through May of only \$7.8 billion.

Mr. SCHNEEBELI. I believe there is more of this fiscal income going into debt repayment and savings than there was earlier this year. So possibly the total difference may not be going into the economy.

Mr. ACKLEY. Certainly the rate of personal saving has been high, but it has also been declining.

Mr. SCHNEEBELI. I understand the rate of personal saving is higher than it was the first of the year, percentage-wise.

Mr. ACKLEY. On the contrary it has declined from the first to the second quarter, appreciably.

The CHAIRMAN. Mrs. Griffiths.

Mrs. GRIFFITHS. I would like to ask you if the deficit is \$29 billion this year, what percentage is that of the budget first, and secondly of the estimated gross national product.

Mr. SCHULTZE. If the deficit were \$29 billion, you would have expenditures of \$144.2 billion, which would make the deficit, I will guess, roughly 18 percent of the budget. I haven't done the arithmetic.

Mrs. GRIFFITHS. How much is that of the gross national product?

Mr. SCHULTZE. \$29 billion on a round number of \$800 billion of GNP. That is around $3\frac{1}{2}$ percent.

Mrs. GRIFFITHS. What was the highest previous deficit in any one year?

Secretary FOWLER. Leaving out World War II?

Mrs. GRIFFITHS. Yes. In 1958.

Secretary FOWLER. In fiscal 1959. I think the ratio was about 2.4 percent as against what Mr. Schultze has computed here would be about $3\frac{1}{2}$ percent.

Mrs. GRIFFITHS. What was that in gross national product?

Secretary FOWLER. 2.4 percent.

Mrs. GRIFFITHS. What do you say it would be now?

Mr. SCHULTZE. It would be, if you had the \$29 billion deficit, approximately $3\frac{1}{2}$ percent.

Mrs. GRIFFITHS. Approximately how much?

Mr. SCHULTZE. Approximately $3\frac{1}{2}$ percent.

Mrs. GRIFFITHS. Why can't a wealthy nation bear that kind of debt? What are we really talking about?

Mr. SCHULTZE. May I start on that?

I think this question really involves two points. First, relatively moderate changes in the balance between income and expenditures either in the Federal Government or in the private sector, can affect the economy with a fairly heavy impact precisely because it is an imbalance between revenues and expenditures. In other words, its impact on the economy cannot just be measured in terms of its own size, because it, in turn, affects incomes in the private sector of the economy and thereby spending, which further affects income. And that does have a multiplier effect and drives the economy much harder than you would think by simply looking at the size of the deficit alone.

Secondly, if the economy were running in the neighborhood of full employment, relatively marginal gains above full employment can give you significant price pressure, just as an economy operating at $5\frac{1}{2}$ to 6 percent unemployment is an economy with a good bit of stagnation, even though it is only 2 percentage points below the full employment rate.

So, in terms of performance of the economy, in terms of what drives it, relatively moderate changes in this balance between income and expenditures can result in a good bit of drive.

The second point is that this is also true in the credit markets. Relative to the total amount of funds to be borrowed perhaps this amount may not seem large, but as an incremental amount on top of that to be financed, it can really have a big impact on interest rates just as a relatively moderate inflationary pressure can drive prices up by 3, 4, 5 percent.

Now, that is not Brazilian inflation, no, but it is far more than we want.

So then, in summary, modest amounts of deficits can have fairly big impacts. Those impacts can give us pretty bad performance from the point of view of U.S. goals, maybe not in terms of a South American economy, but in terms of U.S. goals they give us pretty bad performance in terms of interest rates and prices.

Mrs. GRIFFITHS. What is the mean average wage?

Mr. ACKLEY. Hourly or annual?

Mrs. GRIFFITHS. Annual.

Secretary FOWLER. 2.6 percent on the ratio of GNP to the deficit in 1959. I said about 2.4. It is 2.6.

Mr. ACKLEY. Average weekly earnings in manufacturing in July were \$113.24.

Mrs. GRIFFITHS. What about the rest of the country? You don't have anything close to \$5,000 as the mean average wage, do you?

Mr. SCHULTZE. I admit I may be answering too quickly, but I am almost positive the mean average wage would be over \$5,000.

(The following information from Mr. Ackley, was received by the committee:)

The Department of Commerce publishes estimates of average full-time annual earnings of employees. In 1966, this figure was \$5,954 in all industries, 7,016 in construction, \$6,647 in manufacturing, \$7,786 in transportation, and \$2,247 in agriculture.

Mrs. GRIFFITHS. How much? Supposing it is 6, half the people then are drawing less than that, aren't they?

Mr. SCHULTZE. Yes.

Mrs. GRIFFITHS. How much less money are they going to have to spend if this tax bill is enacted as you suggest?

Mr. SCHULTZE. In the first place, a man with a wife and two children with an income up to \$5,000 will not have a penny less than under current tax laws, because the bill is written to give an exemption to such a family. A single person, for example, with \$1,900—

Mrs. GRIFFITHS. Would have \$4 less.

Mr. SCHULTZE. The family man earning \$5,000 would have nothing less. This tax proposal would not take anything from him. A man with a wife and two children would lose nothing because the exemptions from the proposed surcharge go up to that \$5,000 level. So the proposal would not take a penny from him. As a matter of fact, in terms of real purchasing power, we think he will be better off because we will avoid some price increases which would otherwise occur.

I can't prove that mathematically, but we are sure that will be the impact—to hold prices down. So, in terms of purchasing power, he will end up better off.

Mrs. GRIFFITHS. At \$25,000 how much less?

Mr. SCHULTZE. The Secretary's statement, on the last page, shows that at \$25,000 the total impact of the tax, when it is fully effective—in other words, on 1968 tax liabilities—would be \$441 less than at present.

Mrs. GRIFFITHS. At \$25,000 those people are not really going to delay what they are going to purchase. They may put less money in the bank, so that you will have less money to lend.

Mr. SCHULTZE. Mr. Ackley may want to comment further on this, but what you are after is the spending rate of additions to income at that \$20,000 to \$30,000 income range. On the basis both of my wife's buying habits, and perhaps more appropriately, on the basis of studies which have been done, the indications are that the spending portion of that extra income is still quite significant. I don't know what numbers would come out, but the marginal rate is still quite significant. Any study which has been run will show it is quite high, although I can't give you a specific percentage.

Mrs. GRIFFITHS. If this tax is enacted, what effect is it going to have on wage negotiations? Since the auto companies will have less money will they be more willing to resist wage demands and since the unions know that they have somewhat less money will they withdraw demands?

Mr. ACKLEY. If I may start the answer to that, the impacts are several. One, of course, is the direct impact of the additional tax on the profits of the corporations which makes them all the more resistant to wage increases, and the impact of the knowledge of that on the unions.

I think the more important anti-inflationary impact of the tax action is in avoiding the kind of labor market shortage, excess demand situation, in which businesses are competing with each other to find additional workers and willing to do whatever it takes to get them. It is a climate in which they know they can easily raise prices to cover the cost of excessive wage increases. It is a climate in which the cost of living is rising more rapidly and the workers feel the need to get larger wage increases to keep up with the cost of living. Employers recognize that.

The whole climate of negotiations is affected by the state of the economy.

Mrs. GRIFFITHS. You have already told me it is not going to have any effect at all on half of the persons.

Secretary FOWLER. No; I think up to \$5,000. Sixteen million out of 98 million taxpayers would be exempt from the surcharge. That is our computation of the effect of the exemption from the surcharge of those in the two lower brackets—a little over 16 million out of 98 million taxpayers.

Mrs. GRIFFITHS. It seems to me, frankly, that the new economics is running into old politics. It was hard enough to sell my district on the idea that if there was a tax cut we could pay our bills better. This was back when the first tax cut was offered. Now I am going to have to go back again with your suggestion that we increase taxes to start paying our bills and stop inflation.

In the first place, I don't think this is enough to do anything in the face of the problem.

Mr. SCHULTZE. May I make one comment on that, Mrs. Griffiths?

It is not a very fancy analogy, but in a colloquy with Mr. Curtis earlier this morning, I pointed out that when a doctor is treating a patient, whether the patient has a chill or fever, he still has the same objective, which is restoring his health. You treat a chill and you treat a fever differently. In 1964, when the economy had a chill, it was true that tax reductions on top of an economy with a high unemployment rate, with very low pressure or no pressures, as a matter of fact, in the labor market, could generate activity sufficient so that you built up a tax base to get you more revenues than you started with.

Right now the problem is not a chill, but a fever. One measure of that fever, and, I admit, only one, is the fact that without the combined expenditure and tax program of the President, on a national income accounts basis, you would be running a deficit of something in the neighborhood of \$15 to \$18 billion on top of an economy which is already in the neighborhood of full employment.

