

Programs to achieve these overall goals are carried out by the Department's constituent bureaus and other organizations under a variety of subgoals and objectives. At present, the Department's programs are grouped into six major program categories plus a general support category as follows:

Table R-8. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Manpower development assistance:			
Training.....	396.4	412.2	666.3
Special manpower programs.....	20.3	15.8	18.0
Work programs.....	13.0		
Research.....	5.0	5.0	5.2
Policy planning and evaluation.....	2.0	2.4	2.6
Comprehensive manpower program planning.....			34.0
Information.....	.1	.2	.8
Manpower management data systems.....	.8	.8	3.5
Administration.....	2.3	2.6	3.0
Category total.....	439.9	439.0	733.4
Employment assistance:			
Employment market information.....	18.0	20.3	21.1
Job development and placement services.....	145.6	143.9	149.2
Employability assistance.....	69.3	91.0	94.5
Civil rights compliance.....	1.1	.9	.9
Administration.....	80.8	86.3	90.3
Category total.....	314.9	342.4	356.0
Income maintenance:			
Unemployment insurance.....	93.0	154.5	116.9
Workmens compensation.....	61.4	69.5	60.9
Unemployment trust fund (excluding amounts distributed to other subcategories).....	3,461.8	3,407.9	3,716.2
Administration.....	13.6	20.7	21.2
Category total.....	3,629.9	3,652.6	3,915.2
Wage and labor standards:			
Wages and working conditions.....	23.3	25.3	25.3
Occupational fatalities and injuries.....	2.6	2.9	3.4
Utilization of women workers.....	.7	.7	.8
Research in the area of wage and labor standards.....	2.2	2.2	2.3
Administration.....	1.6	2.2	2.2
Category total.....	30.4	33.3	34.0
Labor-management relations:			
Administration of reporting and disclosure laws.....	6.6	6.8	6.9
Veterans reemployment rights.....	.8	1.0	1.2
Labor-management relations assistance.....	.3	.4	.4
Research and policy development.....	.3	.3	.3
Administration.....	.6	.6	.6
Category total.....	8.6	9.0	9.4

Table R-8. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY—Con.
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Data collection, analysis, and dissemination:			
Manpower and employment statistics.....	7.7	8.2	8.7
Prices and living conditions.....	3.5	3.6	3.7
Wages and industrial relations.....	3.5	3.6	3.7
Productivity, technology, and growth.....	1.2	1.4	1.4
Foreign labor and trade.....	.5	.5	.5
Field services.....	1.2	1.3	1.3
Administration.....	3.5	3.5	3.6
Revision of the Consumer Price Index.....			.6
Category total.....	21.0	22.0	23.5
General support:			
Executive direction and management.....	4.4	4.9	5.1
Legal services.....	4.8	5.2	5.1
International labor activities.....	1.3	1.4	1.4
Category total.....	10.6	11.4	11.6
Total distributed to programs above.....	4,455.3	4,509.7	5,083.1
Deductions for offsetting receipts.....	-3.2	-.6	-4.1
Pay supplemental and other separate transmittal.....		1.8	
Total budget authority, Department of Labor.....	4,452.1	4,510.9	5,079.0

POST OFFICE DEPARTMENT

The program structure of the Post Office Department is descriptive of the major functions involved in providing postal services from the acceptance of mail through delivery and the supporting activities required to maintain an effective service. Currently, the Department's functions are grouped into eight program categories as shown below.

Table R-9. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category	1968 actual	1969 estimate	1970 estimate
Direct services to mailers.....	1,273.8	1,400.2	1,438.7
Processing of mail.....	1,453.1	1,585.8	1,622.8
Delivery services.....	2,053.6	2,244.4	2,295.5
Transportation.....	602.9	630.0	645.0
Enforcing postal laws and regulations.....	24.9	28.2	32.0
Research, development, and engineering.....	22.1	34.0	50.0
Administrative postal support.....	441.2	522.7	576.2
Logistical postal support.....	764.2	899.1	1,095.9
Total distributed to programs above.....	6,635.8	7,344.4	7,756.2
Financing adjustments.....	61.9	-20.9	-----
Postal revenues.....	-5,505.3	-6,287.6	-7,006.4
Total budget authority, Post Office Department.....	1,192.4	1,036.0	749.8

DEPARTMENT OF TRANSPORTATION

The broad objectives of the Department of Transportation are to:

- Increase economic efficiency through improved transportation;
- Increase safety in transportation;
- Increase the benefits derived from the preservation and enhancement of environmental social values, when impacted by transportation; and
- Support other national objectives, such as national defense and scientific research.

The objectives of the specific programs of the Department are identical with, or in support of, these broad departmental objectives. The Department's programs are grouped into four major program categories plus a general support category as follows:

Table R-10. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Urban transportation:			
Highways.....	1,868.0	2,153.2	2,171.3
Urban mass transit.....		168.5	202.0
Category total.....	1,868.0	2,321.7	2,373.3
Interurban transportation:			
Highways.....	2,804.0	3,238.4	3,281.2
Rail.....	16.0	18.6	23.3
Air.....	679.7	829.3	1,156.8
Water.....	181.6	184.5	194.5
Intermodal.....	2.5	2.4	2.4
Category total.....	3,683.9	4,273.2	4,658.1
International transportation:			
Highways.....	5.0	2.0	
Air.....	143.9	1.4	1.4
Water.....	59.6	58.4	49.3
Category total.....	208.4	61.8	50.8
Other national interests:			
National security, boundaries, and treaties.....	93.7	90.7	89.1
Support of science.....	9.4	25.8	21.5
General transportation safety.....	153.5	141.1	177.7
Other highway programs.....	129.4	104.0	106.5
Category total.....	386.1	361.7	394.8
General support:			
Research and development.....	33.1	37.1	59.5
General highway planning.....	54.8	61.9	62.2
Administration.....	251.2	288.6	318.6
Coast Guard retired pay.....	48.2	52.4	55.7
Category total.....	387.3	440.1	496.1
Total distributed to programs above.....	6,533.7	7,458.5	7,973.0
Deductions for offsetting receipts.....	-19.7	-27.8	-20.4
Intragovernmental transactions.....	-15.1		
Total budget authority, Department of Transportation.....	6,498.9	7,430.7	7,952.6

DEPARTMENT OF THE TREASURY

The Treasury Department is responsible for the central fiscal operations of the Federal Government. The Treasury PPB system deals with the operating elements of the Department, which are funded mainly through annual appropriations but also receive a substantial amount of reimbursements and other miscellaneous funds.

The Department's functions are grouped into program categories as shown in the table. Not included in the PPB structure is interest on the public debt, which accounts for most of the budget authority for the Department, and several permanent appropriations which are aggregated in the adjusting entry in the table.

Table R-11. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Administration of Government finances:			
Public debt.....	55.9	58.5	61.0
Issuance, payment, and servicing of Government checks.....	37.9	43.9	44.9
General activities.....	4.8	4.6	4.5
Category total.....	98.6	107.0	110.4
Collection of revenue:			
Revenue accounting and processing.....	143.6	151.2	158.1
Taxpayer assistance and services.....	62.3	68.7	69.8
Delinquent accounts operation.....	78.4	85.6	89.4
Delinquent returns operation.....	22.4	23.2	28.8
Audit of tax returns.....	237.6	262.4	281.7
Tax fraud investigations—taxpayers in general.....	27.1	27.3	25.9
Taxpayer appeals.....	33.2	35.6	37.4
Alcohol and tobacco revenue and regulatory controls.....	16.0	18.0	19.8
Collection of customs duties.....	78.2	87.4	93.3
General activities.....	48.9	56.4	63.3
Category total.....	747.8	815.8	867.5
Manufacture and distribution of coins, currency, and other financial instruments.....	14.2	15.2	19.4
Special law enforcement:			
Tax fraud investigations—racketeer segment.....	9.5	14.9	17.2
Alcohol and firearms investigations.....	19.8	22.3	25.9
Other investigations.....	26.2	24.7	28.4
Security responsibilities.....	7.9	10.3	12.9
General activities.....	.1	.1	.1
Construction of facilities.....		.8	1.9
Category total.....	63.5	73.1	86.4
Policy determination and related activities.....	7.0	7.8	8.5
Total distributed to programs above.....	931.1	1,018.9	1,092.2
Items not included in the program structure:			
Interest on the public debt.....	14,573.0	16,000.0	16,800.0
Other appropriations not included in the program structure.....	312.7	303.0	278.4
Deductions for offsetting receipts.....	-1,077.2	-978.4	-1,115.2
Intragovernmental transactions.....	-82.0	-86.3	-81.4
Total budget authority, Treasury Department.....	14,657.6	16,257.2	16,974.0

ATOMIC ENERGY COMMISSION

The Atomic Energy Commission conducts a variety of production, research and development, and supporting activities to discharge its responsibilities for national defense and the peaceful applications of atomic energy. The agency's functions are grouped into eight major program categories, as follows:

Table R-12. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Procurement and production of source and special nuclear materials:			
Procurement of uranium concentrates	125.5	104.3	66.3
Production of special nuclear materials	360.4	371.1	361.5
Category total	485.8	475.4	427.8
Military applications:			
Nuclear weapons	886.8	1,139.4	950.4
Naval propulsion reactors	115.0	128.5	139.8
Category total	1,001.7	1,267.9	1,090.2
Development of space applications:			
Space propulsion	72.8	59.1	55.5
Space electric power	56.1	51.7	38.8
Category total	128.9	110.8	94.4
Development of central station nuclear power:			
Converter reactors	24.2	26.0	19.5
Advanced converter and low-gain breeder reactors	52.0	31.8	32.8
High-gain breeder reactors	84.5	163.2	116.6
Desalting applications	2.8	7.9	5.0
General research and development	3.4	3.0	2.8
Category total	166.9	231.9	176.7
Development of other civilian applications:			
Merchant ship propulsion reactors	.1	1.4	-----
Terrestrial electric power development	6.9	4.1	4.7
Isotopes development	8.3	8.5	8.1
Civilian applications of nuclear explosives	17.9	15.2	14.5
Category total	33.2	29.2	27.3

Table R-12. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY—Con.
(in millions of dollars)

	1967 actual	1968 estimate	1969 estimate
Basic research:			
High energy physics research.....	152.8	186.9	242.9
Other physical research.....	175.4	214.1	184.3
Biomedical research.....	93.2	101.9	97.9
Category total.....	421.4	502.9	525.1
Nuclear science and technology support:			
Supporting reactor development activities.....	114.2	154.2	130.2
Training, education, and information.....	18.0	17.9	17.4
Category total.....	132.2	172.1	147.6
General support:			
Program direction and administration.....	95.3	108.6	114.7
Community support.....	6.4	6.8	10.1
Security investigations.....	6.8	7.7	7.9
Cost of work for others.....	14.3	31.3	13.1
Construction planning and design.....	1.4	3.9	-----
Category total.....	124.2	158.3	145.8
Total distributed to programs above.....	2,494.3	2,948.5	2,634.9
Adjustments to budget authority, net.....	13.9	-377.7	-196.7
Total budget authority, Atomic Energy Commission.....	2,508.2	2,570.8	2,438.1

GENERAL SERVICES ADMINISTRATION

GSA provides, on a centralized basis where it is efficient to do so, a variety of goods and services for the agencies of Government. Among the things provided are: office and other building space, supplies, automatic data processing equipment, property and stock-pile management, communications, motor transport, records management services, and other common services. It also operates the National Archives and presidential libraries.

GSA's PPB system groups these diversified activities into five basic program categories to facilitate analyses of costs and effectiveness. A sixth program category covers agency direction and a variety of support services.

Table R-13. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Facilities:			
Acquisition.....	163.6	94.3	114.7
Management.....	274.4	288.3	301.7
Service direction.....	1.5	1.5	1.6
Category total.....	439.5	384.1	418.0
Supply services:			
Provision of supplies.....	58.8	65.2	65.2
Supply management.....	1.1	1.2	1.2
Automated data management services.....	11.6	2.4	2.4
Service direction.....	1.9	2.0	2.0
Category total.....	73.5	70.9	70.8
Other property management and disposal services:			
Property management.....	13.5	13.3	14.4
Real property disposal.....	4.3	4.5	4.4
Personal property disposal.....	7.4	8.0	8.3
Program support.....	1.0	1.0	1.0
Service direction.....	.6	.6	.6
Category total.....	26.8	27.5	28.8
Transportation and communications services:			
Transportation (other than motor equipment).....	2.4	2.4	2.4
Motor equipment.....	.4	.4	.4
Communications.....	1.8	1.9	1.9
Public utilities.....	.1	.1	.1
Service direction.....	.7	.7	.7
Category total.....	5.4	5.5	5.5
Records services:			
Management.....	11.7	13.1	13.5
Archival services.....	4.8	5.9	7.0
Federal Register.....	.6	.6	.7
Service direction.....	.6	.7	.7
Category total.....	17.8	20.4	21.9
Agency direction and support services:			
Executive direction.....	1.8	1.9	1.9
Administrative operations.....	12.8	13.7	13.8
Allowances and services to former Presidents.....	.3	.3	.4
Presidential transition.....		.9	
Category total.....	14.9	16.8	16.2
Total distributed to programs above.....	577.8	525.2	561.3
Deductions for offsetting receipts.....	-196.8	-205.9	-273.9
Total budget authority, General Services Administration.....	381.0	319.3	287.4

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

The principal statutory functions of NASA include conducting research for the solution of problems of flight within and outside the earth's atmosphere, conducting activities required for the exploration of space with manned and unmanned vehicles, and arranging for the most effective utilization of the scientific and engineering resources of the United States with other nations that are engaged in aeronautical and space activities for peaceful purposes.

These functions are reflected in the program structure shown below. The table shows the NASA budget authority distributed to the category level except for the general support category which is shown at the subcategory level.

Table R-14. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Extension of manned space flight capability.....	2,829.7	2,180.8	2,011.0
Lunar exploration.....	46.5	13.6	22.5
Planetary exploration.....	109.1	106.8	174.6
Astronomy.....	92.9	90.1	76.4
Space physics.....	73.9	64.4	62.0
Space biology.....	37.5	30.0	28.0
Space applications.....	110.3	105.0	148.6
Space technology.....	237.7	193.7	198.5
Aircraft technology.....	84.6	94.9	105.4
Supporting activities:			
Tracking and data acquisition.....	275.9	279.7	298.0
Other supporting activities.....	102.4	70.2	102.1
Research and program management.....	639.3	648.6	650.9
Total support activities.....	1,017.6	998.5	1,051.0
Total distributed to programs above.....	4,639.8	3,877.8	3,878.0
Financing adjustments.....	-51.0	117.2	-117.5
Deductions for offsetting receipts.....	-1.5	-2.9	-3.0
Total budget authority, National Aeronautics and Space Administration.....	4,587.3	3,992.1	3,757.5

VETERANS ADMINISTRATION

The Veterans Administration administers laws authorizing benefits for former members of the Armed Forces, and for their dependents and survivors. The agency's functions are grouped into six major program categories, as follows:

Table R-15. **PROGRAM DISTRIBUTION OF BUDGET AUTHORITY**
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Compensation for service-connected disabilities and death:			
Compensation for veterans disabilities	1,950.4	2,080.0	2,162.6
Compensation to survivors	515.6	525.2	532.4
Miscellaneous	16.3	10.2	10.3
Administrative support	37.7	40.7	44.6
Category total	2,520.1	2,656.1	2,749.9
Alleviation of financial needs of veterans and survivors not connected with military service:			
Veterans pensions	1,270.3	1,283.5	1,286.6
Survivors pensions	778.2	848.6	904.7
Burial allowances and related benefits	66.9	71.0	20.2
Administrative support	44.7	47.9	52.4
Category total	2,160.1	2,251.1	2,263.8
Educational and training assistance:			
Readjustment educational assistance to veterans	378.5	570.5	668.6
Rehabilitative training of disabled veterans	22.8	31.0	37.9
Educational assistance to children of deceased and disabled veterans	33.2	37.2	37.6
Administrative support	38.5	45.8	46.6
Educational assistance to wives and widows		1.4	17.4
Category total	473.0	685.8	808.1
Housing and other credit assistance:			
Credit assistance for homes, farms, and businesses	149.0		
Servicing and management of loans and properties	701.6	9.5	5.7
Administrative support	38.7	40.6	43.3
Category total	889.3	50.1	49.1
Insurance:			
Veterans life insurance trust funds	744.7	754.3	760.4
Veterans life insurance revolving funds	1.6	4.3	6.0
Administrative support	18.2	19.3	21.2
Category total	764.6	777.9	787.5
Health services:			
Direct medical care	1,280.3	1,369.1	1,427.5
Medical and prosthetic research	45.9	48.1	59.7
Research and development in health services	4.9	5.0	4.8
Education and training	64.1	79.1	96.1
Medical support and miscellaneous services	41.1	44.7	49.2
Construction of facilities	56.6	11.9	101.4
Category total	1,492.9	1,557.9	1,738.7
Total distributed to programs above	8,300.0	7,978.9	8,397.1
Deductions for offsetting receipts	-494.0	-483.9	-480.1
Intragovernmental transactions	-5.4	-6.0	-5.6
Total budget authority, Veterans Administration	7,800.7	7,489.1	7,911.4

NATIONAL SCIENCE FOUNDATION

The fundamental purpose of the National Science Foundation is to strengthen basic research and education in the sciences. The Foundation's activities are reflected in the program structure shown below.

Table R-16. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Support of scientific research:			
Scientific research project support.....	170.6	177.3	197.0
Specialized research facilities and equipment.....	18.9	7.0	15.0
National research programs.....	15.5	13.0	23.2
National research centers.....	31.5	25.7	25.7
Category total.....	236.5	223.0	260.9
National sea grant program.....	5.0	6.0	10.0
Computing activities in education and research.....	22.0	17.0	22.0
Institutional support for science.....	83.2	41.0	74.0
Science education support:			
Precollege education in science.....	54.7	49.0	48.8
Undergraduate education in science.....	21.5	20.0	20.5
Graduate education in science.....	48.7	47.1	48.2
Category total.....	124.8	116.1	117.5
Science information activities.....	14.4	11.0	14.0
International cooperative science activities.....	1.4	1.8	2.0
Planning and policy studies.....	2.4	2.5	2.9
Program development and management.....	15.4	16.6	17.0
Total distributed to programs above.....	505.2	435.0	520.3
Adjustments to budget authority, net.....	-10.2	-35.0	-20.3
Deductions for offsetting receipts.....	-3.5	-1.1	-1.1
Total budget authority, National Science Foundation.....	491.5	398.9	499.0

OFFICE OF ECONOMIC OPPORTUNITY

The Office of Economic Opportunity contributes to the national goal of eliminating poverty by aiding in the development of Federal antipoverty policies and programs and by administering or coordinating various antipoverty program efforts. Achievement of this goal involves the provision of opportunity for people and communities to help themselves through work, education, and training in a decent and dignified environment. Effort to reach these subgoals is carried out through activities under several major program categories, as shown in the table.

