

lower rates of interest and competing more effectively for funds against other borrowers in capital markets. However, the exemption also reduces the progressivity of the Federal individual income tax, since it produces much bigger tax savings to those in high income tax brackets than to those taxable at lower rates. This is a relatively inefficient means of channeling aid: the Federal Government loses far more revenue than the States and cities gain in reduced interest costs.

Apart from the general question of interest exemption, and of immediate concern, is the use of so-called industrial development bonds. Through the use of these bonds, localities have passed to private industries the benefit of the exemption of their interest from Federal tax, in many cases without assuming any real obligation for repayment of the bonds. This questionable practice is becoming increasingly widespread, and the lack of any obligation by the locality authorizing the bonds permits proliferation without limit. The use of the Federal tax code in this fashion is inefficient and inappropriate.

Another fiscal problem concerns State taxation of corporate income. Since most corporate income is generated by interstate corporations, States must establish formulas to apportion the income assumed to be earned from business done in other areas. The formulas give various weights to such factors as location of plant, percent of payroll, sales destination, location of sales offices, and "origin" of sales. In 1966, after several years of study, the House Judiciary Committee recommended legislation that would require a uniform State formula based solely on two factors, property and payroll. The States have responded unfavorably to this proposal. As an alternative, additional Federal grants to the States might be used to persuade them to relinquish a tax which is more efficiently collected at the national level.

* * * * *

Secretary FOWLER. Congressman Reuss, you will have an opportunity to deal with some of those problems, because in the President's economic message, he said that there will be a second tax measure which would come forward.

Representative REUSS. Right, but why have the first tax measure which will have the effect of—

Secretary FOWLER. Just by reason of the fact that experience has shown that there is a timing problem on loophole-closing tax measures. It is a very lengthy process. I would have no expectation that the Congress would be able to act with the promptness on that type of measure that it will on the surtax which carries out the thrust of the recommendations of the Subcommittee on Fiscal Policy which Representative Martha Griffiths chaired last year. The subcommittee report described an acceptable neutral type of pattern for increasing revenues which I think, if it is accepted by the Congress, could be accepted much more promptly and with much more dispatch than the other kind of measure so as to be effective for the entire fiscal year beginning July 1.

Representative REUSS. I would say, that the long day's battle on loophole plugging is not going to begin until the administration sends up its loophole-plugging package, and there is enough in the collected works of Stanley Surrey, sitting behind you, to get together a great package.

Secretary FOWLER. I have him very busy on lots of things, but you will have your package, Congressman Reuss.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, as I understand it, our gold stock is down to a little over \$13 billion, and we need \$11 billion of this as backup for our currency. Is this substantially what the figures are?

Secretary FOWLER. My latest figures, at least as of December 31, show that the so-called free gold, which is what you have reference to, is \$3,213 million.

Senator MILLER. Do you have the figure on how much gold is needed for our currency reserve?

Secretary FOWLER. Yes.

Senator MILLER. How much is that?

Secretary FOWLER. In addition to that—

Senator MILLER. How much would that be? Would that be \$11 billion or can you give us a figure on it?

Secretary FOWLER. The free gold figure I have, and it is the figure I gave you, it is the \$3,213 million. So taking into account the so-called gold cover, domestic gold cover requirement, we have in excess of that amount as of December 31, 1966, \$3,213 million.

Senator MILLER. Do you have the two figures that give us the net figure you just gave us?

Secretary FOWLER. I will be glad to supply them for the record.

(The figures referred to follow:)

	<i>Millions</i>
Federal Reserve notes outstanding, Feb. 1, 1967-----	\$38, 090
25 percent cover requirement for above notes-----	9, 522
25 percent cover requirement for U.S. notes-----	156
Total cover requirement-----	9, 678
U.S. gold stock, Feb. 1, 1967-----	13, 200
Excess of stock over cover requirements-----	3, 522

Senator MILLER. Now, as you know, this has been going down steadily, and I recognize that perhaps the drop last year was somewhat encouraging compared to previous years.

Secretary FOWLER. Only encouraging because it was largely due to one source.

Senator MILLER. Yes, but whether it is one source or 10, it is still going down, and the question I wanted to ask you is whether there are any plans being discussed, to come over to Congress to ask Congress to reduce or eliminate the gold cover.

Secretary FOWLER. Not at this time. We think we have for the time being a substantial margin, and that there is no near-term likelihood that that would be necessary. Of course, I could be proven wrong by events that would take place that are unpredictable now. But as we see the situation now, it is a reasonably stable one, and we wouldn't need to ask for the removal of the cover at this time.

Senator MILLER. Is it correct that there are about \$30 billion to \$32 billion of short-term claims that could be used against that \$3 billion of free gold?

Secretary FOWLER. Actually, technically that is true, but a large portion of that figure is dollars that are held in private hands, and they are not honored unless they are submitted by, as you know, central banks.

I think the amount that is outstanding in the hands of central banks today is about \$14 billion. That is the amount of dollars that, in a sense, you might say is directly overhanging.

Senator MILLER. What kind of a ratio are we going to have before you would come over here to ask us to do something about this—\$13 billion in the hands of central banks against \$3.3 billion plus about another \$17 to \$19 billion in the hands of private owners, which might end up in the central banks? I have heard a number of people express deep concern over this.

I am wondering why you say not now do you have any plans to ask Congress. I am wondering how much worse this ratio is going to have to get before you are going to come over here to ask us to do something about the situation.

Secretary FOWLER. It isn't a matter of the ratio so much, Mr. Miller, as it is the acts of the various central banks in converting those dollars into gold. Many people believe, and I express neither approval or disapproval of this belief, but many people contend that the amount of dollars that is outstanding in private hands is only adequate for the international purpose the dollar serves as a transaction currency, and that is a desirable thing rather than something to be feared or to cringe from.

The question of what various central banks do with their dollars is of course one that is of constant concern to us, and we are pleased to say at this time that, although there is an ebb and flow of smaller purchases, insofar as threats to our gold stock are concerned, they are pretty well confined we think now to one country.

Senator MILLER. Would you supply for the record the figures of the central bank holdings that you referred to.

Secretary FOWLER. Yes, indeed. I have them here and will be glad to supply them.

The material referred to follows:

As of November 30, 1966, United States liquid liabilities to official institutions of foreign countries amounted to \$14 billion. This figure includes liabilities to ministries of finance and other official institutions as well as to central banks. No separate data are available on liabilities to foreign central banks.

Senator MILLER. Thank you.

Mr. Secretary, when the Government issues Government securities do they do this to finance the administrative-budget deficit or the income-accounts deficit?

Secretary FOWLER. You raise the money to pay the bills.

Senator MILLER. I understand. I am trying to get—

Secretary FOWLER. The administrative deficit is the measure which you look to in order to determine how much you need in your debt limit. That is the determining factor.

Senator MILLER. So that even though the income-accounts budget might show a fairly close to break-even point or even a surplus, that would have no bearing whatever on the amount of money needed to finance a deficit in the administrative budget, is that correct?

Secretary FOWLER. That is correct.

Senator MILLER. Now, Mr. Secretary, in your statement you refer to economic achievements: "One of these was net income per farm having risen more than 10 percent."

On the other hand, Mr. Secretary, you did not include in your statement the fact that there are 690,000 fewer farms today. I trust that you recognize that fact.

Secretary FOWLER. I do indeed. It means, if I understand it, that many marginal farmers who have been eking out a meager existence on the land have found useful job opportunities in urban and suburban areas. This I would count as a principal advance.

Senator MILLER. Mr. Secretary, I think a number of economists would agree with you, but they would attribute this advance not to economic achievements as such, not economic policies of this administration, but to the fact that there are 690,000 fewer farms.

Now I would like to ask you this question.

I understand that parity has consistently been below 80 for the last 6 years. With that in mind, how do we arrive at net income per farm more than 10 percent above?

Secretary FOWLER. I understand Chairman Ackley ran into this one up here the other day, and he is preparing a report and analysis on this question. If you will permit me to collaborate with him, we will try to supply an answer too.

Senator MILLER. Yes, sir, and if perchance you should disagree with Mr. Ackley, I would appreciate your independent views, Mr. Secretary.

Secretary FOWLER. You certainly will have them.

Senator MILLER. Now another figure that was used here is unemployment averaging below 4 percent. Mr. Secretary, that may be an achievement, but in order to get to that 4-percent figure, I think we ought to look at some things which I do not personally think are achievements.

One of these is the fact that there are 446,000 more employees, civilian employees, in the Federal Government than there were 6 years ago.

Another on the war side, there are 860,000 more men in the Armed Forces today than there were 6 years ago, and I have heard various estimates that at least 1 million, or perhaps more people, are working in defense plants because of the war.

Now if these figures were not present, I think the unemployment figure would run around $5\frac{1}{2}$ to 6 percent. I just put these in the record so we can take economic achievements in perspective.

Secretary FOWLER. I don't accept for a moment, Senator Miller, the proposition that is implicit in your statement that if it were not for the war, these people would be unemployed.

As is shown by its remarkable peacetime performance in job creation in the period 1961 through the middle of 1965, I think the American economy, absent the war, will find ample place for them when they return. And I don't believe that figure would be $5\frac{1}{2}$ percent unemployed. I think it would be about where it is.

Senator MILLER. Mr. Secretary, I hope you are right, but there is nothing that you can use to prove this.

Secretary FOWLER. Nor the other way.

Senator MILLER. Nor the other way, except for the fact that we do have these figures presently and I can prove them. I think that they ought to be in the record, so that people can consider these economic achievements in perspective. That is all I want to do, so that people can consider these economic achievements in perspective; so that people will know what is going on.

Secretary FOWLER. Senator Miller, I think it is a very dangerous thing to imply, to give rise to any consideration that the conduct of this war is what is keeping the American economy prosperous. I don't believe that to be the case.

Senator MILLER. Mr. Secretary, I have stated the same thing myself publicly on a number of occasions, but what I am getting at is this, Mr. Secretary:

You come up here and give us some economic achievements without giving for the record some of the other things that might just tend to counterbalance these achievements in the minds of a number of people. All I wanted is for the people to know what is going on, and to get the full facts and not just part of the facts.

I have said the same thing you just said about this war situation, and I trust, Mr. Secretary, that there is no implication that my questions are founded on anything other than your belief and my belief on that point.

Do I have time for another question, Mr. Chairman?

Chairman PROXMIRE. Your time is up. I ask unanimous consent that Senator Miller may have another minute.

Senator MILLER. Thank you.

Mr. Secretary, I would like your comments on this observation. A year ago I pointed out to you during the previous year we had had \$18 billion of inflation in this country. Now a year later I have to point out to you most regrettably that the record shows that last year we had \$29 billion of inflation. In other words, inflation last year took a little better than half as much purchasing power away from the American people as the Federal income tax did.

A year ago 30 percent of our increased gross national product consisted of inflation. Last year 47 percent of our increased gross national product consisted of inflation.

Now I submit to you that with this worsening of the inflationary picture, the worsening of the relationship of inflation to the increased GNP, that there has in fact been a failure of the economic policies of this administration, and that at least they haven't succeeded in achieving one of our twofold objectives of national economic policy; namely, a stable dollar. I would appreciate your comment.

Secretary FOWLER. Mr. Chairman, I would like to put up two charts and give members of the committee copies of two charts that deal with this.

Chairman PROXMIRE. Would the Secretary defer for just a minute. After the questioning by the members you may proceed with this.

Secretary FOWLER. If I may defer, and put this in the record at the appropriate point.

Chairman PROXMIRE. You may.

Mrs. Griffiths?

Representative GRIFFITHS. Mr. Secretary, the fiscal policy of this Nation is largely in control of the Executive and the Congress. We raise and lower the expenditures. We raise and lower the taxes. But the monetary policy is not really completely within the control of the same group of people.

Secretary FOWLER. That is correct.

Representative GRIFFITHS. May I ask you in your judgment, don't you think it would be better if it were?

Secretary FOWLER. Mrs. Griffiths, I noticed the same question asked of Chairman Ackley the other day, and I believe I will stand pretty much on the answer that he gave.

I think if we were starting all over again, we might very well design it differently, but I think that by and large there are going to be problems of coordination, and I am not here to advance any substantial change in the present setup.

I think that is a matter for Congress to make its own judgment on. It has decided to delegate responsibilities directly to the Federal Reserve Board, to a number of so-called independent agencies; the Federal Deposit Insurance Corporation, many of the powers are going to the Comptroller of the Currency, the Federal Home Loan Bank Board are all more or less independent. They take their authority directly from the Congress, according to policies laid down by the Congress, and the control span you might say of the Executive is very limited with regard to them. This does give rise to a need for coordination in an attempt to work together, and I think by and large we do a pretty good job at it.

Representative GRIFFITHS. In my opinion there is something quite ridiculous about our lowering taxes and the Federal Reserve decreasing the interest rate, and I will remember the banking fraternity's statement on lowering taxes both before this committee and before Ways and Means. It was their theory this would give them a great opportunity to increase the interest rates, and thereby do something to satisfy the balance of payments.

