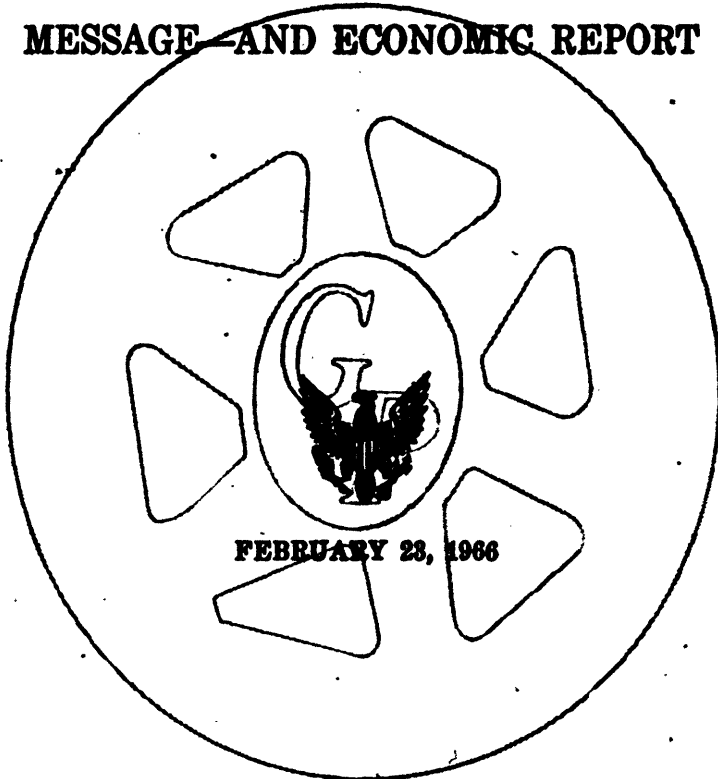


[COMMITTEE PRINT]

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

EXCERPTS FROM THE PRESIDENT'S 1966
STATE OF THE UNION MESSAGE—BUDGET
MESSAGE—AND ECONOMIC REPORT



(Prepared for the Use of the Committee on Finance)

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON: 1966

59-251

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INTRODUCTION

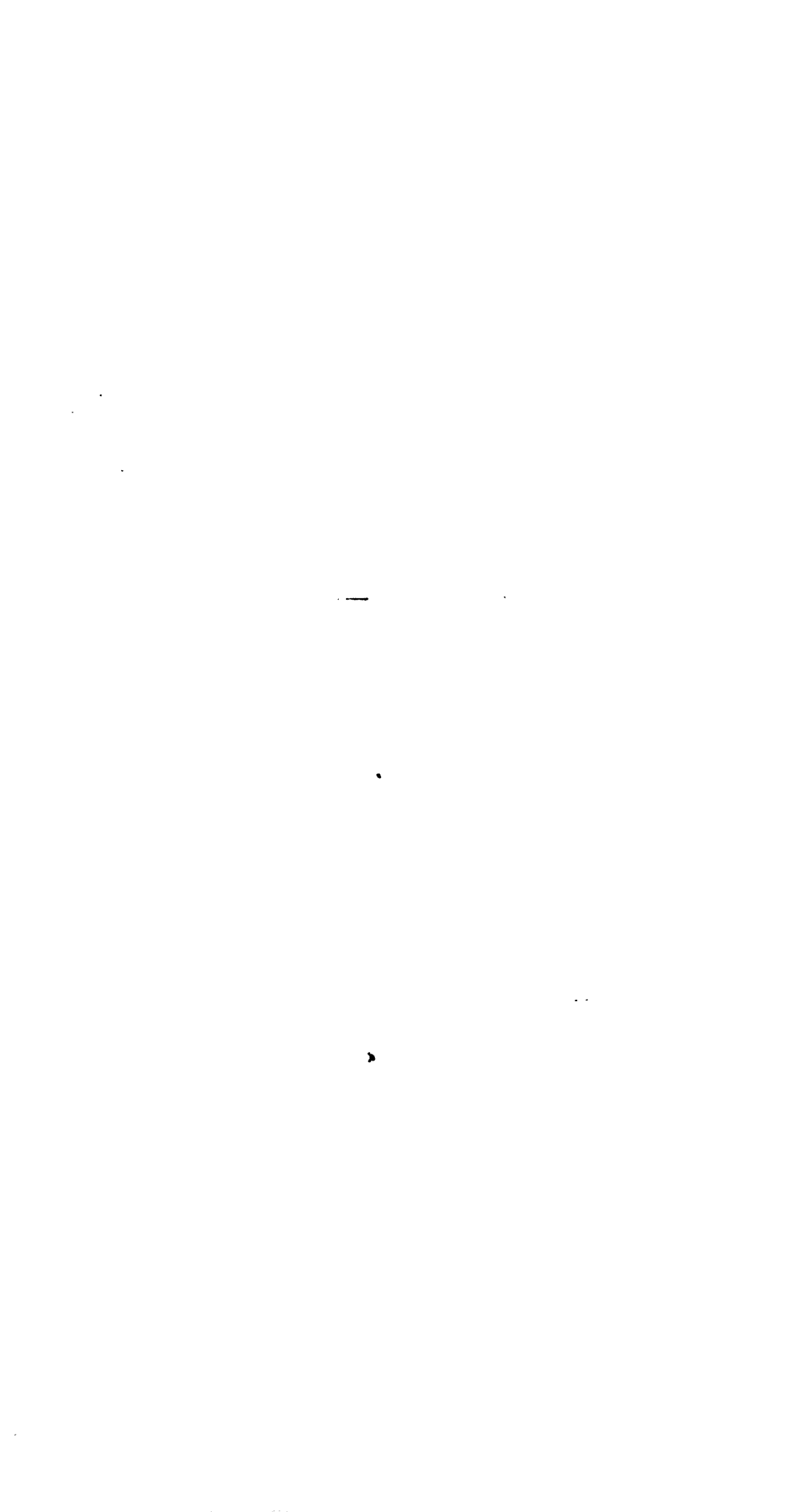
The President's important statements to Congress include several comments, or recommendations, of particular significance to the Committee on Finance. This pamphlet contains excerpts from three of these statements—the State of the Union Message of January 12, 1966, the Budget Message of January 24, 1966, and the Economic Report of January 27, 1966.