Table R-17. PROGRAM DISTRIBUTION OF BUDGET AUTHORITY
(in millions of dollars)

Program category and subcategory	1968 actual	1969 estimate	1970 estimate
Employment:			
Job training and work experience assistance.....	625.6	752.7	825.1
Other employment assistance.....	16.2	16.5	17.0
Category total.....	641.8	769.2	842.1
Individual and family improvement:			
Compensatory and other educational assistance.....	568.4	577.0	614.7
Health assistance.....	60.7	95.5	127.8
Other individual and family assistance.....	8.3	8.8	10.8
Category total.....	637.4	681.4	753.3
Community betterment:			
Resource mobilization assistance.....	293.5	294.8	312.2
Volunteer assistance.....	29.2	32.0	37.0
Housing assistance.....	11.9	14.1	24.4
Legal assistance.....	35.9	42.0	50.0
Loan assistance.....	17.0	6.0	12.0
Economic development assistance.....	21.6	23.9	48.0
Other community betterment assistance.....	62.1	66.1	72.0
Category total.....	471.2	478.9	555.6
Poverty research and evaluation.....	3.6	3.6	13.0
General support:			
Executive direction and administration.....	11.9	12.5	12.6
Coordination and other.....	1.5	2.5	3.4
Category total.....	13.4	15.0	16.0
Total distributed to programs above.....	1,767.4	1,948.0	2,180.0
Deductions for offsetting receipts.....	— .5	— .5	— .5
Total budget authority, Office of Economic Opportunity...	1,766.8	1,947.5	2,179.5

Chairman PATMAN. Mr. Bolling of Missouri is recognized.

Representative BOLLING. Mr. Chairman, I really do not have any questions but I have got a couple of comments.

We have seen two examples at least today of the difficulties that these gentlemen have faced for their tenure in office, in dealing with an institution which likes to place all the blame for any misadventure on the Executive. I cannot understand frankly—and I think I can say that all of these gentlemen before us are friends of mine—how they have managed over the years to keep their good humor and even their sanity in dealing with an institution which, while they themselves head relative modern institutions in the executive, has not troubled to modernize itself.

As one—and it is no help to be a Cassandra as most of you have been—as one who supported publicly a tax increase in January 1966, I should think that by now the institution to which I belong which must start all tax measures and the institution to which others on the committee belong, might recognize that we have not been overwhelming success in acting in a timely fashion on fiscal matters.

I have been an advocate of a limited authority for the President to increase and decrease tax rates for so many years I am not quite clear as to when I first started. And I would like to say categorically that as an observer with some experience in the House of Representatives, that the delay in the enactment of a tax increase falls in the lap of the House of Representatives in particular. It was long delayed there and it was the House's fault, and plenty of room for plenty of bipartisan complaints because both parties were responsible.

Now, as far as this question of the waste and inefficiency in Defense are concerned. I think again it might be very, very well if we in the Congress looked to ourselves because I have some awareness of the occasional pressures that are brought by regions and areas on the Defense Establishment and the Executive, and I get a little tired as a 20-year member of the House of Representatives, of hearing people criticize the Executive for things that are actually done largely on the Hill. That is not to say for a moment that the Executive is perfect. I do not think so. But I do think that it is time that we began to look at the place where the greatest difficulty lies.

Mr. Rumsfeld was talking about the need for greater information and I think Mr. Zwick's reply made a lot of sense. It is not an adversary situation because we are not an adversary. I think that we in the House of Representatives have taken modern methods of storing and retrieving information to the extent of installing one computer in the Clerk's office. I hope the Senate has done better. We are using techniques on the Hill and we pass on the budget just as the administration submits it, which are not even up to the day of the early Model "T." And frankly, I compliment you gentlemen for your service. I wish you well, and I hope that each one of you separately will tell me how you kept your sanity and your sense of humor in dealing with the Congress. [Applause.]

Senator PROXMIRE (now presiding). Senator Percy?

Secretary BARR. Mr. Bolling, I will speak for all my colleagues. It has not been difficult. After all, you know you get harassed a little bit but when you meet the fellow who has been harassing you at a cocktail party it seems in the last analysis that you are all pretty good

fellows, you know, and ladies. None of us have bled. We are all in good health and good spirits.

Senator PROXMIRE. They also get paid more.

Representative BOLLING. That is good, too.

Senator PROXMIRE. I just observed to Mr. Bolling they also are getting paid a lot more than we are.

Senator Percy?

Senator PERCY. Mr. Chairman, I would like to use this occasion to express my appreciation to Secretary Barr for the fine relationship I have had with him for 2 years. We have agreed completely on the necessity of a tax increase and I hope I was somewhat helpful in this regard. We disagreed on the matter of Federal backing of homeownership bonds, but every point of view that I and my colleagues have had has been given full hearings and I am most appreciative of that.

I understand that this morning there was some discussion of the balance of payments, particularly with respect to purchase of bonds by Germany. I attended the NATO parliamentary sessions a couple of months ago as part of the Senate delegation and it seemed to me, as we worked on the Economic Committee, that it was a precarious thing to leave to annual negotiations; for us to go hat-in-hand and to be subject to the political problems of a country like Germany—when it might not be a very popular thing for a government to buy our bonds. It seemed that this is a continuing problem.

It we could adopt as a principle the position that no country should benefit or lose in a balance of payments sense as a result of its contribution to the mutual defense of the 15 NATO countries, then we ought to be able to be ingenious enough to create a mechanism for doing this automatically rather than in these annual negotiations.

I found the 15-member nation body very receptive to the unanimously approved resolution that I presented to the Economic Committee to the effect that such a device be worked out. I was pleased that the Ministers at their meeting included this section in their report. This would save us about \$750 million a year in balance of payments.

Secretary BARR. In Europe alone.

Senator PERCY. It would get us out of this 4½ year short-term bond. They ought to be for 15 or 20 years. There ought to be some sort of a central bank set up to do this automatically by the purchase of bonds from the debtor countries, and the sale to surplus countries by some central bank.

Now, this resolution, has been adopted.

Would you recommend that this be a high item of priority by the new administration? Is the Treasury Department the right place to implement this and make all the necessary arrangements?

Secretary BARR. First of all, Senator Percy, I think the country—I do not want to get too flowery here—and the whole world owes you and the people working in this area a deep debt of gratitude because the one thing we have never had to do and the one thing I pray that Secretary Kennedy does not have to do is go to the Defense Department and say we simply do not have the reserves to keep the 7th Army in Germany or we are going to have to pull the 6th Fleet out of the Mediterranean because we do not have the foreign exchange reserves.

It is difficult to bring these things down to where you can explain them to your constituents, but let me give you something I think all Americans can understand. This is something I have never told before, but I think it belongs in this record.

You will remember the days of the financial crisis of last March when we called our partners in the gold pool to Washington. The London exchanges closed down. I went over to visit my colleague, Mr. Nitze, in the Defense Department on Saturday afternoon while we were still negotiating. He was talking on the phone to Germany and I could hear somebody yelling on the other end of the line. Nitze said, "Just a minute. The right man has just walked in." He was speaking to our commanding general in Germany, I do not know the gentleman's name. Well, I will not repeat the words the general was using. He was talking like a general, I can tell you, but his complaint was that his troops were out on the streets and when they tried to get a dollar cashed to buy a beer, the money changers would give them only 85 cents. They would write a check on the post exchange bank, or whatever they have, to pay their rent, and people would not take their checks.

That is an example of the bind that you can get in—that is the ultimate end of the road, Mr. Percy, and that end is chaos and really it would be a dreadful blow to world peace. Then you would have Europe just helpless. It would be helpless. It would be defenseless.

So let me say if we all want to stay alive, peace is the highest priority. There is no higher priority I know for the new administration.

Now, you have moved with resolution. May I suggest, Mr. Percy, that you continue to push, but be tolerant and be helpful, because it is a long way from a resolution to a specific plan. You will find that the Finance Ministers of these countries and their Parliaments have difficulties when they get down to trying to implement the plan. We have tried several times with all sorts of plans. It is an extremely difficult thing. I will tell you what happens. A good offset arrangement, Mr. Percy, inevitably gets into their budgets and they have to vote to raise taxes and they have to vote to raise expenditures, and I am sure the committee will agree with me, this is not easy in any country. That is the nub of the problem.

Maybe you can work it out financially. We have not found any way out of it except the German offset which I will agree is not completely satisfactory. The satisfactory way is to do it in the budget through the appropriation and tax system and that is hard business in any country—but keep pushing. If you would like, one of the great experts in this area, one of the deep thinkers, is Mr. Okun, who has puzzled and worried over this problem as much as anybody I know. Mr. Okun can supply you a list of people this long—and I will be glad to come in and give you any political or practical advice I can give.

Secretary Fowler has worked years on this. So had Secretary Dillon and Secretary Anderson before him. I just want to tell you the priority is high; the solution is difficult. I congratulate you for trying.

Senator PERCY. I very much appreciate your statement on this. I think you have to strike while the iron is hot. We have a resolution that has now been approved by the NATO parliamentary group and by the Ministers and the conditions are favorable right now. But if we let too much time go by, this opportunity may slip by.

They have directed me to report back in May that steps have been taken. The initiative will not be taken by any other country. We are the real benefactor here in the short run. In the long run all NATO countries are the benefactors because we may some day say we are quite willing to take the budget impact of this but we can't stand balance-of-payments impact. And we know the bulk of the spending is going to be in Europe.

Secretary BARR. That will indeed be correct after the Vietnam conflict is terminated.

Senator PERCY. I will send to your office today one suggested proposal. If the Treasury Department can undertake immediately to consider this proposal, I will then in the transition period take it up with the incoming Secretary of the Treasury to see if we can't move forward rapidly and have something concrete to suggest by May when NATO meets again.

Secretary BARR. May I suggest, Senator Percy, that it is my understanding that Prof. Richard Cooper of Yale University, is coming down to assist Mr. Kissinger in this foreign policy area. It has been my experience that Professor Cooper—would you agree, Mr. Okun—has done as much work in this area as anyone. He is young and imaginative in this area.

Mr. OKUN. A Yale faculty member. [Laughter.]

Secretary BARR. No commercial plugs, please. But I would suggest, sir, that you are getting the right man. Mr. Kissinger is bringing in the right man, the best man I know outside of Mr. Okun to attack this problem.

Senator PERCY. Mr. Chairman, could I make just one last comment? I am very sorry I wasn't here for the full testimony on this Economic Report. I would just like to register the fact that I am concerned about the new budget. I think there have been some items slashed out of it that are going to be dangerous in their impact on the country, one of them being, I think, the whole area of health.

In the President's state of the Union message another program has been talked about. Yet we have a totally inadequate base for sustaining the existing programs that we have. We have a lot of work ahead of us, I think, to look into this to see whether or not the surplus is really a genuine surplus or whether we have turned the crank awfully tight and we simply aren't going to be able to live with those figures and we would be foolish to think that we can—

Secretary BARR. Senator Percy, this budget was peculiar. Most Presidents, when they are leaving office, don't really agonize about their last budget because they will not be around to work with it. President Johnson really did have to agonize on it and all of us did because we had to have a budget that was responsible and realistic. We also had to try to make our best estimates as to what the Congress would do to these proposals, not because we are going to be around to implement them, but because we were recommending that the surtax be extended.

We had to have a credible budget to support the recommendation that the surtax be extended and a surplus be maintained.

I don't know how well we did, Senator Percy, but we did do our best to be responsible, to be realistic, and also to try to figure out what

you gentlemen are going to do to that budget down here in the Congress.

Mr. ZWICK. Let me just add two comments, Senator Percy. One; it is a tight budget, no doubt about that. I think we can demonstrate that fact in a number of different ways.

Two; there is always the issue of how you set your priorities. I just would not want to let the record be left without indicating that we did increase significantly health expenditures by 12 percent, and that is clearly more than the budget on the average went up. Whether 12 percent is enough or too little or too much is a matter of legitimate concern and debate, but certainly health expenditures did go up in this budget.

Senator PERCY. Thank you.

Senator PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much, Mr. Chairman.

I would like to say to you, Mr. Secretary, that I think one of the problems of being a high appointive official is that you have first to convince your friends that you are competent to hold the job—and I can remember when President Kennedy first put you in the Cabinet, I thought he had run out of potential appointees rather quickly. [Laughter.]

At any rate, I would like to say to you today, that you convinced me.

Secretary BARR. Thank you.

Representative GRIFFITHS. I think you have done a marvelous job and I would like to say to you that I treasure as one of the really best statements ever made by a high appointive official your statement last year—before, I believe, a Senate committee—that if you gave \$5 billion to Wilbur Cohen, it would take him quite a little while to spend it, but if you gave it to the Defense Department, in 2 weeks they wouldn't know where it has gone. I agree. [Laughter.]

Secretary BARR. That caused me a little trouble, Mrs. Griffiths. [Laughter.]

Representative GRIFFITHS. I liked it and I agree with it and I think it took great courage to say it, and I think you were right, absolutely right. And I notice that in this Economic Report there is a statement that total package procurement, a major procurement innovation of the 1960's, has extended competition and permitted more fixed-price contracts.

Well, it is an innovation and it does have a sort of fixed price. But I would like to show you—Senator Proxmire and I examined one of these yesterday afternoon—how this thing operates.

The contract extended for 6 years. That is 2 years beyond the term of a President. That is twice the tour of duty of a military officer in the Pentagon. That is approximately the tour of duty of a Senator. It is three times the tour of duty of a Congressman. There will be nobody with any responsibility for the prices in this contract. Not at all.

This is not the way to go. The way to go is to break these into component parts, into simpler items over which someone has some control and for which somebody has some responsibility.

This type of contract is for all practical purposes a retainer contract to the industry to which it is offered. We will never arrive at the

goal toward which I think both you and I would like to strive. That is to reduce the prices paid in the Defense Department.

Now, they have proved through the years that they really aren't capable of buying even screws, nuts, and bolts. Time after time it has been proved that they have paid too much and each time it has, they have said, well, of course, that is the only instance, the only instance.

Now, anybody that knows anything about purchasing knows that this isn't true. This contract could be repealed, this type of contract form should be repealed by this Congress if necessary. This contract is foolish.

I hope the next time you come back, Mr. Secretary, you are made Secretary of Defense and we cut down on the price they are paying for these items.

Thank you.

Secretary BARR. Mrs. Griffiths, I have the greatest respect in the world for you and I think that the Congress and the country took a great step forward when they put a woman on the tax-writing committee, but, for goodness' sake, Mrs. Griffiths, don't wish Secretary of Defense on me. [Laughter.]

I would even prefer to be Secretary of Agriculture first. [Laughter.]

Senator PROXMIRE. Senator Javits?

Senator JAVITS. There is one thing, Mr. Zwick, that I would like to ask you. I know you gentlemen have other engagements, so I will be very brief.

I must apologize for leaving you but we had Ambassador Lodge before us in the Foreign Relations Committee, and I am sure you will agree that this was a very urgent priority for all of us.

I gather you took some exception to my feeling that this administration had not really set an order of priorities and pointed to the trend in the Federal budget outlays to demonstrate that fact.

Now, would you say that there was—that there was some deliberate decision on priorities, Mr. Zwick, and if so, what was it?

Mr. ZWICK. Yes. I think there clearly was a deliberate decision on priorities, and it is reflected in the two charts I discussed earlier, the 6-year budget chart which shows that we doubled our expenditures on major social programs—or increased them by 123 percent—when the overall budget went up 67 percent, which clearly reflects a set of priorities. That 6-year chart is very consistent with the chart which shows the changes between 1969 and 1970.

Now, I will say two other things very quickly. One, we can all have an opinion as to whether we have gone far enough, or too far; whether we have the right amount, the right mix. Obviously, this is a matter of great difficulty and of diverse opinion. The only point I was really trying to make is if you look at a special analysis which we have on "Aid to State and Local Governments," you will find that they have gone up 150 percent since 1964. They have a big \$4.2 billion increase in fiscal 1970 over 1969.

And we have also shifted dramatically from 55 percent of those aids going to urban areas in 1964 to 67 percent in the 1970 budget.

Now, it turns out that that happens to be equal to the proportion of people living in urban areas. And in addition we have Urban De-

velopment Bank and other proposals to funnel funds into the urban area.

Now, I am not saying that therefore all the needs of urban areas have been met. Far from that, Senator Javits. I am not arguing that point. I just want the record to show that there has been a shift toward urban areas and a concern on the part of this administration for urban areas, no more than that.

Senator JAVITS. Of course, the big argument about what you say with respect to this administration has been that expenditures, for example, for farm price supports, highways, that is public works, have continued at a high level during the course of the war, while our urban problems and needs have not received a high enough priority and adequate funds. I would like to ask unanimous consent to include in the record at this point a recent editorial from the New York Times of yesterday, January 16, entitled, "Unbalanced Budget Priorities."

Senator PROXMIRE. Without objection, that will be printed in the record.

(Editorial mentioned follows:)

[From the New York Times, Jan. 16, 1969]

UNBALANCED BUDGET PRIORITIES

President Johnson's last budget is fiscally balanced, but woefully unbalanced in terms of social priorities. Government expenditures are likely to be matched by revenues in the coming fiscal year, a relationship highly desirable for an economy gripped by inflation. But too little money is allocated to the cities with their explosive human problems while too much is funneled into Federal programs that fulfill less urgent needs—programs with claims based on inertia, tradition and the political influence of narrow interest groups.

In one respect, however, the budget is outstanding. Thanks to the reforms initiated by President Johnson and formulated under the direction of David M. Kennedy, Mr. Nixon's Treasury Secretary-designate, the budget for the fiscal year 1970 is virtually free of the gimmickry that was used to overstate revenues and understate expenditures in former years. Within the limits inherent in any attempt to look eighteen months into the economic future, the budget represents the most objective and authentic projection in many years.

Mr. Johnson forecasts a \$2.4-billion surplus for the current fiscal year and \$3.4-billion surplus for the year ending June 30, 1970. These estimates are predicated on such uncertain factors as smaller outlays for farm price supports and the passage of revenue measures which Congress has in the past rejected. But the precise size of the surpluses or deficits is of secondary importance in a period when inflation inevitably distorts both the expenditure and receipt sides of the budgetary ledger. What is important is that the 1969 and 1970 budgets are likely to be roughly in balance, thus obviating further Treasury borrowing and a more inflationary monetary policy.

Under the current circumstances—which could be radically altered by success in negotiating an end of the war in Vietnam or by changing business conditions—a budgetary balance requires the extension of the 10 per cent income tax surcharge beyond its June 30 expiration date. Fortunately, both President Johnson and President-elect Nixon are in essential agreement on this issue.

Defense programs account for more than half of the total of \$195.3 billion in expenditures budgeted for 1970. Because of the bombing halt and fewer heavy construction projects, outlays for the war in Vietnam are expected to decline by \$3.5 billion. But over-all defense outlays will go up anyway. Included in the \$5 billion of increases outside of Vietnam are more funds for the production and deployment of the Sentinel antiballistic missile system. That project is supposed to provide a defense against a possible Chinese attack, but its more certain and disquieting impact will be an escalation of the nuclear arms race with the Soviet Union. Funds which are freed by virtue of a cessation of hostilities in Vietnam should be transferred to urban renewal and antipoverty programs, not siphoned off for military hardware that will actually increase American insecurity by spurring a new competition in instruments of mass destruction.