To me it was a ridiculous thing, and it is ridiculous now. I feel that the Federal Reserve really is responsible to Congress, and we ought to exert a little authority to bring them back into the fold before they start stockpiling their own nuclear weapons. They are controlling this policy.

Now I would like to say also that while many people seem to feel we should be having a substantial tax increase, we should have had it last year, in place of suggesting it this year, but the truth is that even when you would ask for the suspension of the investment credit, I am the only member of the Ways and Means Committee, and I think the record will prove it, that objected strenuously to the fact that you were not suspending the investment credit. You were in fact changing the law and suspending that law that was then changed.

If I recall correctly some of the more starry-eyed members came over to us on the floor of the House, and asked, that in addition to all of the other exemptions that had been made, that there be a further extension for those who were putting in antipollution devices.

I think I stated, time after time, that I thought we should simply have suspended or repealed the investment credit, and the next time it was reenacted, use it as a device; so that I don't think it is really very simple to enact tax bills or to repeal tax bills.

Since there has been mention made, of the lack of work among Negroes and teenagers, I want to make real sure that we are talking about Negro men and women and teenagers, boys and girls, and I would like to ask you if you would have some of those bright young men who do that work for you figure out how much it would cost the Federal government to give women in the civil service, and as employees of the Federal Government, exactly the same fringe benefits that men are given. By fringe benefits I mean pensions; I mean overseas pay; I mean dependency allowances, etc.

Finally, I observe that Mr. Blough has made a statement in New York that we would like to have a tax bill that permits the young people to borrow money to go to school, and afterwards pay it back in taxes, and that one of the big problems is what to do about women.

I would like to point out that 81 percent of all women with college degrees work.

I also would like to suggest that you inquire about credit risks to women, and I would assume that you would find those women who borrow for their schooling were more apt to pay it back.

But if the new tax bill that you are going to bring up here has anything to do with this, I think it would be a great day in this country if we treated men and women as taxpayers and not women as somebody to be given some special consideration, because in general it turns out to be a special discrimination.

Thank you, Mr. Chairman.

Secretary FOWLER. I will ask Mr. Surrey to take notes on this.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Secretary, in the Economic Report and in your appearance on television yesterday, which I enjoyed very much, you remarked about the 4-percent rate of growth in real terms objective for this year.

You indicated that we are approaching a level of full employment, full use of our plant capacity, and you said, "It is hard to ride this position between inflation and deflation."

I am wondering, Mr. Secretary, if this 4-percent projection is altogether too modest, in light of the job yet to do. Still 3.7 or 3.8 percent of the working people are unemployed in this country.

Last year some 2 million people were added to the work force, new people coming in, as well as the reduction of those who were unemployed. Productivity of labor increased last year by a percentage some place between 3 and 4 percent. It seems to me adding all this up, the forecast or the projection of 4 percent is recessionary, Mr. Secretary. Will you comment on that?

Secretary FOWLER. Yes, Senator. I would not agree at all that it is recessionary. I would think that your point, however, as to whether or not the 4 percent is just for next year or whether that is an acceptable target for the years that stretch out ahead is a very good one.

I had occasion to comment on this last May. I said that we have used up a substantial amount of the slack that existed in the unemployed, and have to rely for growth primarily on new additions to the labor force, increased productivity, and structural attack on unemployment. This being the case, I thought somewhere between 4 and 4½ percent would be the proper long-range target that could be sustained, on the assumption of continued productivity advances and an intensive attack on the problem of structural unemployment.

We are not just beginning, but are well underway on an intensive national effort in the fields of job training, vocational guidance, and education generally. This effort should prove fruitful over a period of time in achieving the growth figures that economists have provided the staff of this committee. These are found in a most interesting report that was issued last week.

However, we are just getting underway in a number of these job training and manpower and womanpower programs, and I think, given those circumstances, that next year our target of around 4 percent is the right one. I wouldn't be satisfied with it, however, for the long-term future. I think we could hope for and strive for something better.

Senator JORDAN. How far do we calculate we can reduce unemployment; to what level, when it becomes irreducible?

Secretary FOWLER. I think the present argument is over the methods that are to be employed. My own position is that, having reached a level of unemployment of somewhat under 4 percent, that the principal reliance for reducing it further, and I think it can be reduced substantially further, ought to be the attack on structural unemployment rather than simply expanding demand, to points that might prove excessive and invite undesirable and unsustainable price and wage pressures.

Senator JORDAN. I have a little difficulty in the position you have expressed, Mr. Secretary, here with regard to tax increases, and I want you to clear it up for me if you will, please, sir.

You said, as I understood it, that a general tax increase early last year would have been a mistake, and you cited the growing weakness in the economy that appeared to be showing up at that time. Yet the administration in September got the repeal of the investment tax credit, which is an increase of sorts, and now when the economy shows even more soft spots, the administration asks for a general tax increase which last year, when the economy was still booming, you said would have been a terrible mistake. Do I detect an inconsistency in that or will you express yourself?

Secretary FOWLER. I would like to try to explain to you why I think it is consistent.

Senator JORDAN. All right.

Secretary FOWLER. There were selective weaknesses developing in the economy last year, due to, for example, the discriminatory impact that tight money always has on the housing industry.

There were boom conditions in some sectors of the economy, and almost recessions in others. And this year we are hopeful that those imbalances will tend to be reduced and corrected and that we will have a fairly well balanced advance in all sectors of the economy.

We believe that with the shift in monetary policy—made possible by a number of changing conditions—from one of moving toward increasingly rigid restraints, which characterized the first 9 months of 1966, to a more moderate one of moving toward ease, which will have been the posture, assuming no change in direction, for about 9 months by the time July 1 of this year rolls around, we would have a better balanced private sector, with all the elements moving forward in a moderate but sustained way, and not characterized by the booms in some and the recessions in others that characterized 1966.

At the present time, this is an assumption. We will have to wait until April or May to see what the situation really is. By midyear, given the enactment of the social security law, along the lines recommended by the President, substantial increase in purchasing power would be involved. We think in the atmosphere of a movement toward monetary ease, toward the availability of credit on more reasonable terms over a period of months, that the situation will have thawed out sufficiently so that the imposition of these surcharges would be wholly consistent with a balanced, sustained prosperity for the fiscal year 1968.

Senator JORDAN. Is there any magic in the figure 6 percent? Why not 4, why not 8, why not 10?

Secretary FOWLER. No. I think 5 or 7—actually the revenues that will be available from the 6-percent figures are not dollar for dollar

but roughly in the same ballpark with the present estimates of the increase in Vietnam expenditures in fiscal 1968.

Senator JORDAN. One question on balance of payments, Mr. Secretary.

The fact that our interest rates were so high last year, induced some foreign investors to enter the domestic market, and now as interest rates recede, is it not likely that these foreign investors will seek investment elsewhere and thus react unfavorably against our balance of trade?

Secretary FOWLER. Senator, that depends upon several other factors. It depends in very large degree on what happens to interest rates in other capital markets at the same time. If our interest rate levels are moving down, and their interest rate levels are moving down in somewhat the same general proportion, and the gap that exists today or last year is no greater, with this more or less simultaneous downward movement, there wouldn't be the impulse for those funds to seek other investment channels that there would be if our interest rates moved down and interest rates in other capital markets either remained the same or continued to go up.

Therefore, the answer to your question depends very much on whether or not there can be effectuated a gradual but nonetheless clearly defined movement downward internationally—a so-called international de-escalation of interest rates. The discussion of that and the development of understanding of it was the purpose of my recent visit to a conference with the Finance Ministers of four of the other major Atlantic countries.

You should also take into account two other factors: We announced in December the tightening of our two voluntary programs on the outward movement of funds from the United States—the voluntary program on direct investment administered by the Department of Commerce, and the programs on bank lending and lending of nonbank financial institutions, which are administered by the Federal Reserve Board.

Finally, there is pending before the Congress a request from the President to extend the authority under the interest equalization tax, and enable him to move the 1-percent rate up to 2 percent, if this interest gap should widen, and it should prove necessary to compensate, so to speak, for the different structural levels of interest rates here and in other countries.

A combination of those three elements gives you some of the answers to your question, as to whether or not the downward movement in U.S. interest rates that is characterising the current period will, if continued during the year, give rise to outflows that would be damaging to our balance of payments.

Senator JORDAN. My time is up. Thank you, Mr. Secretary.

Chairman PROXMIER. Senator Symington?

Senator SYMINGTON. Thank you, Mr. Chairman.

Mr. Secretary, it is a pleasure to see you here this morning, sir. Your figures on gold. Have you no figures on the amount of gold the Treasury holds since December 31?

Secretary FOWLER. Yes. I can give you figures that are a little more up to date.

Senator SYMINGTON. Just furnish them for the record.

Secretary FOWLER. Yes; I will, Senator Symington. There hasn't been any marked change since the December 31 figures. The gold stock was \$13,235 million at that time.

Senator SYMINGTON. Just give the latest statement you have.

Secretary FOWLER. Yes.

(The information requested follows:)

The total U.S. gold stock at the end of January 1967 was \$13,202 million.

Senator SYMINGTON. Is there any other country in the free world that buys gold at \$35 an ounce and sells gold at \$35?

Secretary FOWLER. No, sir.

Senator SYMINGTON. Except the United States?

Secretary FOWLER. No, sir.

Senator SYMINGTON. What other countries besides the United States have denied their citizens the right to possess gold?

Secretary FOWLER. I can't recall any, Senator Symington, that has a law that is as complete and restrictive as the United States. The British have regulations similar to ours, and there may be other countries, but by and large we are somewhat unique in that respect.

Senator SYMINGTON. Thank you.

Is it correct that last year most of the gold in the free world did not go into government stocks?

Secretary FOWLER. That is correct, sir.

Senator SYMINGTON. And if we lower interest rates, that means we will probably lose more gold to foreign central banks or foreign investors, is that right?

Secretary FOWLER. It doesn't necessarily follow, Senator Symington. It depends first, as I answered Senator Jordan, on whether the lowering of interest rates results in any increased outflows, and thus on the three factors that I mentioned; and then, in turn, the question of whether we lose gold as a result would depend upon whether those outflows of dollars into private hands are turned in by the private holders of those dollars to central banks; and then finally it depends upon the judgment of the central banks as to whether they will continue to hold the dollars as a part of their reserves, or whether they want to turn those dollars into gold.

Senator SYMINGTON. I understand. Would you let the committee know for the last 10 years for developed countries, the date each country held, country by country, the most dollars, and what at that time their gold reserves were; also another column as to what their gold holdings are now and what are their dollar holdings?

Secretary FOWLER. Say from 1958 to date?

Senator SYMINGTON. Correct.

Secretary FOWLER. Yes, we keep those figures current and will be glad to furnish them for the record.

(The following table was subsequently supplied in response to the request of Senator Symington:)

Gold and dollar holdings of selected foreign countries, date of peak dollar holdings since 1958, and Nov. 30, 1966

[In millions of dollars]

Country	Date of peak dollar holdings			Nov. 30, 1966 ¹	
	Date	Dollars	Gold	Dollars	Gold
Belgium.....	Nov. 30, 1966	492	1,524	492	1,524
Canada.....	May 31, 1963	3,981	746	3,154	1,034
France.....	June 30, 1963	1,730	2,814	1,131	5,237
Germany.....	Feb. 28, 1961	3,588	3,030	2,572	4,291
Italy.....	Dec. 31, 1965	1,746	2,404	1,494	2,382
Japan.....	Nov. 30, 1965	3,029	² 328	2,638	³ 329
Netherlands.....	Feb. 28, 1960	514	1,141	369	1,730
Sweden.....	Mar. 31, 1965	804	189	704	203
Switzerland.....	Sept. 30, 1966	1,902	2,681	1,857	2,679
United Kingdom.....	Nov. 30, 1966	4,747	³ 1,940	4,747	³ 1,940

¹ Preliminary.

² As of Dec. 31, 1965.

³ As of Sept. 30, 1966.

NOTE.—“Dollar holdings” represent U.S. short-term liabilities to official and private foreigners, foreign official and private holdings of marketable U.S. Government bonds and notes, and foreign official holding of convertible nonmarketable Treasury bonds and notes. Figures for some countries include small amounts of U.S. liabilities denominated in convertible foreign currencies.

Senator SYMINGTON. When I was in Asia and the Far East this year, I spent quite a little time in one of the few countries that broker gold. As I understand it, the price of gold now in private trading retails at around \$54, but in some places as high as \$80.

What in your opinion would happen if the United States, at this time, under these circumstances, decided it would not buy gold any more at \$35 an ounce?

Secretary FOWLER. What would happen?

Senator SYMINGTON. Yes. What would be the results?

Secretary FOWLER. A number of things would happen, Senator Symington, some of which are predictable, some of which are not predictable.

Senator SYMINGTON. I will gladly give you the balance of my time if you will tell us those that are predictable.

Secretary FOWLER. The most clearly predictable one is that I think the system of trade and payments which has characterized the postwar period set up under the Bretton Woods arrangement, which has been one of the remarkable success stories of all time, would suffer a very severe dislocation, and we would move from this system of fixed parities, under which all currencies are related to the dollar and the dollar in turn to gold, and we would move into a period of fluctuating currency relationships, which in my judgment would be very disruptive of the trade patterns that currently exist.