These excerpts relate to matters within the legislative jurisdiction of the Committee on Finance. Their consolidation is intended to facilitate the work of the Committee.



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STATE OF THE UNION MESSAGE—THE ADDRESS OF THE PRESIDENT OF THE UNITED STATES

Mr. Speaker, Mr. President, Members of the House and Senate, My Fellow Americans:

I come before you tonight to report on the state of the Union for the third time. I come here to thank you and to add my tribute once more to the Nation's gratitude for this, the 89th Congress.

* * * * *

I recommend that you make it possible to expand trade between the United States and Eastern Europe and the Soviet Union.

* * * * *

Because of Vietnam we cannot do all that we should or all that we would like to do. We will ruthlessly attack waste and inefficiency. We will make sure that every dollar is spent with the thrift and with the commonsense which recognizes how hard the taxpayer worked in order to earn it.

We will continue to meet the needs of our people by continuing to develop the Great Society.

Last year alone the wealth that we produced increased \$47 billion, and it will soar again this year to a total over \$720 billion. Because our economic policies have produced rising revenues, if you approve every program that I recommend tonight our total budget deficit will be one of the lowest in many years. It will be only \$1.8 billion next year.

Total spending in the administrative budget will be \$112.8 billion. Revenues next year will be \$111 billion. On a cash basis, which is the way that you and I keep our family budget, the Federal budget next year will actually show a surplus.

That is to say, that if we include all the money that your Government will take in and all the money that your Government will spend, your Government next year will collect one-half billion dollars more than it will spend in the year 1967.

* * * * *

I was informed this afternoon by the distinguished Secretary of the Treasury that his preliminary estimates indicate that our balance of payments deficit has been reduced from \$2.8 billion in 1964 to \$1.3 billion or less in 1965.

This achievement has been made possible by the patriotic voluntary cooperation of businessmen and bankers working with your Government.

We must now work together with increased urgency to wipe out this balance-of-payments deficit altogether in the next year.

* * * * *

I believe it desirable because of increased military expenditures that you temporarily restore the automobile and certain telephone

excise tax reductions made effective only 12 days ago. Without raising taxes or even increasing the total tax bill, we should move to improve our withholding system so that Americans can more realistically pay as they go; speed up the collection of corporate taxes; and make other necessary simplifications of the tax structure at an early date. I hope these measures will be adequate, but if the necessities of Vietnam require it, I will not hesitate to return to the Congress for additional appropriations or additional revenues if they are needed.

* * * * *

For those who labor I propose to improve unemployment insurance, to expand minimum wage benefits, and by the repeal of section 14(b) of the Taft-Hartley Act to make the labor laws in all our States equal to the laws of the 31 States which do not have tonight right-to-work measures.

* * * * *

And as the process of election becomes more complex and more costly we must make it possible for those without personal wealth to enter public life without being obligated to a few large contributors.