The imbalance in the setting of national priorities is not limited to the defense budget. Two-thirds of all Americans live in urban areas, and in recent years urban areas accounted for more than 80 percent of the national population growth. Yet those facts of life find no rational reflection in the budget. The total outlays for "community development and housing"—a group of programs that encompasses urban renewal—are estimated at \$2.3 billion in fiscal 1969 and less than \$2.8 billion in 1970. In the same years the expenditures on "farm income stabilization"—the farm price-support programs that raise the cost of food and clothing to the poor—are estimated at \$4.5 and \$3.9 billion respectively. A visitor from outer space might read the budget and conclude that ours is still a rural society.

Among the other misallocations are the \$219 million to be spent in the year ahead on the supersonic air transport and the nearly \$9 billion for highways. Neither sum is justified when outlays for urban mass transportation are limited to \$400 million.

It is commonplace to point to political obstacles whenever it is suggested that radical changes in budgetary priorities are required. But unless those barriers are surmounted, the social imbalance in the Federal budget will have even more disruptive consequences than would a lack of control on the fiscal side. The test for the incoming Nixon Administration will be to reorder the priorities and address itself at once to the ill-met needs of the cities.

Mr. ZWICK. May I just make one comment. On farm price supports, for example, I did a calculation last year on the 1967, 1968, and 1969 budgets. If you take the three last Eisenhower budgets, and the 1967, 1968, and 1969 budgets, you will find that the growth in those programs was much smaller than the tremendous growth in the social and urban programs.

I am still not saying that is necessarily the right mix. I am just saying there have been shifts and I thought that New York Times editorial missed that point. Obviously, they haven't had a chance to read the special analyses.

(The following was later submitted by the Budget Director:)

With the approval of the Joint Economic Committee, I would like to have inserted in the record the following letter, which I have sent to the Editor of the *New York Times* concerning the editorial of January 16 entitled "Unbalanced Budget Priorities."

BUREAU OF THE BUDGET,
OFFICE OF THE BUDGET DIRECTOR,
January 18, 1969.

THE EDITOR,
The New York Times,
New York, N.Y.

SIR: I was dismayed by the inaccuracies and lack of sophistication in your lead editorial of January 16, entitled "Unbalanced Budget Priorities."

My heart was warmed—as would any Budget Director's be—by your assessment that President Johnson's 1970 budget "represents the most objective and authentic projection in many years." And, of course, there are always understandable differences in judgment. But the readers of the *Times* have the right to expect the same accuracy on the editorial page as they have become accustomed to on the news pages. Most of the judgments in this editorial are based on careless disregard for readily available facts in articles that appear elsewhere in the very same edition of the *Times*.

The editorial focused on the amount of resources which the Federal Government is channeling to urban areas. The President's Budget Message contains an entire section labeled "Aids to Urban Areas," reprinted in the same edition of the *Times* on page 20. However, the editorial writer appears to have read only the first paragraph.

After reporting correctly that the number of people living in metropolitan areas is almost two-thirds of our population and that more than 80% of our population growth between 1960 and 1966 did occur in such areas, the quality of reporting deteriorates. Outlays for the functional grouping "community development and housing," as used in the editorial, clearly fall short of all Govern-

ment outlays to aid urban areas. Federal aid to State and local governments—the direct flow of resources between governments—has channeled a rising share of funds to meet the needs of the city. Quoting from the President's Message, as reported on page 20 of the *Times*: "In 1964 we spent an estimated \$5.6 billion, or 55% of total Federal grants in such areas. The 1970 budget provides \$16.7 billion for aid in metropolitan areas, about 67% of total Federal grants." This represents almost a tripling in only six years, with the *increase* alone greater than the total aid to urban areas in 1964. Let me repeat that this is only the most easily measured flow of "aid," and does not count direct Federal spending or payments to individuals.

The implications of the editorial are doubly unfortunate in a year in which the budget will provide for a start on more than 500,000 housing units for families with low incomes—more than triple the number started last year. Beyond that, the budget includes President Johnson's proposal of an Urban Development Bank, to channel more private and other governmental resources into badly needed community facilities. Even in a very tight budget, Model Cities grants increase more than \$475 million, and urban renewal outlays rise by over \$175 million. Advance appropriations sought for each of these programs in 1971 will be \$1.25 billion. These facts and others are stated quite clearly in the Budget Message.

This is not to argue that we should be sanguine about our efforts to meet the urgent needs of our cities. As President Johnson said in his State of the Union Message, a great deal of what we have committed needs additional funding. The question is one of what *can* be done. Viewed in this light, I believe the 1970 budget is both attainable and a further step in the direction President Johnson has set in the six budgets he has submitted to Congress. A basic emphasis in all of these budgets has been on social—especially urban—problems.

CHARLES J. ZWICK, *Director.*

Senator JAVITS. Well, I shall read it and we will have other witnesses before us. I am rather hopeful, Mr. Chairman, when we get the Economic Report of this administration with Dr. McCracken as the Chairman, that you gentlemen will be available to testify because I think that the country can profit enormously, Mr. Chairman. These gentlemen will appear in their own private capacity at that point. I hope very much that they will agree to do that because I think it would be extremely important to the Nation to have the addition of debate if any debate is occasioned, or if it is not, so much the better, to have the fortification of support so that we may know what the former chief fiscal officers of the Government believe about the same set of figures and the same set of facts upon which the new fellows will be commenting.

Senator PROXMIRE. Senator Javits, I think that is an excellent suggestion. I certainly favor it and support it and, of course, it will be up to Chairman Patman, but I will support you on that enthusiastically.

Senator JAVITS. I really think you could help the country enormously if you could allow us to have that leave.

I have just one other point about the Urban Development Bank. I have made myself the proposal, and I have the legislation, for a "Domestic Development Bank." Can any of you tell us, perhaps you Mr. Zwick, as you mentioned it, whether there is any fundamental conceptual difference between the administration's proposal and my own. The name is immaterial. I just wondered whether he had something else in mind.

Mr. ZWICK. I am not completely familiar with your proposal except in general terms. I think they are quite consistent, but—

Senator JAVITS. Quite consistent.

Mr. ZWICK (continuing). But I would have to sit down and examine it item by item.

Senator JAVITS. The reason I asked that, because it happens to be critically important, not because I have proposed it but because President Nixon has endorsed it. [Laughter.]

Secretary BARR. Senator Javits, is this the plan in which you were joined by Senator Goodell and Mr. Widnall and others?

Senator JAVITS. That incorporates it. That is the Community Self-Determination Act and incorporates the Domestic Development Bank.

Secretary BARR. I have been intimately involved with the development of the Urban Development Bank. There is a great deal of similarity. I don't think ours is as far-reaching as yours but perhaps you can look with interest at it. The Urban Development Bank has been the product of a huge amount of staff work. We worked on this for 2 years. It may well be possible to make improvements, but there already is a lot of work involved.

Senator JAVITS. Where is the detail?

Secretary BARR. I will sign the letter covering the legislation this day.

Mr. ZWICK. We will have a bill up.

Secretary BARR. There is a legislative proposal, a bill drafted.

Senator JAVITS. I am very grateful to you, Mr. Chairman, and gentlemen. I am sorry to have been so late and I apologize.

Senator PROXMIER. Mr. Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Chairman, Secretary Barr has said that is finishing a decade of public service for which I can testify because 10 years ago Joe Barr and I were first elected to Congress and started to serve sitting side by side on the Banking and Currency Committee, and it might interest you to know that freshman Congressman Barr suggested to me that we travel around the country at our own expense visiting the Federal Reserve banks and meet and talk with bankers so that we could better understand our duties on the Banking and Currency Committee.

Coincidence would have it that one stop was at the Continental Illinois Bank in Chicago where we met with Mr. David Kennedy, who of course will be the successor to Secretary Barr. No one succeeds like a defeated Congressman.

In this last testimony that you made before the committee, Mr. Secretary, I commend you. I appreciate especially your candor on the tax reform issue. Your bank may have lost some oil company depositors. [Laughter.] I am also interested that you have come out very strongly in favor of a more multilateral foreign aid program.

I remember that in our freshman year in Congress we worked together on the International Development Association. I think you would like to know that Mr. William Gaud made some very cogent and eloquent remarks—I suppose you would call him a bilateral AID man in favor of IDA and multilateral aid before a subcommittee of this committee.

I know that you have been, and I think very wisely, a strong advocate of the surtax. I might say, like Congressman Bolling. I also had a tax increase bill introduced in 1966, which was an election year, and I want to just throw one idea out to you as Secretary and as a former Member of Congress.

What do you think of a proposal that would—unlike Congressman Bolling's proposal which would permit the President to raise or lower taxes—permit the President to raise but not to lower tax rates—subject to a congressional veto—because I believe we have learned the theory and the political popularity of cutting taxes? I think if a President would want us to cut taxes, I think that the procedures of the Congress are such that we could move quickly. [Laughter.]

Secretary BARR. That has been amply demonstrated. The record supports your statements, Mr. Moorhead, and I have stated publicly that when we first went forward with Walter Heller's variable tax proposal—I think it was 1962 or 1963—we made one mistake. We should have followed the line that you did. In other words—what you are suggesting, Mr. Moorhead—to give the President the authority to raise taxes. He can take the heat if he has to, and when economic conditions dictate that he must. Rest assured that the Congress will cooperate completely and promptly when the suggestion to reduce taxes is laid before them.

I think it is a very practical political solution.

Representative MOORHEAD. Also, I think it is a dangerous congressional delegation of political power to provide the President with discretionary power to cut taxes.

A President could use this power judiciously before reelection time and almost assure his reelection.

Secretary BARR. Mr. Moorhead, I am sure no Presidents are going to be unscrupulous or vicious, but I have heard the argument made, you know, in a little different context, that he gets the delicious pleasure of reducing them while others get the onerous chore of increasing them.

You are quite correct. It is a good idea.

Representative MOORHEAD. As I see it, we are not eroding the congressional prerogative in the tax field with this plan.

Secretary BARR. No. I support your position on the bill. I think it is an excellent idea and it is practical.

Representative MOORHEAD. Mr. Zwick, I was also puzzled by the New York Times editorial that is now a part of the record at Senator Javits' request, and I was particularly puzzled by the figure of \$9 billion for highways for fiscal 1970. Is that a correct figure?

Mr. ZWICK. No, sir. The regular highway trust fund program in fiscal 1970 is set at about the same level as in fiscal 1969—\$4.8 billion of obligations. As of now, spending is going to go up because of the way we held down spending in fiscal 1969, but the obligation level—and that is really the best index of program level for the highway program—has been held constant, year to year, for the regular Interstate A-B-C program.

Now, in addition, we have added some new programs to the trust fund. We have taken the existing safety program and highway beauty program and put them into the trust fund. There are also new programs, such as TOPICS which go up. But if you take out the new programs and look at the Interstate and A-B-C program, which is the basic highway program, we held in the 1970 budget about the same program level as we did for 1969, and I am sure we are going to hear some concern that it didn't go up enough. I don't know where the \$9

billion came from. It is not \$9 billion in any case. The basic program level will be \$4.8 billion.

Senator PROXMIRE. Maybe they are referring to public works as including the highways which would be close to \$9 billion.

Mr. ZWICK. Could be, but certainly not the highway program.

Representative MOORHEAD. Mr. Zwick, concerning the highway program it seems to me unfortunate that we always refer to it as the highway program. What we should be thinking about, it seems to me, is the problem of moving people and goods, particularly into and out of cities. Would it not be more economical for this effort to earmark certain public funds in a mass rapid transit system?

Mr. ZWICK. Well, I can't answer that categorically. You have to look at the volume of traffic, the geographic situation, and everything. But I agree with your basic principle, that we ought to be looking at transportation functions, urban transportation functions, cross-modes, intercity transportation functions.

Of course, that was the whole drive that created the Department of Transportation and moved urban mass transit out of HUD into the Department of Transportation.

Representative MOORHEAD. Have there been any studies showing the net benefit to the motorist of a reduction in traffic jams, resulting from the development of a mass rapid transit system, which would hopefully handle the bulk of commuter traffic—a system possibly funded with a portion of highway trust money?

Mr. ZWICK. Yes. That argument, of course, has been made for a number of years. We haven't been quite that bold in this proposal. Our proposal does have a number of innovations. It does include the so-called TOPICS program which is a traffic control system to use the highway fund not only for building additional highways, but to do work on traffic control, to get greater utilization out of existing rights-of-way.

We use our existing rights-of-way quite inefficiently. We use them as parking lots in the first place, curbside parking.

We don't get anywhere near the flow down these streets that we could if we had a better traffic control system. So we have initiated a new program in this area. We sent up a bill last year, I believe, to include some parking as part of the highway fund.

So I think there is a movement to broaden the definition of what the moneys in the highway trust fund can be used for.

Now, when you go as far as using them for non-highway uses, you will create quite a storm, but I suspect over the next several years as the Interstate System comes to an end—the original Interstate System is going to be completed and these revenues continue to come into the highway trust fund—there is going to be a very significant and very important public policy decision as to whether we eliminate these taxes, whether we transfer them back to general revenue, or whether we change the concept of the highway trust fund. I think it is one of the most important policy decisions that you are going to be facing over the next several years.

Secretary BARR. May I add to that briefly, Mr. Moorhead. You are going to be here. We are not. But as Mr. Zwick correctly pointed out, these huge revenues are pouring in and, for heaven's sake, I hope you gentlemen and Mrs. Griffiths will not let them pave the whole country.

Representative MOORHEAD. Amen to that, Mr. Secretary.

Mr. Okun, although we have the first surplus in our balance of payments since 1957, I am very much disturbed that it is such a tenuous surplus because of the unnaturally high inflow of capital and the deterioration of the balance of trade.

To what extent can we look for an improved picture in the merchandise trade balance during 1969?

Mr. OKUN. I think we do see a prospect for a significant improvement providing the program to keep the growth of the economy moderate is implemented and is successful. The story last year was the 22-percent surge in our imports of good and services. That certainly reflected the fact that an overheated economy which couldn't meet all the demands that were being placed on it shunted some of those demands to foreign goods. Our exports had a healthy growth, 9 or 10 percent.

What we would see for this year is a continuation of that growth of exports with a very modest growth of imports and that should begin to widen our trade surplus.

But it is going to be a long uphill course to get back to the kind of healthy trade surpluses we had in 1964 and 1965 which did provide a very firm foundation for our balance of payments. There is no question that the United States has to have a significant trade surplus to maintain the fundamental strength of the dollar in the years ahead.

Representative MOORHEAD. Thank you, sir. My time has expired, Mr. Chairman.

Senator PROXMIER. I know the hour is late. I know you have another engagement. I am going to be as brief as I can.

I do wish to get into the balance of payments. I think it has been in the worst shape it ever has been, at least in the years I have been here, especially because of the merchandise balance and the balance on goods and services, which we were told about by Mr. Deming yesterday is minus 1.8 billion.

We have this extraordinary inflow of capital at \$7 billion capital account which is favorable, but that is so tentative and so temporary.

Let me get back to Mr. Zwick with two questions.

No. 1, Mr. Zwick, this follows up the questioning I had before: Why does the Bureau continue to approve budget requests for programs where exorbitant cost overruns are repeated year after year such as the C-5A cargo plane, the F-111, F-4, Minuteman, and almost every other major program?

We had testimony from Mr. Charles that on the average during the 6-year life or so of the big weapon procurement programs they escalate 200 to 400 percent, and we have talked to analysts at the working level in the Bureau of the Budget who were very disturbed about this and very concerned. Why doesn't the Bureau of the Budget ever say no, or are you in a position to say no?

Mr. ZWICK. Of course, the issue is modernization in the Military Establishment versus efficiency in procurement, and that is always a difficult tradeoff. If we would procure standard items, stop modernization, clearly we could improve efficiency.

Senator PROXMIER. What I am getting at, if you could only get into this operation which I think is something which has been neglected, we haven't had a report on it, certainly it has been neglected by those of us in the Congress. We haven't investigated it the way we

should have, and it is the biggest expenditure we have, and there just seems to be no justification for these big increases.

They can't justify them on the grounds of inflation. The inflation is a very, very small proportion of this.

Mr. ZWICK. I think it is design change, overly optimistic expectations about technological advances, and so forth, that leads into them.

Senator PROXMIRE. If you gentlemen could get into it, I think it would be so helpful for us in Congress in making up our minds in these areas. We have votes on the floors of the House and Senate on these programs and if we can get some notion of whether or not we should agree with—I am on the Senate Appropriations Committee, too, where we have votes on this.

Mr. ZWICK. Let me assure you I am not sanguine with the current situation. It is a very difficult area. It is an area where you are pressing the technology. People are making assumptions that if you invest x dollars you will be able to push the state of the art to y . And therefore it will cost that much.

Senator PROXMIRE. Have you gentlemen ever said no on any of this? You have said no on some of the other projects, civilian programs. Do you feel you are in a position to recommend to the President that we not go ahead?

Mr. ZWICK. Yes. I participate in these decisions.

Senator PROXMIRE. Have you done that?

Mr. ZWICK. Yes, sir.

Senator PROXMIRE. You have said no.

Mr. ZWICK. Yes. I sometimes win, and usually [laughter] we don't know quite how we come out on those, but I have as much to say about these issues as I do any other.

Senator PROXMIRE. Let me finally ask you about the Trinity River project.

The Trinity River project, as you know, is a project that would provide for, as I understand it, developing a waterway between Fort Worth and the Gulf of Mexico.

Mr. ZWICK. That is right.

Senator PROXMIRE. Dredge a channel. And there are those critics who say, and I think with considerable conviction and reason, that it would be cheaper to move Fort Worth to the gulf. On that, I am not saying that this proposal which is going to cost three-quarters of a billion dollars before it is through and which has a very small—\$150,000—advance engineering project, is in the budget because Texas has extraordinary influence in this administration. But certainly it is something to think about.

Here is a project which has a benefit-to-cost ratio of 1.5 on the $3\frac{1}{4}$ -percent discount basis. It has a benefit-to-cost ratio of 1.09 on the $4\frac{5}{8}$ %, which is now, as I understand it the discount basis that is being used.

Now, if we recognize, as we should, it seems to me, and I know it is very difficult because of the way Congress in working on this, if we recognize that the only reason it has a positive benefit-to-cost ratio at all is because we show in here the savings which shippers experience in using the waterway rather than the appropriate concept of savings in the national resources, if we showed it on a national resources basis, it would have a negative benefit-to-cost ratio and heaven

knows if we used the discount ratio recommended to us by Otto Eckstein and the other experts, a discount ratio of around 7 or 10 percent in this very, very risky project, it would show a negative benefit-to-cost ratio.

How can you at a time when we have a so-called tight budget go ahead with a project which is going to cost such an enormous amount on such a flimsy—has such flimsy support on the merits?

Mr. ZWICK. Mr. Proxmire, as I am sure you are aware, this is a project that has been under study for years. It was authorized several years ago—I am not sure whether it was 3 or 5 years by the Congress, subject to restudy. It was restudied. The Corps of Engineers, given the same ground rules they are using for other projects, reported a 1.5 benefit-to-cost ratio. You are now questioning whether that is an appropriate evaluation procedure for all projects.