What the end result would be over a period of time is very difficult to say, but it certainly would not be a welcome prospect for those who believe that increased trade and development ought to characterize the free world.

Did you say that we would say we wouldn't buy gold? Was that your question? Or sell gold?

Senator SYMINGTON. We would no longer buy gold.

Secretary FOWLER. No longer buy gold?

Senator SYMINGTON. That is what I said.

Secretary FOWLER. I have given you an answer to the question on selling gold.

Senator SYMINGTON. It would appear so. I think even I understand what would happen if we—

Secretary FOWLER. No, no. What would happen if we took the position we wouldn't buy gold, that is a much more interesting question, Senator Symington. I think there would be a measure of disruption. I don't think it would be of the same type and character as the one I have described if we refused to sell gold.

I think it would give rise to questions in the minds of many people throughout the world as to whether or not the gold that they have was as valuable as they think it is. I think it would cause some people, some countries, to wonder whether the gold they held in reserves, whether the total of the world's reserves, made up of gold and dollars, and some of the other currencies, was as much as we think today, and this in turn might have a retarding effect on trade and development, but not nearly to the same marked degree I think as the other phase of the problem.

Senator SYMINGTON. If we refused to sell gold at \$35 an ounce, we, in effect, go off the gold standard. If we refuse to buy gold at \$35 an ounce, it is not so clear what would happen; am I right?

Secretary FOWLER. That is correct, sir.

Senator SYMINGTON. My final question: Would you supply for the record at this point the excess of exports over imports in the private sector over the last 10 years?

Secretary FOWLER. Yes, Senator Symington. I have those figures. (The information referred to follows:)

U.S. trade surplus

[In billions of dollars]

	Overall trade surplus	"Commercial" trade surplus (excluding exports financed by U.S. Government grants and capital outflows) ¹
1956	4.6	(2)
1957	6.1	(2)
1958	3.3	(2)
1959	1.0	(2)
1960	4.8	2.9
1961	5.4	3.2
1962	4.4	2.1
1963	5.1	2.4
1964	6.7	3.9
1965	4.8	2.0
1966	3.7	(2)

¹ For example, Export Import Bank financing.

² Not available.

Senator SYMINGTON. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Chairman PROXMIRE. Mr. Moorhead?

Representative MOORHEAD. Just to carry on what Senator Symington has said, it seems to me, Mr. Secretary, that it makes eminently good sense to consider, not that we should discontinue to use gold to prop the dollar, but I am not sure it makes as much sense to use the dollar to prop the value of gold. I think that is the thrust of the Senator's question.

Secretary FOWLER. The thought crosses my mind frequently, Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Secretary. On the question of a tax increase, last year I thought an additional and general tax increase was necessary, even though it was an election year, and politically unpopular. I introduced a bill to have standby authority.

Secretary FOWLER. I recall you were one of those brave souls that did.

Representative MOORHEAD. Your testimony today about the fact that there was no clear signal last year for a tax increase is so persuasive that it also persuades me that there is no strong signal this year. It seems to me what you are asking the Congress to do is to say there is a strong signal today, that there will be a strong signal in July for a tax increase. Now this is asking us to take a mighty big step, Mr. Secretary.

Secretary FOWLER. I am not up here yet on that mission. That will be a few months later, Congressman Moorhead.

Representative MOORHEAD. Would you agree, Mr. Secretary, that it would be wisdom on the part of the Congress to postpone the final decision until this direct signal comes in May or June, rather than to rely on the signal that a signal will come?

Secretary FOWLER. I hope no one will get locked into any position on that before April or May, and until all the evidence is in and we have had a chance to present our case in the light of the circumstances that exist at that time.

Representative MOORHEAD. Would I be correct in my assumption that you think with the declining interest rates, that there will be an additional upturn in the economy coming somewhere between May and August?

Secretary FOWLER. I think we will have a better balanced, healthier economy that could well handle a tax increase of the type and the dimensions that have been suggested. For the three reasons I discussed with Congressman Reuss, I believe it will commend itself as a basic component of economic and financial policy for the continued period of the war.

Representative MOORHEAD. Mr. Secretary, we started out these hearings with the chairman saying that this wasn't a time for handing out merit badges, but I do think that you have a good record on your making of estimates of income and outgo, and I have the feeling that the error on the estimate of the Vietnam war should be isolated from your other estimates and predictions.

I wonder if you have some figures that show us what estimates for income and expenditures you have with and without the Vietnam war, so we can isolate that. I also would be interested to know where your

figures show we would have been, surplus or deficit, if we could isolate the additional expenditures for the Vietnam war.

Secretary FOWLER. Thank you, sir. I do know it is a matter of constant concern to take both the receipts, for which I have responsibility for estimating the receipts, and the Director of the Budget has responsibility for estimating expenditures. We mesh them and arrive at our estimates or deficits or surpluses as the case may be. It is a joint act, and I think that it is the total result of those two things which ought to be viewed rather than just one or the other.

May I respond now to Senator Miller?

Chairman PROXMIRE. Are you through, Mr. Moorhead?

Representative MOORHEAD. I take it that the Senator's question and mine are somewhat similar?

Secretary FOWLER. No. I am going to use a chart to answer his, a couple of charts, and I have a chart dealing with your question, so when the appropriate time comes, I would like to answer your question.

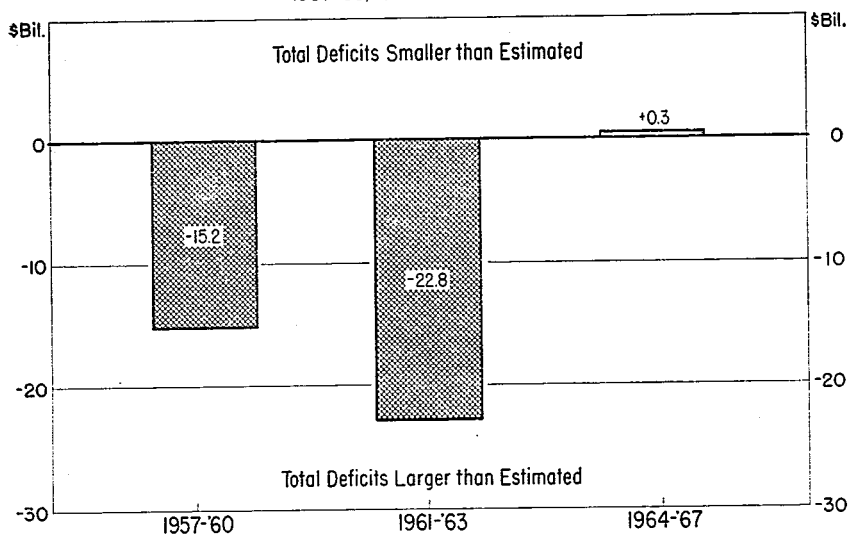
Representative MOORHEAD. Would you like to use the chart to answer my question now?

Secretary FOWLER. Yes. Here is a chart entitled, "Errors in Deficit Estimates."

CHART 3

ERRORS IN DEFICIT ESTIMATES

1957-'60, 1961-'63 and 1964-'67



Just for comparative purposes I would like to show you the record over the last 10 years, 1957 to 1960, 1961 through 1963, and 1964 to 1967. Now, the estimates made in January project the deficit or surplus in the fiscal year that follows, from the following July 1 through the next June 30. It appears that during the years 1957 to 1960, the original estimates made in January for these 4 years were, in all, roughly \$15 billion too low. There was a cumulative underestimate of the deficits during those 4 years of \$15 billion.

In the next 3 years, the error was larger, \$22.8 billion.

In the 4 years, 1964 to 1967, including the one that has been characterized as the "big goof," President Johnson's personal projections in his four budgets, were \$300 million off on what I would call the plus side.

Representative MOORHEAD. How much was the error for fiscal 1967?

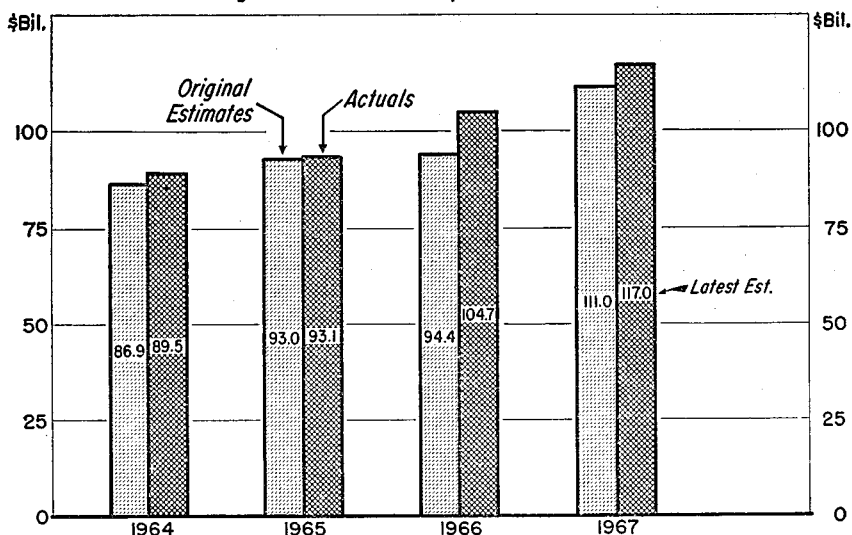
Secretary FOWLER. The difference between \$9.7 billion and \$1.8 billion—\$7.9 billion.

Now insofar as the revenue side of it goes, I have been guilty, I guess, of underestimates.

CHART 2

REVENUES

Original Estimates Compared With Actuals



In chart 2 which I have here, the light bar represents the original estimate. The dash bar represents what finally came in. In each of these 4 years, we have been underestimating our revenues. This is due, of course, to the fact that the economy has been in a constantly advancing and prosperous condition. Incomes have been moving up and the calculation of the marginal tax take is difficult to predict precisely.

It is also, I think, due in some measure to the fact that the Internal Revenue Service has been more successful in collecting taxes beyond original estimates.

Representative MOORHEAD. Mr. Secretary, on the tax increase, considering the fact that we have acted, the Congress has acted in the past few years to cut taxes, does the proposal that you are making or will make, return us to a tax rate above or will it still be below that which we were paying say before 1961?

Secretary FOWLER. I think if you take into account the reduction in taxes which was effected by the Revenue Act of 1962, the Revenue Act of 1964, the Excise Tax Act of 1965, and the change in the admin-

istrative procedures on depreciation, you would find that as of today, there has been a \$22.5 billion tax reduction as a consequence of those actions.

Now for fiscal 1967 and fiscal 1968, taking into account the proposals that have been made, we would take away some of that tax reduction—certainly not more than 25 percent although the estimates would indicate that it is much less than that.

Even taking into account the surcharge proposals, in calendar 1968, tax liabilities would be roughly \$20 billion less than they would have been had it not been for the tax actions taken to that date.

The rates, Congressman Moorhead, will be well below the pre-1964 rates. We could put in a table for the record to indicate to what degree they will be lower than the pre-1964 rates.

Representative MOORHEAD. I think that would be helpful.

Thank you, Mr. Chairman.

(The following table was later supplied for the record:)

Estimated effect on fiscal year receipts (administrative budget) of tax changes since 1962

[In billions of dollars]

	Fiscal years					
	1963	1964	1965	1966	1967	1968
Revenue Act of 1962:						
Investment tax credit.....	-1.1	-1.4	-1.6	-1.9	¹ -2.1	¹ -1.3
Other provisions.....		+ .8	+ .8	+ .8	+ .8	+ .8
Depreciation guidelines of 1962.....	-1.3	-1.4	-1.5	-1.6	-1.7	-1.8
Revenue Act of 1964:						
Individuals.....		-2.4	-8.7	-12.4	-14.1	-15.5
Corporations.....			-1.5	-2.9	-3.2	-3.2
Acceleration of corporate payments.....		+ .3	+1.0	+2.0	+2.0	+2.2
Revenue Act of 1965: Excise reduction.....				-2.2	-3.7	-4.1
Tax Adjustment Act of 1966:						
Graduated withholding and increase declaration 70 to 80 percent.....				+ .1	+ .4	- .2
Acceleration of corporate payments.....				+1.0	+3.0	-1.3
Excise tax increases.....				+ .1	+1.2	+1.5
Total, enacted to date.....	-2.4	-4.1	-11.5	-17.0	-17.4	-22.9
Proposed legislation:						
Individual.....						+3.4
Corporation.....					+ .2	+2.1
Excises.....						- .4
Total, enacted and proposed.....	-2.4	-4.1	-11.5	-17.0	-17.2	-17.8

¹ Including effect of Investment Credit Suspension Act of 1966.

NOTE: This table is presented only for historical background. Although figures for any one year are believed to be reasonably accurate approximations, with possibility of duplication, they cannot be used or estimates of year-to-year changes.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 3, 1967.

Chairman PROXMIRE. Congressman Brock?

Representative BROCK. Thank you, Mr. Chairman.

I just have one comment, Mr. Secretary. I have enjoyed your presentation, the part in which I participated, but I would like to say when you have a cumulative figure on the errors made, that really does not affect the future actions we take in any given year. We have to make a study of that specific year.