Therefore, I will submit new legislation to revise the present unrealistic restriction on contribution to prohibit the endless proliferation of committees, bringing local and State committees under the act, to attach strong teeth and severe penalties to the requirement of full disclosure of contribution, and to broaden the participation of the people through added tax incentive, to stimulate small contributions to the party and to the candidate of their choice.

* * * * *

We will work to strengthen economic cooperation, to reduce barriers to trade, and to improve international finance.

* * * * *

We follow this principle by building bridges to Eastern Europe. I will ask the Congress for authority to remove the special tariff restrictions which are a barrier to increasing trade between the East and the West.

* * * * *

Thank you and good night.

[Excerpts from the President's Budget Message]

BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

* * * * *

The budget for 1967 bears the strong imprint of the troubled world (7)* we live in.

It provides the funds we now foresee as necessary to meet our commitments in Southeast Asia. If our efforts to secure an honorable peace bear fruit, these funds need not be spent. Yet it would be folly to present a budget which inadequately provided for the military and economic costs of sustaining our forces in Vietnam. And those costs are substantial.

In this setting I have sought to frame a balanced program.

We are a rich nation and can afford to make progress at home while meeting obligations abroad—in fact, we can afford no other course if we are to remain strong. For this reason, I have not halted progress in the new and vital Great Society programs in order to finance the costs of our efforts in Southeast Asia.

But even a prosperous nation cannot meet all its goals all at once. For this reason, the rate of advance in the new programs has been held below what might have been proposed in less troubled times, many older and lower priority activities have been reduced or eliminated, and economies have been sought in every operation of the Government.

At the same time, I want to insure that the necessary increase (8) in budget expenditures is so financed as to promote economic stability. For this reason, I am proposing several tax measures designed to increase Federal revenues.

With this balanced program we can:

Meet our international responsibilities with firmness.

Maintain continued prosperity and economic stability at home.

Raise the productivity, earnings, and living standards of our poorer citizens.

Improve the quality of life for all citizens.

Preserve and protect our national resources for the generations to come.

And we can achieve these ends without unduly straining our economic resources or impairing our steady economic expansion.

* * * * *

FISCAL PROGRAM

This budget presents a responsible fiscal program. It accommodates (9) our foreign and domestic responsibilities in an environment of strong but noninflationary economic growth.

*Bold face figures in outside margins indicate page numbers in original documents.

The 1967 fiscal program consists of the following elements:

* * * * *

Second, I propose to supplement the expansion of Federal revenues which is a consequence of economic growth by a series of tax measures which will yield \$1.2 billion in fiscal year 1966 and \$4.8 billion in 1967:

A plan for improving the pay-as-you-go effectiveness of the withholding system on personal income taxes.

A corresponding plan to accelerate the transition of corporate income tax payments to a full pay-as-you-go basis.

A temporary reinstatement of the excise taxes on passenger automobiles and telephone service which were reduced at the beginning of this calendar year and deferral of the further reductions scheduled in the future.

Third, the combined increase in revenues from economic growth and from my tax proposals will amount to \$11.0 billion in 1967. This is substantially larger than the growth in administrative budget expenditures. In fact, it virtually covers the total special costs of operations in Vietnam as well as the small increase in regular budget expenditures from 1966 to 1967.

* * * * *

c) *Fifth*, on a consolidated cash basis—which is the most comprehensive measure of budget totals—the 1967 budget will show a surplus of \$0.5 billion.

No one can firmly predict the course of events in Southeast Asia. They depend not only upon our own actions but upon those of our adversaries. As a consequence, ultimate budgetary requirements could be either higher or lower than amounts I am now requesting. Prior experience shows that such estimates are extremely difficult to make. During the Korean war, for example, actual military expenditures fell substantially below the original budget estimate. The amounts which I am presenting here reflect the best judgment which can be made at this point in time.

Because of the uncertainties inherent in this situation, the 1967 budget is designed to provide flexibility of response to changing conditions. In the new programs authorized by Congress in the last several years, we have an effective array of weapons to attack the major domestic problems confronting the American people—in the fields of health, education, poverty, housing, community development, and beautification. The 1967 budget provides funds to press forward vigorously with these new programs. But because of the costs of maintaining our commitment in Vietnam, those funds are, in many cases, less than the maximum authorized in the enabling legislation. Should our efforts to find peace in Vietnam prevail, we can rapidly adjust the budget to make even faster progress in the use of these new programs or the solution of our domestic problems.

If, on other hand, events in Southeast Asia so develop that additional funds are required, I will not hesitate to request the necessary sums. And should that contingency arise, or should unforeseen inflationary pressures develop, I will propose such fiscal actions as are appropriate to maintain economic stability.

