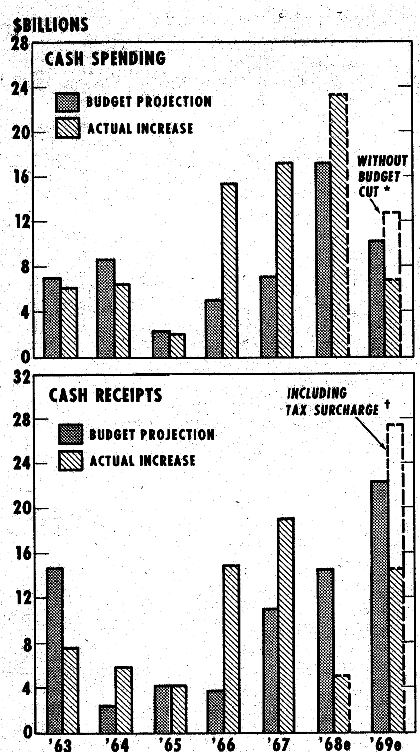

Annual Changes in Federal Cash Spending and Receipts, Fiscal Years 1963-1969

* $6 billion expenditure reduction.

† Assumes a 10 per cent surcharge on corporate income taxes retroactive to January 1, 1968, and on personal income taxes retroactive to April 1, 1968 but with payments beginning in fiscal '69.

Notes: Budget projections measure changes that would have occurred if estimates of receipts and payments in January budgets had been correct. Estimates of actual revenue increases in fiscal '68 and '69 are FNCB projections.

revenues from individual and corporate income taxes from $72.2 billion in fiscal '64 to $74.3 billion in fiscal '65. As a result, worries about the budget deficit were replaced by fears of a growth-inhibiting surplus. In mid-1964, Walter W. Heller, the President's chief economic adviser, warned that the prospects for budget surpluses posed the threat of a "fiscal drag" on the economy in the years immediately ahead.

Counting on the fiscal dividend from revenue growth and a projected decline in defense spending, President Johnson asked Congress to launch a huge expansion of welfare programs in his Budget Message in January 1965. By the end of the year, however, the fiscal outlook was completely reversed. The enlarged commitment to defend South Vietnam made in July 1965 pushed up defense outlays sharply. At the same time, Congress turned out to be even more expansive than the Administration in enlarging domestic programs. Congress added to the requested Social Security-Medicare bill. The Administration's budget proposals were also topped by a $1.7 billion pay increase for servicemen and civilian personnel.

The serious miscalculation of Vietnam War costs occurred at a crucial time when Administration officials and Congress were pushing a major expansion of civilian programs that created severe budgetary problems in subsequent years. Would Congressmen have been less openhanded in approving new programs had they known how fast Vietnam costs were rising? Administration officials, too, were apparently in the dark. The President's chief economic adviser Gardner Ackley, for example, told the American Statistical Association in September 1965 that although "further appropriation requests may be necessary," the rise in Government spending during the first year of our major commitment in the Vietnam War was likely to be only about $3½ billion:

> Figures sometimes quoted in the press—that run to $10 to $14 billion—can at this point only be pure figments of someone's imagination. The estimates we at the Council have put into our tentative projections do not even approach that order of magnitude.

However, the "figment" soon turned out to have a tough core of fact. Defense outlays rose $13 billion during the following year.

Cash spending in fiscal '66 soared $10 billion above the original budget projections. Instead of cutting back civilian programs, however, the Administration kept the budget deficit down through sales of certificates of participation in Government-owned loans—which were entered in the budget as negative expenditures. The deficit was also held down by relying on acceleration of corporate income tax payments, by boosting the withholding rate on individual income taxes, and by speeding Treasury collections of income and Social Security taxes withheld by employers. The speedup in tax collections depleted cash balances of individuals and employers, leading to larger credit demands at a time when the demand for funds was already threatening to overwhelm the money and capital markets.

The upward pressure on interest rates became so intense that in September 1966 the Government decided to stop selling participation certificates until monetary conditions eased later in the year.

In fiscal '68, the budgetmakers provided a much more realistic estimate of Vietnam costs.