Secretary FOWLER. That is correct.

Representative BROCK. And the impact that that revenue collection and spending will have on the economy.

Secretary FOWLER. That is correct. Just because the revenue estimates have been conservative in other years may not prove to be the case this year. I recognize this is an annual event. All I am saying is that I think the cumulative record of the President is deserving of a little bit more recognition than it seems to have received.

Representative BROCK. I appreciate it. I think that what Senator Proxmire and a number of the rest of us have been seeking is some hope that the specific annual budget will be as accurate as possible.

Secretary FOWLER. We try to make them just as accurate as we can, but Congressman Brock, when you get a war it's a ripe time for estimating errors.

Representative BROCK. I am very much aware of that, sir. Let me ask you just a couple of questions related in general to dealing with our balance-of-payments problem. The administration has asked for authority to raise or lower the interest equalization tax between zero and 2 percent. Do you envision this as an opening wedge to obtain more general Presidential authority?

Secretary FOWLER. No, I do not. Very much to the contrary. This is a very special situation, in which this tax functions to offset the gap between our structure of interest rate levels—which has always been somewhat lower than the continental Europeans'—and those abroad. It's a compensating element, and it seems undesirable to come up—if that gap should change for the first 6 months of the year—and ask the Congress, because you always have to make it back-dated to the date when the request is made. Otherwise a lot of built-in inequities would be created that would have to be taken into account. I think this is a very special and unique situation dealing with capital flows that ought not to create any precedent or any carryover effect on the general function of the Congress in levying for revenue purposes.

Representative BROCK. I can understand the logic, but I think the concern that I fear and that some other people fear is over the impact such legislation would have upon the investor, because it just adds one more factor of uncertainty.

When Congress acts, at least whether right or wrong, at least he knows where we are going, but if there is this sword hanging over the market, he never knows what is going to happen next, and I think it creates a great state of flux and perhaps more instability, or it could lead to that, and this is my concern.

Secretary FOWLER. I will try to deal with that when we come up with the interest equalization tax proposal.

Representative BROCK. Let me ask you one more question. The former Under Secretary of the Treasury, Mr. Roosa, has suggested he fears this might be a crucial year for the dollar, if the balance of payments should increase substantially this year.

Secretary FOWLER. Every year, as far as I'm concerned, is a crucial year for the dollar, Congressman Brock.

Representative BROCK. I am aware of that.

Secretary FOWLER. And this will be no exception.

Representative BROCK. The items which gave us a favorable balance last year, is there a potential for a continuation of that trend this year? I am speaking particularly as it relates to interest rates in this country. You suggested that we could foresee a reduction in interest

rates. What impact do you think this will have on the balance of payments?

Secretary FOWLER. I tried to deal rather extensively with that same question from Senator Jordan. I don't know whether you were here.

Representative BROCK. No, I'm sorry.

Secretary FOWLER. But if my answer has been inadequate in any respect, I will be glad to go into it further with you, but roughly and quickly, there are three factors that we would hope would give rise to a situation in which we could have our interest rates lower, but not necessarily give rise to any marked outflows of capital.

One is the fact that we would hope interest rate levels in other countries would come down so that the gap would not be enlarged.

Secondly, we are tightening our two voluntary programs as far as outflows are concerned here—the Federal Reserve programs on banks and nonbank financial institutions, and the direct investment program administered by the Department of Commerce.

And finally, the interest equalization tax proposal, which you have just referred to, is the third element is the tripod that we would hope to use to accomplish two desirable objectives—a reduction in interest rate levels, without accentuating our difficulties in balance of payments.

I would also like to say I hope that this year will be marked by a return to an increasing trade surplus rather than suffering further declines in the trade surplus, such as we have had over the last 2 years.

Representative BROCK. I very much hope you are right. I think the only concern that I have was that if our interest rates do decline, whether we can honestly expect a decline in interest in—

Secretary FOWLER. That is why I went to Chequers, Congressman Brock, to work on that.

Representative BROCK. One further question. Has the administration, in light of the suggestion of some, by the Senate Finance Committee particularly, made a reappraisal of the cost of our military operations in Europe, and is there any study directed toward this insofar as it affects our balance of payments, running in any direction we might anticipate?

Secretary FOWLER. Yes, there is a great deal of study going on and I would like to comment on that briefly, both as to the budgetary aspects and as to balance-of-payments aspects.

First, as to the study. We are engaged in so-called "trilateral" discussions and negotiations with the West German Government and the United Kingdom Government to reappraise the military requirements and the force goals in the light of the changing situation.

And, secondly, as a part of that, how in the light of any feasible reductions, consistent with overall NATO goals and principles, the financial imbalances that result, because a large body of the forces are located by reasons of geography in a particular country, how that situation—the financial "fallout," so to speak, for NATO—is to be handled for the future.

As for estimates on budgetary savings, which I think the chairman adverted to the other day, I did check with Secretary McNamara, and he tells me that, so far as he is concerned, there would be no budgetary savings in returning whatever number of divisions one might mention. Indeed, in the first year, there might be some increases in budgetary

costs because of the problems of the additional costs of movements and returning dependents, et cetera.

The only circumstances under which there would be budgetary savings would involve a second question of whether, if bringing them home, you would demobilize those divisions and reduce the forces. Unless you did that, there would be no budgetary saving.

This is as much as I think I should say at this time insofar as the trilateral discussions are concerned. After these discussions are completed between the three countries, I should say, of course, that any results would be considered with our other allies in the context of the entire NATO establishment.

Representative BROCK. Thank you very much, sir.

Mr. Chairman, I would like to have unanimous consent to insert in the record at this point an editorial in the Washington Post on interest equalization.

Chairman PROXMIRE. Without objection, it is so ordered.

(The article referred to follows:)

[From the Washington Post, Feb. 4, 1967]

MORE INTEREST EQUALIZATION

In 1963, during a period of great consternation over the balance of payments, Congress levied a special tax—the Interest Equalization Tax—on foreign securities purchased by Americans from foreign sellers. The object was to stanch the outflow of capital by making it more costly to float security issues in this country where interest rates were much lower than in Europe, hence the term “interest equalization.”

This newspaper opposed the tax as an unwarranted interference with the free flow of capital and a disguised form of dollar devaluation which, by perpetuating differentials in international levels of interest rates, would prove counterproductive in the long run. Now the Administration proposes a far more reprehensible tax, one that would grant the President unprecedented power to raise or lower the tax rate on foreign investment without the consent of the Congress.

The new tax proposal gives the President the authority to raise the interest paid on foreign bonds from zero to two percentage points. On a bond of 28.5 years maturity or more, this amounts to a 30 per cent tax or double the rate under the present tax with its fixed levy of one percentage point. Under the new proposal the President would be able to vary the rate over a two-percentage-point range and in reducing the tax rate, he would be empowered to make the cuts retroactive.

Why are these extraordinary powers being requested? The logical explanation is that flexibility in setting the rate is required in the event that the differential between interest rates in this country and in Europe should narrow or widen. But in practice there would be a tendency for the rate to be set at the maximum of two percentage points. If it were lower, American investors, fearing a higher rate, might sharply increase their purchases of foreign securities and increase the outflow of dollars. And such anticipatory purchases are not likely to be affected by the prospects of rebates through retroactive tax reductions.

If one assumes that investors are so naive as not to anticipate increases in the IET rate, then investing in foreign securities becomes something of a lottery where, because of unforeseeable changes in the IET, no one can know what a bond will really yield.

In addition to compounding the uncertainty with which investors must contend, the IET runs counter to this country's policy of integrating the international capital markets and thereby diminishing interest rate differentials. By insulating the United States capital market, the IET works in the opposite direction. Moreover, in granting the President the authority to vary tax rates, it threatens a prerogative which Congress is properly jealous in guarding.

In a recent speech, Mr. M. A. Wright, the president of the United States Chamber of Commerce, asked pointedly whether our balance of payments restrictions do not involve costs, reckoned in terms of diminished efficiency, that far exceed any benefits conferred. The new IET proposal falls into that category and ought to be rejected by the Congress.

Chairman PROXMIRE. Before we go into Senator Miller's charts, I do have some questions. I can see why you are a great trial lawyer. This has happened to me at least twice. It happened to me the first time I questioned this morning and now a second time; just when I am about to launch into a useful and constructive discussion, you come up with something that makes it impossible for me to do it. We spend the whole time hassling over that, and that is the end of my 10 minutes.

I must say, without asking you for response, your statement that withdrawing four of our six divisions from Europe wouldn't have any positive budgetary or at least reduction of spending in the first year is on a false assumption that either you have to demobilize them completely, or the cost may increase.

Of course, what I have in mind is that we would withdraw those divisions from Europe and use them in Vietnam, and we can slow down to some extent the pulling into our Armed Forces through the draft other people who otherwise wouldn't be in the Armed Forces. And we can reduce to some extent the size of our total Armed Forces, which is now bigger than China or Russia, for the first time I think in many, many years, if not ever. So that what I have in mind is something that I think could be realistic, and would have a favorable budgetary impact, as well as a favorable balance-of-payments impact.

Secretary FOWLER. And present much more serious security problems.

Chairman PROXMIRE. Not necessarily; 42 Senators seem to disagree with you at the present time. They have cosponsored the measure, including every member of the Democratic policy committee, which includes Senator Russell and others.

Secretary FOWLER. Is demobilization, a reduction in the total force, a part of that proposal?

Chairman PROXMIRE. Well, no, but I think that certainly they would have in mind that we now have an Armed Force which is adequate to do the job we have in mind. If we withdraw four of those six divisions from Europe, we don't have to increase our reserve in this country by four divisions.

While I have the chance, let me get on to something else. In view of the great uncertainty in forecasting, which you have really reinforced this morning very well—and incidentally, it would have been an interesting chart if you had shown the average statistical error rather than the net effect—

Secretary FOWLER. I am sure that will be developed.

Chairman PROXMIRE. In view of the uncertainty that we face with the Vietnam war still going on; in view of the uncertainty we face with Federal Reserve policy on interest rates; in view of the fact that we are not sure what Congress is going to do on appropriations; doesn't it make more sense to follow a policy of trying to exert fiscal restraint by having the President control spending, which he can do without acts of Congress, rather than have it done by higher taxes now, with the notion that we can reduce those taxes later on? With the experience that we have had to either increase taxes or reduce taxes, it is likely to take 6 months or a year, and meanwhile we don't know what is going to happen to the economy.

Secretary FOWLER. Well, I think that fiscal restraint is very much a part of the President's thinking and his current budget. He has stated

in the budget that what he is trying to do, in effect, is to walk a fairly narrow path here in conserving existing programs rather than dismantling them, and standing still, so to speak, in some areas. These will be very useful and desirable areas for growth and expansion when the Vietnam period is passed, and therefore, you want to keep these programs in being.

Chairman PROXMIRE. You see, what I have in mind, if I can interrupt for a minute, that the President is in a position, as he demonstrated by reductions in spending of \$3 billion. We can put them into effect without months of congressional debate that a tax hike involves.

He can go further than that with road building programs, with much of our public works, with some of our space or much of our space program, and then he can resume them because he has the obligational authority from Congress without having to go through hearings, debates, and delay.

If we have the situations as we have had in the past with prices rising and unemployment rising at the same time, it is going to be very hard for Congress to resolve this and to cut taxes.

Secretary FOWLER. I think, Mr. Chairman, the President feels that he has done a very, very substantial job already. In the fall he and the Director of the Budget, I know, went over expenditures painstakingly, in order to defer or reduce expenditures to the extent of roughly \$3 billion in this fiscal year, and to reduce total authorizations by about \$5.3 billion.

Now he thinks he has gone just about as far as is desirable from his point of view. It may well be that the Congress could and will find other areas. You mentioned several the other day that might be profitable to pursue. However, experience as to what Congress has done with Presidential budgetary recommendations in public works and NASA doesn't give me any great encouragement that additional reductions in expenditures can be made to the tune of \$5 to \$6 billion—the amounts involved in this tax program. I just don't believe it is going to happen.

Chairman PROXMIRE. Almost everything depends upon what the President decides he is going to do, (a) he can veto spending measures, (b) as he has shown in the past, he has a very effective item veto. He can just refuse to spend the money.

I can recall fighting hard against the additional wing of B-52 bombers on the advice of Secretary McNamara in 1962, and losing on the floor of the Senate, with only four votes. President Kennedy just didn't spend the money. President Johnson can do the same thing.

Secretary FOWLER. He is doing that; and he is doing it now to the tune of about \$3 billion in this current fiscal year, and he feels he has gone as far as he should go from his point of view. He feels that he has tailored these programs down as much as possible.

Now, Congress may have a different judgment about that. I hear a lot of comments up here that we are going to cut this budget an additional \$5 billion, and we won't need this tax increase. I would just like to point out in the area that you are focusing on, what happens. I have a lot of detail here I could submit for the record. In fiscal 1965, 35 projects were budgeted for the Corps of Engineers, and Congress added 28 additional ones. In 1966 they budgeted 37; Congress added an additional 25. In 1967 they budgeted 25, and Congress added 33.

Chairman PROXMIRE. Congress does this. There is no question about that. You are right about this.