* * * * *

FEDERAL REVENUES

Since 1962, private demands for investment and consumption have (13)
 been stimulated by several major tax revisions. The stimulus result-
 ing from these tax changes has been the single strongest contributor
 to 5 full years of sustained economic growth. In the current year,
 private wage earners and investors are benefiting from tax reductions
 totaling \$20 billion as a result of:

The Revenue Act of 1962, highlighting an investment tax credit
 for business.

Liberalized depreciation allowances.

The Revenue Act of 1964, providing a record cut in personal and
 corporate income tax rates.

The Excise Tax Act of 1965, authorizing a broad program to
 abolish most Federal excise taxes and reduce others.

Despite this massive tax reduction, administrative budget receipts
 under existing legislation are estimated to be about \$21 billion greater
 in 1966 than they were 5 years earlier in 1961. This increase is more
 than double the increase during the previous 5 years, when there were
 no significant tax cuts. Thus, we have a clear illustration of the direct
 relationship between tax policies, economic growth, and Federal
 revenues.

* * * * *

Tax policy, however, must be used flexibly. We must be equally (14)
 prepared to employ it in restraint of an overly rapid economic expan-
 sion as we were to use it as a stimulus to a lagging economy.

The current situation calls for a modest measure of fiscal restraint.
 As a consequence, I am recommending a tax program which consists
 primarily of desirable reforms in tax collection procedures, having the
 effect of increasing revenues in the current and coming year. In
 addition, I am proposing the deferral of certain scheduled excise tax
 reductions.

Larger corporations are beginning the third step of a seven-stage
 transition to a full pay-as-you-go system for corporate income taxes by
 1970. I propose that this transition be accelerated this year and com-
 pleted in 1967 to produce increased corporate tax collections of \$1.0
 billion and \$3.2 billion, respectively.

Similarly, higher income individuals now find that withheld taxes
 under the existing flat-rate system fail to cover the full tax liability
 at the end of the year. Establishment of a graduated withholding
 system will increase tax collections by \$0.1 billion in fiscal 1966
 and \$0.4 billion in 1967, without a change in total personal tax
 liabilities.

In the case of the self-employment social security tax, individuals
 may now elect to make payments annually instead of quarterly. By
 requiring these payments to be made quarterly, trust fund receipts will
 be increased by \$0.1 billion in both fiscal 1966 and fiscal 1967.

Together, these three changes in collection procedure will put higher
 income individuals and corporations closer to the full pay-as-you-go
 schedules which now apply to moderate and lower income wage
 earners.

However, it is desirable that the economic impact of these three col-
 lection speedup reforms should be supplemented by temporarily

rescinding reductions in excise tax rates on automobiles and telephone service which took effect in January of this year and by postponing the reductions in rates on these items now scheduled to take place in the future. Together these temporary tax measures will yield \$0.1 billion in 1966 and \$1.2 billion in 1967.

An increase in the payroll tax rate and wage base to finance higher social security benefits and the new hospital insurance programs took effect on January 1, 1966. A further increase in the rate will occur on January 1, 1967, under existing law. These increases are expected to provide additional trust fund receipts of \$1.5 billion in fiscal year 1966 and \$6.2 billion in 1967.

(15) The nature of many government services is such that they should be provided without any charge or with only a nominal charge. However, in certain cases when a Government program provides special benefits or privileges to specific, identifiable individuals or businesses, appropriate user charges should be initiated. To this end, legislation will be proposed when necessary, and equitable user charges will be instituted administratively where authority exists to do so.

This budget proposes a number of new or increased charges, the largest of which are in the transportation field. I again urge the Congress to enact legislation so that the primary beneficiaries will defray a larger part of the costs incurred by the Federal Government in providing transportation facilities and services to these beneficiaries.

Increased highway user charges are essential for completing the Interstate Highway System on a pay-as-you-go basis and for financing certain additional activities of importance to highway travelers, such as safety programs.

The users of the airways bear substantially less than the full cost of the Government investments and services upon which they rely. Accordingly, I am recommending an increase in the passenger ticket tax, increased taxes on fuels used by general aviation, and a new tax on air freight. Receipts from the fuel tax on general aviation which now go into the highway trust fund should be retained in the general fund.

The facilities of the inland waterways system, which have been improved steadily by the Federal Government, presently are available to general and commercial users free of charge. I propose that they meet a portion of the cost of the system through a fuel tax.

* * * * *

FEDERAL PROGRAMS AND EXPENDITURES

* * * * *

(26) *Health, labor, and welfare.*—Outside of defense, the Federal Government's largest outlays are devoted to improving the Nation's health, protecting workers and their families against loss of income, and assisting the disadvantaged to overcome poverty and unemployment.

Last year, the Congress enacted more than a score of major bills which will advance us toward the goal of a better and more secure life for our citizens. This was an unsurpassed achievement. However, there are still a number of important gaps which we should begin now to fill.