That is almost bound to generate a fever, even though nobody can predict precisely what parts of the body the fever might affect most. So I think it is perfectly legitimate to say that the same economics which told you when the economy had a chill you needed a tax cut would now say you need a tax increase.

The only way, the only possible way, in which a no-tax-increase situation could bring you more revenues would be one in which at this stage of the game you started to get inflationary increases in income, and that certainly we do not want.

I would say it is no more difficult to explain about treating the economy with different medicine when the ills are different than it is the human body. A good doctor does not necessarily give the same pill, no matter what kind of situation the patient is in.

Mrs. GRIFFITHS. We never did pay the bills with the last cut.

Secretary FOWLER. There is another part of this picture. I tried to stress yesterday that the cost of the conflict in Vietnam has now reached such a proportion—that is \$22 billion or in excess of that amount—that according to the experience we have had, such a special temporary cost of war—you might put it in those blunt terms—we customarily try to defray by tax increases not dollar for dollar, not in any complete way, but pay a substantial part of the bill out of current revenues.

People will recall that in the Korean war, individual taxes were increased not equivalent to the 10-percent surcharge but a 28-percent surcharge. Of course, the tax increases that took place in World War II are not comparable in any sense because it represented a whole fundamental change in the income tax structure. But it is, I think, a fact of fiscal life that when you have a temporary special cost that is not a permanent part of your picture, you try to defray at least a portion of that out of extra earnings if you are an individual.

In the case of a government, the customary and natural thing to do is to pay part of that cost by increasing taxes.

Now, history may prove me wrong on this, but as to this question: "Are we going to get more revenue out of this increased rate?" I think the answer is, "Sure, we are, given the economy in the State it is in today." The only time I think history will prove in our experience that an income tax increase did not yield substantially increased revenues was in the depression period when there was a tax increase in the early 1930's.

It reacted contrary to the conventional expectations of the time. If we were in a recession or if we were threatened to be in a recession, we would not be here counseling with this committee to impose a tax increase. We did not recommend that it be imposed as of January 1 because we had some concern about what the economy would do in the early months of this year.

I can say to you with all conviction that we have kept a very constant watch on the movement of the economy since the President's message went up. Now we come to you not in April or May, but in the light of the current developments, with the full conviction that the danger of any downturn is now well behind us, and that the real problem of the economy and our financial system is the threat of compounding the inflationary thrust by a continuance of a highly stimulative fiscal policy that would put undue pressure on the money markets which would result in ever higher interest rates.

Mrs. GRIFFITHS. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Watts?

Mr. WATTS. Did I understand you a few minutes ago, Mr. Ackley, to say that the wages had gone up \$4.4 billion in June and that you anticipated that it would be \$4½ billion in July?

Mr. ACKLEY. That was not wages. That was total personal income. It included wage income and all other kinds of income.

Mr. WATTS. Did it include corporate income, too?

Mr. ACKLEY. Personal income includes corporate dividends. There was a small increase of two-tenths of a billion dollars in dividends in June and three-tenths of a billion dollars in dividends in July.

Mr. WATTS. I am amazed that there was that much steam going ahead. Of course, that does not cover all of it if it does not cover corporations, does it?

Secretary FOWLER. We did comment this morning, Congressman Watts, that the decline in corporate profits in the last quarter of last year and the first quarter of this year, apparently has bottomed out because of a report which came out of the Department of Commerce yesterday, reported in this morning's papers, that the second-quarter profits are going to be slightly, \$200 million in excess of first quarter profits.

Mr. WATTS. Then there is an upturn in not only the personal income but the corporate income.

Secretary FOWLER. At least you can say the downturn in corporate profits for this second quarter has flattened out.

Mr. WATTS. I did not anticipate this kind of increase. Did you at the time you made up the budget?

Secretary FOWLER. This kind of increase in personal income?

Mr. WATTS. Yes, to this extent.

Mr. ACKLEY. Yes, I think we have been counting on a substantial improvement in personal income. The figures for June and July are indeed rather large. But, I think, they are most relevant here as symptomatic of the fact that the economy has begun to advance more rapidly and that the upturn we have expected in January has indeed arrived.

Mr. WATTS. Do you expect this to continue throughout the rest of the year?

Mr. ACKLEY. We do indeed.

Mr. WATTS. At about the same rate?

Mr. ACKLEY. I tried to indicate in my statement yesterday some rough ideas of the magnitudes of expected advance. Measuring in terms of gross national product, as developed this morning with Mr. Byrnes, with the tax increase we expect an increase in gross national product of something over \$25 billion between the second and the fourth quarters of this year.

Mr. WATTS. Between the second and fourth quarters. That would cover two quarters, would it not?

Mr. ACKLEY. Yes. And with the tax increase, from second quarter of this year to the second quarter of next year the increase in gross national product might be in the neighborhood of \$55 billion.

Mr. WATTS. If personal income continues at the same rate that would be in the neighborhood of \$48 to \$50 billion a year, would it not?

Mr. ACKLEY. Yes, if you simply extrapolated the increase from May to July it would be in that kind of magnitude which is undoubtedly higher—

Mr. WATTS. Would that be within the bounds of reason?

Mr. ACKLEY. No, I think one would not extrapolate that same increase.

Mr. WATTS. What do you anticipate will be the increase on a yearly basis at the rate it is going now?

Mr. ACKLEY. If we take from January to July, the increase in personal income was something a little less than \$17 billion. Certainly it would be a larger increase than that in the second half.

Mr. WATTS. You have \$9 billion in 2 months according to your statement, have you not, sir?

Mr. ACKLEY. That is right.

Mr. WATTS. There will be taxes paid on all that additional income, will there not?

Mr. ACKLEY. Yes. This is certainly before taxes.

Mr. WATTS. In other words, if you had an increase of \$40 billion in a year, the tax on that was 20 percent that would be about \$8 billion.

Mr. ACKLEY. The average rate of taxation on personal income is less than 20 percent.

Mr. WATTS. About 18, is it not?

Secretary FOWLER. The figure is 15½ percent for personal income adjusted to a tax basis.

Mr. WATTS. Can personal income continue to go up without corporate income following it to a certain degree?

Mr. ACKLEY. We are certainly predicting that corporate profits will be rising over the next year.

Mr. WATTS. I am just wondering if you have taken into consideration this extra income you are going to derive from these additional wages that have gone up so fast and the corporate profits which are going to go up in determining your need.

Mr. ACKLEY. Yes, I think the answer is clearly yes, that the forecasts we have made of revenues are based on the expected path of the economy.

Mr. WATTS. Your forecast of revenue was based on the rate of increase in June of \$41½ billion and July of \$41½ billion and at that rate for several months?

Mr. ACKLEY. Our view would be that an increase in gross national product in the neighborhood of \$55 billion for the second quarter next year over the second quarter this year would be associated with a gain of something like \$45 billion in personal income.

Mr. WATTS. Have you calculated what taxes you would get on this in making your determination?

Secretary FOWLER. That is right. They are reflected in the revenue estimates I gave.

Mr. WATTS. What amount of money did you allocate to these increases? Do you have that?

Secretary FOWLER. I don't think it is computed exactly on that basis.

Mr. WATTS. How much did you compute the revenue for this year over the last fiscal year?

Secretary FOWLER. We came in, Congressman Watts, with an estimate in the January budget of \$126.9 billion.

Mr. WATTS. What is that?

Secretary FOWLER. We came in with the January budget with a computation of revenue of \$126.9 billion.

Mr. WATTS. Income?

Secretary FOWLER. Revenue from all sources.

Mr. WATTS. What did you come in with the year before? Do you remember?

Secretary FOWLER. Do you want the estimate we made or the actual?

Mr. WATTS. The figure for the year before that you were using when you gave me \$126.9 billion.

Secretary FOWLER. This January?

Mr. WATTS. You said you estimated in January or figured in January that your revenues would be \$126.9 billion.

Secretary FOWLER. At that same time we gave you an estimate of revenues for fiscal 1967, of \$117 billion. It actually emerged at \$115.8 billion as of June 30 when we settled our books.

Mr. WATTS. In other words, this \$126 billion you are talking about is for fiscal 1968, is that correct?

Secretary FOWLER. That is right.

Mr. WATTS. And for fiscal 1967 what did you estimate it at?

Secretary FOWLER. We estimated in January that fiscal 1967 figures would produce \$117 billion. In actual fact it was \$115.8 billion.

Mr. WATTS. You were short?

Secretary FOWLER. That is right.

Mr. WATTS. You estimated about \$9 billion difference between fiscal 1967 and fiscal 1968?

Secretary FOWLER. That is right. That assumed a 6 percent tax increase.