Secretary FOWLER. This goes all across the board.

Chairman PROXMIRE. It requires a presidential veto. It requires a tough, hard, maybe a losing presidential fight in Congress, but then again he doesn't have to spend the money.

Secretary FOWLER. I am trying to be realistic about this.

Chairman PROXMIRE. Yes.

Secretary FOWLER. And I don't believe—whether it might be more agreeable or not—that the Congress is going to cut spending in fiscal 1968 an additional \$5 to \$6 billion over what the President feels is the proper amount. He has submitted what he thinks is the right budget.

Chairman PROXMIRE. Now let me ask you this. Mr. Secretary, you are a very moderate man and a man with an open mind and you are certainly not dogmatic in any way. I certainly take it from the tenor of your presentation this morning that you are not completely and finally wedded to the 6-percent surtax.

You are supporting it, but conditions may change, and if they do, you may not press it in May or June, if conditions change significantly. I would like to ask you if you could tell us what criteria you would apply to determine that you might not press the 6-percent surtax. How would the situation have to appear in May or June?

Secretary FOWLER. Well, someone asked me that the other day, and I gave them the only answer I could give them. I don't think there is any one or two magic tests. Come April or May, when this judgment is being made, one would look at a number of the economic indicators, a number of the trends, what the general outlook is for some of the sectors of the economy that have been ailing, such as housing, whether housing seemed to be well on the way back toward a normal pattern of starts, say by the end of the year. I think we will also have to take a very careful look at the SEC-Department of Commerce report on plant and equipment expenditure projections for the remainder of the calendar year, which become available later on this month or in early March.

Personal consumption expenditure levels will be important as well as the question of what happens in inventory adjustment. I think there will be a measure of inventory adjustment in the first 3, perhaps 6 months of the years.

I think those are illustrative of a much larger number of elements which will have to be assessed. I don't have any particular econometric equation in mind as to what weight you give to each one.

In the final analysis, these things involve a subjective judgment. But I do think it is very important that for the remainder of this period, while we are involved in this extraordinary situation in southeast Asia, that we give the private sector the assurance that I think normally it is entitled to have, that there is going to be available money and credit on reasonable terms. That is the element of confidence that to me is the most important one, and also a feeling that spending is not out of control, that the deficit that we have is a measured deficit. It is one which obviously is as a direct consequence of the war.

If we didn't have this war going on, we would have a very substantial surplus in the budget for 1968. But I can't give you, Mr. Chair-

man, any fixed formula for judgment. I think all of these factors are involved. Chairman Ackley's testimony indicated that we are certainly going to keep an open view.

Chairman PROXMIRE. I think the illustrations you have given are certainly very encouraging to this committee and certainly to this chairman. You are looking at the economic situation—the economic impact of the surtax. I suggest if you look too much on the deficit side, although I am concerned with that as you are, that we might have a situation of less growth in the economy, stagnation, even conceivably recession, in which case, of course, the deficit would be bigger than you estimate. But a surtax would be most unwise.

Secretary FOWLER. That is not likely, but it is possible.

Chairman PROXMIRE. The reason I raise that point is that we have failed to look at one very important element. That is that during 1965 and the early part of 1966, unemployment was diminishing. Pressure on plant facilities was increasing. But we have had reasonable stability in unemployment throughout most of 1966.

We have a situation now where the Council of Economic Advisers tell us they don't expect unemployment to drop at all. It may increase. We have a situation where they say they expect pressure on plant facilities to be less, not 92 percent as it is now, but 89 percent at the end of the year.

Under these circumstances, with the automobile industry in some difficulty, at least with sales falling off compared with last year's, with retail sales falling generally, with housing suffering, with the record showing that it takes some time for housing to recover. Lower interest rates may not push housing back up. You can't push the string as Chairman Martin has said; it may well be that a surtax would be a serious economic blunder. Not so much because of its size, although size is significant, but because of the psychological effect and of its irreversibility.

You know, I remember Martha Griffiths saying so amusingly that you could get a tax cut through Congress more quickly than a declaration of war. We all know that is not really true. It took 2 years to get the last one through. Meanwhile, we might be pushed into a recession, and I would hope under these circumstances, that you would do as you so well indicated this morning—give very careful consideration to the economic situation in April and May before you press this.

Secretary FOWLER. Mr. Chairman, as I think Senator Javits said in the statement on behalf of the minority—I would put it a little differently from the way he put it—that the price of success in keeping a full employment high utilization economy moving is always treading a very narrow line between the prospect of deflation on the one hand, and the prospect of inflation on the other.

Now when your economy is slack and is not dynamic and isn't doing very well, you don't have those two things usually to worry about. But in the kind of economy that we have now, both of these are always possibilities that you have to keep in mind.

I think there is an equally good and in my mind a more persuasive case that in the fiscal year 1968 the likelihood is going to be a return of inflationary pressures. This danger is something that we would want to guard against, and even if inflationary pressures did not return, we would nevertheless want to have the assurance that we were

going to have some continued ready availability of money and credit, which the private economy needs so much.

That access can be denied for a period of months or for a period of time, in order to curb things, but to have it over a long, long period of time is a very risky business. Taking all these factors into account, I feel now, although we will certainly look at the situation again, that in treading this narrow path, we will need the combination of monetary ease and some additional taxes, particularly since they are needed for other purposes. While we are able to make out a fairly good case now; it will depend, of course, on the circumstances at the time.

Chairman PROXMIRE. And I particularly urge you to give careful consideration to repealing the suspension of the investment credit, either promptly or at the rate of 1 percent a month, which is an appealing idea.

At any rate, you are going to have a real problem in the fourth quarter of this year, with the postponement of purchases of machinery and equipment. It could be very, very serious.

Secretary FOWLER. I am quite conscious of that.

Chairman PROXMIRE. In the light of these circumstances, you might repeal it. But I hope you won't, as was indicated in the story in the Washington Post on Saturday, feel that because you have repealed the investment credit, you would compensate the equity and add a little more of a surtax on corporations. It would seem to me that the across-the-board neutrality which you emphasized this morning in answering another question should apply, disregarding whatever effect the investment credit suspension may have.

Thank you very much. Senator Miller?

Secretary FOWLER. Senator Miller, in dealing with your question of price increases, I want to present two or three charts which I think show comparable conditions.

We share with you a great regret that we do not have the price stability and have not had the price stability last year that we had in the previous period, running from about 1958 to 1965. Chairman Ackley has stated our concern about that.

But to get it in perspective, I had some charts prepared for a presentation tomorrow to one of the other committees, and I thought I would bring them along here today in case this question arose.

Chart 7 shows "Consumer Price Increases in Selected Countries, 1965 to 1966."

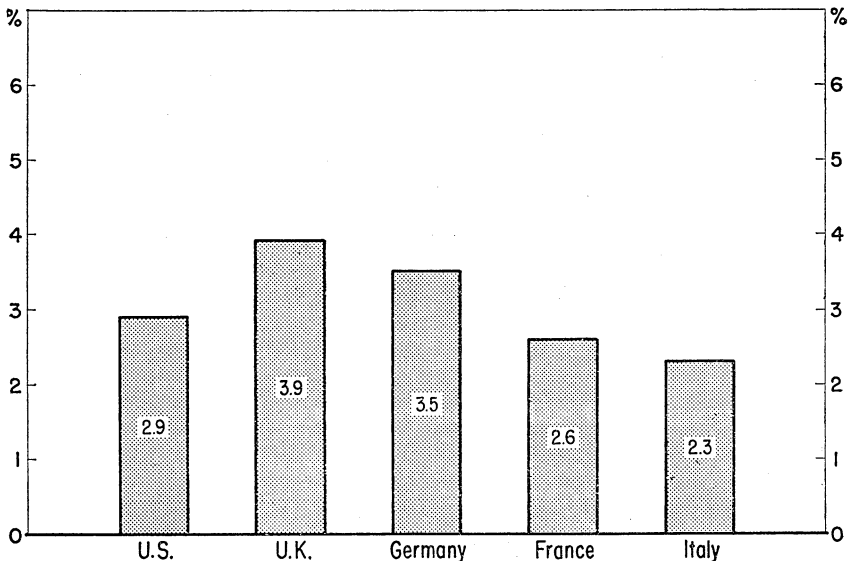
Despite the fact that we are engaged in southeast Asia in a situation which creates heavy and unusual demands on the economy, it shows that the United States has a very good price record compared to the other major industrialized countries in the Western World whose economies are operating in a normal peacetime environment.

This chart shows the 2.9 percent increase for the United States; 3.9 for the United Kingdom; 3.5 for West Germany; 2.6 for France; and 2.3 for Italy.

Senator MILLER. May I ask you a question on that chart, Mr. Secretary? What about the statement I hear that we still have to be very concerned about this, even though from a comparative standpoint it may not look so bad, because of the lower base which these other countries have with many of their prices, which means that they can have even a larger increase in the Consumer Price Index, a larger

CHART 7

CONSUMER PRICE INCREASES IN SELECTED COUNTRIES 1965 to 1966



percentage increase than is shown on that chart, and still they can seriously affect our competitive position in world markets.

Secretary FOWLER. This is not relevant to that point. I am simply trying to show comparative performance, and am not addressing myself to the question of relative competitiveness, which is another and much more complicated question on which I think your point would be very relevant.

Next, I would like to show you, in chart 5, what has happened in the past year in the perspective of the previous years for these same countries.

From 1955 to 1960, the rate of increase in the United States was roughly around 2 percent. For the years 1960 to 1965 it was reduced. The average increase was around 1.3 percent.

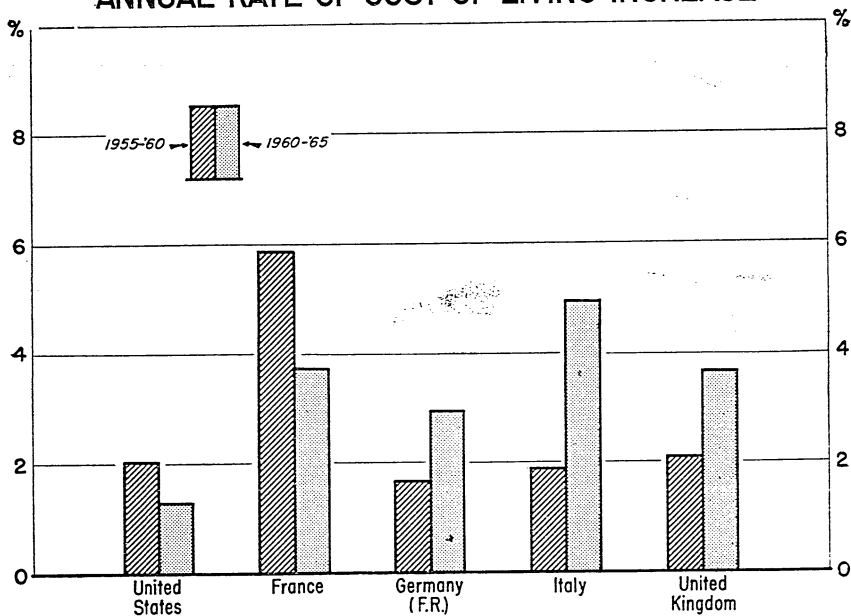
Now, comparing this to what was going on in the same 10-year period in the other countries, France was just under 6 percent, from 1955 to 1960, and a little under 4 percent from 1960 to 1965.

West Germany, from 1955 to 1960, had less than 2 percent, really comparable to what we have enjoyed in the first part of this decade, but its cost of living increased very substantially, and for the last 5 years has been running around 3 percent.

Italy again shows the same pattern as Germany in a more exaggerated fashion in 1960 to 1965. This is, I think, more relevant to your point. There was a much lower base. It has had a rate of price increase, a cost of living increase of 5 percent, and the United Kingdom almost 4 percent.

CHART 5

ANNUAL RATE OF COST OF LIVING INCREASE

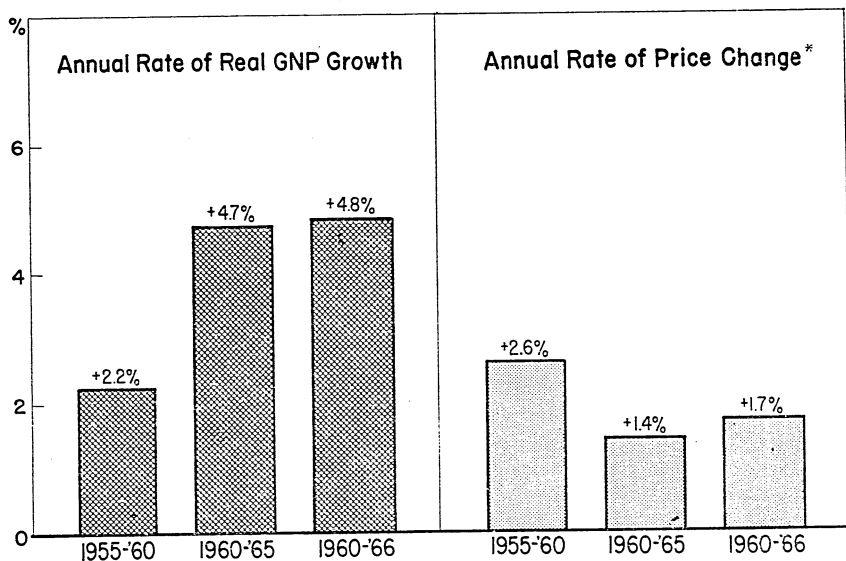


Source: OECD and Economic Report of the President.