Senator PROXMIRE. You come up with a new—as I understand it, the executive branch has agreed to the 4½%.

Mr. ZWICK. That is right, for projects that are being evaluated from here on out, but the ground rule was that for any projects which up to this date were approved and authorized by Congress, we would use the old procedure. So we are using a consistent procedure.

Senator PROXMIRE. This is in the 1970 budget. We haven't approved the initial expenditure. Once we do, it is likely to be done forever, as you know, so this is coming up now.

Mr. ZWICK. There is money in the 1970 budget for initial planning and design work, that is correct.

Senator PROXMIRE. Why shouldn't we do it on the 4½ percent now in view of the fact it is not even going to be planned until 1970?

Mr. ZWICK. You would change the procedure. What you are saying, if I understand you correctly, is that you would change the procedure that the executive branch is recommending for all projects. There is no special treatment for this project. You are saying we ought to go back and re-do all the ones we have.

Senator PROXMIRE. For 1970.

Mr. ZWICK. That is up to Congress if you want to do it. We thought it would be most appropriate to have a consistent policy across projects, and so we arbitrarily said that projects approved before a certain date would use the old formula and new projects would be evaluated with the new formula.

Secretary BARR. Mr. Chairman, we will be delighted to come back this afternoon, but we do have our last Cabinet meeting.

Senator PROXMIRE. I understand. It won't be necessary for you to come back. I appreciate it. All you gentlemen have done a marvelous job. I know Mr. Barr has been praised by all, but certainly Mr. Okun and Mr. Zwick have done superb work. We are very grateful to you. You have been very helpful and persuasive.

Secretary BARR. That is the way we feel precisely about you and your committee, sir.

Senator PROXMIRE. Thank you very much. We will include as an appendix to this day's hearing a Treasury Department document called "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy."

(Whereupon, at 12:20 p.m., the Joint Economic Committee adjourned, subject to call of the chair.)

MAINTAINING THE STRENGTH
of
THE UNITED STATES DOLLAR
in
A STRONG FREE WORLD ECONOMY
A 1968 PROGRESS REPORT

THE DEPARTMENT OF THE TREASURY

December 1968

FOREWORD

In January, I released for public information the U.S. Treasury Department report entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy."

That report gave the history of the United States balance of payments position and described various programs that had been undertaken to resolve our balance of payments problem. The paper also described in detail the Action Program that President Johnson announced in his Message to the Nation on the Balance of Payments on January 1, 1968.

As the President said in his message, our efforts to bring our balance of payments into equilibrium and keep them there are "a national and international responsibility of the highest priority." This is certainly just as true now as it was in January. We have progressed greatly in implementing many of the steps called for by the Action Program. Unfortunately, some recommendations were not implemented as quickly as we would have liked and certain ones not at all.

The results for the first three quarters of 1968 are a source of encouragement. We have made steady progress during the year in bringing our balance of payments closer to equilibrium. Nevertheless, there is still a great deal to be done. We will have to continue the policies and programs detailed in the Presidential message of January 1, 1968, if we are to bring our balance of payments into durable equilibrium.

As Secretary of the Treasury and Chairman of the Cabinet Committee on Balance of Payments, I am releasing this Treasury Department report entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy—A 1968 Progress Report." This supplemental paper describes the progress we have made so far in 1968 and points out the actions still required.

Henry H. Fowler

HENRY H. FOWLER,
Secretary of the Treasury.

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BALANCE OF PAYMENTS

*Statement by the President Outlining a Program of Action,
January 1, 1968*

WHERE WE STAND TODAY

I want to discuss with the American people a subject of vital concern to the economic health and well-being of this nation and the free world.

It is our international balance of payments position.

The strength of our dollar depends on the strength of that position.

The soundness of the free world monetary system, which rests largely on the dollar, also depends on the strength of that position.

To the average citizen, the balance of payments, and the strength of the dollar and of the international monetary system, are meaningless phrases. They seem to have little relevance to our daily lives. Yet their consequences touch us all—consumer and captain of industry, worker, farmer, and financier.

More than ever before, the economy of each nation is today deeply intertwined with that of every other. A vast network of world trade and financial transactions ties us all together. The prosperity of every economy rests on that of every other.

More than ever before, this is one world—in economic affairs as in every other way.

Your job, the prosperity of your farm or business, depends directly or indirectly on what happens in Europe, Asia, Latin America, or Africa.

The health of the international economic system rests on a sound international money in the same way as the health of our domestic economy rests on a sound domestic money. Today, our domestic money—the U.S. dollar—is also the money most used in international transactions. That money can be sound at home—as it surely is—yet can be in trouble abroad—as it now threatens to become.

In the final analysis its strength abroad depends on our earning abroad about as many dollars as we send abroad.

U.S. dollars flow from these shores for many reasons—to pay for imports and travel, to finance loans and investments, and to maintain our lines of defense around the world.

When that outflow is greater than our earnings and credits from foreign nations, a deficit results in our international accounts.

For 17 of the last 18 years we have had such deficits. For a time those deficits were needed to help the world recover from the ravages of World War II. They could be tolerated by the United States and welcomed by the rest of the world. They distributed more equitably the world's monetary gold reserves and supplemented them with dollars.

Once recovery was assured, however, large deficits were no longer needed and indeed began to threaten the strength of the dollar. Since 1961 your Government has worked to reduce that deficit.

By the middle of the decade, we could see signs of success. Our annual deficit had been reduced two-thirds—from \$3.9 billion in 1960 to \$1.3 billion in 1965.

In 1966, because of our increased responsibility to arm and supply our men in Southeast Asia, progress was interrupted, with the deficit remaining at the same level as 1965—about \$1.3 billion.

In 1967, progress was reversed for a number of reasons:

- Our costs for Vietnam increased further.
- Private loans and investments abroad increased.
- Our trade surplus, although larger than 1966, did not rise as much as we had expected.
- Americans spent more on travel abroad.

Added to these factors was the uncertainty and unrest surrounding the devaluation of the British pound. This event strained the international monetary system. It sharply increased our balance of payments deficit and our gold sales in the last quarter of 1967.

THE PROBLEM

Preliminary reports indicated that these conditions may result in a 1967 balance of payments deficit in the area of \$3.5 to \$4 billion—the highest since 1960. Although some factors affecting our deficit will be more favorable in 1968, my advisors and I are convinced that we must act to bring about a decisive improvement.

We cannot tolerate a deficit that could threaten the stability of the international monetary system—of which the U.S. dollar is the bulwark.

We cannot tolerate a deficit that could endanger the strength of the entire free world economy, and thereby threaten our unprecedented prosperity at home.

A TIME FOR ACTION

The time has now come for decisive action designed to bring our balance of payments to—or close to—equilibrium in the year ahead.

The need for action is a national and international responsibility of the highest priority.

I am proposing a program which will meet this critical need, and at the same time satisfy four essential conditions:

- Sustain the growth, strength, and prosperity of our own economy.
- Allow us to continue to meet our international responsibilities in defense of freedom, in promoting world trade, and in encouraging economic growth in the developing countries.
- Engage the cooperation of other free nations, whose stake in a sound international monetary system is no less compelling than our own.
- Recognize the special obligation of those nations with balance of payments surpluses to bring their payments into equilibrium.

THE FIRST ORDER OF BUSINESS

The first line of defense of the dollar is the strength of the American economy.

No business before the returning Congress will be more urgent than this: To enact the anti-inflation tax which I have sought for almost a year. Coupled with our expenditure controls and appropriate monetary policy, this will help to stem the inflationary pressures which now threaten our economic prosperity and our trade surplus.

No challenge before business and labor is more urgent than this: To exercise the utmost responsibility in their wage-price decisions, which affect so directly our competitive position at home and in world markets.

I have directed the Secretaries of Commerce and Labor, and the Chairman of the Council of Economic Advisers to work with leaders of business and labor to make more effective our voluntary program of wage-price restraint.

I have also instructed the Secretaries of Commerce and Labor to work with unions and companies to prevent our exports from being reduced or our imports increased by crippling work stoppages in the year ahead.

A sure way to instill confidence in our dollar—both here and abroad—is through these actions.

THE NEW PROGRAM

But we must go beyond this, and take additional action to deal with the balance of payments deficit.

Some of the elements in the program I propose will have a temporary but immediate effect. Others will be of longer range.

All are necessary to assure confidence in the American dollar.

TEMPORARY MEASURES

1. Direct Investment

Over the past three years, American business has cooperated with the government in a voluntary program to moderate the flow of U.S. dollars into foreign investments. Business leaders who have participated so wholeheartedly deserve the appreciation of their country.

But the savings now required in foreign investment outlays are clearly beyond the reach of any voluntary program. This is the unanimous view of all my economic and financial advisers and the Chairman of the Federal Reserve Board.

To reduce our balance of payments deficit by at least \$1 billion in 1968 from the estimated 1967 level, I am invoking my authority under the Banking Laws to establish a mandatory program that will restrain direct investment abroad.

This program will be effective immediately. It will insure success and guarantee fairness among American business firms with overseas investments.

The program will be administered by the Department of Commerce, and will operate as follows:

- As in the voluntary program, overall and individual company targets will be set. Authorizations to exceed these targets will be issued only in exceptional circumstances.
- New direct investment outflows to countries in continental Western Europe and other developed nations not heavily dependent on our capital will be stopped in 1968. Problems arising from work already in process or commitments under binding contracts will receive special consideration.
- New net investments in other developed countries will be limited to 65% of the 1965-66 average.
New net investments in the developing countries will be limited to 110% of the 1965-66 average.

This program also requires businesses to continue to bring back foreign earnings to the United States in line with their own 1964-66 practices.

In addition, I have directed the Secretary of the Treasury to explore with the Chairmen of the House Ways and Means Committee and Senate Finance Committee legislative proposals to induce or encourage the repatriation of accumulated earnings by U.S.-owned foreign businesses.

2. Lending by Financial Institutions

To reduce the balance of payments deficit by at least another \$500 million, I have requested and authorized the Federal Reserve Board

to tighten its program restraining foreign lending by banks and other financial institutions.

Chairman Martin has assured me that this reduction can be achieved:

- Without harming the financing of our exports;
- Primarily out of credits to developed countries without jeopardizing the availability of funds to the rest of the world.

Chairman Martin believes that this objective can be met through continued cooperation by the financial community. At the request of the Chairman, however, I have given the Federal Reserve Board standby authority to invoke mandatory controls, should such controls become desirable or necessary.

3. Travel Abroad

Our travel deficit this year will exceed \$2 billion. To reduce this deficit by \$500 million:

- I am asking the American people to defer for the next two years all nonessential travel outside the Western Hemisphere.*
- I am asking the Secretary of the Treasury to explore with the appropriate congressional committees legislation to help achieve this objective.*

4. Government Expenditures Overseas

We cannot forego our essential commitments abroad, on which America's security and survival depend.

Nevertheless, we must take every step to reduce their impact on our balance of payments without endangering our security.

Recently, we have reached important agreements with some of our NATO partners to lessen the balance of payments cost of deploying American forces on the Continent—troops necessarily stationed there for the common defense of all.

Over the past three years, a stringent program has saved billions of dollars in foreign exchange.

I am convinced that much more can be done. *I believe we should set as our target avoiding a drain of another \$500 million on our balance of payments.*

To this end, I am taking three steps.

First, I have directed the Secretary of State to initiate prompt negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Europe. Our allies can help in a number of ways, including:

- The purchase in the U.S. of more of their defense needs.
- Investments in long-term United States securities.

I have also directed the Secretaries of State, Treasury and Defense to find similar ways of dealing with this problem in other parts of the world.

Second, I have instructed the Director of the Budget to find ways of reducing the number of American civilians working overseas.

Third, I have instructed the Secretary of Defense to find ways to reduce further the foreign exchange impact of personal spending by U.S. forces and their dependents in Europe.

LONG-TERM MEASURES

5. Export Increases

American exports provide an important source of earnings for our businessmen and jobs for our workers.

They are the cornerstone of our balance of payments position.

Last year we sold abroad \$30 billion worth of American goods.

What we now need is a long-range systematic program to stimulate the flow of the products of our factories and farms into overseas markets.

We must begin now.

Some of the steps require legislation:

I shall ask the Congress to support an intensified five year, \$200 million Commerce Department program to promote the sale of American goods overseas.

I shall also ask the Congress to earmark \$500 million of the Export-Import Bank authorization to:

—Provide better export insurance.

—Expand guarantees for export financing.

—Broaden the scope of Government financing of our exports.

Other measures require no legislation.

I have today directed the Secretary of Commerce to begin a Joint Export Association program. Through these Associations, we will provide direct financial support to American corporations joining together to sell abroad.

And finally, the Export-Import Bank—through a more liberal rediscount system—will encourage banks across the Nation to help firms increase their exports.

6. Nontariff Barriers

In the Kennedy Round, we climaxed three decades of intensive effort to achieve the greatest reduction in tariff barriers in all the history of trade negotiations. Trade liberalization remains the basic policy of the United States.

We must now look beyond the great success of the Kennedy Round to the problems of nontariff barriers that pose a continued threat to the growth of world trade and to our competitive position.

American commerce is at a disadvantage because of the tax systems of some of our trading partners. Some nations give across-

the-board tax rebates on exports which leave their ports and impose special border tax charges on our goods entering their country.

International rules govern these special taxes under the General Agreement on Tariffs and Trade. These rules must be adjusted to expand international trade further.

In keeping with the principles of cooperation and consultation on common problems, I have initiated discussions at a high level with our friends abroad on these critical matters—particularly those nations with balance of payments surpluses.

These discussions will examine proposals for prompt cooperative action among all parties to minimize the disadvantages to our trade which arise from differences among national tax systems.

We are also preparing legislative measures in this area whose scope and nature will depend upon the outcome of these consultations.

Through these means we are determined to achieve a substantial improvement in our trade surplus over the coming years. In the year immediately ahead, we expect to realize an improvement of \$500 million.

7. Foreign Investment and Travel in the United States

We can encourage the flow of foreign funds to our shores in two other ways:

—*First, by an intensified program to attract greater foreign investment in U.S. corporate securities, carrying out the principles of the Foreign Investors Tax Act of 1966.*

—*Second, by a program to attract more visitors to this land. A Special Task Force headed by Robert McKinney of Santa Fe, N. Mex., is already at work on measures to accomplish this. I have directed the task force to report within 45 days on the immediate measures that can be taken, and to make its long-term recommendations within 90 days.*

MEETING THE WORLD'S RESERVE NEEDS

Our movement toward balance will curb the flow of dollars into international reserves. It will therefore be vital to speed up plans for the creation of new reserves—the Special Drawing Rights—in the International Monetary Fund. These new reserves will be a welcome companion to gold and dollars, and will strengthen the gold exchange standard. The dollar will remain convertible into gold at \$35 an ounce, and our full gold stock will back that commitment.

A TIME FOR RESPONSIBILITY

The program I have outlined is a program of action.

It is a program which will preserve confidence in the dollar, both at home and abroad.

The U.S. dollar has wrought the greatest economic miracles of modern times.

It stimulated the resurgence of a war-ruined Europe.

It has helped to bring new strength and life to the developing world.

It has underwritten unprecedented prosperity for the American people, who are now in the 83d month of sustained economic growth.

A strong dollar protects and preserves the prosperity of businessman and banker, worker and farmer—here and overseas.

The action program I have outlined in this message will keep the dollar strong. It will fulfill our responsibilities to the American people and to the free world.

I appeal to all of our citizens to join me in this very necessary and laudable effort to preserve our country's financial strength.

Exchange of Letters Between President Johnson and Secretary Fowler Announcing the 1969 Balance of Payments Program

THE WHITE HOUSE,
December 18, 1968.

DEAR MR. SECRETARY:

I have reviewed and approved the report of the Cabinet Committee on Balance of Payments setting forth recommendations for 1969.

Our balance of payments program consists of a series of ongoing policies in a number of related areas. It must at all times be coordinated and pulled together. We have made our recommendation for 1969 at this time to facilitate an effective transition to the new Administration and the orderly development of future policies in this important area.

We have made a great deal of progress in 1968 toward our goal of a healthy equilibrium in our balance of payments. More progress must be achieved to assure the continued strength of the United States dollar. The stability of the international monetary system, and the great amount of world trade which it supports, depends upon that strength.

I would like to thank you and the other members of the Cabinet Committee on Balance of Payments for your determined efforts to propose and to do whatever is necessary to keep the dollar strong.

Sincerely,

(Signed) LYNDON B. JOHNSON.

The Honorable,
HENRY H. FOWLER,
Secretary of the Treasury

THE SECRETARY OF THE TREASURY,
Washington, D.C., December 17, 1968.

DEAR MR. PRESIDENT:

Near the end of each year beginning in 1965, your Cabinet Committee on Balance of Payments has submitted a recommended Program to guide and coordinate the many Federal activities relevant to our international balance of payments. This letter report will set forth the recommendations of the Cabinet Committee on Balance of Payments for the 1969 Program. Your approval of this Program should facilitate an effective transition and orderly development of future policies in this important area.

With my colleagues on the Cabinet Committee and the aid of your staff, we have coordinated the execution of the Action Program contained in your Balance of Payments Message to the nation last New Year's Day. A 1968 Progress Report will be separately submitted.

We have also considered together the nature and extent of the program needed for 1969 if the nation is to build on the progress made in 1968 and achieve a viable and durable equilibrium in our international balance of payments. It is submitted below.

The Cabinet Committee on Balance of Payments has worked with me in preparing the 1969 Program. The following participants join with me in these recommendations:

The Secretary of Defense

The Secretary of Commerce

The Secretary of Transportation

The Under Secretary of Agriculture

The Under Secretary of State for Political Affairs

The Administrator of the Agency for International Development

The Special Representative for Trade Negotiations

The Director of the Bureau of the Budget

The Chairman of the Council of Economic Advisers

The Chairman of the Federal Reserve System.

A few preliminary comments are in order concerning the overall policy framework in which these recommendations are submitted.

Our determination to achieve equilibrium in our international accounts is as vital today as it was on January 1, 1968, the day you announced your Balance of Payments Action Program. The removal of our international payments deficit remains "a national and international responsibility of the highest priority".

The execution to date of the broad and comprehensive Action Program you announced on last New Year's Day has substantially improved our balance of payments situation. A huge deficit in 1967 has

been whittled down to near equilibrium in the second and third quarters of this year on the liquidity basis of measure. There is a substantial surplus for the first three quarters on the official settlements basis.

We are pleased that the nation is making substantial progress toward achieving equilibrium in our international balance of payments. But we cannot be satisfied with the relative composition of its components. Our progress is spotty and some of it may be transitory. It is spotty because two big elements in our current account—trade and tourism—are far from satisfactory, and a third—a reduction in net deficit in Government military expenditures in Southeast Asia—must in large measure await the restoration of peace in the area.