Mr. WATTS. What I am trying to say is, if your gross national product is going to go up \$55 billion in the course of the year, I don't know how much taxes you expect to get out of that. I guess you probably did take in a good part of the \$55 billion, whatever you realized in taxes on it. But I am astounded at the growth that is evidenced in the wage field. I am just wondering if that was taken into consideration in arriving at your needs. You say it was.

Mr. SCHULTZE. One way to look at that, Mr. Watts, is that in the Secretary's statement he says that we are assuming for the current calendar year a \$625 billion personal income figure.

Now, to get \$625 billion means that personal income between the first half and second half of the year has to go up about \$20 billion at annual rates.

Mr. WATTS. I have to go and answer a rolcall, but I wish you would put in the record, Mr. Secretary, the percentage of gross national product for 1967 and 1966 that was paid in taxes and rationalize that with your estimate of gross national product this time and figure out what amount of taxes you would have. Will you do that, sir?

Secretary FOWLER. Yes, sir.

(The following information was received by the committee:)

There have been several legislative and administrative actions which have affected receipts in varying amounts in the three fiscal years, 1966, 1967, and 1968. To compare the three years, they must be first adjusted to a common base. Any one of the three years could be taken as the base. In the explanation which follows, the mid-year, 1967 has been used as the base and 1966 and 1968 adjusted to it.

The adjustments to achieve comparability are:

[In billions of dollars]

	Adjustments to fiscal 1967 base	
	In 1966	In 1968
1. Acceleration of corporation payments (1964 and 1966 acts).....	+2.0	+4.1
2. Speed up in collections of withheld income and excise taxes (administrative).....	-.6	+3
3. Revenue act of 1964 (corporation income tax).....	-.5	-----
4. Excise taxes (1965 and 1966 acts).....	-.5	+1
5. 1966 act (individual).....	+5	+1.0
6. Suspension and restoration of investment credit.....	-.3	-----
7. Proposed 1967 tax program.....	-----	-7.4
8. Other proposed legislation (safety-beauty trust fund).....	-----	+4
Total adjustments.....	+6	-1.5

The comparison of the 3 years would then be:

[Dollar amounts in billions]

	Fiscal year		
	1966	1967	1968
1. Total administrative budget receipts.....	\$104.7	\$115.8	\$122.5
2. Deduct miscellaneous receipts, primarily nontax receipts.....	-5.2	-6.2	-5.2
3. Total tax receipts.....	99.5	109.6	117.3
4. Adjustments for comparability.....	+0.6	-----	+1.5
5. Tax receipts, adjusted.....	100.1	109.6	115.8
6. Gross national product.....	715.3	763.1	809.0
7. Tax receipts, adjusted as a percent of GNP.....	13.99	14.36	14.31

¹ Average for fiscal year 1968 with a gain of \$55,000,000,000 from the 2d quarter of calendar year 1967 to 2d quarter of 1968.

The CHAIRMAN. Mr Battin.

Mr. BATTIN. Mr. Secretary, as I understood from your statement, the only reason the surcharge method was used rather than a straight percentage increase was for simplicity of administration. Is that correct?

Secretary FOWLER. No, I think there were a number of other factors that entered into it, Congressman Battin, or were alluded to. I tried in a rather generalized way to incorporate, you might say, by reference as a part of our reasoning the report of the Fiscal Subcommittee of the Joint Economic Committee last March, and there were a number of criteria or standards developed in that report for a temporary tax increase or tax reduction.

While I think simplicity is one of the factors that should be stressed, I think that there are a number of other elements. This approach minimizes the arguments that always arise and take up a great deal of time and effort as to changing the structure of the tax system. It takes the tax system as we have it and applies the surcharge with a minimum of disturbance to the existing relationships among taxpayers and, therefore, has an appeal as being fair, sensible, moderate, and temporary. In the light of that entire range of considerations in that report, we felt the surcharge approach was the right one.

Mr. BATTIN. It was easily identifiable, you say with a temporary increase.

Secretary FOWLER. That was one of the things I mentioned yesterday. I think it was in a colloquy with the chairman. It stands out on the form in such a way that it is going to be properly much more susceptible to elimination after the cost factors; that is, the cost of hostilities in Vietnam have passed.

Mr. BATTIN. I do not understand the figures you gave yesterday. I don't understand the logic that applies. Maybe you can help me out. In the 1966 fiscal year we had an administrative budget deficit of \$2.3 billion.

Secretary FOWLER. That is correct.

Mr. BATTIN. Then in 1967, just ended, we had an \$8 billion deficit.

Secretary FOWLER. \$9.9 billion.

Mr. BATTIN. Now, in the fall of 1966, which would have been the last half of the 1967 fiscal year, is when we had the high interest and the tight money and inflation.

Secretary FOWLER. It was really characterized by tightness more in the late spring and summer, more or less terminating in September and October with the new program that came in. Actually there was a very marked reaction and the peak of interest rate movements turned down shortly after the introduction of that program, including the action of this committee last fall.

Mr. BATTIN. That was the suspension of the investment credit.

Secretary FOWLER. The investment credit suspension and the announcement of the expenditure control program and the new policing on our part of entry into the money market by Government agencies other than the Treasury.

Mr. BATTIN. Also about that time there was an announcement that there would be no further sale of participating certificates.

Secretary FOWLER. That was part of that third element of the program.

Mr. BATTIN. Now, this is where your logic breaks down. Then you are stating that without the tax there is going to be about a \$29 billion deficit for this fiscal year, but with the tax somewhere between \$14 and \$18 billion deficit—

Secretary FOWLER. No, it is with the tax and the various elements of expenditure restraint that were identified by Mr. Schultze in his testimony at some length, I believe in a colloquy with Mr. Byrnes.

Mr. BATTIN. Mr. Schultze was saying—at least this morning—that every effort was going to be made by the administration to override the action the House took in the sale of participating certificates which would indicate your going to have to go back into the market at some time during this fiscal year to do some financing in order to take care of the deficit.

Secretary FOWLER. If we don't sell participation certificates we have to sell Treasury securities. It is the same magnitude whether you use the PC's or not.

Mr. BATTIN. There is a little difference in perhaps the saleability of interest paid. That is not the point. The point is that last year where you had to finance the 9.9 deficit in the 1968 fiscal year, you are going to have to plan to finance \$14 to \$18 billion. I think this would be really a far more difficult thing to do than was done last year and I don't see where you are going to be able to control the interest and the inflation and the tight money?

Secretary FOWLER. Let me say there is one major difference between the state of the market last year and this year which we are very anxious to preserve, Mr. Battin. It is very important to have it and that is a monetary policy of relative ease—the fact that bank credit is being expanded in substantial amounts and that the money supply is being increased at a substantial rate, around 6 to 7 percent compared to last year's rate of 1.9 percent. So, we would hope, while I think my statement does not put any optimistic gloss on the problem that confronts us, with the deficit at the range indicated, nonetheless we think it is a lot more tolerable and a lot more manageable at that level than would be the case if it were at the higher levels of \$28, \$29 billion.

Mr. BATTIN. Now, anticipating a \$14 billion deficit does that mean that sometime before the 1st of June 1968, we will have to raise the debt limit again?

Secretary FOWLER. Let me give you these elements. The debt limit that is applicable to the fiscal year 1968, as you recall, is \$358 billion.

We are of the clear opinion that a deficit of \$14 to \$18 billion, which is the range we are seeking here would fit under that limit because it was set high enough to cover some of the very contingencies that we have now under consideration, that have either come to pass or seem likely. A deficit of \$29 billion I do not believe could be accommodated under the debt limit. To the extent that a bigger deficit was due to a short fall in PC sales it would not use up the leeway under the limit because of the modification in the limit that is provided but I do not want to imply in anything that I say the debt limit is the reason we are here urging the tax action or expenditure control.

The present limit applicable to fiscal 1968 could accommodate deficits for that year which we believe are clearly excessive in the view of the financing burden on the market and the inflationary potential in the economy. As for the maximum deficit that would get us under that limit I think a precise figure would depend very much on timing patterns within the fiscal year, and how much of the "deficit" might be due to short falls in PC sales. I would hate to give you a hard estimate but I think any time the deficit got anywhere substantially above \$20

billion we would begin to be concerned about the problem of staying within the debt limit. I said in the very early part of my statement, Congressman Battin, that the real purpose of coming here is to keep the use of the borrowing authority that the Congress did provide to much lesser proportions. These proportions, we think, are a lot more compatible with the economic and financial health. Of course, the borrowing authority is there and the Treasurer usually wants to be in a position to borrow or get it out of revenues.

Now, my distinct preference is to hold that deficit down because I think to borrow up to the limit that would be permissible given the economic facts that we have been discussing the last few days, is the wrong course to take.

Mr. BATTIN. We reinstated the 7-percent investment tax credit because I believe we felt that the business community was slowing down and something had to be done to get that picking up again.