CHART 8

GNP GROWTH AND PRICE COMPARISONS

1955-'60, 1960-'65 and 1960-'66



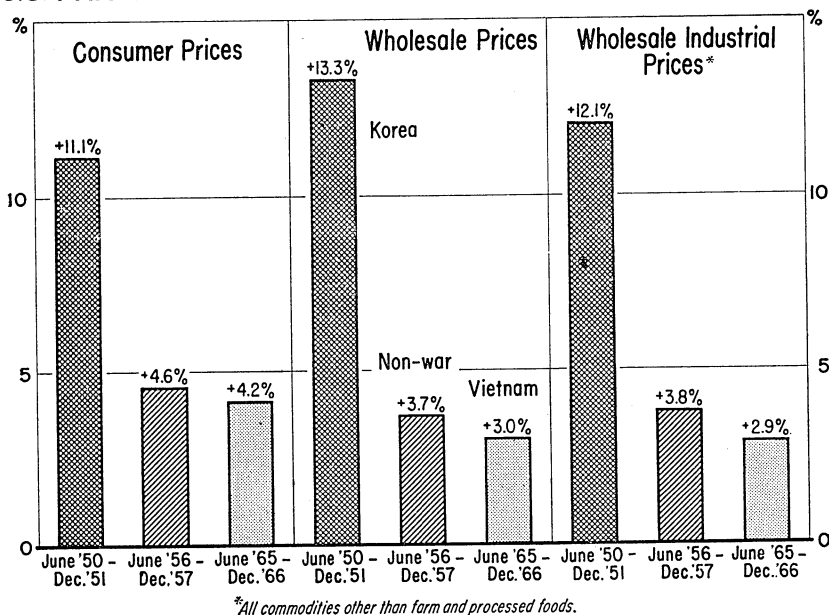
*GNP Price Deflator.

Now returning to our own record, charts 8 and 9 compare two related factors which are important. Chart 8 shows what happened in growth, in gross national product, and in price comparisons. Chart 9 shows price movements for three selected periods in our recent history—one, the Korean war period, which while not entirely comparable, had some of the same elements of dislocation, and second—

Senator MILLER. Are you referring to that Korean war period of 1955 to 1960?

CHART 9

U.S. PRICE MOVEMENTS - SELECTED 18-MONTH PERIODS



Secretary FOWLER. No. In chart 9, I am referring to the period June 1950 to December 1951, and then I am taking a peacetime period, which was in the heart of our last lengthy expansion, which was June 1956 to December 1957, and then taking the last 18 months, from July 1, 1965, to December 31 of the year just ended, and showing you what happened to price movements in those three periods of time.

In Korean period, from June 1950 through the following 18 months, consumer prices went up 11.1 percent. In June 1956 through December 1957, which was a peacetime period of expansion and growth, consumer prices went up 4.6 percent. Here in the last 18 months, with a heavy involvement in military activities of both production and deployment, the consumer price level went up only 4.2 percent, or somewhat less than the peacetime period of the last major expansion in the mid-1950's.

Now the same pattern prevails on the wholesale price side. You can see here by the bars what happened in Korea on wholesale prices, an increase of 13.3 percent; an increase of 3.7 percent in the nonwar period in the 1950's and 3 percent in the last 18 months.

Wholesale industrial prices: 12.1 percent in the Korean period, 3.8 percent in the peacetime expansion of the mid-1950's, and 2.9 percent from June 1965 to 1966.

So that you will have the full picture of this, chart 8 shows both the factor of growth and price comparisons. These are over 5-year periods, 1955 to 1960, 1960 to 1965, and 1960 to 1966, which includes the current period, and therefore reflects all that has happened up to now.

The annual rate of growth from 1955 through 1960 was 2.2 percent. The annual rate from 1960 to 1965 was 4.7 percent. Including 1966 into that period from 1960 to 1966 it was 4.8 percent. And yet with this more than doubled rate of growth in the 1960 to 1965 and 1960 to 1966 period, the annual rate of price change is far less in the 1960 to 1965 period and the 1960 to 1966 period than it was in the 1955 to 1960 period.

It was 2.6 percent annual rate of price change in 1955 to 1960, 1.4 percent in 1960 to 1965, and then taking into account 1966 with its higher change in level of price, you have a 1.7-percent figure.

I think that we should keep this in perspective. I regret any loss of price stability as much as you do, and Chairman Ackley has made our concern well voiced about price stability. Taking into account both the measure of growth that we have enjoyed during that period, the greatly increased employment that has characterized it, I think the price changes have been quite limited and quite impressive in their stability.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Mr. Secretary, I appreciate your presenting us with those charts, and I think that it is good to look at these matters in perspective. However, I can't overimpress upon you that the people we represent may be interested in looking at those charts, too.

They may be interested in knowing that the price rise in the United States is not at as high a rate as it is in some other country. They still want to have this inflation stopped, and it has been getting worse. You take, for example, last year, with \$29 billion of inflation on the backs of the people of this country.

The people over here in Virginia had a share of that, which was the equivalent of a 12-percent sales tax. The people out in my State, Iowa, had as their share the equivalent of about a 10-percent sales tax. And so, while all these things may be interesting in perspective, I still think that the people want this inflation stopped, and I suggest to you that what really counts as far as this committee is concerned is the twofold objective of our national economic policy; namely, full employment and a stable dollar.

I recognize that some people want to trade one off against the other, but I think that at the economic conference held last year on the occasion of an anniversary of the founding of this committee and the Full Employment Act,¹ that it was the consensus that both objectives should be obtained.

I wonder if you could tell us what steps you think can be taken to put a stop to this inflation, so that a year from now, when you are back before the committee, we will see a steady line, which will indicate a stable dollar?

¹ Twentieth Anniversary of the Employment Act of 1946, An Economic Symposium. Hearings before the Joint Economic Committee, Feb. 23, 1966.

Secretary FOWLER. I think a great many steps have already been taken to moderate what was an excessive rate of growth, taking into account the fact that most of the slack in the economy has been absorbed.

I call attention to the moderation from an increase in gross national product averaging around \$16 billion in the last two quarters of calendar 1965, and the first quarter of 1966 to the more modest levels of \$11 to \$13 billion that have characterized the second, third, and fourth quarters of calendar 1966. The combination of policies that effected that result are giving rise to a different situation. The wholesale price index is today about what it was in August. And that price movement seems, at least for the time being, to be fairly well arrested, and presumably some of that will be reflected in the Consumer Price Index, which in each of the last 2 months I think has only crept up about one-tenth of 1 percent.

Another observation is that careful study should be made of the reports, such as the report of the Subcommittee on Economic Statistics of the Joint Economic Committee, which conducted a careful examination of the Consumer Price Index and the wholesale price index, and pointed out the various factors of bias, if one can call it that, that caused, particularly the consumer, the CPI, to move upward, and which are reflected in these figures that you cite as representing inflation.

I think that it is going to be very important in the year ahead, in the year we are currently in, for all of those interested in this problem of price stability, and a return to price stability—and I refer not only to the executive, but I think to Congress, and to the organs of public opinion—to impress, through whatever our channels and methods are, the importance of the principle embodied in the guideposts of holding down increases in wages to something in the neighborhood of increases in productivity.

Now as Chairman Ackley has explained, we are not going to get that right on the nose this year, in view of the fact that the cost-of-living has increased to some extent in the past year, but an emphasis on the cost-push aspects of inflation is one that all bodies of government and public opinion ought to be constantly concerned with, and I welcome the attitude and the concern that this committee has voiced in the course of these hearings, that more and increasing attention be paid to it.

We on our side in the executive will certainly try to do so.

Senator MILLER. Thank you very much, Mr. Secretary. My time is up, Mr. Chairman.

Chairman PROXMIRE. I understand that Mr. Brock had a question or two, and then Senator Percy has a couple of questions.

May I just interrupt for a minute to say that I apologize, Mr. Secretary. We are detaining you a long time. However, it will save your coming back this afternoon.

Secretary FOWLER. That is fine. Thank you. That is all right.

Representative BROCK. Our questions have been cut short by our appetites, I am sure.

Mr. Secretary, you did mention a word which caught my attention just a moment ago when you mentioned the wage/price guideposts and guidelines. When we had Dr. Ackley before the committee, we

examined at some length his statement that we are substituting this year the word "restraint" for a specific guidepost.

Secretary FOWLER. Yes, I followed that dialog. I know.

Representative BROCK. Yes, I am sure you did. In my opinion we have abandoned guideposts because the word "restraint" is as broad as anybody wants to make it. As Mr. Ackley himself pointed out, it is more restraint to have a 7-percent deficit than it is a 10-percent deficit. But it seems that we have come out with the same policy on this budget you have submitted here.

You say the President has exercised as much fiscal restraint as he thinks it is possible to exercise. Now I can't see what the word "restraint" means anymore, because I just saw the report of the St. Louis Federal Reserve bank.

Their full employment budget for the fourth quarter of calendar 1966 says that this is the most expansionary, the most inflationary situation we have been in in years. Now in face of the fact that the Council of Economic Advisers suggested that we can anticipate something along a 2.2-percent increase in prices this year, considering the fact that you have gone primarily to the NIA budget and it in turn shows an inflationary budget of \$2.1 billion, I don't see where the restraint is.

I looked back just a couple of years ago when the President said he was going to keep the budget under \$100 billion. I remember very well how well that was received here in Congress and throughout the land. This year, just a couple of years later, we are up to \$135 billion on the administrative basis.

Secretary FOWLER. Mr. Chairman, I have another chart I would like to turn to if you don't mind.

Representative BROCK. Let me point out that even with the \$135 billion, that is a 35-percent increase. Vietnam is only taking 20-plus billion dollars of that. I don't see where the restraint is, in this budget. Would you like to respond?

Secretary FOWLER. Maybe I can as I have tried to with Senator Miller. Chart 1 analyzes the deficits and surpluses over the last 3 or 4 years. There is no getting around the fact that expenditures for these years, 1964 through 1968, are very large.

But I think this chart is worthy of some examination. It shows that aside from the special costs of Vietnam, in the 3 fiscal years ending with the one you are discussing, apart from those special costs of Vietnam, we are running very large and increasing surpluses in the budget.

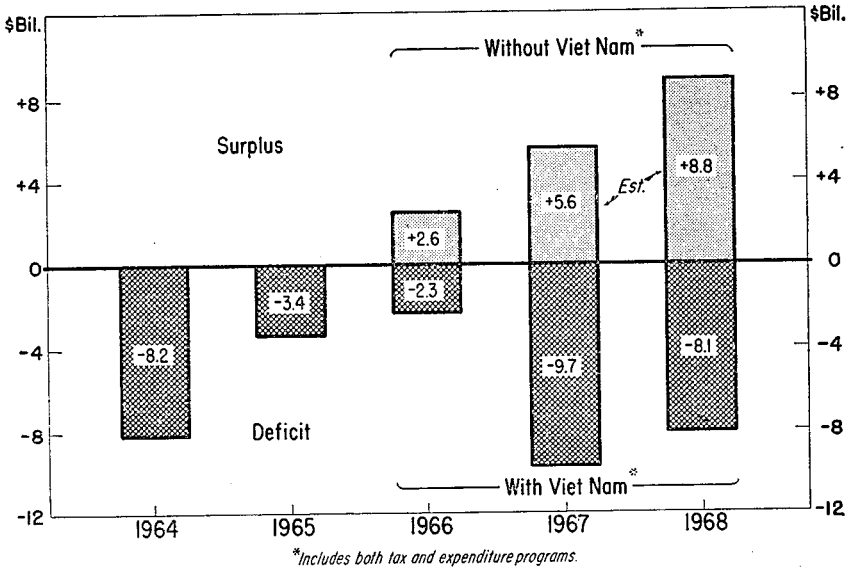
Now the fiscal 1968 figure here represents the \$8.8 billion that without Vietnam would be the surplus in the 1968 budget. This assumes all other things were the same, and assumes the same level of treatment of the nondefense needs, which undoubtedly would not be the case. Therefore, it is a spare budget, as far as the nondefense side of it is concerned.

Now in 1964, which is the first year, we had a \$8.2 billion deficit. In 1965, by holding down the increase in expenditures while revenues went up as a result of the Revenue Act of 1964 and other related economic factors, we brought that deficit down to \$3.4 billion.

And in 1966, despite the fact that there was in that fiscal year an expenditure in Vietnam of \$5.7 billion, we had a deficit of only \$2.3

CHART 1

DEFICITS AND SURPLUSES With and Without Viet Nam Programs



billion, and we would have had a surplus in that year, 1966, roughly 1 year before the schedule that Secretary Dillon expounded to Congress in connection with the Revenue Act.