There is reasonable prospect of continuing improvement next year. This assumes that there is no dismantling of the ongoing elements of your Action Program. It also assumes that the initiatives launched in that program to improve our trade surplus and reduce the net deficits in military expenditures abroad and private travel will be vigorously pursued. Until these elements of the program are effectively executed, we will not have the durable surplus or the assurance of a long-term equilibrium that will enable us to abandon some of the temporary and less desirable measures we have been forced to employ.

These temporary measures have served us well. They helped bring the necessary immediate improvement in our balance of payments and have given renewed confidence in the strength of the United States dollar. These temporary measures, appropriately modified, are needed for some additional period. As the longer-term measures, instituted last year and in some of the preceding years, yield increasingly larger benefits, the restraint achieved by the temporary measures may be phased out.

To complete our task, a continued and sustained effort will be needed. This is the quickest and surest route to the strong and viable payments position which will permit us to eliminate those aspects of our program that are not wholly compatible with the free flow of trade and capital movements.

These are the underlying principles which your Cabinet Committee on Balance of Payments believes should govern the program in 1969.

1. A Stable Economy and the Restoration of a Healthy United States Trade Surplus Should be the Primary Objective for 1969.

The keystone of a sound international financial position of the United States and of the dollar is a trade surplus. Without it, the United States cannot do what is natural and desirable for its role in the Free World—to export capital, to provide its share of the com-

mon defense, to give foreign aid, and to have large numbers of its citizens traveling abroad.

Hence, the first order of business in your last New Year's Day Message was for Congress to enact an anti-inflation tax, which, coupled with expenditure restraint and appropriate monetary policy, could help stem the inflationary pressures which threatened our economic prosperity, stability and our trade surplus. You also urged labor and management restraints in wage-price decisions and instructed your principal officers in the economic area to work with leaders in business and labor to make effective a voluntary program of wage-price restraint. A similar instruction on preventing our exports from being reduced and our imports increased by crippling work stoppages was prescribed.

Unfortunately, delays in attending to this first order of business in 1968 contributed to a continued instability in the economy and a very substantial decline in our trade surplus. However, the progress that has been made in recent months has laid the foundation for a much better national performance in the area in 1969 and years ahead, *if* the nation carries through with the program now in progress.

The Revenue and Expenditure Control Act, finally enacted in late June, established our commitment to fiscal restraint.

The Congress and the President will have to decide in the months ahead on fiscal policy for the period beginning July 1, 1969. This policy will require decisions on expenditures and taxes necessary to provide that degree of fiscal restraint which is a fundamental element in an adequate follow-through in the ongoing process of disinflation, restoration of our competitive position and provision of a healthy trade surplus. This fiscal policy, coupled with appropriate monetary policy by the Federal Reserve Board, will make possible the avoidance of the excessive demand that has contributed to the decline in our trade surplus. It will also enhance our competitive position by arresting inflation and enabling the economy to move back toward reasonable price stability, given accompanying voluntary restraint in wage-price decisions.

The Cabinet Committee on Price Stability, after consultation with business and labor leaders, including the President's Labor-Management Advisory Committee, is submitting a report on the progress made and the plans for future cooperative efforts on the wage-price front.

In 1968 we witnessed the adverse effects on our international trade position of the work stoppage in copper and the potential work stoppages in steel and on the docks. These focused renewed attention on the need for both labor and management to recognize the implications of their actions and their positions on wage disputes and their relationship to the protection of our national interest in maintaining the strength of the dollar.

2. Initiatives Pursued in 1968 To Assure Fairness to United States Trade in World Markets Should Culminate in 1969 in Co-operative Action by the United States and Our Trading Partners.

In 1969 further reduction of non-tariff barriers and appropriate changes in the General Agreements on Tariff and Trade rules on border tax adjustments must be achieved. International trading rules and practices are established through multilateral consent and negotiated in the multilateral forum of the GATT. In early 1968 United States representatives inaugurated a determined effort to eliminate non-tariff barriers, review agricultural trade, achieve improvements in the trading rules and minimize the disadvantages to our trade which arise from differences in the application of national tax systems to exports and imports.

The GATT Committee on Industrial Products has developed a catalog of non-tariff barriers to trade and is now turning to the removal of these restrictions. Similarly the Agriculture Committee of the GATT is conducting a general review of agricultural trade problems. In attempting to solve problems in these areas, we must be realistic in our objectives and timetable. On the other hand, we cannot be satisfied without real progress soon to eliminate the significant non-tariff barriers. We must bear in mind that the Trade Expansion Act of 1962 does not permit the United States to compensate with trade concessions the removal by others of illegal non-tariff barriers.

The GATT Working Party on Border Taxes must complete its task as early as possible next year. We believe there is a structural disadvantage to the United States, and to other predominantly direct-tax countries, which arises from the border tax adjustment system as presently permitted under the GATT rules. The lack of an overall limitation on border tax adjustments, the proliferation of the practice, and the unequal treatment prejudicial against one tax system as opposed to another are problems in the GATT rules which must be addressed.

The United States has also raised the issue of the provisions in the GATT rules which pertain to the process by which international payments imbalances are adjusted. Under the GATT, countries suffering temporary balance of payments difficulties may introduce short-term trade restricting practices such as quotas but the GATT is silent on the responsibilities of surplus countries.

We have seen, in the month of November, two countries employ other measures which also facilitate the adjustment of their balance of payments position. Through the manipulation of border tax adjustments, both France and Germany are endeavoring to influence their trade accounts in a manner conducive to better overall payments equilibrium. This course of action was chosen as an alternative to a

change in parity—an action which would have a permanent effect on trade. This experience should be examined to consider its lasting implications for the process by which a nation's international payments are brought into balance.

3. The Department of Commerce Should Intensify Efforts to Expand Commercial Exports Generally and in Conjunction with Foreign Assistance, and the Agency for International Development Should Continue Measures to Assure Additivity and to Minimize Substitution in Foreign Assistance.

The long-term trade promotion program which you outlined in your New Year's Day message should be pursued vigorously. These efforts have been helpful to date, and they will have to be reinforced. The recent recommendations of the National Export Expansion Committee provide suggestions for reinforcements. These should be considered.

The efforts of AID and other concerned agencies to minimize the balance of payments cost of bilateral economic assistance have been successful in keeping these costs to a minimum. The principles by which this is done are established. The implementation of these principles has now been under way for some time; and the regular, vigilant administration of these methods is what is required and is what we are receiving.

Some of the most important by-products of economic assistance are the trading benefits arising from the development and growth of viable economies abroad. We trade and prosper together. Our tied bilateral economic assistance, which transfers real resources has the effect of facilitating the introduction of American goods and services to these foreign markets. In distant areas, purchases of capital goods, often bought to last for a lifetime, provide a continuing introduction of the product names of our factories to foreign buyers.

In 1969 we must concentrate on developing follow-up sales after these early "calling cards" have been delivered. Industry, assisted, if need be, by Government, must expand upon the export opportunity created by our economic assistance. This will require a sustained and positive program.

The Commerce Department has cooperated closely with AID in seeking ways to maximize United States commercial exports following upon the foreign assistance program. In the area of publicity, Commerce provides information on AID business opportunities through a variety of media such as *International Commerce* and *Quarterly Summary of Future Construction Abroad*.

In addition to information available through these publications, Commerce provides information on AID export opportunities and guidance on the procedures for selling under the AID programs directly to American businessmen through personal contacts. The Commerce Department also puts together annual United States trade and investment programs for approximately 60 countries of main commercial interest in the world. Specific informational, promotional, and policy activities to be carried out in support of the program objectives are delineated. For countries with AID Missions, the AID operations generally constitute an important factor in achieving progress toward the investment program objectives. Additionally, the Department of Commerce through its trade programs, commercial exhibits and trade missions actively assists the United States exporter.

4. Consistent with Our Security Commitments, the Nation in 1969 Should Continue to Minimize Its Net Military Deficit by Reducing These Expenditures Whenever Conditions Permit and by Neutralizing Them Through Cooperative Action by Our Allies.

We should stand by the principles which you enunciated in the January 1 program:

“We cannot forego our essential commitments abroad, on which America’s security and survival depend.

“Nevertheless, we must take every step to reduce their impact on our balance of payments without endangering our security.” As we look at our overall balance of payments position and prospects, it remains a key concept that the foreign exchange drain from United States defense expenditures outside our borders for mutual security is an extraordinary item in the balance of payments. It should be met by special governmental action—it does not result from normal economic developments; nor is it subject to normal economic management through fiscal, monetary and incomes policies.

We need to maintain existing programs and constantly seek new ways to reduce our defense expenditures abroad. The types of actions by the Defense Department to reduce net foreign exchange costs during the years 1961–1967, as described in “Maintaining the Strength of the United States Dollar in A Strong Free World Economy”, Tab B, United States Treasury Department, January 1968, and in the Supplemental Progress Report for 1968, must be constantly pursued.

We welcome the extensive cooperation from countries in the North Atlantic Treaty Organization and in other parts of the world during 1968 to minimize our military foreign exchange costs through:

- Purchase in the United States of their defense needs; and
- Investments in long-term United States securities.

In 1969 we will want to continue cooperation and conclude new arrangements, with particular emphasis on NATO Europe. In the coming year, we will want to build on past experience in ways which:

- Proceed from the NATO recognition of the principle that the solidarity of the Alliance can be strengthened by cooperation between members to alleviate burdens arising from balance of payments deficits resulting specifically from military expenditures for the collective defense;
- Increase the emphasis on purchases in the United States to meet country needs for the improvements NATO has recently called for in country forces; and
- Reduce reliance on investments in long-term United States securities as a means for dealing with our foreign exchange costs resulting from defense expenditures outside our borders, since these investments do not provide the basis for a long-term solution.

In other parts of the world, we should give particular attention to the Far East. Military expenditures related to Vietnam and the prospective longer-term security situation in the region may be expected to continue a heavy drain on United States foreign exchange. We will be looking to countries in the region to continue and expand their cooperation with us to deal with this problem on a continuing basis. Active negotiations to this end should be a continuing responsibility of the Secretaries of State, Treasury, and Defense.

Of course, the principal opportunity to achieve actual reductions in our gross defense expenditures abroad, without damage to our long-term mutual security interests, is most likely to occur in connection with progress in the negotiations looking to a peaceful settlement of the conflict in Southeast Asia.

Even before our substantial involvement in military operations in Vietnam in 1965, United States military expenditures in the major Far Eastern countries were considerable. The direct foreign exchange costs of these expenditures averaged about \$700 million per year before 1965. They are currently running approximately \$1.5 billion *higher*.

This heavy direct loss of dollars to and through East Asia must be reduced when the fighting stops.

Therefore, a high priority must be given to the problem of neutralizing, to the maximum possible extent, the balance of payments cost of our security forces in East Asia while the fighting continues, and reducing the gross cost when the fighting diminishes or ceases.

5. The Mandatory and Temporary Foreign Direct Investment Program, as Announced in Modified Form by the Secretary of Commerce on November 15, 1968, Should Be Maintained.

The mandatory direct investment control program for 1968 has not interrupted the high, indeed, unprecedented, level of total American

investment abroad. It has had the intended effect of reducing capital outflows from this country by increasing the use of funds borrowed overseas for direct investment by United States affiliated enterprises.

Our base for future earnings continues to increase and the present balance of payments costs are maintained within tolerable limits. The private sector has for the most part understood this. The best way to keep the program temporary is to press ahead vigorously on all features of the balance of payments front.

There is little disagreement that this program should be temporary and terminated as soon as possible. It is the view of your Cabinet Committee that it is not possible to terminate the program in 1969 without running a grave risk that our progress toward balance of payments equilibrium would be reversed and a heavy deficit become a likely prospect. As stated earlier in the principles governing the formulation of the 1969 program, until the nation has a durable surplus or the assurance of long-term equilibrium, it would be unwise to abandon some of the temporary and less desirable measures that it has been forced to employ.

This has a special relevance to the Foreign Direct Investment Program as the following observations underscore:

First, overseas investments by American business (excluding Canada, which is exempt from the direct investment program) are projected to increase again in 1969, with plant and equipment expenditures reaching close to \$8 billion—up from an estimated \$7.5 billion this year, and up from \$4.6 billion in 1964, the last year before the introduction of the voluntary program.

Second, in order to hold the balance of payments impact of such investment in 1968 to the \$2.6 billion you targeted last January, it may be necessary for United States companies and their foreign affiliates to utilize between \$2 and \$2.5 billion of the proceeds of foreign borrowing in addition to foreign borrowing for day-to-day working capital requirements. To meet the new target for foreign direct investment of \$2.9 billion in 1969, we project it may be necessary for business to utilize another \$2–2.5 billion in foreign borrowing next year.

Third, growing restraint upon capital flows from the United States since the start of the voluntary program in February 1965 has resulted in a substantial, and to some extent abnormal level of foreign debt by United States companies and their foreign affiliates, as compared to what it might otherwise have been without the foreign direct investment programs. We do not have any precise way to measure its size, but it could approach \$5 billion by the end of this year.

Fourth, during the past four years, in cooperation with the capital programs, many United States companies have decreased their overseas liquidity through the reduction of inter-company accounts and

the repatriation of earnings, and, as a result, are more active, albeit reluctant, borrowers for working capital purposes.

All of this suggests that termination of capital controls in 1969 could result in a sharp increase in capital outflows and retained earnings—it is difficult to estimate the precise amount for much will depend upon market conditions and other factors, but there is a potential exposure of as much as \$3–\$4 billion. The outlook for 1969 does not permit taking the risk of that much additional direct investment hampering progress in our balance of payments program.

Basically, the 1969 Foreign Direct Investment Program will follow closely the format of this year's program. However, some additional leeway is needed (a) to provide additional flexibility for companies with limited or no overseas investment experience; (b) to make the Regulations more responsive to those companies whose investment quotas are unrealistically low in relation to the return flow of earnings from their direct investments; (c) to assure that the program does not unnecessarily inhibit the growth of inter-company exports of American goods and services to foreign affiliates; and (d) to enable the Office of Foreign Direct Investments to be more responsive to special industry problems and some of the inequities in the Regulations which have become apparent during 1968.

We recognize that just to maintain their existing overseas operations on a sound basis, companies must have the capability to retain abroad a certain percentage of their foreign earnings. Furthermore, retention of a portion of foreign earnings will be necessary to insure an orderly retirement of the growing debt being contracted abroad. We therefore recommended that the target level of direct investment be increased to insure that every company has, in 1969, an investment quota of at least 20 percent of its 1968 earnings from foreign direct investment. This change was announced on November 15.

Some adjustment in the target was also necessary to assure that United States companies have additional quotas to expand exports of goods and services through their foreign affiliates.

Further adjustments of the target were needed to make the Program more responsive to hardships arising from the application of the Regulations to special industries such as the international construction and transportation industries, whose operations and accounting procedures do not dovetail with the Regulations; to provide relief for companies whose ability to meet the repatriation requirements of the Regulations is restricted by law or lack of control; to encourage private investment of a developmental character in the less developed areas, and to provide companies with no or limited prior overseas investment experience with a somewhat higher level of permitted direct investment.

Finally, to enable companies to plan ahead and to insure that investment projects with important future balance of payments potential are not discouraged, the Office of Foreign Direct Investments evolved its incremental earnings formula, under which additional direct investment in future years is authorized on the basis of future incremental earnings.

6. The Federal Reserve Voluntary Foreign Credit Restraint Program Should be Maintained with Present Ceilings on Foreign Lending from the United States, but in the Coming Year Attention Should be Given to Possible Modifications to Encourage Further the Promotion and Financing of Exports by the Commercial Banking System.

The Federal Reserve program has required a great deal of United States financial institutions and they have responded well. Since 1964, United States commercial banks have not increased the volume of United States credits to foreign borrowers, even though the foreign banking business has grown substantially in all other respects. In their international operation, United States banks have had to meet the demands of clients for foreign loans within their voluntary ceilings and through the extensive use of resources in foreign branches.

The prospects for 1969 do not permit any basic change in the need for restraint on foreign lending of United States banks and other United States financial institutions. Accordingly, the existing voluntary ceilings for foreign lending by these institutions should be continued for 1969.

During the coming year, attention should be given to the effect of the program on increasing United States receipts as well as on reducing United States capital outflows. Since 1964, annual exports from the United States have increased by about 32 percent. Financing to support the growth in exports has become available as banks have changed the composition of their portfolios of foreign credits in response to the voluntary program and to a lesser extent by the use of funds in foreign branches and by the expansion of the Export-Import Bank's direct lending. The Federal Reserve Board intends, in the light of developments in the United States and abroad, to review its Voluntary Foreign Credit Restraint program early in 1969 in order to determine whether additional flexibility for financing United States exports might usefully be provided in the program's guidelines.

7. The Interest Equalization Tax, which Expires July 31, 1969, Should be Extended with the Existing Authority to Vary the Rate from 1½ Percent Down to Zero, Depending on Circumstances.

The size and efficiency of the American capital market necessitated the Interest Equalization Tax in 1963. This tax has served to facilitate

greatly the expansion of the European capital market and to develop additional techniques for employing savings around the world in productive investments. Through preserving an exemption for lesser developed countries, the access they need for development assistance is assured. In 1967, Congress granted the President certain discretionary authority in order that the purpose of the legislation—which is to limit but not prevent access to the capital market from developed countries—is best served.

In 1969, this legislation will need to be extended. In order that we have available a method for phasing out this tax, the existing authority to vary the rate of the tax from zero to 1½ percent per annum should be retained.

8. A Five-Year Program is Needed to Narrow the Travel Deficit Through Promotion of Foreign Travel in the United States by Both Public and Private Action.

As has been pointed out repeatedly to the public and to the appropriate Committees of Congress, the trend of the contribution of travel to and from the United States to our balance of payments deficit is such that the United States cannot continue to ignore the problem.

It was for this reason that in your New Year's Day Message you sought to reduce the travel deficit by calling for voluntary action and appropriate legislation. In 1967 this deficit exceeded \$2 billion. If the nation is to prevent the tourist deficit from continuing to rise and possibly exceed \$4 billion by 1975 (as United States disposable income and the portion of it spent on foreign travel increases, and the new airplanes with larger capacities and greater speeds bring lower fares), the nation must begin to implement *now* a comprehensive long-term program to increase rapidly the amount of foreign travel to this country.

The President's Commission, formed in 1967, has provided numerous suggestions worthy of attention, not only for immediate measures already taken in 1968, but for the longer-term future.

Although final figures are not yet available, we must anticipate a continued large travel deficit in 1968. It might well have been larger but for the fact that many of the remedial measures recommended by your Commission were carried out by Government and voluntarily by the private sector.

The longer-term measures recommended by your Commission to promote travel to the United States will require regular and adequate financing. The simple fact is that the United States has a smaller annual budget for promoting tourism than that of almost any other industrial country.

One way to finance an appropriate and effective travel promotion program would be to eliminate the exemption of international flights from the long existing five percent tax on airline tickets and to dedicate a portion of the proceeds to a special fund to be used and expended for travel promotion during the fiscal years 1970-74. There are, of course, other ways. Early Congressional action is highly desirable.

We must not allow an increased tourist deficit to jeopardize progress in other areas of the balance of payments nor to necessitate the maintenance of temporary restrictive measures on capital flows, nor to handicap the United States in discharging its national security commitments outside the United States.