Now, how do you equate giving somebody a 7-percent investment credit and then turning around and putting a 10-percent surcharge on their earnings? Does that have any counteracting effect to the point where maybe we should talk about some other action by the committee rather than just a surtax?

Secretary FOWLER. I don't think so because I think the investment credit was there as a permanent part of the law to begin with. It was suspended last September in the special circumstances that were indicated. I think it served its purpose, as Chairman Ackley's testimony and the study of the charts indicated this morning. There is no longer the excessive escalation in the rate of plant and equipment expenditures that characterized the period of a year ago. It has flattened out. Indeed it could edge up some in the period ahead, without causing great concern. Therefore, having made a commitment at the time we suspended the investment credit that when the conditions to which it was addressed had passed we would restore it, I think having made good that commitment I do not personally see a real connection between that and the action we are taking here on taxes. I realize that there are those who will dispute that but to me they are two entirely different propositions.

Mr. BATTIN. What effect might this have as an offset? Here is a credit on the one hand and on the other hand a tax. Is there a loss here for the people who are in a position to take advantage of the 7 percent? I realize they are applied to dividends.

One of them was capital investment. The other comes out of the earnings. How much of an incentive might it be for business now to take the 7 percent where they perhaps delayed building or equipping their plants because they wanted to offset income?

Secretary FOWLER. I don't believe there would be very much connection between those two in that regard. I think the decisions on whether to purchase new plant and equipment, thereby giving rise to the 7-percent investment credit, involve a much larger and different group of considerations than simply taking the tax advantage and profit advantage or the cash flow advantage. For one thing we must remember on the cash flow side of the picture the marked acceleration in corporate tax collections which has characterized recent years. The revenue from that drops off appreciably, about \$4 billion or more, so an excess of \$4 billion drops out of the receipts structure.

Now, that main period of acceleration is behind us. So there will be some better cash flow pictures on the part of companies that have been undergoing that acceleration process. Therefore, I do not believe that they will be the same motivation or purpose in just using the investment credit for the sake of having a credit on taxes.

Mr. BATTIN. Mr. Schultze, you probably remember a period before the Appropriations Committee on the 1968 budget when you had a colloquy with Congressman Cederberg of Michigan and Congressman Jonas of North Carolina, I guess I will have to paraphrase, on on the phantam savings where some credit was being taken for cuts or savings in the budget and in fact on money which had been appropriated. What brings this to mind is that now we are talking about cutting spending of the executive agencies.

Are we talking about real dollar savings, money that has been appropriated, or are we talking about something that was not appropriated?

Mr. SCHULTZE. I recall the colloquy. I think you are referring to a sum of about \$500 million, or something like that.

Mr. BATTIN. No; it dealt with something between \$4 and \$7 billion.

Mr. SCHULTZE. Then I am sorry. Let me reconstruct the situation that I am fairly sure you are referring to.

Last year in September before this committee we indicated that we would make savings in a number of ways. In particular I mentioned two of them. One was that where the Congress had authorized additional sums for new programs we would not come up and request an appropriation for them.

Secondly, we would, once appropriations had been made, reserve, impound, use whatever word you want, some of those sums and not spend them. We did both. Of the \$2.6 billion savings in the administrative budget, about \$500 million—I don't remember the exact number—resulted from not sending up appropriations in cases where the Congress had increased the authorization for new programs over the budget recommendation.

Now, the situation this year so far is quite different than last year with a few exceptions. In general we are not faced with the situation, as we were last year, of the Congress authorizing new programs, \$4 to \$5 to \$6 billion above our budget. Consequently the question of our not coming up with appropriations to finance those new programs does not arise. Hence, the \$2 billion-odd savings I am talking about for this year basically comes from the Congress itself cutting appropriations below our budget and/or the administration, to the extent that Congress does not do that, saving from those appropriations themselves. Either way, to the extent that Congress does cut, we have to do less and I will be happy for their cooperation.

Mr. BATTIN. Incidentally, this appears on page 40.

Mr. SCHULTZE. I remember this colloquy in which Congressman Cederberg and Congressman Jonas said it was not legitimate for us to claim the savings of \$500 million. I pointed out that we had already told the Congress we would get the savings in three different ways.

Mr. BATTIN. What I am trying to point out here is that the effect the savings that we are talking about, you are not going to request appropriations but you are actually going to cut down on money which has been appropriated.

Mr. SCHULTZE. And/or. I say to the extent that Congress itself cuts some of these appropriations, both of us, between us, would do this in terms of appropriations that are not spent. Let me add, of course, that to the extent in future weeks or months the Congress does add additional authorization over and above the administration's recommendations, then we would as a general proposition not necessarily come up and ask for the full appropriation, but that is separate from anything I have said so far. I have not counted that in the \$2 billion.

Mr. BATTIN. I have one other question. I have a special report of the Tax Foundation which was prepared recently concerning the controllable and uncontrollable items in the budget. I would ask for unanimous consent that they appear at this point in the record.

The CHAIRMAN. Without objection, it is so ordered.

(The special report on controllability of fiscal 1968 budget expenditures follows:)

TAX FOUNDATION—SPECIAL REPORT

CONTROLLABILITY OF FISCAL 1968 BUDGET EXPENDITURES

Analysis Rebuts Claim that 1968 Budget is Relatively Uncontrollable

The budget message of the President for the fiscal year 1968, transmitted to Congress in January, contends that major cuts cannot be made in the estimated \$135.0 billion of Administrative budget expenditures "without serious impairment to vital national objectives." In support of this contention the message identifies various uncontrollable areas to show that only \$14.9 billion—or 11 percent of the total—may be considered as "controllable." And it goes on to suggest that even this relatively controllable area includes certain "indispensable" programs.

On the other hand, sources within and outside the Congress have been calling for substantial reductions, of from \$3 billion to \$6 billion, in expenditures for fiscal 1968. Demands for spending reductions of this magnitude obviously run counter to the contention of the budget message that almost 90 percent of these expenditures are beyond effective control.

Claims as to the controllability or uncontrollability of the budget expenditures of course, vary with the assumptions on which they are based. The budget message, for example, marks down the entire expenditure for national defense (\$75.5 billion) as "uncontrollable." However, while Vietnam requirements obviously introduce an element of uncontrollability the great emphasis placed upon the Defense Department's cost reduction program suggests that other areas of defense spending are susceptible to control.

In recent testimony before the Committee on Appropriations of the House of Representatives, Budget Director Charles L. Schultze, while presenting a breakdown supporting the "relatively uncontrollable" viewpoint set forth in the budget message, also acknowledged that "there is no such thing as an absolutely uncontrollable expenditure."

This Special Report presents an analysis of the projected fiscal 1968 administrative budget expenditures, by factors which influence annual Congressional control, in an effort to provide some information on possibilities for budget reductions. While it is impossible, lacking detailed information in some areas, to be precise in arriving at such estimates, this analysis suggests that as much as \$55 billion of estimated expenditures for fiscal 1968, or roughly 40 percent of the total, may be classified as "relatively controllable"—i.e., subject to possible reductions by the Congress (or the Executive).

Relatively Uncontrollable Expenditures

There are areas of Federal expenditures which are not readily susceptible to annual Congressional control through the appropriation or legislative process—or which at best are subject to very limited control. Table 1, on the following page, summarizes these relatively uncontrollable areas, grouping them according to the factor which influences the degree of Congressional control. Detailed information on the programs and items involved in each of these categories is set forth in the series of tables which appear at the end of this report, pages A-1 through A-16.

A brief explanation of the "relatively uncontrollable" areas summarized in Table 1 follows:

Expenditures from Obligational Authority of Prior Years.—Of the \$135.0 billion of administrative budget expenditures projected for fiscal 1968, the budget document reveals that \$39.3 billion will be made from spending authorization already provided by Congress, in previous years. While no breakdown of these expenditures from “carry-over balances” or prior appropriations and other authorizations is available, they do represent the largest area of “relatively uncontrollable” expenditure.

The accumulation of these huge carry-over balances—estimated to total more than \$125 billion at the start of fiscal 1968—reflects one major limitation upon Congressional efforts to exercise annual control over Federal spending. Although Congress is being requested to approve almost \$144 billion of new spending authorizations for fiscal 1968, only \$95.7 billion of this authority is expected to be spent in that year, with the remainder to be expended in later years.

Technically, these carry-over balances are subject to rescission by the action of the Congress; such rescissions, however, have been infrequent.

Contributions to Trust Funds, Payments of Claims, Payments Required by Treaties, Etc.—Items covered in this category represent fixed charges growing out of commitments established by statute or by treaty or agreement, which the Congress is, in effect, obligated to approve. It is estimated that such fixed charges will total about \$9.5 billion in fiscal 1968.