Health: Last year, the enactment of Medicare marked a milestone in the social history of the United States. To make that legislation

effective and to assure that the American people have access to high quality medical care at reasonable costs, we need to concentrate our efforts on the provision of adequate medical facilities and manpower. The 1967 budget is designed to that end. Increased funds are made available under legislation enacted last year to help educate more doctors, dentists, nurses, and graduate public health personnel. Funds are also provided for newly enacted programs to increase the number of community mental health centers and help support their staff. I shall propose legislation to assist our communities in modernizing and replacing older hospitals. Similarly, legislation should be enacted to extend training assistance to medical assistants and other health personnel not now eligible. (27)

* * * * *

Labor: I urge enactment of legislation to:

Provide long-needed improvements in our unemployment compensation system.

Repeal Section 14(b) of the Taft-Hartley Act.

Increase the minimum wage and extend protection of the Fair Labor Standards Act to over 5 million more workers.

* * * * *

Other aids to the needy: I intend to propose legislation to:

Strengthen programs giving assistance to unemployed parents of needy children by providing work experience, services, and training to equip them for regular employment. (28)

Improve the nutrition of needy children.

Older programs will be redirected, shifting more of their resources to helping the disadvantaged:

The school lunch and special milk programs will focus more on needy children, helping to provide them with adequate and well-balanced meals.

The public assistance program will provide more financial aid and better medical care to families with dependent children.

The Federal-State vocational rehabilitation program will enroll more handicapped persons who are receiving public assistance.

* * * * *

Veterans benefits and services.—The Nation properly provides special help to those who suffer disabilities while in the service of our country; this help is extended through programs of income maintenance, vocational rehabilitation, and medical care. We also have a continuing obligation to the widows and children of those who have died in performing military service. (29)

The first session of the 89th Congress recognized both of these basic trusts by:

Increasing disability compensation payments.

Liberalizing vocational rehabilitation benefits.

Affording more generous allowances for children receiving educational aid under the War Orphans Act.

Providing a new program of insurance coverage for men in our uniformed services.

- (30) We are currently engaged in armed conflict and have called upon the youth of our Nation to serve in that conflict. We should develop and expand programs to ease their readjustment to civilian life by providing education and training assistance.

The 1967 budget also provides for further improvements in the high quality of medical care administered in VA hospitals. New services will continue to be added to bring to veterans the latest advances of medical science.

Veterans programs should continue to emphasize the needs of the service-disabled. All veterans and their families are, of course, eligible to participate in the steadily improving general health, education, and welfare programs provided by the Government for all citizens.

* * * * *

PUBLIC DEBT

The size of the public debt varies from year to year primarily as a result of the Government's surplus or deficit. Based on the estimates of receipts and expenditures in this budget, the debt on June 30, 1966, will be \$320.0 billion. On June 30, 1967, it will have risen to \$321.7 billion.

- (31) Present law provides a temporary debt limit of \$328 billion until June 30, 1966. After that date—if no action is taken—the limit will revert to the permanent ceiling of \$285 billion. It is necessary, therefore, that the ceiling for the period after June 30, 1966, be raised.

A workable debt limit should allow for two factors in addition to the estimated size of the debt at the end of fiscal year 1967:

Seasonal fluctuations in the size of the debt.

The need for flexibility in managing the debt.

The first is necessary to allow for periods when the debt will exceed the end-of-year total. This results from the seasonal pattern of receipts, which are lower in the first half of the fiscal year.

Adequate provision for flexibility will permit the Treasury to take full advantage of favorable market conditions and thus avoid unnecessary interest costs.

* * * * *

IMPROVING GOVERNMENT MANAGEMENT

* * * * *

- (33) *Substitution of private for public credit.*—In recent budgets, I have pressed for the encouragement of private financing in the major Federal credit programs wherever I have felt it to be consistent with the public interest. I will need the cooperation of the Congress to carry this effort still farther in the coming year.

This is an important and sensible way to manage our Federal credit programs. I, therefore, urge prompt action on legislation being proposed to authorize a considerable expansion in the sale of participations in Government loans. The budget assumes its enactment. With the authority provided by such legislation, my budget proposals for encouraging the substitution of private for public credit will reduce 1967 expenditures by \$4.7 billion from what they would have been otherwise.

* * * * *

LYNDON B. JOHNSON.

JANUARY 24, 1966.

ANALYSIS OF RECEIPTS BY SOURCE

(54)

This section of the budget presents detailed information about the revenue estimates and the recommended changes in tax laws.