The Cabinet Committee on Balance of Payments believes that these policies will continue the very real gains already achieved under the Action Program you announced last New Year's Day, will maintain the strength of the dollar, and will contribute to a strong free world economy. In the year ahead, these policies will help to preserve these gains and their contribution to a strong free world economy.

Faithfully yours,

HENRY H. FOWLER.

The PRESIDENT,
The White House.

I. The International Monetary System in 1968—Progress and Problems

The year 1968 has been a crucial one in the evolution of the international monetary system—probably the most significant year since the establishment of the Bretton Woods institutions in 1944–45. Conceivably this year will prove the most important turning point in the monetary system since the emergence of the pre-war international gold exchange standard system.

There have been two major developments during the year.

The first was the establishment of the two-tier gold price system drawing a clear distinction between the role of gold as a monetary reserve and the private commodity market for gold.

The second was the completion of negotiations on a Proposed Amendment to the Articles of Agreement of the International Monetary Fund establishing the facility for Special Drawing Rights. This amendment was approved by the Governors of the Fund for submission to member governments. When this Amendment is ratified by the requisite number of member countries of the IMF, it will enable the nations of the Free World for the first time to create international reserves by deliberate multilateral decision. They will, thereby, bring to an end the traditional reliance on uncertain supplies of newly-mined gold or the growth of liquid claims in the form of dollars, sterling or other reserve currencies, associated with balance of payments deficits of the reserve currency countries.

Role of Gold in the Monetary System

Following the devaluation of the pound sterling on November 17, 1967, the international monetary system was placed under severe pressure by heavy speculation in gold. Large amounts of gold were purchased in the London market by foreign holders of dollars and other currencies. This demand far exceeded current supplies of newly-mined gold, and was met from gold supplied by the active members of the gold pool—Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom, and the United States. (France withdrew from active participation in the pool in the summer of 1967.) Through selling gold in the market the pool was able to maintain the commodity price of gold in London at about \$35.20, a figure roughly equivalent to the monetary price plus handling charges and costs of shipping gold to London from the United States.

The active members of the gold pool met in Frankfurt, Germany, on November 26, 1967, and issued a statement reiterating their agreement to continue gold pool operations. For a short time this statement calmed the speculation. But the private demand for gold continued at an abnormally high level in December and in the first twelve weeks of 1968.

During the last quarter of 1967 and the first quarter of 1968, the gold reserves of monetary authorities and international agencies were drawn down by about \$2.7 billion. Purchases were primarily for non-monetary purposes, going into the hands of private holders.

The major loss was borne by the United States, whose gold reserves dropped by \$2.3 billion. The conversion of liquid assets into gold on such a large scale placed a very serious strain on the international money market, and short-term interest rates tightened severely. The world faced the possibility of a severe financial squeeze, with rapidly constricting international credit.

The members of the gold pool had continued to supply gold during January, February, and the first half of March, in the hope that the unusual speculative demand would disappear. One factor in this excessive demand was the United States statute requiring gold to be held as a domestic reserve equivalent to 25 percent of Federal Reserve notes in circulation. This gold cover requirement, an historical survival from earlier days when gold and currency notes both circulated domestically, was regarded in the market as a possible limitation on the amount of gold which the United States would be prepared to pay out. The Administration, therefore, recommended legislation to eliminate the gold cover requirement. The House of Representatives approved the measure on February 21, and the Senate acted on March 14. This provided the United States with the flexibility of policy needed to undertake a new approach to the gold problem.

On March 16-17, the Governors of the Central Banks actively participating in the gold pool met in Washington, under the chairmanship of Chairman Martin of the Federal Reserve Board. They adopted the so-called "two-tier" gold price system under which the private commodity price of gold is permitted to fluctuate without official intervention, while the official price of gold in its monetary role remains fixed at \$35 per ounce in transactions among monetary authorities. The participants agreed that in view of the forthcoming facility for Special Drawing Rights, they "no longer felt it necessary to buy gold from the market". The decisions taken in Washington have been broadly supported by most of the monetary authorities of the Free World. During the IMF meeting in Washington in early October 1968 this position was reinforced during some special sessions of the central bank governors of the active gold pool members plus those from Canada, Japan and Sweden.

Under the two-tier system, the commodity price for gold has fluctuated within a range of about \$38 to \$42 per ounce and the loss of monetary gold to the commodity market has ceased. Monetary authorities have continued to cooperate in a responsible manner in managing their transactions in monetary gold at the official price, and the gold reserves of the United States have risen since the end of March 1968.

The Washington Communiqué of March 17 made clear the fact that it is unnecessary to rely in the future on gold as a major source of additional monetary reserves. Existing monetary gold reserves will continue to play their role but over time should gradually become a smaller part of total world reserves. Special Drawing Rights, which will serve as a supplementary reserve to both gold and dollars, will be the long-run growth element in world reserves.

Facility for Special Drawing Rights

The second major development in 1968 was the completion of the Proposed Amendment establishing the Special Drawing Rights Facility in the International Monetary Fund and its approval by the Governors for submission to member governments for formal ratification. This process of ratification is now in progress. The new facility comes into existence when 67 members of the Fund (three-fifths of the membership), having 80 percent of the votes in the Fund, formally ratify the Amendment and when, in addition, members of the Fund having 75 percent of the total quotas in the Fund certify to the Fund that they are qualified and able to participate in the facility. The process of ratification and certification is expected to be completed early in 1969.

Although an Outline Plan for the Special Drawing Rights had been approved at the Annual Meeting of the Fund in Rio de Janeiro in September 1967, some further negotiations were required to complete the detailed provisions of the plan and to prepare certain other amendments to the Fund's Articles of Agreement proposed by the continental European countries. These other amendments strengthen to some extent the position of the creditor countries in the Fund.

These issues were resolved among the Group of Ten Ministers and Governors at a meeting in Stockholm on March 29-30, 1968. The French representative, however, did not join with the other members of the Group of Ten in approving the compromise text of the omnibus Proposed Amendment, but reserved France's position. Following the Stockholm meeting, the Executive Directors were able to complete the formal legal text of the Proposed Amendment. This was submitted to the Governors of the Fund on April 16, 1968, and subsequently received the favorable vote of the Governors of the Fund.

The Proposed Amendment was then submitted to the member governments for formal ratification.

In the United States, the National Advisory Council on International Monetary and Financial Policies prepared a Special Report on the Proposed Amendment which Secretary Fowler transmitted to the Congress on April 26, 1968. President Johnson addressed a Special Message to the Congress on April 30, 1968, entitled *Strengthening the International Monetary System*, recommending approval of the Amendment and authorization of participation by the United States in the Special Drawing Rights facility. The House of Representatives approved the necessary legislation on May 10, 1968, by an overwhelming majority of members of both parties, and the Senate on June 6, 1968, by a voice vote. The United States became the first member of the Fund to complete acceptance of the Proposed Amendment and certification of participation in the facility.

Special Drawing Rights will not be created until the Amendment has been ratified and "activation" is decided upon by the participants in the new facility. To assure that there is a very wide consensus among the members of the plan as to the amount of Special Drawing Rights to be created, a decision to activate must be approved by an 85 percent weighted vote of the participating members of the Fund.

An excessive addition to international reserves could give some impetus to world inflationary pressures. However, a deficient supply of world reserves can create a difficult and persistent strain on the international monetary system. When there is no increase in global reserves, one country can add to its reserves only at the expense of some other country or countries. The resulting competition for reserves can lead to an escalation of world interest rates, and to a cumulative spreading of restrictions on international transactions, as countries try to protect their existing levels of reserves or make additions to their reserves. It is already clear that few countries are prepared to look with equanimity on any sizable or prolonged reduction of their reserves, even when these reserves have grown substantially in recent years, as is the case in continental Western Europe. These are some of the considerations that will be taken into account in the initial decision as to activation of the Special Drawing Rights.

It is very clear, however, that despite a general beneficial effect on the equilibrium of the monetary system as a whole, the Special Drawing Rights will not remove nor even appreciably modify the need to achieve equilibrium in the balance of payments of individual countries through appropriate adjustment policies. While Special Drawing Rights can moderate the extreme severity of balance of payments pressures that would occur in the absence of any reserve creation, the process of adjustment of international balances remains one of the

most difficult and challenging problems in the field of economic policy and international economic cooperation.

The Franc-Deutschemmark Crisis, November 1968

In May and June 1968, the French franc came under pressure in the exchange markets as a result of an outbreak of strikes and student disorders on a large scale. Settlements in labor negotiations were estimated to increase wage rates within a range of 10 to 14 percent, or about double the previously anticipated annual rise in money wages. The shock of the May-June events was reflected in a heavy outflow of capital from France; French reserve of gold and foreign exchange were drawn down from \$6 billion at the end of April to \$4 billion at the end of November.

In September, the pressure on the franc was accentuated by rumors of a possible appreciation of the Deutschemmark. These rumors subsided soon but resumed in early November when liquid funds again began to flow into Germany in large volume. The speculation was encouraged by the continuation of a very large German trade surplus and by the market's belief that the Federal Republic of Germany could not maintain sufficient long-term capital outflows to offset its current account surplus.

The market situation worsened at mid-November. The major European exchange markets were closed on November 20, and a special meeting of the Ministers and Governors of the Group of Ten was called for November 20 in Bonn. Secretary Fowler, who had attended the North Atlantic Treaty Organization Ministerial Meeting in Brussels and was paying a series of farewell visits to his colleagues in Europe, took an active role in the calling of the meeting.

The primary objective of the United States, supported by the other Ministers, was to obtain assurances that the pressures of the crisis would not result in any excessive exchange rate adjustment that would seriously undervalue any currency and introduce the threat of cumulative or competitive devaluations. The United States set forth the basic principle that exchange rate changes of major financial powers should not take place without consultation between the governments of these major countries.

The decisions associated with the November meeting did not in fact result in any exchange rate adjustments. The German authorities proposed, as their principal contribution to reducing the German surplus, an adjustment in border taxes having effects somewhat similar to a revaluation of the Deutschemmark but applicable only to trade in physical goods. They estimated that this measure would reduce Germany's annual trade surplus in 1969 by about one-fourth. The French decision, announced on November 23, was to maintain the value of the

franc without change. France also announced measures of internal restraint, restored tight exchange controls, and made limited adjustments in border taxes designed to strengthen its trade position. The impact of these measures on France's current account alone has been estimated to be as much as \$1 billion in 1969. Finally, the authorities of the United Kingdom introduced a system of import deposits, increased internal taxation, and imposed additional credit restraints as a means of assuring their balance of payments objective of a substantial surplus by the end of 1969. At the same time, a large multilateral credit arrangement, amounting to \$2 billion, was established by the monetary authorities of the Group of Ten, Switzerland, Norway, Denmark and the Bank for International Settlements, to support the French franc.

Thus the franc-Deutschemmark speculative crisis was met by a further instance of international cooperation, in which actions were taken to reduce imbalances by both deficit and surplus countries, and financial support was mobilized for a threatened currency. The exchange difficulties in November were confined to the major European currencies. Unlike the gold crisis earlier in the year, there was no drain on the reserves of the United States.

Since November 25, the pressure on the franc has subsided and funds have been flowing from Germany.

Nevertheless, this crisis demonstrated once again that very large amounts of funds may move in response to concerns regarding domestic inflation or the possibility of gain through monetary appreciation. It underlined the need for continuing efforts to strengthen cooperation among the monetary authorities.

One important aspect in the pursuit of this ideal is the completion of ratification and the early activation of the Special Drawing Rights facility. Other techniques for strengthening the system will need to be explored as experience accumulates.

Further evolution of the international monetary system may not involve such fundamental changes as we have seen in 1968. However, it is important that, while conserving our proven arrangements, we be prepared to consider future changes in the international monetary system with an open mind. It is also essential that we continue to build upon the foundations of multinational cooperation that have been developed in recent years.

At many times in the past, there has been a tendency to look upon international monetary problems from a narrow nationalistic and short-range view. In recent years, we have made significant progress toward establishing the principle of cooperative multilateral action in handling the financial affairs which affect the major countries and major currencies. If this principle is observed, we can be assured that future changes in the system will be discussed and agreed upon in a

cooperative way by a preponderant majority of the nations that have a large stake in the functioning of the international monetary system. Hopefully, the acceptance of this principle will also mean that future destabilizing influences will be contained by the cooperative action of all of the nations immediately concerned.

In Secretary Fowler's speech at the Annual Meeting of the International Monetary Fund in Washington in October 1968 he noted the approval of the new facility for Special Drawing Rights. He pointed out that this major step in the evolutionary process of improving the international monetary system resulted from the thorough study and painstaking discussion of the problem in international bodies, in legislative committees, and in academic circles and the press. He expressed the hope that:

"Further evolutionary changes in the international monetary system would emerge in the same way. The only appropriate way to seek improvement in the system is through the same procedure of careful study, widespread official and public discussions, and carefully considered action."

Secretary Fowler also commented that:

"We started with the strong foundation built at Bretton Woods. We built an impressive network of international cooperation on that foundation. We built a major addition to that foundation in the Special Drawing Rights Amendment. We must be prepared in the future, as we have in the past, to approach together and to work out together additional ways to strengthen the international monetary system. To do less is to fail in our responsibilities to maintain and advance our public trust."

II. United States Balance of Payments—The Record to Date

For three successive quarters,¹ our over-all balance of payments position has improved under the impetus of the President's Action Program. The huge liquidity deficit of \$1,742 million in the fourth quarter of 1967 was reduced this year to \$680 million in the first quarter and \$160 million in the second quarter. In the third quarter, the United States achieved a small surplus of \$35 million, the first quarterly surplus since the second quarter of 1965.

Improvement of the official settlements balance was also impressive. The fourth quarter, 1967 deficit of \$1,082 million was reduced to \$552 million in the first quarter of this year. Surpluses of \$1,523 million and \$439 million were recorded in the second and third quarters, respectively.

For the first nine months of 1968 the liquidity deficit showed a \$1 billion improvement over the same period in 1967, while the official settlements balance showed a \$3.7 billion improvement between the two nine-month periods.

These results are encouraging and they have contributed to a strengthened position of the dollar in foreign exchange markets. But the gains in these over-all measures do not reflect a balanced improvement in all the major balance of payments components covered by the President's Action Program.

The trade account, which began deteriorating in the fourth quarter of last year, continued that trend in the first two quarters of this year. Only a mild turn-around occurred in the third quarter.

Exports have performed creditably, except in the agricultural sector; but there has been an extraordinary surge of imports. This resulted partly from the excessive level of domestic demand fostered by the tardy passage of the anti-inflation fiscal package. But strikes and the threat of strikes in various industries caused extraordinary imports of between \$600 and \$700 million, representing an irreversible loss to the balance of payments.

The trade position must be restored to a much higher level of surplus in order to sustain the over-all improvement in the balance of payments.

Achievement of the program goals was also thwarted in the travel account. The Congress has not approved recommended measures to

¹ Data given here are those contained in the report for the third quarter of 1968 released by the Department of Commerce on November 15, 1968; some preliminary figures there in are subject to later revision.

reduce the growing tourist deficit. While that deficit is running somewhat below the 1967 level (when Canada's "Expo '67" attracted an unusually large number of American visitors) the underlying trend of increased net outflows is likely to continue far into the future. Gross expenditures of American tourists are approaching \$4 billion per year, not much less than total military expenditures abroad.

The continued increase in foreign purchases of American securities has been a particularly favorable factor this year. This result is in part attributable to the efforts set in motion by a Presidential Task Force Report in 1964 on Promoting Foreign Investment in United States Corporate Securities. The increase in these purchases in the first three quarters of 1968 over the same period a year ago was about \$800 million (excluding a large capital input by a foreign firm into its American subsidiary).

While part of this increased investment was influenced by political disturbances abroad, it must be borne in mind this trend started long before the events of May in France or the invasion of Czechoslovakia in August. Indeed, reflecting the continued high preference for the dollar, the level of net foreign purchases of portfolio equity securities actually accelerated between November 1967 and February 1968. After the gold crisis in early March, the level of inflow continued to increase substantially.

The Foreign Direct Investment Program of the Department of Commerce has progressed favorably toward its goal of a \$1 billion reduction between 1967 and 1968 in direct investment subject to the program. In the first three quarters of this year, utilization of funds borrowed abroad has been several times greater than in the corresponding period of last year and remitted earnings from direct investment were running 14 percent above the level of the same period a year ago. At the same time the program would not appear to be interfering in any serious degree with overseas plant and equipment expenditures by American firms.

The 1968 goal of the Voluntary Credit Restraint Program of the Federal Reserve Board is to achieve a \$500 million improvement in our balance of payments from a reduction of loans to foreign borrowers by United States banks and other financial institutions. This target seems likely to be exceeded on the basis of performance in the first ten months of this year.

The programmed \$500 million reduction in net government expenditures outside the United States will probably be exceeded. Special financial arrangements to reduce or offset our military expenditures abroad are proceeding satisfactorily, particularly in the NATO-European area. The Agency for International Development is reducing its cash transfer below last year's level and is striving

to insure that exports of American goods which it finances are additional to normal commercial sales. The program for reduction of civilian employees overseas is on schedule.

The above developments attest to the importance and large measure of success of the January 1 program. These achievements occurred during a year in which the excessively rapid growth of the domestic economy, serious strikes and strike threats, and the lack of legislative authority to deal adequately with the tourist deficit presented formidable obstacles to improvement in the balance of payments.

III. An Intensified Effort to Achieve and Maintain a Healthy United States Trade Surplus

A. Introductory Comments

The cornerstone of the United States balance of payments position has always been a substantial trade surplus. In the years 1950-55, the surplus averaged \$2.2 billion; in 1955-60, it averaged \$3.8 billion; and in 1960-65, it averaged \$5.2 billion. Our trade surplus reached an all-time high of \$6.7 billion in 1964, when some particularly favorable factors were operating; however, since 1964, it has steadily declined. The surplus narrowed to \$4.8 billion and \$3.7 billion in 1965 and 1966, respectively. The 1967 surplus was reduced to the somewhat lower level of \$3.5 billion. In 1968, our trade surplus has deteriorated sharply from the 1967 level, and it is expected that it will be less than \$1 billion or \$3 billion less than the target established in the President's January 1 balance of payments message and \$2.5 billion less than the 1967 total.

Certainly, the most disappointing aspect of our recent balance of payments performance has been the steep decline of our trade surplus which started in the latter part of 1967 and continued through the first half of 1968.

It has been natural for the United States, as the most economically advanced nation in the world with a comparative trade advantage in a wide range of products, to have a surplus in its trade account. The United States has special responsibilities because of its role of leadership in the Free World. Therefore, it is necessary for the United States to have a sufficient surplus in its trade account so that it will be able to export capital, to pay its fair share of the collective defense and foreign aid efforts, and to phase out the temporary restraints in the balance of payments program.

United States' exports and imports are strongly influenced by the pressures generated in our economy which affect the competitiveness of American products and also by the economic and trade policies followed by the major trading nations of the world. Future trade prospects for the United States will depend upon:

- sound management of our domestic economy;
- success in our efforts to obtain reasonably free access to foreign markets for our goods;
- the level of demand in our markets abroad; and

—the realization of the export potential of our industry through selective export expansion programs.