In the fiscal year that we are in now, were it not for Vietnam, you would have a problem, and the President would have a problem of determining how this \$5.6 billion surplus would be employed, whether it would be in tax reduction, whether it would be in debt retirement, or whether it would be in increased expenditures. And similarly here for 1968, the surplus would be \$8.8 billion.

Now that, of course, assumes that the economy, as I believe to be the case, would have enjoyed generally the same rate and scale of growth that has characterized it and did characterize it in 1964 and 1965.

Representative BROCK. Mr. Secretary, I very much appreciate this point of view, but the fact remains that the Congress, at least individually, must ascertain the priorities, the priorities on which we are going to allocate the national expenditures that we make, with the limited resources we have.

The fact is that we are in Vietnam. We do have a war, and whether it is costing \$5, \$16, or \$25 billion, that fact requires us to place that item on top of the priority list. We must accept the fact that these troops are going to be supported, that we are going to expend this much money, and therefore we have got to look at the rest of the budget and see where we can exercise some judgments on restraint.

Secretary FOWLER. No question about that, not a bit, Congressman Brock. The President has exercised his judgment, reflecting his sense of priorities. He fully expects the Congress to exercise its sense of judgment, its sense of priorities as to whether the overall totals are the same.

All I can say is that the experience of the last year, and maybe this year, is going to be a lot different, but last year, from May on, my concern was simply that in the exercise of its sense of priorities, the Congress didn't add a very, very great deal to the overall totals.

Representative BROCK. I share your concern, even though we have a somewhat different Congress. What I am trying to say is that we can't consider these problems as individual problems. They are all interrelated.

And when you talk about the chart which you showed Senator Miller, where our price increases on a percentage basis were less than the price increases in Italy, Germany, and so forth, the fact remains that our business people are not competing on percentages. They are competing on dollars. They have got to charge a price which rewards them for the making of that product, and when we go up, if our base is higher, when we go up 2 percent, it means a higher price in terms of real dollars than the increase on a broader percentage base than of a smaller base.

Secretary FOWLER. I have compared many briefs dealing with that particular point in tariff proceedings. I realize fully what you are talking about.

Representative BROCK. I am very much aware of your concern. The concern that I have then is this. We last year, if I recall correctly, experienced a decline in our favorable trade balance of about \$2 billion. Is that pretty close, \$1.5 billion, somewhere in that area? Now, unless we can assure that prices are not going to run through the roof from underneath, the cost-push, or whatever the situation involved, we are faced with a situation where we may even be worsening our balance of payments and in this case Mr. Roosa may be understanding the case and we may have a real crisis with the dollar.

Secretary FOWLER. I am concerned with that problem, too, about our competitiveness, and I would agree with you that losing ground, losing our competitive position pricewise, in the export markets and in our own internal markets, opening up to increasing import competition on a price basis, would present a most serious problem.

We have been focusing on this ever since the balance-of-payments problem became a matter of serious national concern. I think what I would want to say on that subject now is that for the first 5 years, from 1960 to 1965, I think we increased our competitive advantage, because in terms of relative price levels, however you measure them, our position was better each year because many competing countries were undergoing much more substantial changes in costs and prices. Since the Vietnamese conflict has emerged, these gains have not continued, but we appear to be holding our ground.

The Subcommittee on Economic Statistics of this committee brought out in its report the fact that we don't have adequate statistics, and for budgetary reasons we haven't been able to get them. Within the executive branch, Treasury has been pressing other departments that are concerned with statistical operations, to improve our statistical measurements, and what we collect, so that we can get a better fix on this.

I can't really say more to you on the subject, except I share your deep concern on that, and my best judgment is that right now we are just probably holding our own. We should be increasing our competitiveness, and I would welcome it.

Representative BROCK. I am very grateful for your concern. I know that you share it. As far as I am concerned, the only basis on which I can analyze the situation is to look at the reduction in exports as opposed to the increase in imports, not reduction in real terms but in relative terms.

Secretary FOWLER. We haven't had a reduction in exports. Our exports have really done extremely well.

Representative BROCK. I am aware of that.

Secretary FOWLER. 11 percent last year.

Representative BROCK. I am talking about the closing of the gap.

Secretary FOWLER. Well, the surplus of exports over imports has declined because of an extraordinary trajectory of imports, and I think that was due to some of the unusual demands on the economy that are directly or indirectly a consequence of the war in Vietnam.

I keep coming back to this. It is an element in the picture of our deficits and surpluses. It is an element, a dislocative factor in dealing with prices. It is an element that affects our foreign trade balance.

All of these are prices that we pay for doing what we think is right and proper and necessary in terms of overall national security. But the surprising thing to me, during this whole period, is that we have been able to traverse this particular shoal without reimposing the direct controls that tend to leave a permanent distortion on the economic scene, and that by some combination of luck or management or whatever, we have been able to traverse these waters, using these rather feeble but useful monetary and fiscal tools.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. Mr. Secretary, nice to see you, sir. We opened up on sort of a partisan note.

Secretary FOWLER. I didn't open up on that note, Senator Percy. The hearings opened up on that note.

Senator PERCY. I understand my responsibility on this committee is absolutely as nonpartisan as we can make it. My attitude will be that, and I can assure you I intend that statement as a partisan statement.

On the other hand, I do think we have a responsibility to present a point of view as effectively as we can whenever we feel that the point should be brought out.

Chairman PROXMIRE. If the Senator will yield just a minute, I might say I try hard to make it nonpartisan and get some criticism from my own party the way I do it.

Secretary FOWLER. I think it has been very, very bipartisan. I think both Democrats and Republicans have enjoyed putting us on the griddle up here. It is a healthy exercise.

Senator PERCY. With that preamble, my three questions are short and I think fairly straightforward. In the President's budget message, there is a section in which Mr. Johnston said:

"To permit a higher deficit than the \$2.1 billion predicated in the national income accounts budget would be to renew inflationary pressures, and that a lower deficit would be unwarranted and self-defeating and could depress the economic activity."

We have a Subcommittee on Economy in Government of the Joint Economic Committee. However, the President makes it look like

we would be unpatriotic if we tried to cut Government expenses and reduce the deficit. I wonder if truly we are in that much of a strait-jacket, and whether or not economics can be that scientific as to pick this narrow gap and say that you can't go above it and you can't go below it?

Secretary FOWLER. You might shave that surcharge from 6 to 5 percent as a result of your labors.

Senator PERCY. Could you explain in more detail what the President's budget message did mean in the strong implication that we really can't afford to have the range change much, that the economy apparently is so precariously balanced that if we in the Congress changed the expenses or the revenues, that we might upset the whole economy?

Secretary FOWLER. I can only make my own comment on it. My comment is that these sharp shifts from heavy stimulus to heavy restraint or from heavy restraint to heavy stimulus are not conducive to the stability and the sustained activity that we like to see in the economy. And we have been through, necessarily, a couple of these as a result of the events that have occurred in the last 18 months.

What the President has in mind, the way I read it, is that for the duration of these hostilities, for however long they may last, that we could hope to avoid these major swings. The NIA budget, which is the best measure we have, is estimated to run a deficit of \$3.8 billion in the fiscal year 1967. For fiscal 1968 the surcharges should pull this deficit down some \$1.7 billion to about \$2.1 billion. Staying in that general neighborhood, without another big swing back in the other direction to a heavy surplus, or without having the NIA deficit go on up from 3.8 to 7.5 or some other figure is a desirable course to try to steer.

Now I don't think he meant that there was any particular magic in 2.1 as distinct from 1.5 or 2.7, but in that general range of moving back from the 3.8 to something fairly close to balance.

Senator PERCY. The Congress is going to have to make many decisions this year, has the surcharge increase of 6 percent, the increase in the base of social security, and also an accelerated tax collection schedule. If there is resistance by both the Democrats and the Republicans to increasing taxes, how serious would it be if the expenditure level was not reduced and none of these tax increases were enacted?

Secretary FOWLER. It would be very serious the way I see it now. Now, as the chairman and I in exchanges have indicated, intervening economic events before the time that decision must finally be taken may change our minds in various directions. But I feel after our experiences last year, that it would be very serious not to have a general condition of monetary ease, or at least ready availability of money and credit on reasonable terms. I also feel that this is the moderate and the appropriate course to try to follow in paying for the war. We just can't continue to have the costs of it go up and not try to defray them.

There is some hope, I know, in various quarters in the Congress, that by reducing appropriations and expenditures, you may be able to take care of some of the fiscal policy.

Given the results of our own experience and the experience of what Congress has done to the various elements in the budget, certainly if we take the last 2 or 3 years as any commentary. I don't believe in my heart today that you are going to reduce that budget \$5 or \$6 billion for fiscal 1968. I don't think it would be good for the country if you did.

It is my belief, Senator Percy, that the proper mix is somewhere, not on the nose but pretty much in the same neighborhood as the budget presents.

Senator PERCY. Finally, I think perhaps putting it another way than it has been put several times today, the question that keeps coming to me in my correspondence is why, if a tax increase wasn't good last year when the economy was stronger in most industries than it is today, why is it good for the country this year when the economy is softer than a year ago?

Secretary FOWLER. Because you are trying to achieve a mix of fiscal and monetary policy for the duration here that will take care of the imbalances that were created last year, and that for that return to what I would call general stability and moderate growth in all sectors, so that they are ready to go and take up the job and take up the slack when and if hostilities end. That is the best environment. The one distinction I would draw between supporting a modest increase in income taxes this year and last year, is that last year you would have been adding to an increasingly severe monetary restraint, an increasingly severe fiscal restraint, whereas hopefully this year when we approach the decisionmaking point, you will have an economy which has been bathed for the preceding 7 to 9 months in relative monetary ease.

Now that is the real acid distinction between the two situations as I see it.

Senator PERCY. Thank you, Mr. Secretary.

Chairman PROXMIRE. I want to thank you very much, Mr. Secretary, for your usual excellent job. You have shown more fine fighting qualities even than you have in the past, which have been considerable.

Secretary FOWLER. Thank you, Mr. Chairman.

Senator MILLER. Mr. Chairman?

Chairman PROXMIRE. I beg your pardon, I thought you were through. Do you have another question?

Senator MILLER. I have probably six or seven questions, and I would like to ask permission to prepare them, turn them over to Secretary Fowler and have them answered for the record.

Chairman PROXMIRE. Yes, that is fine. I appreciate that.

Secretary FOWLER. Thank you, Senator Miller. I will be glad to comply.

(The questions submitted to Secretary Fowler and the Secretary's responses follow:)

RESPONSE TO QUESTIONS BY SENATOR MILLER

1. *Question:* What action is the Government taking to discourage foreign central banks from converting their dollars into gold?

Answer: During 1966 the net monetary gold transactions of the United States resulted in a loss of \$430.6 million to other countries. The Bank of France was the purchaser of \$600.9 million of gold during the year. It is, therefore, apparent that if it had not been for French purchases the United States, rather than sus-

taining a loss on monetary transactions would have had a gain of approximately \$170 million. This gain is more than accounted for by the purchase of \$200 million in gold from Canada which leaves a net balance of U.S. gold losses of approximately \$30 million distributed among transactions with over thirty countries.

The United States, as is well known, stands ready to sell gold to monetary authorities for legitimate purposes upon demand and requests for gold are not refused. The United States, on occasion, has indicated its belief that it is not generally appropriate for an aid-recipient country to be adding to its gold reserves but since most developing nations are well aware that the needs of their economies require goods rather than gold, the purchase of gold from the United States is seldom a matter which arises. While some less developed countries appear as purchasers of U.S. gold the large majority of the transactions were in amounts of less than \$5 million and represented purchases by numerous countries to cover payments which they were obliged to make in gold to the International Monetary Fund or other international institutions.

Our current efforts in the negotiation for new means of providing international liquidity which I described in my testimony to the committee, stem in part from the fact that there is not a sufficient amount of gold entering monetary reserves each year to provide for growing liquidity needs. Agreement on a new form of reserve asset should, therefore, be an important step in economizing on the use of gold which is in monetary reserves and relieve some pressure on the gold stocks of the United States.

2. *Question:* If the spending budget were reduced by \$5 billion, as some are advocating in lieu of the \$5 billion tax increase, there would still be the same budget deficit as forecast. And in order to stop inflation, would it still not be necessary to have a tax increase?

Answer: Hypothetically speaking, a tax increase would probably not be necessary to curb inflationary pressures (assuming no change in the general economic situation we foresee in FY 1968) if spending could be reduced to yield the same budget deficit as the one expected as a result of the proposed tax increase. For it is the net impact on the economy of Government receipts and expenditures—the budget deficit or surplus—which must be considered in judging the effects of Government activity on prices in the economy.

In practice, however, we believe that the tax increase which the President has proposed provides the best means for decreasing inflationary pressures after the beginning of the new fiscal year. The budget for fiscal 1968 has already been reduced to the lowest levels commensurate with our responsibilities at home and abroad.