Examples of such expenditures include payments to the social security trust funds for health insurance to the aged, veterans' compensation and pensions, and the contributions of Federal agencies to the civil service retirement fund. These expenditures are detailed in Table A, beginning on page A-1.

Expenditures Under Permanent and Indefinite Authorizations.—About \$14.7 billion of estimated fiscal 1968 expenditures will be made from permanent authorizations of various types, which become available without requiring specific annual Congressional action. Such arrangements are entered into to meet the annual requirements of certain Federal statutory obligations and commitments. The largest item in this category, of course, is the estimated \$14.1 billion to be required in fiscal 1968 for payment of interest on the public debt.

More detail on this type of relatively uncontrollable expenditures is set forth in Table B, beginning on page A-4.

3. Expenditures to liquidate contract authorizations (see table C, A, p. A-1 for detail).....	9, 519
Balance relatively controllable expenditures.....	55, 648

TABLE 1.—Federal budget expenditures by factor influencing annual congressional control, fiscal year 1968

Factor	[Millions]	Amount
Total administrative budget expenditures.....		\$135, 033
Deduct relatively uncontrollable expenditures:		
1. Expenditures from obligational authority of prior years ¹		39, 328
2. Contributions to trust funds, payments of claims, and payments required by treaties and international agreements (see table A, p. A-1 for detail).....		9, 519
3. Expenditures under permanent and indefinite authorizations (see table B, p. A-4 for detail).....		14, 660
4. Expenditures to liquidate contract authorizations (see table C, p. A-7 for detail).....		8, 646
5. Expenditures under “open end” programs (see table D, p. A-9 for detail).....		6, 399
6. Expenditures of Government enterprises (public enterprise revolving funds) (see table E, p. A-11 for detail).....		833
Total, relatively uncontrollable expenditures.....		79, 385
Balance relatively controllable expenditures.....		55, 648

¹ This item appears in table 8, p. 48, Federal Budget for fiscal 1968. No breakdown by agency or function is available; thus there exists some overlap of the amount shown for item 1, in the totals shown for items 2 through 6.

Expenditures to Liquidate Contract Authorizations.—In fiscal 1968 about \$8.6 billion will be required to meet payments due under contractual obligations previously entered into. Such expenditures are largely outside effective annual control through the appropriation process. Expenditures to liquidate contract authorizations are detailed in Table C, page A-7.

Expenditures Under So-called "Open-End" Programs.—Under certain types of Federal programs expenditures are largely governed by formulas established by statute, or in some cases are affected by economic or other conditions. The best example of a program involving expenditures governed by a statutory formula is the \$4.2 billion public assistance grant program. Certain agricultural expenditures, on the other hand, can be affected by economic or weather conditions.

Expenditure requirements for such programs (identified in Table D, beginning on page A-9) often cannot be accurately estimated in advance. Under such statutory commitments, however, Congress has at best only a very limited opportunity to control the annual rate of expenditure. In fiscal 1968 expenditures for these "open-end" programs are expected to total \$6.4 billion.

Expenditures of Government Enterprises.—Certain Federal Government operations—such as housing programs, mortgage purchases and guarantees, other lending programs, certain power operations, etc.—are carried out through government corporation or revolving fund operations. Expenditures under such programs are reflected in the administrative budget on a net basis.

These programs are governed through basic statutes, or in some cases are affected by economic or other conditions in the flow of their disbursements and receipts. In the practical sense, Congressional control over the expenditures of these operations is restricted primarily to general limitations upon certain of the agencies' administrative expenses.

Table E, beginning on page A-11, sets forth the gross disbursements and receipts, and the net expenditures, of these government enterprises. In fiscal 1968 the net expenditures of these activities total only an estimated \$.8 billion, substantially below the amounts reflected in the total budget expenditure in other recent years. Primarily this lower net expenditure results from the increased use of the participation sales device, under which participations in pools of Federally-held loans are sold to the public and the proceeds are counted as an "offset" against other expenditures.

Comparisons With Previous Fiscal Years

The data provided in Tables A through E, appended to this report, include not only the amounts of "relatively uncontrollable" expenditures under the listed programs for fiscal 1968, but also comparable figures for the fiscal years 1966 and 1964. While the basic issue is the extent to which estimated fiscal 1968 expenditures may be susceptible to possible control and reduction, these comparisons are of some interest in order to reveal the increases in areas of expenditures which, under the concept used in this analysis, are considered to be "relatively uncontrollable."

Reducible Areas

As shown in Table 1, this analysis suggests that, after deducting the total of \$79.4 billion of "relatively uncontrollable" expenditures discussed here, the balance of \$55.6 billion—or approximately 40 percent of the estimated expenditures (\$135.0 billion) in fiscal 1968 may be considered relatively "controllable."

There is admittedly some question as to this "controllable" total, primarily because of questions involving defense expenditures. However it is equally clear that the total of "relatively controllable" expenditures includes more than \$30.0 billion of nondefense spending which appears to be susceptible to control and possible reduction.

TABLE A.—CONTRIBUTIONS TO TRUST FUNDS, PAYMENTS OF CLAIMS, AND PAYMENTS REQUIRED BY TREATIES AND INTERNATIONAL AGREEMENTS

[In thousands of dollars]

Organization unit and program	Fiscal year		
	1968 estimated	1966	1964
Claims			
Department of Defense: Military operation and maintenance, claims, Defense.....	30,000	23,338	19,421
Department of Labor: Wage and Labor Standards, claims and expenses, employees' compensation.....	55,160	55,634	48,515
Treasury Department: Bureau of Accounts, claims, judgments, and relief acts.....	5,164	38,895	31,896
Independent Offices: Foreign Claims Settlement Commission.....	1,305	1,853	8,924
Total claims.....	91,629	119,720	108,756
Payments Required by Treaties and International Agreements			
Department of Defense: Civil, Ryukyu Islands:			
Administration.....	14,829	10,932	10,899
Construction of power systems.....	4,000	408	5,907
Pre-treaty claims.....	9,000		
Department of the Interior: Public Land Management, Office of Territories, Trust Territory of the Pacific Islands.....	25,576	16,593	20,300
Department of State:			
International organizations and conferences:			
Contributions to international organizations.....	109,350	94,376	99,503
Missions to international organizations.....	3,700	3,334	2,741
International conferences and contingencies.....	2,025	1,885	2,080
International tariff negotiations.....	115	834	115
International Conference for Water for Peace.....	200		
International commissions:			
International Boundary and Water Commission, United States and Mexico:			
Salaries and expenses.....	851	855	714
Operation and maintenance.....	1,985	1,965	2,051
Construction.....	16,300	15,616	7,546
Chamizal settlement.....	3,560	14,263	
American sections, international commissions.....	650	473	404
International fisheries commissions.....	2,300	2,063	1,840
Facilities for International Pacific Halibut Commission.....	350		
Other: Payment to the Republic of Panama.....	1,930	1,930	1,930
Independent offices: Veterans Administration: Grants to the Republic of the Philippines.....	1,625	326	258
Total payments required by treaties and international agreements.....	198,346	165,853	156,288
Contributions to trust funds and other retirement payments			
Department of Defense: Military, military personnel, retired pay, Defense.....	2,010,000	1,591,097	1,209,447
Department of Health, Education, and Welfare: Social Security Administration:			
Payment to trust funds for health insurance for the aged.....	930,631		
Payment to trust funds for military service credits.....	105,000		
Department of Labor: Manpower Administration, unemployment compensation for Federal employees and ex-servicemen.....	65,000	94,647	152,514
Department of State: Administration of foreign affairs, payment to Foreign Service retirement and disability fund.....		45	
Department of Transportation: Coast Guard, retired pay.....	48,250	40,636	34,152
Independent Offices:			
Veterans Administration:			
Veterans service-connected compensation.....	2,429,542	2,221,453	2,157,600
Veterans non-service-connected pensions.....	2,037,049	1,910,281	1,743,105
Other veterans benefits and services.....	81,409	82,555	60,500
Civil Service Commission:			
Annuities under special acts.....	1,344	1,487	1,723
Government payment for annuitants employees health benefits.....	111,748	29,220	24,300
Payment to civil service retirement and disability fund.....		67,000	62,000
Railroad Retirement Board: Payment for military service credits.....	17,839	16,558	
Miscellaneous: ¹			
Agency contributions to civil service retirement and disability fund.....	1,140,000	1,097,453	979,941
Agency contributions to employees health benefits fund.....	189,115	139,801	132,585
Agency contributions to employees life insurance fund.....	62,400	57,982	52,426
Total contributions to trust funds, etc.....	9,229,327	7,320,995	6,610,294
Grand total.....	9,519,302	7,606,568	6,875,338

¹ Items in this category are included in the regular Salaries and Expenses appropriations requests for each contributing department or agency. Bureau of the Budget advises it is not possible to break these totals down to properly determine the individual department or agency contribution.