B. Soundly Managing the United States Economy To Keep It Competitive and Stable

President Johnson stated in his January 1 Message On The Balance of Payments that the first order of business was to take the necessary steps to stabilize our economy. Enactment of the Revenue and Expenditure Control Act of 1968 was the key to stability. The President also urged labor and management restraint in wage-price decisions and instructed the principal officials in the economic area of the Administration to work with leaders in business and labor to make effective a voluntary program of wage-price restraint. A similar instruction dealt with preventing costly work stoppages which could reduce exports and increase imports.

Unfortunately, delays beyond the reach of the Executive Branch in accomplishing this first order of business contributed to continued instability in the American economy and thus to an unsatisfactory performance in the trade areas. Our exports grew by a very satisfactory rate of 9.1 percent during the first nine months of 1968 to a level of \$25 billion—or an annual rate of \$33.4 billion. A large part of the deterioration in the trade account was due to overheating in the domestic economy which led to an excessive high rate of imports. Imports rose by 24.9 percent in the first nine months of 1968, as compared with 1967, to reach a level of \$24.8 billion—an annual rate of \$33 billion. Our trade account in 1968 has been hurt also by a series of major work stoppages or threats of strikes in industries such as copper, steel and aluminum. It is estimated that the trade account suffered in the first nine months by over \$600 million as a result of these labor difficulties. There has also been the threat of a possible strike by the East and Gulf Coast Longshoremens Association now a reality, this strike if continued for any length of time will affect the balance of payments adversely.

Passage of the Revenue and Expenditure Control Act of 1968, although delayed to midyear, had an important effect on stabilizing the domestic economy. The outlook today is for a small budget surplus for Fiscal Year 1969 as compared with an estimated deficit before passage of the legislation of approximately \$25.4 billion for FY 1968. Also passage of this tax and expenditure control legislation, particularly in an election year, did much to restore confidence in the United States Government's determination to manage its financial affairs appropriately. As a result, the recent disturbances in the foreign exchange markets of the world hardly affected the dollar. The Revenue and Expenditure Control Act expires on June 30, 1969. Decisions will

be necessary in the months ahead on the appropriate fiscal and monetary policies for the period beginning July 1, 1969, and on the desirability of extending the income tax surcharge.

Our overall performance in 1968 with regard to wage-price restraint has not been at all satisfactory. Some settlements were clearly excessive. The Cabinet Committee on Price Stability, after extended study and consultation with business and labor leaders, including particularly the President's Labor Management Advisory Committee, is submitting recommendations for a more lasting and effective effort on the wage-price front.

C. Making United States Industry more Export Minded Through Selective Export Expansion Programs

Our objective has been to encourage the nation's producers to export more. We have employed active and direct measures to supplement our efforts to achieve a soundly managed economy and an open trading community. To this end, the United States Government is involved in making American industry more export minded through a number of export expansion programs.

In 1968, we established and activated the following programs:

- The \$500 million Export Expansion Facility was created within the Export-Import Bank to expand and improve export financing, guarantee and insurance facilities available to American exporters. This facility, enacted into law in early July, through November had already helped to finance over \$90 million of American exports.
- The Export-Import Bank announced a liberalized discount system on April 1 that has been well received in the financial community. In the period between April 1 and November 30, 1968, export credits totalling \$184 million were financed through this facility. This compares to a total activity of \$270 million from the program's inception in September 1966 to March 30, 1968.

The Commerce Department has launched the five-year, \$200 million comprehensive export program announced by the President in January. Although budgetary limitations have been present, Commerce has achieved the following results:

- The first Joint Export Association contracts are in the final stages of negotiations and will be signed early in January 1969. Under these contracts the Department of Commerce will provide financial assistance to groups of American firms in developing overseas markets.
- The Department of Commerce has expanded its overseas commercial exhibition program and related activities in the United States to make American business more export minded.

- Foreign markets are being systematically and continuously analyzed and the best markets for American industries are being pinpointed, product by product.
- Significant improvements in automated informational services have been made.
- Two new Trade Centers are in the process of being established. The first will open in Paris in the fall of 1969.
- A national strategy for expanding exports over the next five years is in process of development.

These positive, carefully planned, long-range efforts yield important results. For example, during the FY 1964-67 period, Commerce spent \$19.9 million promoting exports by means of overseas trade fairs, trade centers and American Weeks. Confirmed first year sales that resulted from these promotions amounted to \$300.5 million—more than 15 times the initial cost. On a balance of payments basis, results are even more favorable. Since only about 45 percent of our appropriated funds for these three programs is expended overseas, the direct impact on the balance of payments has been \$33 in export sales within one year of the export promotion event for each Commerce dollar spent overseas.

Recent analysis indicates that \$300.5 million in sales will generate tax receipts by the Treasury of \$18 million. Thus the net cost of the program during this four-year period, on the basis of one year sales results, was \$1.9 million. Succeeding year sales and revenue receipts are obviously very large and could more than offset this cost.

To make these long-term programs effective, energetic and continuous efforts, and adequate funding, are required. Comparatively small amounts of carefully spent dollars yield important dividends in the future, both in revenue and in balance of payments terms. In the competing requests for budgetary funds positive programs to achieve long-range balance of payments effects must get an important and a reliable commitment of financial resources over the long run.

D. Keeping World Markets Open and Fair

The United States has consistently taken the lead in bringing the world community toward more liberal trade. Our policy has been directed toward a freer flow of goods, services, and capital. President Johnson emphasized this policy in his New Year's Day Message: "In the Kennedy Round we climaxed three decades of effort to achieve the greatest reduction in tariff barriers in all the history of trade negotiations. Trade liberalization remains the basic policy of the United States."

The world of international trade and finance has come a long way since World War II. Reconstruction of the industrialized countries

reached the point some time ago where the generation of capital and savings was sufficient to satisfy their domestic needs. The improved economic and financial position of the industrialized countries has enabled them to assume, for the most part, their responsibilities to end currency restrictions as provided under Article VIII of the International Monetary Fund Agreement. Since post-war economic reconstruction has long since been completed, the United States can no longer look aside when any of these industrialized countries takes action which prejudices our own trading and payments position. The United States can no longer be as tolerant, as it was in the early post-World War II period, of harmful trade measures employed or continued too long by other countries. President Johnson took note of this point in his New Year's Day Message:

"We must now look beyond the great success of the Kennedy Round to the problems of nontariff barriers that pose a continued threat to the growth of world trade and to our competitive position. American commerce is at a disadvantage because of the tax systems of some of our trading partners"

Steps Underway To Reduce Non-Tariff Barriers

Efforts to achieve and maintain a healthy United States trade surplus must be directed not only toward obtaining price stability at home but toward expanding liberal trading practices which provide equal access to the markets of the world. This past year has seen a pronounced increase in our efforts to make world markets more open and fair.

Most of these efforts have been pursued multilaterally, through the General Agreement on Tariffs and Trade, where international trading rules and practices have been codified and established. Basically, the rules limit the extent to which countries can raise new nontariff barriers and they provide a framework for the reduction of such barriers. Countries in balance of payments difficulties are permitted to maintain or establish quantitative import restrictions and are required to consult with other countries in the General Agreement on Tariffs and Trade under a waiver procedure. The United States has increased the emphasis it places upon the GATT by furthering multilateral discussions on compliance with its provisions. To this end, we have participated in complaints regarding specific practices of others. In addition, we have initiated new efforts to examine old or unclear rules of GATT, with the intention of relating them more closely to the experiences of recent years and the requirements of the future.

Compliance with the GATT

Review is presently underway in the GATT of several specific actions or failures to act by other countries. The United States is

participating through this multilateral forum to make sure that rules and objectives of the GATT are followed by others as well. For example, several countries—Brazil, Chile, and Israel—have revised their tariff schedules and Austria and Spain have taken actions which adversely affect American trade. The United States is negotiating with these countries to obtain new concessions to offset the effect of their actions. Should redress not be achieved through the avenue of first recourse, the action may be advanced to a point where under GATT, if ultimately unsatisfied, other nations would be permitted to take specific and compensating trade measures to offset the losses suffered from these unfair practices.

Bilaterally, we have insisted on compensation for any new trade restrictive measures imposed on our exports even temporarily. For example, Canada gave tariff concessions in agricultural trade as compensation for the introduction of temporary special import charges on imports of potatoes and corn into Canada.

Through the Organization for Economic Cooperation and Development (OECD) in Paris in a matter closely related to the GATT, the United States has initiated consultations to examine the trade effect of forthcoming tax measures in the Netherlands and Belgium. In the course of harmonizing the indirect tax system of the member countries, within the Common Market, the Netherlands and Belgium will be changing their indirect taxation from existing cascade tax assessment to the turn-over, value-added system. In a similar move a year ago, the Federal Republic of Germany achieved a significant trade benefit.

After World War II, in an effort to protect local industry and foreign exchange, many countries employed import quotas. As these industrial countries improved their economies and their international balance of payments positions, they were able to assume the responsibilities of nations with freely convertible currencies as described in Article VIII of the Agreement of the International Monetary Fund. A country may qualify as an "Article VIII country" without having fully achieved the removal of all its quota restrictions; however, it is the understanding of an Article VIII status that these restrictions will be progressively removed over not too long a period of time. For the most part, this has been done—but in nations such as France and Japan quota restrictions (among others) linger. We started using the GATT framework to achieve the removal of these restrictions well before 1968 with respect to France. With respect to Japan, we are presently negotiating bilaterally. In the summer of 1968, we successfully obtained a relaxation of the Japanese restrictive trade practices with respect to our automotive trade and investment in that country. Nevertheless, many other areas of our trade remain encumbered by restrictive Japanese practices. We are vigorously pressing ahead to make this important market open and fair.

A Fresh Look at Provisions of the GATT

At the GATT Ministerial Meeting in November 1967, it was agreed that new Committees in industry and agriculture would be established to examine nontariff barriers (NTB's) and other trade restrictions. The rules, laws, administrative practices, commercial practices, and preferences employed around the trading world are numerous, insidious and always difficult to identify. Therefore, the first task was to establish a useful if incomplete catalog of these nontariff barriers. This has been accomplished. The GATT Committees are now turning to the more difficult task of preparing for the negotiation of the reduction and removal of these nontariff barriers.

The normal objective in negotiating bilateral or multilateral trade provisions is to achieve a neutral trade effect. This means that one nation will agree to make an adjustment involving a certain amount of trade, on the condition that another country makes a compensating gesture involving an opposite and equal amount of trade. In negotiating the removal of illegal nontariff barriers, this principle of balance must be set aside. It is clearly unfair to have a country impose a nontariff barrier and then, as a condition for its removal, demand a compensating trade benefit.

At the November 1967 GATT Ministerial Meeting it was also agreed to establish a Working Party on countervailing duties, export subsidies and other export incentives. During the Kennedy Round negotiations, many countries complained about the countervailing duty law of the United States and its exemption from the provisions of the GATT. This legislation, passed in 1896, requires the United States to impose an equal and compensating import levy (countervailing duty) for an export subsidy (bounty or grant) used by a foreign nation to aid its exporters. This requirement to countervail is unrelated to the degree of trade injury to the United States resulting from the foreign subsidy.

The GATT recognizes countervailing duty practices and the laws that many countries have in this field. However, the GATT authorizes a nation to countervail only to the extent that it is injured, and then only after efforts to achieve removal of the export subsidy through normal GATT procedures have failed.

In view of the 1947 GATT Agreement and our prior legislation, the United States is not covered by the GATT provisions. The absence of an injury requirement in our legislation is heavily criticized by foreign countries—some call it a major United States nontariff barrier. During the course of the Kennedy Round we agreed to discuss this subject with other countries. This was in keeping with the tradition that trading partners, when they have differences, should be willing to discuss them freely. We have refused, however, to have our countervailing duty law subjected to multilateral review, without simultaneous detailed examination of export subsidies of other countries, which are

the target of this statute. Unfortunately, more than a year of negotiation has failed to reach agreement on the terms of reference of this Working Party. The European Community has not found it possible to agree to a basic examination of all export subsidies.

Progress in the review of border taxes received a boost from President Johnson's New Year's Day Message in which he called for both short-term and long-term trade measures to improve our trading position:

"American commerce is at a disadvantage because of the tax systems of some of our trading partners. Some nations give across-the-board tax rebates on exports which leave their ports and impose special border tax charges on our goods entering their country.

"International rules govern these special taxes under the General Agreement on Tariffs and Trade. These rules must be adjusted to expand international trade further."

Border Tax Adjustments

In 1968 a new Working Party was established on the question of border taxes.

The rules of the GATT permit goods sold for export to be relieved of the indirect taxes the products would have borne if sold in domestic markets. There is no such privilege pertaining to direct taxes. Imported products are burdened with the domestic indirect tax. These rules were established over twenty years ago, when indirect taxes were low. In the late 1940's they were employed by relatively few countries, and covered only a small portion of the volume of goods traded internationally. With the rapid growth of world trade and the increased revenue needs of the industrial nations, the use of indirect taxes broadened and their levels rose to rates undreamed of in 1946. With regard to the experiences of recent years and the requirements of the future, it is necessary to renegotiate the GATT rules on border tax adjustments in order that they are more neutral or equitable with respect to trade.

The United States undertook this effort when it requested GATT in March 1968 to convene the Working Party agreed to in November, 1967. At the first meeting of the Working Party, last April 30, and in four subsequent meetings, the United States has explored, with its trading partners, the history, the provisions, and the implications of the existing GATT rules on border taxes. We have pointed out that countries which employ primarily a system of direct taxation are disadvantaged by the GATT trading rules, vis-a-vis countries that employ indirect taxes significantly. We have argued that there is absolutely no limitation under the existing rules of GATT on the degree of border tax adjustments permitted for indirect taxes. We

have also demonstrated a proliferation of these adjustments over the past few years. Finally we have pointed to the changes that the future will see in the adoption of indirect taxes by additional countries with the explicit objective of obtaining the trading advantages offered by the GATT rules on border taxes.

The United States delegation at the GATT has demonstrated that changes in the form of indirect taxes can also have an effect upon the patterns of trade. It is now clear that the provisions of the GATT lack precision and, therefore, encourage interpretations which frequently have the effect of improving a nation's trading position.

The time has now come to transcribe our understanding and new experience into constructive language in the GATT.

Temporary Border Adjustment for Balance of Payments Purposes

The President's New Year's Day Message stated:

"In keeping with the principles of cooperation and consultation on common problems, I have initiated discussions at a high level with our friends abroad on these critical matters—particularly those nations with balance of payments surpluses.

"These discussions will examine proposals for prompt cooperative action among all parties to minimize the disadvantages to our trade which arise from differences among national tax systems.

"We are also preparing legislative measures in this area whose scope and nature will depend upon the outcome of these consultations."

In the days following President Johnson's message, Under Secretary of State Katzenbach, Under Secretary of the Treasury for Monetary Affairs Deming, Ambassador Roth, the President's Special Trade Representative, and Ambassador to the Organization for Economic Cooperation and Development Trezise visited with officials of our major trading partners in Europe to discuss the United States balance of payments program. Under Secretary of State for Political Affairs Rostow made a similar trip to Asia.

These emissaries in addition to describing the elements of our new balance of payments program, emphasized the necessity of restoring confidence in the exchange markets and the need for cooperative action to support the international monetary system. They distinguished between the long-term effects to be achieved through negotiations in the GATT on rules governing border tax adjustments and consultations with our trading partners to consider the best temporary actions to improve the United States' trade account. In these extensive consultations, we explored whether a temporary United States export rebate and import surcharge would necessitate or provoke similar measures by others which would have the effect of neutralizing the benefits the United States was seeking.

An alternative scheme was suggested by some which had the benefit of demonstrating a responsive attitude and a multilateral approach toward achieving short-term benefits to the United States trade account. This involved a proposed *acceleration* of the timing of the Kennedy Round tariff cuts by our trading partners and a *deceleration* or postponement of the implementation of some of our own tariff cuts. This acceleration/deceleration proposal appeared promising; however, our trading partners linked the implementation of this scheme to legislative approval of the elimination of the American Selling Price (ASP) system of valuing certain chemicals and other goods for customs duty purposes—an American nontariff barrier of sorts.

The acceleration/deceleration proposal was not implemented and thus did not benefit our trade account in 1968. However, the principle of multilateral consultations on short-term trade measures to meet countries' temporary balance of payments problems was firmly established.

This important principle was employed during the Group of Ten Ministerial Meeting in Bonn in November 1968. The Federal Republic of Germany agreed to manipulate its border tax adjustments for the explicit purpose of reducing its trade surplus by a substantial amount. This was done in consultation with Germany's trading partners—and with their approval. Another outcome of this meeting and of the monetary crisis occurring at the time was a decision by the French Government to alter its tax system and its border tax adjustments in such a way as to benefit France's trading position, and thus to help France meet her short-term balance of payments problems. This was recognized to be an alternative during the course of the Bonn Meeting; France's trading partners have accepted these temporary measures designed to improve her trade account. In the circumstances, it is an appropriate alternative to the more permanent effect created by a change of parity.

The General Agreement on Tariffs and Trade in Article XII permits a country with balance of payments problems temporarily to employ direct measures to improve its balance of trade. These recent actions by Germany and France are new examples of direct measures that can be employed. The use of border tax adjustments by surplus and deficit countries to help improve a temporary balance of payments problem is an alternative preferable to quota restrictions and it could develop into an appropriate additional temporary measure under certain circumstances. Never substituting for appropriate fiscal and monetary policy and perhaps other measures, short-term border adjustments can contribute to the workings of the process by which balance of payments equilibrium is reestablished in a nation's accounts.

IV. An Intensified Program to Moderate the Foreign Exchange Costs of Government Expenditures Abroad for Security, Development and Other Activities

A. Military

1. Measures to Reduce the Net Impact of Military Expenditures Abroad

The Department of Defense has continued its efforts to minimize the net impact of its expenditures on our balance of payments. (These efforts were detailed in Tab B of the Treasury publication, "Maintaining the strength of the United States Dollar in a Strong Free World Economy," January, 1968.) Nevertheless, owing primarily to the continuing Vietnam conflict and wage and price increases overseas, DOD expenditures continued to increase during 1968. This increase, however, is expected to be markedly less than those experienced during 1966 and 1967. Defense expenditures worldwide increased from \$3.8 billion in 1966 to \$4.4 billion in 1967 and are expected to increase by some \$200 million in 1968 to a level of about \$4.6 billion. These increases have appeared largely in the Far East area. In Western Europe, we expect to achieve a slight decrease in expenditures during the year; nevertheless, these expenditures are still running at about \$1.6 billion annually.

In its efforts to restrain expenditure increases, DOD has continued programs in effect prior to 1968. Construction and subsistence expenditures abroad have been held down as a result of special efforts. In addition, new programs were undertaken to reduce the number of American civilians working overseas and the expenditures for official travel overseas as a part of government-wide efforts in these areas. During the year DOD also completed a redeployment of about 35,000 United States military personnel from Germany under previously announced plans.