Economic base of estimates.—Continued economic expansion is expected to raise gross national product to \$722 billion in calendar year 1966, an increase of \$46.4 billion over calendar year 1965. This projection should be considered as the midpoint of a \$10 billion range, from \$717 billion to \$727 billion. Personal income and corporate profits will rise with the growth in output.

With the proposed substantial increase in Federal spending added to the expected further strong rises in private investment and consumption, the GNP growth of 7% will bring the economy sufficiently close to full employment of its resources to raise the threat of price instability. Therefore, moderate restraint through tax policy—rather than the tax stimulus applied in 1962, 1964, and 1965—is being recommended.

Some economic restraint will result from the increases in the social security tax rates and wage base which became effective on January 1, 1966; and the increased user charges proposed in this budget will also have some restraining effect.

Calendar year tax collections will be increased by \$500 million in 1966 as a result of enactment of the proposal to reinstate the pre-January 1966 excise tax rates on automobiles and telephone service. Other legislative proposals which will moderate the growth of private demand consist of changes in tax collection procedures which will place the payment of income and self-employment taxes on a more current basis without changing final tax liabilities. These collection changes will add \$2 billion to tax receipts in calendar 1966, although there will be automatic offsets by lower final settlements in subsequent years.

The revenue estimates in the budget for 1967 are based on the following economic assumptions, including the effect of the proposed tax legislation on incomes:

Economic assumptions

[Calendar years. In billions]

	1964 actual	1965 preliminary	1966 estimate
Gross national product.....	\$628.7	\$675.6	\$722
Personal income.....	495.0	530.7	567
Corporate profits before taxes.....	64.8	74.6	80

Given the tax rates and structure, the level of aggregate economic performance is the primary determinant of tax revenues. However, estimates of tax revenues cannot be derived directly and simply from the assumed levels of economic performance. Several important factors intervene, including the timing of tax payments, differences between the definitions of statutory and economic incomes, and the distribution of various forms of income among taxpayers. (55)

Receipts from the public

(Fiscal years. In millions)

	1965 actual	1966 estimate	1967 estimate
Administrative budget receipts:			
Individual income taxes.....	\$48,792	\$51,400	\$56,240
Corporation income taxes.....	28,461	29,700	34,400
Excise taxes.....	10,911	9,169	8,879
Estate and gift taxes.....	2,716	2,932	3,301
Customs.....	1,442	1,655	1,845
Miscellaneous budget receipts.....	3,749	5,143	6,333
Subtotal, administrative budget receipts.....	93,072	100,000	111,000
Trust fund receipts:			
Employment taxes.....	16,908	18,819	24,339
Deposits by States, unemployment insurance.....	3,052	2,900	2,900
Excise taxes.....	3,659	3,859	4,378
Federal employees retirement systems.....	2,173	2,222	2,244
Interest on trust funds.....	1,770	1,822	1,978
Veterans life insurance premiums.....	488	460	460
Other trust fund receipts.....	3,001	3,427	3,286
Subtotal, trust fund receipts.....	31,047	33,539	41,608
Intragovernmental and other noncash transactions.....	-4,420	-5,385	-7,069
Total, receipts from the public.....	119,699	128,154	148,539

Estimated changes in revenues.—Total receipts from the public are estimated at \$145.5 billion in fiscal year 1967, an increase of \$17.4 billion over the level estimated for fiscal year 1966.

Individual income tax receipts are estimated at \$56.2 billion in fiscal 1967, \$4.8 billion higher than in 1966. Higher personal incomes will yield a substantial increase in receipts.

Corporation income tax receipts will reach an estimated \$34.4 billion in 1967, a rise of \$4.7 billion above fiscal 1966. Tax liabilities are increasing, as do corporate profits before taxes, in response to the continuing growth in the economy. Tax collections in 1966 and 1967 will rise faster than corporate pre-tax incomes as the proposed stepped-up acceleration of corporation payments on estimated tax liabilities becomes effective.

Excise tax receipts in the fiscal year 1967 administrative budget will amount to \$8.9 billion, \$290 million less than 1966. The restoration of the automobile and telephone and teletypewriter excise taxes will partially offset the permanent excise tax repeals that went into effect on January 1, 1966. Enactment of the proposed transportation user charges also will yield higher excise tax collections for both the general fund and the highway trust fund.

Miscellaneous receipts will increase by \$1.2 billion to \$6.3 billion in 1967. Seigniorage receipts will increase from \$117 million in 1965 to \$901 million in 1966 and \$1,568 million in 1967, reflecting full-scale production of coins with the new metallic composition authorized by the Coinage Act of 1965. Receipts will also rise as revenues from previously disputed Outer Continental Shelf lands are released from escrow and as the British Government resumes principal and interest payments on its loans.