TABLE B.—EXPENDITURES UNDER PERMANENT AND INDEFINITE AUTHORIZATIONS

(In thousands of dollars)

Organization unit and program	Fiscal year		
	1968 estimated	1966	1964
LEGISLATIVE BRANCH			
Library of Congress: Oliver Wendell Holmes devise fund.....	34	18	34
DEPARTMENT OF AGRICULTURE			
Consumer and Marketing Service:			
Perishable Agricultural Commodities Act fund.....	966	828	835
Removal of surplus agricultural commodities.....	175,000	117,745	239,611
Commodity Credit Corporation: National Wool Act.....	44,700	38,178	72,937
Forest Service:			
Expenses, brush disposal.....	9,600	8,943	8,255
Roads and trails for States, national forests fund.....	17,160	14,204	12,001
Other forest service.....	43,653	35,972	30,725
DEPARTMENT OF DEFENSE—Civil			
Corps of Engineers: Civil:			
Payments to States, Flood Control Act of 1954.....	1,928	1,959	1,719
Hydraulic mining in California debris fund.....	172	174	18
Maintenance and operation of dams.....			148
Miscellaneous: Wildlife conservation etc., military reservations.....	191	149	61
DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE			
Office of Education:			
Colleges for agriculture and the mechanic arts.....	2,550	2,550	2,550
Promotion of vocational education.....	7,161	7,161	7,117
Public Health Service: Retired pay of commissioned officers.....	12,000	7,259	6,150
St. Elizabeths Hospital: Salaries and expenses.....	8,810	10,023	8,631
DEPARTMENT OF THE INTERIOR			
Public land management:			
Bureau of Land Management.....	75,750	68,989	63,086
Bureau of Indian Affairs:			
Claims and treaty obligations.....	161	197	190
Other.....	6,624	6,640	6,578
Office of Territories: Internal revenue collections for Virgin Islands.....	10,000	10,406	7,042
Fish and Wildlife and Parks:			
Bureau of Commercial Fisheries:			
Administration of Pribilof Islands.....	2,000	2,391	2,389
Promote and develop fishery products.....	7,000	5,681	5,273
Payment to Alaska from Pribilof Island funds.....	400		589
Bureau of Sport Fisheries and Wildlife:			
Federal aid in wildlife restoration.....	18,500	16,770	16,019
National wildlife refuge fund.....	3,500	1,936	2,532
National Park Service: Other.....	117	108	
Water and Power Development:			
Bureau of Reclamation Other.....	3,583	3,389	4,614
DEPARTMENT OF STATE			
Administration of Foreign Affairs: Replacement of passenger motor vehicles sold abroad.....		395	260
Educational exchange.....	400	489	450
TREASURY DEPARTMENT			
Office of the Secretary: Miscellaneous.....	16	37	13
Bureau of Accounts: Interest on uninvested funds.....	15,287	13,988	10,719
Bureau of the Mint: Minor coinage profits and silver profit fund.....	1,500	1,802	1,222
Internal Revenue Service:			
Refunding internal revenue collections, interest.....	87,200	103,696	88,409
Internal revenue collections for Puerto Rico.....	52,000	51,764	44,962
U.S. Secret Service: Contributions for annuity benefits.....	600	543	426
Interest on the public debt.....	14,050,000	12,013,863	10,665,858
INDEPENDENT OFFICES			
Federal Power Commission: Payments to States under Federal Power Act..	103	71	96
General Services Administration: Real property activities expenses, disposal of surplus real and related personal property.....	1,000	772	994
Total expenditures under permanent and indefinite authorizations...	14,659,666	12,548,790	11,309,815

TABLE C.—EXPENDITURES TO LIQUIDATE CONTRACT AUTHORIZATIONS

[In thousands of dollars]

Organization unit and program	Fiscal year		
	1968 (estimated)	1966	1964
Legislative branch:			
Architect of the Capitol:			
Extension of the Capitol.....		232	509
Expansion of facilities, Capitol Power Plant.....	876	750	
Acquisition of property construction and equipment, additional House Office Building.....	3, 017	10, 386	10, 987
Funds appropriated to the President: Military assistance.....	800, 000	1, 058, 083	
Department of Agriculture:			
Agricultural Stabilization and Conservation service:			
Agricultural conservation program.....	225, 876	209, 516	213, 563
Cropland conversion program.....			7, 097
Forest Service: Forest roads and trails.....	110, 500	101, 009	58, 913
Department of Commerce:			
Transportation:			
Operating differential subsidies.....	200, 000	186, 628	203, 037
State marine schools.....	1, 700	1, 838	1, 409
Department of Housing and Urban Development:			
Metropolitan development: Open space land programs.....	57, 800	8, 387	5, 130
Demonstrations and intergovernmental relations: Low-income hous- ing demonstration program.....	2, 000	1, 337	803
Department of the Interior:			
Public land management:			
Bureau of Land Management: Public lands, development roads, and trails.....	3, 500	2, 764	710
Bureau of Indian Affairs:			
Education and welfare services.....	124, 708	103, 902	89, 020
Road construction.....	19, 000	18, 821	14, 970
Fish and wildlife and parks: National Park Service: Parkway and road construction.....	38, 000	37, 186	33, 703
Department of Transportation:			
Federal Highway Administration:			
Bureau of Public Roads:			
Forest highways.....	{ 33, 000 }	31, 304	33, 277
Public lands highways.....	{ -33, 000 }		
Inter-American Highway.....	{ 10, 000 }	11, 290	4, 710
National Highway Safety Bureau: State and community highway safety program.....	{ -10, 000 }	4, 955	1, 813
National Highway Safety Bureau: State and community highway safety program.....	{ 100, 000 }		
National Highway Safety Bureau: State and community highway safety program.....	{ -100, 000 }		
Department of Defense: Military operations and maintenance, Army.....	7, 050, 000	4, 524, 056	
Total, expenditures to liquidate contract authorizations.....	8, 645, 977	6, 312, 444	679, 651

TABLE D.—EXPENDITURES UNDER "OPEN END" PROGRAMS—PRIOR CONTRACTS AND AGREEMENTS

[In thousands of dollars]

Organization unit and program	Fiscal year		
	1968 estimated	1966	1964
Funds appropriated to the President:			
International Financial Institutions:			
Investment in inter-American development banks.....	79,500	-----	50,000
Subscription to International Development Association.....	122,000	-----	61,656
Alaska programs: Transitional grants to Alaska.....	-----	5,433	19,430
Public works acceleration: (prior approval).....	-----	88,168	331,820
Department of Agriculture:			
Soil Conservation Service: Great Plains conservation program.....	17,200	13,591	11,882
Agricultural Stabilization and Conservation Service:			
Sugar Act program.....	90,031	87,685	87,071
Conservation reserve program.....	125,000	150,993	289,933
Emergency conservation measures.....	12,915	13,190	3,393
Cropland adjustment program.....	90,000	5,592	-----
Consumer and Marketing Service:			
Payments to States and possessions.....	1,750	1,750	1,500
Food stamp program.....	193,000	69,491	-----
Department of Defense, Civil: Cemeterial expenses.....	19,300	16,246	14,967
Department of Health, Education, and Welfare:			
Office of Education:			
School assistance in federally affected areas.....	421,600	409,593	334,289
Expansion and improvement of vocational education.....	233,290	131,594	33,959
Vocational Rehabilitation Administration:			
Grants for rehabilitation services and facilities.....	301,870	152,521	84,287
Grants for correctional rehabilitation study.....	1,000	260	-----
Welfare Administration:			
Grants to States for public assistance.....	4,188,000	3,527,534	2,944,052
Assistance for repatriated U.S. nationals.....	471	343	396
Assistance to refugees in the United States.....	51,276	30,220	42,566
Department of the Interior:			
Public land management:			
Bureau of Indian Affairs: Menominee educational grants.....	-----	44	132
Bureau of Land Management:			
Oregon and California grant lands.....	12,200	18,898	7,598
Range improvements.....	1,420	1,347	1,240
Fish and wildlife and parks:			
Bureau of Commercial Fisheries:			
Federal aid for commercial fisheries research and develop- ment.....	4,002	615	-----
Anadromous and Great Lakes fisheries conservation.....	1,000	-----	-----
Bureau of Sport Fisheries and Wildlife:			
Appalachian region fish and wildlife restoration projects..	599	51	-----
Anadromous and Great Lakes fisheries conservation.....	1,000	-----	-----
Federal aid in fish restoration and management.....	6,810	6,675	5,906
Justice Department: Federal Prison System: Support of U.S. prisoners..	4,500	4,815	4,270
Independent offices:			
General Services Administration: Real property activities: Payments, public buildings purchase contracts.....	2,350	3,306	5,168
Veterans' Administration: Readjustment benefits.....	417,200	42,115	68,998
Total, "open-end" programs.....	6,399,184	4,782,070	4,404,513