Special efforts also were made during this past year to limit the foreign exchange impact of personal spending by American forces and their dependents in Europe. Primarily, DOD has encouraged individuals stationed overseas voluntarily to contain their spending on the local economy and to increase savings. Working within these guidelines, DOD undertook a general re-emphasis of its existing voluntary programs relating to personal spending, including (a) an expanded internal information program on the balance of payments problem and DOD programs, reaching military and civilian personnel

serving at home as well as overseas; (b) improved stocking of American goods in military exchanges overseas; (c) increased promotion of the use of American sales facilities; (d) re-emphasis of American controlled recreation facilities overseas; and (e) renewed emphasis on current savings programs.

It is recognized, however, that owing to price increases overseas as well as pay increases to American personnel, the ability of DOD to achieve substantial reductions in personal spending overseas depends primarily on the reduction of the number of personnel. Accordingly, DOD has undertaken new efforts, particularly in the areas of reducing staffs in overseas headquarters and streamlining overseas support and administrative operations in an effort to reduce the number of persons employed overseas.

2. Actions to Offset United States Expenditures by Encouraging Foreign Procurement in the United States of Military Equipment

As a part of the Action Program, we have intensified our efforts, particularly with the financially capable countries of Western Europe, to enlist their balance of payments cooperation through procurement of more of their defense needs in the United States. Additional military sales arrangements were consummated with a number of countries in Europe and elsewhere during the year. These sales will provide balance of payments benefits to the United States during the next several years. DOD receipts, stemming primarily from sales of military equipment, will decline about \$300 million from the 1967 level but will nevertheless total approximately \$1.2 billion on a global basis in 1968. In 1967, our receipts benefited from an unusually high level of payments from Germany to complete the existing offset arrangements.

3. Financial Neutralization

In order to assist in further neutralizing the deficit on the military account, we increased our efforts in 1968 to obtain special financial arrangements, principally through sales of long-term United States securities. We have made considerable progress in this area, particularly in Western Europe, and have commitments for about \$1.4 billion of cooperation in this form from other countries this year. If these materialize fully (through November about \$1 billion had been realized), we would reduce our net adverse balance in the military account to about \$2 billion. This would be an improvement of over \$600 million as compared to 1967. It should be noted, however, that these special transactions cannot be regarded as a satisfactory long-term solution to the deficit in our military account.

Cooperation in the military portion of the balance of payments has included countries in the Far East as well as Europe. However, we have focused particular efforts in Europe, both bilaterally and within NATO. In a broader sense, the United States has pursued with its NATO allies the principles that the Alliance requires a foundation of financial viability in addition to political and military strength, and that the members of the Alliance should cooperate through appropriate bilateral arrangements to deal with military balance of payments problems. The communique at the NATO Ministerial Conference in Brussels on November 16, 1968, specifically acknowledged for the first time as a multilateral policy that such cooperation strengthens the solidarity of the Alliance when it stated:

"They (the Ministers) also acknowledged that the solidarity of the Alliance can be strengthened by cooperation between members to alleviate burdens arising from balance of payments deficits resulting specifically from military expenditures for the collective defense."

B. Development Assistance

On January 11, 1968, the President instructed the AID Administrator to reduce overseas expenditures in calendar year 1968 by a minimum of \$100 million below the 1967 level—or to less than \$170 million. Preliminary estimates indicate that these expenditures will in fact be in the neighborhood of \$140 million in 1968—well below the target figure for the year.

The President also instructed AID to review and improve the effectiveness of the arrangements with individual countries to assure that AID-financed goods shipped to recipient countries will be additional to commercial exports from the United States to those countries. The principle here is to assure that the AID program results in a transfer of real resources rather than financial assets.

Our efforts to minimize the adverse balance of payments impact of our bilateral foreign assistance programs are well established and enjoy a high priority in our overseas foreign economic policy objectives. We have been very successful in this area to date. These efforts will have to be continued and reinforced wherever necessary.

In the future, we will have to place increased emphasis on assuring that original AID financing leads to an adequate level of follow-on commercial sales from the United States. This is primarily the responsibility of the American business community; however, it will be necessary to develop better liaison between the AID field staff and American exporters.

We have been pressing for policies and attitudes that give weight to balance of payments considerations in multilateral development activities. This year the Congress authorized a \$300 million contribu-

tion to the Fund for Special Operations of the Inter-American Development Bank. Disbursement of these funds will be controlled in such a way as to assure the financing of American exports which would not otherwise be financed. In addition, we have received assurances that the ordinary capital funds of the IDB will be managed so as to minimize their adverse impact on the U.S. balance of payments. The proposed International Development Association replenishment contained similar balance of payments safeguards. Most significantly, a good deal of progress has been made in 1968 in developing the capital markets of other countries, particularly those with balance of payments surpluses, as a source of long-term capital for development purposes.

The continuation of these balance of payments safeguards will be an important factor in enabling the United States to contribute, in full and fair measure, its share of the financial requirements of the multilateral development institutions. The premise is becoming well established that multilateral development activities should give adequate consideration to balance of payments factors, particularly in the cases of deficit countries. This premise supports the general proposition that the activities of these institutions should not be conducted in a manner which would exacerbate disequilibrium in international payments.

C. Reduction of United States Government Employees Stationed Abroad

The Government announced the initiation of an extensive two-phased program—called “BALPA”, short for “balance of payments”—to reduce the number of people employed abroad by the United States Government. Under BALPA, the number of direct hire Americans stationed abroad is being reduced by approximately 4,000, or 18 percent. The number of local employees is also being reduced by 4,000, or 16 percent.

The present schedule is to have 75 percent of Phase I of this program take place before the end of 1968, with the balance taking place in the first six months of 1969. Of the reductions under Phase II, 75 percent will take place before June 30, 1969, with the balance taking place in the third quarter of 1969.

Balance of payments savings under Phase I will total approximately \$20 to \$22 million on an annual basis after completion of the scheduled reductions. Completion of Phase II is expected to add additional savings of approximately \$8 to \$10 million per year. The balance of payments savings of the BALPA program have significance beyond the amounts involved. Implementation of this program will give evidence of the Government's determination to make its own contribution to the over-all balance of payments program.

V. An Intensified Effort for Temporarily Reducing Outflows of Capital from the United States.

Private capital outflows from the United States have played a vital role in the expansion of world trade and investment since World War II. The United States has been a major source of funds for capital-short areas; United States direct investment has helped to spread advanced technology and management skills; and our foreign investment has yielded good returns to the American investor and to the balance of payments of the United States.

In the 1960's, however, the large flows of investment abroad has been a major factor in the deficit of the United States. Although our net private international investment position has risen substantially throughout this decade, we have built up an increasingly high level of liquid liabilities to foreigners while accumulating non-liquid long-term investments overseas. This growing volume of liquid liabilities has been one factor in the instability of the international monetary system in times of stress.

The action measures on foreign investment announced January 1, 1968, struck directly at both shorter and longer-run needs. The new capital restraint programs were designed to strengthen the United States balance of payments in a major way in 1968 through the reduction of capital outflows and increased reflow of earnings from foreign investments. At the same time, the programs emphasized longer-range goals—to give priority to high yielding investments and to expanding American exports; to encourage the growth of European capital markets; and to assure the continuity of a liberal flow of direct investment in the less developed countries and areas traditionally dependent upon United States capital.

Direct Investment

The goal of the 1968 Foreign Direct Investment Program was to reduce the balance of payments deficit on direct investment by \$1 billion from the 1967 level. It appears that this mandatory program, administered by the Department of Commerce, will reach this target notwithstanding the exemption given to investment in Canada in March 1968.

Over 3,000 firms have effectively complied with this program. The regulations have not reduced the over-all level of foreign investment by United States companies. In fact, the total will likely set a record

high in 1968, thus providing a base for growing income from direct investment in future years. This sustained level of overseas activity, however, has been financed to a far greater extent from foreign sources of capital. Indeed, United States firms will have raised this year close to \$2 billion of long-term capital from foreign sources, thereby reducing their transfers of funds from the United States and their reliance on reinvestment of foreign earnings. At the same time, firms will have reduced their liquid balances held abroad and increased their remittances of foreign earnings.

In 1969, there is a clear need to preserve the savings achieved in 1968. Therefore, on November 15, 1968, the Secretary of Commerce announced a continuation of the Foreign Direct Investment Program, with modifications to adjust to the changing pattern of direct investment and the needs of American companies. Importantly, the program will introduce foreign earnings as a criterion for increasing the allowable direct investment of each company. It will also provide additional flexibility for firms with limited or no foreign investment experience; relieve inequities for companies that received investment quotas unusually low in relation to direct investment earnings; remove potential blocks to the growth of exports by American firms to their foreign affiliates; and reduce some unique problems for special industries which became apparent in 1968.

Foreign Lending

The Federal Reserve voluntary program announced on January 1, 1968, set reduced ceilings on loans from United States institutions to foreign borrowers to achieve a net inflow of at least \$500 million during the year. Savings for the balance of payments were to be achieved primarily by reducing outstanding United States bank credits to the developed countries of continental Western Europe.

The foreign credit restraint program has continued to function effectively in 1968. Banks reduced their foreign assets subject to the ceilings by \$469 million in the first quarter and by another \$193 million in the second quarter, compared with a target of \$400 million for the whole year. This early response to the Action Program contributed greatly to the rapid improvement in the United States balance of payments in 1968 and thus to renewed stability and confidence in international financial markets.

For the year as a whole, it is expected that banks will preserve most of the savings of over \$600 million achieved in the first ten months and that they will meet the target for the year. The non-bank financial institutions in the first half also bettered the targeted savings—a reduction of \$100 million of covered foreign assets. As in the case of the Department of Commerce program, these savings were achieved with-

out major dislocation of trade and investment. Here again, the rapidly growing international capital market has proved an effective alternative source of both bank loans and long-term investment funds.

In view of the necessity to preserve the savings achieved in 1968, the Federal Reserve Board has announced a continuation of the voluntary credit restraint program for the coming year. The basic ceilings on foreign lending will be maintained, and the guidelines will continue:

- to encourage lending institutions to give priority to export credits and loans to less developed countries in the use of any leeway;
- to ask banks not to renew or replace maturing term loans to continental Western Europe; and
- to provide leeway for banks to participate in export credits supported by agencies of the United States Government.

Interest Equalization Tax

In July, 1967, the IET was extended for two years with discretionary authority for the President to vary the rate of tax. In 1968, the rate was maintained at the level of $1\frac{1}{4}$ percent per annum, less than the permissible maximum. It served effectively to place a premium for American investors on portfolio investments and term loans to developed countries. This effective deterrent continued when interest rates in the United States and in other major capital markets gradually declined from the excessively high levels brought about by the crisis in international financial markets in late 1967 and early 1968.

VI. A Long-Range Program for Promoting Foreign Private Investment in United States Securities

Foreign investors have dramatically increased their net purchases of American corporate debt and equity issues since 1964. Net inflows (excluding liquidations by the United Kingdom) increased from \$147 million in 1965 to \$783 million in 1966 and to nearly \$1½ billion in 1967. Through the first three quarters of 1968 these purchases have increased to a record level of about \$3½ billion at an annual rate.

The promotion of foreign purchases of American securities has been an important part of the Government's program to improve the balance of payments since 1963. An Industry-Government Task Force in 1964 recommended a series of specific steps to increase inflows of foreign investment capital. One of the key elements in the recommended program called for revisions of the Internal Revenue Code to improve the tax status for foreign investors in the United States. Enactment of the Foreign Investors Tax Act of 1966 accomplished this goal. This was followed by a series of actions by various groups designed to provide foreign investors with better information on investment conditions in the United States.

A special industry group has also sponsored visits to the United States by key foreign investment decision-makers, in order to assist them in contacting policy-level officials in both industry and government. In addition, various segments of the American securities industry have expanded their contacts with foreign investment organizations by establishing new offices overseas and by devoting an increasing amount of attention to servicing the needs of foreign investors.

In addition, the Government has sought to develop a responsible fiscal and monetary policy which will insure the stability and continued growth of the economy of the United States in order to retain the confidence of foreign investors. These efforts have contributed importantly to improvements in the balance of payments, in general, and especially to the establishment of an improved two-way flow of investment capital between the United States and Europe.

Given the substantial increase in net volume of foreign funds flowing into American securities over the past several years, the extent to which this renewed interest by foreigners remains permanent will be important.

Foreign investors typically point to the relative technological superiority of the large American corporations, many of which are, in fact, international corporations headquartered in the United States. The high rates of earnings and reinvestment for continued growth by these firms are key reasons for renewed European interest in American corporate securities. The United States remains the largest single market in the world, with a strong steady growth rate equal to or better than that of most industrialized countries, and a tradition of political and social stability which seems increasingly crucial to investors in these days of national and international instability elsewhere. Investors see the United States as an eminently secure economy in which to hold a portion of their investment portfolios—both safely and profitably.

In addition, the basic features of the American securities market continue to be attractive to foreign investors. These features are the size of the equities market, the availability of information on corporate activities, and the added touch of credibility due to the efforts of the Securities and Exchange Commission and the work of the exchanges to police themselves.

In order to sustain investment inflows from abroad, we must insure that the American economy, both domestically and in terms of its international impact, continues its steady advance. This requires continuation of the Administration's programs to achieve growth with price stability at home and to maintain worldwide confidence in the dollar as a long-term investment vehicle as well as a fundamental transactions currency underlying international trade and payments.

VII. A Long-Range Program for Narrowing the Travel Gap Through Promotion of Foreign Travel in the United States and Temporary Measures to Reduce Travel Outlays Abroad by United States Residents

Results of our efforts to reduce the travel gap in 1968 have been disappointing. Although complete data will not be available until early next year, it seems clear that we will not reach our goal of saving \$500 million on the tourism account.

We have been more successful in implementing our long-range program to stimulate foreign travel to the United States than we have been in containing American travel abroad. Most recommendations made in the February report of the Industry-Government Special Task Force on Travel have been put into effect. Some, however, including the waiving of visa requirements for temporary visitors to the United States have not yet been implemented. Full implementation of all recommendations must be achieved before the United States can be said to have a meaningful program designed to attract foreign travelers to this country.

The Administration's short-term efforts to secure legislation in the Congress to reduce the outflow of tourist dollars abroad in 1968 were not successful. A bill reducing Customs exemptions and establishing a 5 percent ticket tax on international air travel passed the House of Representatives in June but failed to pass the Senate. The Administration's proposal to levy a graduated expenditures tax was not reported out by the House Ways and Means Committee.

On July 31, Secretary Fowler sent a letter to Senator Long, Chairman of the Senate Finance Committee, in which he proposed a method whereby the short-term and long-term efforts of the United States to reduce its chronic travel deficit could be combined. Under the proposal, a portion of the proceeds from the proposed ticket and expenditure taxes would be used, up to a limit of \$30 million per year over a five-year period, to fund our long-range effort to increase foreign travel to the United States. In this fashion, the proposed taxes would take on a dual character. In addition to accomplishing an immediate balance of payments saving by prompting American travelers abroad to keep their expenditures within reasonable bounds, the law would also constitute a positive measure to promote tourism to the United States. Both steps are necessary to bring our travel deficit within a manageable range. Funding the long-range travel program with reve-

nues raised from the short-term program should be the cornerstone of future United States programs in this area.

In summary, our progress in the travel area has been one of the most disappointing parts of our 1968 balance of payments program. We believe that the basic premises upon which we based our legislative recommendations to the Congress in 1968 are still valid, and that they will remain so in 1969. In the absence of meaningful measures to reduce the travel gap, we may well have an annual travel deficit of \$4 billion by 1975. The best way to reduce the travel gap is to encourage increased foreign travel to the United States. An adequately financed promotional program is, however, a *sine qua non* for achieving this.

VIII. Adjustment Responses Expected of Trading Partners

During 1968 the international payments pattern has been subject to large and, to some extent, unusual capital movements. During the first quarter these were associated with the large-scale speculation in gold. During the second and third quarters the French franc felt the impact of large-scale capital outflow, following the labor and student disturbances in May. The United States was the recipient of substantial inflows of capital for the purchase of portfolio stocks, and from large-scale borrowing from the Euro-dollar market by the American commercial banking system.

At the same time, the combined current balance of payments surplus of the European Community countries as a group appears to have increased even above the extremely high level of 1967, when it amounted to \$41¼ billion. Italy's current account surplus rose to nearly \$21½ billion, and Germany's to perhaps \$23¼ billion. The German trade surplus was again particularly striking, at about \$4 billion a year with imports figured to include insurance and freight, or over \$5 billion a year on a basis comparable to that used in United States trade figures.

These figures are cited to give some indication both of the importance of these large trade surpluses in sustaining the domestic economies in these two countries, and at the same time making it much more difficult for the United Kingdom and the United States to achieve an improvement in their trade and current accounts.

These developments in the current and capital accounts have led to questioning as to whether an adjustment pattern can be based over a longer period of time on an extremely high trade and current account surplus in the European Community, offset by a very large outflow of capital in the form of banking funds and portfolio investments. Partly because of the substantial reserve losses of the French, the European Community countries actually recorded a decline in reserves of \$1.1 billion in the first half of 1968, following a number of years in which these countries regularly added to their reserves at the rate of nearly \$1½ billion a year. This very substantial swing indicates the very large size of capital movements that can occur in a relatively short time when a currency comes under pressure.

Because of these capital movements, the dollar has been strong in the exchange market, and the United States has had a substantial official transactions surplus in 1968, as against a deficit measured on

this basis of \$3.4 billion for the entire year 1967. However, this structure of international payments may be vulnerable in the future. For example, if the German economy should begin to show signs of inflation, a tighter monetary policy would be likely to exert an especially strong restraining effect upon the purchases of foreign bonds, which have been quite large in 1968, and on investments in foreign money markets by the German commercial banking system. The equilibrating capital outflow would then decline much more rapidly, in the event of a German boom, than the corresponding reduction in the German trade surplus as domestic consumption of imported goods increased.

The ideal situation would be for the German and Italian economies to expand while avoiding a resumption of inflationary pressures are to base the expansion upon domestic demand factors, relying less upon the impetus to the domestic economy of the extremely large current and trade surpluses. The Italian economy could make effective use at home of the substantial amounts of real goods that are now being shipped abroad and financed by the export of capital. In fact the Italian authorities recognize that an equilibrium on current account as well as capital account is a desirable objective for Italy. The German authorities took steps in November to reduce the large current account surplus, although they still rely heavily on capital exports to avoid a rise in German reserves.

In sum, the first three quarters of the year 1968 have been marked by capital movements that have tended to strengthen the position of the dollar, as against earlier periods, although this has been partly associated with strain on the French franc. More attention is beginning to be devoted to the more deep-seated and difficult problem of achieving a pattern of trade surpluses and deficits that will be regarded internationally as more satisfactory than the present concentration of strong current account positions in the European Community countries, apart from France.

It is therefore to be hoped that the Continental surplus countries will find ways of relying to a larger extent upon domestic demand, rather than on foreign demand for their products, in maintaining the strength of their economies. Greater reliance on domestic demand would represent an important contribution by the surplus countries to the balance of payments adjustment process.