Employment taxes will produce an increase in receipts to \$24.3 billion in 1967 from \$18.8 billion, developing primarily from the first full year of collections under the higher social security tax rates and larger wage base which became effective on January 1, 1966. At that time,

the combined employee-employer tax rate was raised from 7.25% to 8.4% and the covered annual wage base was raised from \$4,800 to \$6,000. A further increase in the combined tax rate, to 8.8%, is scheduled under existing law for January 1, 1967.

Proposed legislation.—This section summarizes the revenue proposals recommended for action this year.

Individual income tax: The proposed graduated withholding schedule on wage and salary income tax liabilities affects the timing of tax payments during the year, but it does not change the tax liabilities. At the present time, a flat 14% is withheld on taxable wages and salaries; this corresponds to the tax rate on the lowest income bracket, and it is applied regardless of the amount of income. As a result, the taxes withheld on higher bracket wage earners is generally too small. The proposed new schedule would increase the amounts withheld as taxable wages and salaries increase, and thereby would reduce underwithholding to a smaller proportion of total income tax liability. The new withholdings schedules are assumed to become effective on May 1, 1966, increasing receipts by \$400 million in fiscal 1967 and \$95 million in fiscal 1966.

Corporation income tax: Under present law, quarterly payments on estimated tax liabilities greater than \$100,000 per year are being adjusted to a schedule that would run concurrently with the accrual of tax liabilities during each tax year and would reach an even quarterly pattern by calendar year 1970. The legislation proposed in this budget would require a more rapid adjustment and would complete the transition in the 1967 tax year. Collections of corporation income tax payments would increase by \$1.0 billion in fiscal 1966 and by \$3.2 billion in fiscal 1967. The estimates assume the accelerated schedule would first apply to payments due April 15, 1966. (57)

Excise taxes: Excise tax rates on automobiles and general and long distance telephone and teletypewriter services would be restored to the rates in effect before January 1, 1966, and the successive reductions scheduled for the future would be deferred. The estimates assume that (1) the telephone and teletypewriter taxes would return to 10% on April 1, 1966, and (2) the tax on automobiles would return to 7% from 6% on March 15, 1966. On this basis, excise tax receipts would rise by \$60 million in the current fiscal year and by \$1.2 billion in fiscal year 1967.

Self-employment social security tax: A quarterly payment of the estimated social security tax on self-employed persons also is proposed. It would ease the taxpayer's problem of making a single, large payment of his tax liability after the end of the tax year. The proposal is assumed to be enacted in time for the first quarterly payment to be made on June 15, 1966. It will increase trust fund receipts by \$100 million in both fiscal 1966 and 1967.

Federal unemployment tax: Legislation to revise the unemployment insurance program should be enacted. The new program is not expected to affect receipts until after fiscal year 1967.

User charges: Legislation authorizing additional user charges and extending others is recommended, in keeping with the policy that a greater share of the costs of certain programs which provide special benefits or privileges should be borne by identifiable primary beneficiaries. The user charges program also is being extended by admin-

istrative action throughout the executive branch where legislative authority exists, and present charges are reexamined regularly to assure that they adequately reflect the costs incurred.

Certain of the transportation user charges proposals which were proposed last year are being modified to take into account recent growth in transportation traffic.

(58) The tax on air passenger traffic should be raised from 5% to 6% until January 1, 1969. A tax of 2% on air freight waybills should be instituted and an additional 2% added on January 1, 1969, raising this tax to 4%. The growth of air transportation should generate sufficient receipts from these taxes to meet commercial aviation's share of the cost of the Federal airways. Accordingly, the present 2 cents per gallon tax on gasoline used in commercial aviation should be repealed, leaving fuels used in commercial aviation untaxed. Gasoline and jet fuels used in general aviation should be taxed at 4 cents per gallon, and all of the receipts should be retained in the general fund.

Revised estimates of construction costs and the inclusion of new programs in the highway trust fund necessitate some tax increases and a short extension of the fund. The tax on diesel fuel should be raised, and the use tax on heavy trucks should be levied according to a scale graduated by weight. These increases would move the contributions by truckers closer to their share of highway costs. The expiration date of the highway trust fund should be extended until February 28, 1973. Increased revenues for the trust fund would permit financing (1) continued construction of the Federal-aid highway systems, (2) forest and public lands highway programs, and (3) a new highway safety program. The highway beautification program enacted last year should be financed by explicitly designating 1 percentage point of the automobile excise tax for the program and transferring it into the trust fund.

A user charge of 2 cents per gallon is proposed on fuel used by vessels navigating the inland waterways.