TABLE E.—EXPENDITURES OF GOVERNMENT ENTERPRISES (PUBLIC ENTERPRISE REVOLVING FUNDS)
FISCAL YEARS 1968, 1966, 1964

[In thousands of dollars]

Organization unit and program	1968 estimated			Actual net expenditures	
	Gross disbursements	Gross receipts	Net expenditures	1966	1964
Funds appropriated to the President:					
Expansion of defense production: Revolving fund, Defense Production Act.....	84,187	63,349	20,838	-151,995	90,883
Military assistance: Foreign industry sales fund.....	350,000	350,000	-----	-89,948	-----
Economic assistance:					
Alliance for Progress: Development loans.....	464,815	14,815	450,000	290,896	112,580
Development loans revolving fund.....	680,000	30,000	650,000	626,756	566,728
Development loan fund (liquidation account).....	79,087	34,000	45,087	50,147	201,984
Foreign investment guarantee fund.....	116	12,458	-12,342	-9,825	-4,831
Office of Economic Opportunity: Economic opportunity loan fund.....	36,091	14,956	21,135	29,565	-----
Department of Agriculture:					
Commodity Credit Corporation: Price support and related programs.....	5,027,333	3,475,746	1,551,587	1,345,243	3,174,895
Federal Crop Insurance Corporation fund.....	40,704	41,063	-359	10,496	-819
Farmers Home Administration:					
Direct loan account.....	422,578	906,713	-484,135	-31,352	56,129
Rural housing direct loan account.....	36,019	198,126	-162,107	12,289	100
Rural housing insurance fund.....	469,480	483,945	-14,465	31,408	-----
Emergency credit revolving fund.....	68,863	72,527	-3,664	18,684	-9,138
Agricultural credit insurance fund.....	726,841	734,269	-7,428	87,534	42,461
Department of Commerce:					
Economic development assistance: Economic development evolving fund.....	22,739	98,460	-75,721	-7,949	-46,069
Ocean Shipping:					
Federal ship mortgage insurance fund.....	57	5,883	-5,826	1,554	6,907
Vessel operations revolving fund.....	255,929	255,985	-56	3,350	-1,572
War risk insurance revolving fund.....	1,068	1,198	-130	-152	-185
Department of Defense—Civil functions: The Panama Canal Company fund.....					
	139,019	144,564	-5,545	-4,310	2,074
Department of Health, Education, and Welfare:					
Food and Drug Administration: Revolving fund for certification.....	3,100	3,100	-----	-235	-111
Public Health Service: Operation of commissaries.....	237	240	-3	13	-3
Social Security Administration: Bureau of Federal Credit Unions fund.....	6,383	6,326	57	-44	117
Office of Education:					
Student loan insurance fund.....	913	1,210	-297	-----	-----
Higher education loan fund.....	49,854	101,362	-51,508	-----	-----
Department of Housing and Urban Development:					
Renewal and housing assistance:					
Urban renewal programs.....	829,347	359,922	469,425	356,720	235,012
Rehabilitation loan fund.....	23,560	1,560	22,000	1,830	-----
Low rent public housing.....	526,550	251,550	275,000	236,746	149,206
Housing for the elderly or handicapped fund.....	83,527	107,405	-23,878	49,902	29,092
College housing loans.....	396,655	1,658,786	-1,262,131	312,359	219,334
Metropolitan development:					
Public works planning fund.....	19,110	9,110	10,000	8,887	7,077
Urban mass transportation fund.....	110,310	310	110,000	18,660	195
Public facility loans.....	65,614	89,247	-23,633	29,087	43,716
Revolving fund (liquidation programs).....	445	1,131	-686	-3,891	-1,799
Mortgage credit:					
Federal National Mortgage Association:					
Community disposal operations fund.....	4,135	13,950	-9,815	-3,964	35
Federal Housing Administration fund.....	1,000,624	984,176	16,448	191,189	-43,442
Loans to secondary market operations.....	1,400,000	1,400,000	-----	91,820	-66,360
Special assistance functions.....	509,660	324,660	185,000	-313,525	-141,925
Management and liquidation functions.....	238,074	473,574	-235,500	-114,120	-138,359
Participation sales fund:					
Aids to private housing.....	84,000	115,100	-31,100	-56,035	-----
Veterans readjustment benefits.....	103,800	121,900	-18,100	-63,225	-----
Advancement of business.....	85,900	113,230	-27,330	-9,859	-----
Interior Department:					
Public Land Management:					
Bureau of Indian Affairs:					
Revolving fund for loans.....	3,058	2,063	995	-399	5,094
Liquidation of Hoonah housing project fund.....	6	3	3	-----	-2
Office of Territories: Loans to private trading enterprises.....					
	-----	-----	-----	-----	-103
Mineral Resources:					
Bureau of Mines: Helium fund.....	57,473	30,257	27,216	19,282	9,794

TABLE E.—EXPENDITURES OF GOVERNMENT ENTERPRISES (PUBLIC ENTERPRISE REVOLVING FUNDS)
FISCAL YEARS 1968, 1966, 1964—Continued

[In thousands of dollars]

Organization unit and program	1968 estimated			Actual net expenditures	
	Gross disbursements	Gross receipts	Net expenditures	1966	1964
Interior Department—Continued					
Fish and Wildlife and Parks:					
Bureau of Commercial Fisheries:					
Federal ship mortgage insurance fund.....	7	438	-431	350	-30
Fisheries loan fund.....	4,116	2,360	1,756	7	-506
Water and power development:					
Bureau of Reclamation:					
Continuing fund, Fort Peck project.....	1,225	2,988	-1,763	-4,416	-896
Upper Colorado River Basin fund.....	57,958	18,363	39,595	60,615	95,123
Bonneville Power Administration: Revolving fund.....	66,887	113,275	-46,388	-----	-----
Southeastern Power Administration: Revolving fund.....	-----	26,200	-26,200	-----	-----
Southwestern Power Administration: Revolving fund.....	15,612	21,022	-5,410	-----	-----
Virgin Islands Corporation: Operating funds.....	-----	-----	-----	1,055	326
Department of Labor:					
Manpower Administration:					
Farm labor supply revolving fund.....	-----	-----	-----	84	-1,200
Advances to employment security account.....	304,487	308,087	-3,600	-2,217	-7,435
Post Office Department:					
Contributions to the postal fund.....	6,699,256	5,455,038	1,244,218	888,196	577,699
Postal rate increase.....	-----	700,000	-700,000	-----	-----
Department of Transportation:					
Federal Aviation Administration: Aviation war risk insurance revolving fund.....	29	16	13	6	-----
Federal Railroad Administration: Alaska Railroad revolving fund.....	12,091	14,354	-2,263	10,485	1,809
St. Lawrence Seaway Development Corporation: Development fund.....	7,330	7,630	-300	1,216	154
Treasury Department:					
Office of the Secretary:					
Liquidation—Federal Farm Mortgage Corporation.....	1	-----	1	-32	-410
R.F.C. liquidation fund.....	7	169	-162	-183	-2,436
Civil defense program fund.....	-----	-----	-----	-----	-59
Bureau of Accounts: Fund for payment of Government shipment losses.....	152	1	151	135	339
Bureau of the Mint: Mint operating fund.....	70,333	92,346	-22,013	-----	-----
Office of the Treasurer: Check forgery insurance fund.....	750	747	3	3	20
Department of Defense—Military:					
Defense production guarantees.....	24,928	28,128	-3,200	167	3,729
Laundry service, Naval Academy.....	809	822	-13	-51	42
Independent offices:					
Veterans' Administration:					
Canteen service revolving fund.....	60,138	60,180	-42	-106	-207
Direct loan revolving fund.....	178,300	295,010	-116,710	-658,953	-32,303
Loan guaranty revolving fund.....	372,346	696,560	-324,214	15,723	76,498
Service-disabled veterans insurance fund.....	12,090	10,790	1,300	-529	-712
Soldiers' and Sailors' civil relief.....	15	7	7	8	23
Veterans reopened insurance fund.....	10,165	42,339	-32,174	-18,324	-----
Veterans special term insurance fund.....	14,914	44,798	-29,884	-27,577	-15,955
Servicemen's group life insurance fund.....	119,075	119,040	35	-134	-----
Export-Import Bank of Washington fund.....	1,719,862	2,084,521	-364,659	-385,023	-701,784
Farm Credit Administration:					
Revolving fund for administrative expenses.....	3,231	3,231	-----	531	-161
Short-term credit investment fund.....	1,000	200	800	2,290	5,490
Banks for cooperatives investment fund.....	-----	7,500	-7,500	-10,051	-13,926
Federal Home Loan Bank Board:					
Revolving fund.....	18,981	19,241	-260	-35	-324
Federal Savings and Loan Insurance Corporation fund.....	1,177	318,223	-317,046	-255,423	-248,097
Home Owners Loan Corporation fund.....	1	-----	1	1	1
Small Business Administration:					
Business loan and investment fund.....	529,806	561,002	-31,196	146,071	124,316
Disaster loan fund.....	108,660	37,946	70,714	-----	-----
Tennessee Valley Authority:					
Tennessee Valley Authority fund.....	502,993	392,343	45,500	5,862	12,291
Appropriations and nonpower proceeds.....	-----	-----	65,150	48,043	47,000
U.S. Information Agency: Informational media guarantee fund.....	1,483	1,384	99	-71	940
Total expenditures, public enterprise funds..	25,427,476	24,594,528	832,948	2,488,991	4,510,192

Mr. BATTIN. I have and then I will yield the floor.