In this connection, it might also be noted that a budgetary deficit (as for example the one expected in FY 1968) does not necessarily mean that the Government is stimulating inflationary pressures in the economy. The relationship between budgetary deficits and price movements is not a simple, direct one. As a general rule, if there is a deficit it indicates that the government is stimulating the economy by injecting more money into the income stream than it takes out. Conversely, if there is a surplus, the economy is being restrained by the government's draining off more money than is being spent. Whether inflation will result from either a surplus or a deficit depends on what is happening in the private sector of the economy at the time. If demand in the private sector is depressed, a sizable Federal deficit may be compatible with relative price stability, while if private demand is running strong, a budget surplus may accompany large price increases. Table 1 shows calendar year Federal administrative budget surpluses and deficits and the rate at which the GNP price deflator rose during those years. If we omit 1948 and 1951, when price controls and the Korean War had special influences, we see that the largest price increases occurred in 1956 and 1957, two of the few years in which the Federal budget showed a surplus. On the other hand, the calendar year with the largest deficit, 1953, had the smallest post-Korean price increase. (The same results hold if we take the Federal surplus/deficit on a National Income Accounts basis instead of looking at the Administrative Budget.)

The explanation behind the seemingly paradoxical results shown in Table 1 lies, of course, in the varying strength of the private sector. In 1956 and 1957, for example, demand in the private sector of the economy was very high and as a result prices increased very rapidly even though the government was taking more out of the economy (through taxes) than it was putting in (through expenditures). For the last few years, the private sector has been growing rap-

idly as the unemployment rate has dropped from 7 percent to 4 percent. The Federal deficits for these years have, however, been accompanied by below average price increases. If the economy had been operating nearer to full capacity, deficits of this magnitude might have led to more rapid price increases.

Thus we see that while the government's surplus/deficit position is a key factor, it is still only one of many factors to be considered in forecasting price movements. With a large amount of slack in the economy, large deficits do not necessarily imply price increases, while under circumstances of high utilization, these same deficits can mean inflation. It is just because the economy is so close to balance between demand and productive capacity that we have proposed the present tax program for fiscal year 1968. As a result of this program, we anticipate a decrease in inflationary pressures and a movement toward greater price stability.

Budgetary deficits and inflation

Calendar year	Federal administrative budget surplus or deficit (—)	Percent increase in the GNP price deflator	Calendar year	Federal administrative budget surplus or deficit (—)	Percent increase in the GNP price deflator
	<i>Billions</i>			<i>Billions</i>	
1948.....	\$5.2	6.7	1958.....	—\$7.1	2.6
1949.....	—3.6	—6	1959.....	—7.0	1.6
1950.....	—4	1.4	1960.....	2.0	1.7
1951.....	—3.4	6.7	1961.....	—6.3	1.3
1952.....	—5.8	2.2	1962.....	—7.2	1.1
1953.....	—9.2	.9	1963.....	—6.7	1.3
1954.....	—3.7	1.5	1964.....	—8.2	1.6
1955.....	—2.8	1.5	1965.....	—4.7	1.8
1956.....	3.8	3.4	1966.....	—7.3	3.0
1957.....	.6	3.7			

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 13, 1967.

3. *Question:* Would you comment on the impact on our economy and on the problem of inflation of the various alternatives:

(a) Keep expenditures at level proposed in the budget, with no tax increase.

(b) Reduce expenditures by \$5 billion, with tax increase as proposed by the budget.

(c) Reduce expenditures by \$5 billion, with no tax increase.

Answer: (a) Maintaining the level of expenditures proposed in the budget but without a tax increase would, of course, provide more stimulation to the economy than was provided in the budget. As the President stated in his Budget Message, under such a course of action, we would run substantial risks of:

—choking off the much-desired move toward lower interest rates by placing too much of our stabilization effort on the shoulders of monetary policy, and
—renewing inflationary pressures, particularly in the latter half of this year.

(b) A tax increase combined with a large expenditure reduction would be an extremely restrictive fiscal policy. Incomes, both of persons and of businesses, would be lowered substantially from what they would otherwise be. Not only would we run the risk of terminating our present, record-breaking expansion, but the adverse impact on revenues might be so great as to result in a larger, rather than a smaller deficit.

(c) A large expenditure reduction, in place of a tax increase, would be preferable if it were feasible, but in my judgment it is not. To quote again from the President's Budget Message:

"The economy, the budget, and the aims of our society would be jeopardized by either a larger tax increase or by large slashes in military or civilian programs. I have reviewed these programs carefully. Waste and nonessentials have been cut out. Reductions or postponements have been made wherever possible. The increases that are proposed have been carefully selected on the basis of urgent national requirements.

"The Congress through the appropriations process, will, of course, subject these programs to a searching examination. I welcome that examination. But

it is my judgment that major cuts cannot be made without serious impairment to vital national objectives—in defense, in education, in health, in the rebuilding of our cities, and in the attack on poverty.”

4. *Question:* Would you forecast the impact on the mortgage interest rate of the level of the sale of participation certificates proposed by the Administration during the coming fiscal year and the financing of the deficit estimated under the Administrative budget?

Answer: the sale of participation certificates proposed for fiscal 1968 is expected to have practically no effect on interest rates on home mortgages. To the extent that participation certificates are not sold in the coming fiscal year there would have to be an increase in direct Treasury financing. Consequently, the argument that the sale of participation certificates would adversely affect mortgage rates must depend upon the assumption that participation certificates are closely competitive with home mortgages and significantly more so than direct Treasury obligations. There is no indication that participation certificates have been bought heavily by those institutions that play an important role in the mortgage market, and to a considerable extent the maturities of participation certificates have not been closely competitive with those of home mortgages. Of course, to some extent, all debt instruments compete with each other in financial markets; but there is little indication that competition between participation certificates and home mortgages is especially great or that is especially greater than the competition between Treasury obligations and home mortgages. Moreover, the Treasury's intention is that participation certificates will only be sold to the extent that the market can reasonably absorb them. This would limit any adverse impact on the mortgage market that might otherwise occur.

With respect to the impact of the budget deficit on the mortgage market, it is important to realize that the Administrative deficit is not the most relevant figure. The operations of the various trust accounts will reduce the need for Treasury borrowing from the public. As a general proposition, policies designed to reduce the net borrowing of the Treasury and various Federal agencies will tend to increase the availability of funds to the private sector, including the mortgage market. An example of such a policy approach is the Administration's proposed surtax on corporate and personal incomes. In addition to reducing the need for Treasury borrowing, these surtaxes will reduce the level of private demand and thereby encourage monetary policies that will tend to ease financial market pressures and lower the level of interest rates.

5. *Question:* In view of the fact that defense expenditures were budgeted last year on the assumption that the war would end June 30, 1967 which assumption was made to permit a more accurate assessment of follow-on costs to be made last fall, would it not have been more prudent for the level of domestic spending to have been held down pending the latter assessment of defense costs? My point is that this would have prevented the deficit now forecast for the current fiscal year.

Alternatively, would it not have been more prudent to have had a tax increase to be triggered by the President's determination that defense expenditures would continue to rise?

Answer: The fiscal 1967 budget which was recommended last year set civilian expenditure levels at the minimum consistent with the responsibilities of the Federal Government. Outside of defense, international affairs and interest recommended expenditures represented an increase of only \$1.4 billion over fiscal 1966.

The level of civilian spending was indeed held down by the President's action in preventing \$2.6 billion in increases from being made. Without this action, such spending would have risen \$5.8 billion above the original estimates instead of \$3.2 billion as is currently projected.

A tax increase to be triggered by the President's determination on defense expenditures would not have had a desirable fiscal result. The assessment of Viet Nam costs were not finally determined until late in calendar year 1966. By that time inflationary pressures had abated and a tax increase, automatically triggered by the expenditure determination, would have been most inappropriate.

6. *Question:* In your comment on reasons for the decline in our favorable balance of trade you did not mention price rises due to inflation. It had been my understanding that these were a major factor in increased imports into this country, and decreased expansion of exports to overseas markets.

Answer: Our manufactured exports did quite well in 1966 so that it is hard to say that we were priced out of world markets. But our imports, stimulated by the high rate of growth of domestic income, rose at a more rapid rate, so that our net trade balance declined. Part of the unusually rapid rise in our imports is traceable to the conflict in Vietnam. Defense orders undoubtedly added to the pressures on our durable goods industries.

Rising prices can weaken our competitive position in world markets, and this is one of the reasons I regard restoration of U.S. price stability as one of our major tasks.

But I do not think the weakening in our net trade surplus in 1966 should be attributed to any deterioration in our competitive strength. Our ability to sell in world markets depends on what happens to foreign prices, as well as on what happens to U.S. prices. The evidence we have suggests that manufactures costs and prices in our major foreign competitors on balance were rising at least as fast as those in the U.S., so that our international competitive situation in manufactures trade probably did not deteriorate during 1966. What has happened is that the sustained improvement in our competitiveness during the early sixties probably slowed considerably in both 1965, and in 1966 insofar as we have data. Table 2 compares recent increases in prices and costs in the U.S. with those in some other major industrial countries.

Recent increases in prices and costs in selected countries, 1960-66

(Percent per year (+))

	1960 to 1964	2d quarter, 1964, to 2d quarter, 1965	3d quarter, 1964, to 3d quarter, 1965	2d quarter, 1965, to 2d quarter, 1966	3d quarter, 1965, to 3d quarter, 1966
HOURLY EARNINGS, MANUFACTURING					
1. France.....	9.0	5.2	5.1	5.6	6.0
2. Italy.....	15.3	7.0	7.1	3.7	3.0
3. Japan.....	12.3	8.8	9.3	12.5	11.2
4. West Germany.....	10.5	9.9	10.4	7.1	6.5
5. United Kingdom.....	5.8	7.5	7.9	8.8	6.9
6. Change in United States.....	3.0	2.7	2.7	4.3	4.3
WAGE COSTS PER UNIT OUTPUT, MANUFACTURING					
1. Canada.....	² -8	2.3	.7	2.9	5.8
2. France.....	3.0	2.7	-9	0	(³)
3. Italy.....	4.0	0	(³)	(⁴)	(⁵)
4. Japan.....	2.0	0	5.6	1.8	(⁵)
5. West Germany.....	3.3	5.3	7.9	3.4	(⁵)
6. United Kingdom.....	1.8	4.6	3.7	6.2	(⁵)
7. Change in United States.....	-3	-6	-1.1	1.6	2.1
CONSUMER PRICES, NONFOOD					
1. Canada.....	1.2	2.2	2.5	2.6	2.6
2. Belgium (total, excluding rent).....	2.3	4.4	3.8	5.1	3.7
3. France.....	3.6	3.2	2.9	2.0	2.7
4. Italy.....	6.1	4.1	3.0	2.3	2.7
5. Japan (all urban index).....	5.9	5.1	5.9	7.3	6.8
6. West Germany.....	3.2	2.9	3.0	4.3	4.4
7. United Kingdom.....	3.5	4.0	4.6	4.2	4.2
8. Change in United States.....	1.3	1.5	1.3	2.0	2.8
WHOLESALE PRICES					
1. Canada.....	1.5	1.4	2.6	2.8	3.0
2. Belgium.....	1.6	1.4	.7	2.5	1.9
3. France.....	2.5	.7	0	3.7	3.3
4. Italy.....	3.5	2.7	3.0	2.6	1.2
5. Japan.....	1.3	3.6	4.2	3.3	3.1
6. West Germany.....	1.7	2.4	2.9	2.3	2.0
7. United Kingdom.....	1.9	3.9	3.9	3.1	2.9
8. Change in United States.....	.2	.9	.9	1.7	2.1

See footnote at end of table.

Recent increases in prices and costs in selected countries, 1960-66—Continued

[Percent per year (+)]

	1960 to 1964	2d quarter, 1964, to 2d quarter, 1965	3d quarter, 1964, to 3d quarter, 1965	2d quarter, 1965, to 2d quarter, 1966	3d quarter, 1965, to 3d quarter, 1966
EXPORT UNIT VALUES					
1. France.....	1.0	1.0	3.0	2.9	1.9
2. Italy.....	.3	-3.1	-3.1	0	(³)
3. Japan.....	-2.2	-2.2	-2.1	1.1	(²)
4. West Germany.....	1.5	2.8	1.8	1.8	1.8
5. United Kingdom.....	1.7	2.8	2.7	4.5	4.4
6. All countries.....	.8	1.9	1.9	1.9	(³)
7. Change in United States.....	.3	3.8	3.8	¹ -1.5	(²)

¹ Estimated.² Based on data for 1962-64.³ Not available.⁴ Manufactured goods, wholesale prices.⁵ Intermediate goods, wholesale prices.⁶ Consumer goods, wholesale prices.⁷ Manufactured goods, excluding food, wholesale prices. (Data for United States is OECD reweighting of BLS indexes to obtain greater comparability for international comparisons.)

Sources: Business Cycle Developments, Department of Commerce; Main Economic Indicators, OECD; Economic Review, National Institute of Economic and Social Research.

Chairman PROXMIRE. The committee will reconvene tomorrow afternoon. There will be no session tomorrow morning. The Secretary of Commerce will appear on Thursday afternoon instead of tomorrow morning as originally scheduled.

We will reconvene tomorrow afternoon at 2 o'clock to hear Secretary Willard Wirtz, the Secretary of Labor.

(Whereupon, at 1:30 p.m., the committee adjourned until Tuesday, February 7, 1967, at 2 p.m.)