First of all I have two questions. One, I was interested in your statement on page 13 that you made this morning, I think Mr. Byrnes questioned you about the items you have listed and what would happen if the tax did not go into effect. One of your assumptions really laid me low. That is your assumption that there will be no major interruptions from strikes. The Labor Department and everybody else across the country, business people, are preparing for strikes. I don't know how we can assume with all the contracts that are up this year that there are not going to be some major strikes. Let us assume there were some strikes how would that affect the itemization that you have there?

Mr. ACKLEY. I think the effects to which we were referring here were unusually large and lengthy strikes. We have had, of course, a number of strikes this year. The number is higher than in a great many years.

Mr. BATTIN. The copper industry.

Mr. ACKLEY. The rubber industry was on strike for more than 2 months.

Mr. BATTIN. The automobile industry going out.

Mr. ACKLEY. We have so far avoided a rail strike and I trust we will. The effect of a prolonged strike in a major industry such as automobiles would undoubtedly be to put a temporary dent into incomes and production and it would begin to show up in the statistics. The primary effect of that would be to defer production and expenditures to a later period when the strike was over. This could, as sometimes has happened in the past with major strikes, create difficult problems of too fast a spurt in demand, and inventory movements that are disturbing to the economy.

I don't think one would say that it would make the difference between an advancing economy and one—

Mr. BATTIN. Then I don't understand why you made the assumption.

Mr. ACKLEY. A major prolonged strike in the automobile industry, for example, which would affect all producers instead of a single one, if it lasted several months, could undoubtedly delay the rise in expenditures and incomes. The reference here was to gain in the second half of the year and some of those gains would be deferred into the first half of next year.

Mr. BATTIN. Then I will go to the last area. I have been on the committee for 3 short years and there does not seem to be any certainty in tax recommendations that are made. Nobody has determined whether or not as a Federal Government we have certain fixed policies relating to taxation. Would it be fair to say that we are using this method of surtax and the shutting on and off of an investment tax credit, as a means of economic control or direction of the country? Is that a fair statement or is it just a ghost I see somewhere?

Mr. ACKLEY. I think it is certainly fair to say that the tax recommendations have taken account of the economic situation, as I think they properly should. I think there has been something of a false specter raised, the notion that we should delicately adjust taxes all the time to achieve some kind of objective of steady economic growth. I think that is a greatly exaggerated notion. I for one have never felt

that any economist or any government was able to predict the course of private demand with such certainty that it could use taxes to do this kind of so-called "fine tuning" to which you refer.

Mr. BATTIN. The reason I ask is that it seems to me in early 1961 or 1962 there was a request or speech by President Kennedy, suggesting that he should have some authority to raise or lower taxes within a fixed limit in order to control economic conditions as they might present themselves. That authority, of course, was not given.

Mr. ACKLEY. The request for it has not been repeated.

Mr. BATTIN. Yes. The thing I am wondering about—whether it is repeated or not—is that you continue to present piecemeal tax legislation to accomplish that. You said certainly it has to go into your thinking in order to make the recommendation.

Mr. ACKLEY. I think we have to remember that the period of the last couple years and currently is one of a major defense effort in Southeast Asia which has posed very unusual problems for the economy. It has contributed certainly to the capital boom last year which did seem to require the very special measure of the suspension of investment credit and subsequent reinstatement. It was responsible for the Tax Adjustment Act of 1966, which added appreciably to revenues. Certainly it is very much associated with the present tax proposals.

Secretary FOWLER. Mr. Battin, could I for the record indicate that, for example, in 1950, the Revenue Act of 1950, during the Korean war, increased individual income tax rates and corporate tax rates on larger incomes and made minor excise tax increases. Increased revenues at that time were estimated to be about \$4.6 billion. The Excess Profits Act of 1950 imposed a surcharge of 30 percent on excess profits of corporations and raised the corporate surtax rates by two points. The estimated revenue gain was \$3½ billion. In 1951 the Revenue Act of 1951 increased individual income tax rates and corporate rates reduced the base period credit for excess profit tax purposes and imposed some new excise tax rates and increased the rates on some existing excises. The increased revenues were estimated to be about \$5.4 billion. It is not unusual in a special emergency to have these special financing measures associated with war.

Mr. BATTIN. The only thing I would say by way of argument, if you want to call it that, is that the President's tax message proposed this 10 percent surcharge. I thought he made it quite clear that he intends to continue programs which had no association with the war in Vietnam, that had been started, I think, in the last three and a half years.

We are being asked not to make a special tax to support only our commitment in Vietnam but I think he quite clearly said in the message we are being asked to finance programs that were started in the last three and a half years as well as the war in Vietnam. I think that this is what gives many of us great concern.

Mr. SCHULTZE. I will make two points on that. As you will recall, part of the President's program is also a reduction in expenditures. This does not mean abandoning these programs to which you refer, but it does mean reducing across the board.

Secondly, I would point out that one way to look at what we are asking for is that we have estimated Vietnam expenditures running about \$22 million this year, depending on the precise outcome, com-

pared to no defense expenditures for Vietnam in fiscal 1965. We are asking, of that \$22 billion, \$7½ billion in taxes—not on top of a tax system which has been unchanged for the past 5 years, but on top of a tax system in which taxes have come down substantially. So in effect we are not even asking for taxes equivalent to the cost of Vietnam, but taxes which account for only about one-third of the cost of Vietnam—not more than but only one-third. And these taxes, in turn, would only restore something like 40 percent of tax cuts given earlier. So it is not a case, looked at in terms of the long-run fiscal strategy, of taxing fully for Vietnam and taxing on top of that for additional programs. We are asking in this case for roughly one-third of the Vietnam expenditures.

Mr. BATTIN. You might find, Mr. Director, it is like a good many things, whether it is a 1-percent tax, 10 percent or 25 percent, it is a tax.

Mr. SCHULTZE. Yes, sir; I fully agree.

Mr. BATTIN. I sometimes think that it would be better to ask for all you need to begin with because the pain and the penalty that goes along with it is just as great.

The CHAIRMAN. Mr. Gilbert.

Mr. GILBERT. You have the job and business of trying to convince the Members of Congress of the necessity of the proposed surcharge tax. We on the other hand catch a lot of flak back home from our citizens on the street. My wife is a prime example of the average citizen. She says to me, "Why do we need a tax increase? Employment is high. Unemployment is down. Business is booming. Things are relatively good."

I wonder if we could have an explanation in nontechnical terms, if possible, as to the necessity for this tax increase? How do you explain it to people?

Secretary FOWLER. I tried, perhaps ineffectively, Congressman Gilbert, in the conclusion of my statement to say that the average American must look at this tax increase not just in his role as a taxpayer but in the other roles that he has in our society.

I would think that as a consumer your wife and my wife and all of us are very concerned with price stability and they would be anxious for you and your colleagues on the committee to adopt policies that would be designed to restore the relative price stability that seemed to characterize the period from roughly 1959 through 1964 and early 1965.

I would think that many of your constituents would think of themselves primarily in terms of their jobs, jobs they hold, jobs they want to have, and perhaps many of them are too young to remember the days of boom and bust and perhaps many of them have gotten more or less used to taking for granted the fact that for the last better than six and a half years we have had a fairly constant pattern of expansion in which jobs have been created at a very, very remarkable rate and that while the economy has moved faster at some times than at others the rate of growth during that period in the job creating capacity of the economy have been quite remarkable indeed.

Therefore those that have jobs or those that are being educated and trained to seek jobs would be interested in the kind of economic policies that would assure a steady continuation of that expansion at a cruising speed rather than an excessive expansion which would be bound to be followed by something in the nature of a recession.