User charges are also being recommended in several other programs. Some of these charges would become miscellaneous receipts of the general fund, and in other instances, they would be used directly to offset the costs of operation. Examples include: (1) meat and poultry inspections; (2) commodity inspection and classification, and warehouse inspection and licensing; (3) administration of workmen's compensation and safety programs for longshoremen and harbor workers; and (4) overtime border inspections of private vessels and aircraft. In addition, user charges will be proposed to remove the statutory prohibitions or limitations on fees charged for several programs administered by the Attorney General and the Secretary of the Treasury.

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ANALYSIS OF FEDERAL PROGRAMS

Substitution of private for public credit.—Federal agencies will (71) provide substantial credit aids in fiscal year 1967 to help carry out a wide variety of Government programs. Only a small fraction of this aid will entail Federal expenditures. The great bulk will be in the form of Government guarantees of private loans, rather than direct Government loans. Recently enacted authority to encourage insurance of private loans to students and for rural housing will further reduce reliance upon direct Federal loans. In addition, the amount of public credit has been reduced in recent years as a result of substantial sales of direct loans to private financial institutions.

All major direct loan programs of the Federal Government have recently been evaluated with the objective of substituting private for public credit wherever feasible and consistent with the purposes of the programs. On the basis of this evaluation, legislation is being recommended to make a much broader range of Federal loans available for private investment by authorizing sales of participations in pools of such loans. In the past, such participation sales have been highly successful in expanding the market for loans of the Export-Import Bank, the Federal National Mortgage Association and the Veterans Administration. The net effect of this legislation on the budget will be to increase receipts from asset sales by an estimated \$350 million in 1966 and \$2.8 billion in 1967. Total sales of all types under existing and proposed legislation are estimated to rise from \$1.6 billion in 1965 to an estimated \$3.3 billion in 1966 and \$4.7 billion in 1967. These additional receipts will cause corresponding reductions in 1967 budget requirements.

Federal expenditures and the balance of payments.—The deficit in the Nation's overall balance of payments in calendar year 1965 was reduced by about 50% from the 1964 level. The major reason for this substantial improvement was the large drop in the outflow of (72) private capital following actions taken in February 1965 to extend the interest equalization tax to shorter term loans and to initiate a broad program of voluntary restraints on investments abroad by banks and other private business concerns. Income from foreign investments also increased sharply in 1965. These factors more than offset a decline from 1964 in the export surplus of goods and services.

In recent years, actions taken by the Federal Government to reduce the impact of its regular activities on the balance of payments have contributed significantly to the improvement in our overall position. Federal overseas expenditures were reduced by \$715 million between fiscal years 1963 and 1965. Government receipts from abroad also declined during the same period, but much less sharply.

The net outflow abroad (payments less receipts) from regular transactions of the Federal Government declined by 20% between 1953 and 1965. Apart from the costs of special Vietnam operations this net outflow is estimated to decline by another 6% between 1965 and 1967.

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COMMERCE AND TRANSPORTATION

Transportation.—

- 08) In fairness to the taxpayers and to encourage efficient use of Government-financed transportation facilities, the substantial benefits received by travelers and shippers from Federal expenditures on highways, airways, and waterways should be paid for by the users of these facilities in larger measure than is now the case. Accordingly, recommendations are being made for new or increased transportation user charges; these recommendations are discussed in Part 3 of this budget. (See pages 11 and 12.)

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- 1) Highways: Federal highway outlays, financed primarily from the highway trust fund, will increase by \$135 million in 1967 to \$4.2 billion. Nearly three-quarters of this total is for the 90% Federal share of the cost of the Interstate Highway System. The 41,000-mile system, now more than half finished, is estimated to cost a total of \$46.8 billion, of which the Federal share is \$42 billion. Most of the remaining 1967 highway expenditures are for the primary and secondary road programs. Legislation is being recommended to extend these latter programs for 2 years at the current annual level of \$1 billion.

Legislation is also proposed to transfer financing of forest highways, public lands highways, and the programs authorized by the Highway Beautification Act of 1965 to the highway trust fund.

The highway expenditures remaining in the administrative budget are for a special developmental highway construction program for the Appalachian region. These expenditures are estimated to increase by \$82 million to an estimated \$102 million in 1967.

Revenues accruing to the highway trust fund under current legislation are insufficient to provide for (1) the currently estimated Federal share of the cost of the Interstate Highway System, (2) an expanded highway safety program, and (3) the programs proposed for transfer to the trust fund. Therefore, legislation is again being requested to increase highway user taxes. Legislation will also be proposed to finance highway beautification costs by transferring to the trust fund receipts equal to 1 percentage point of the existing auto excise tax, explicitly designated for this purpose.

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HEALTH, LABOR, AND WELFARE

- 2) Federal health, labor, and welfare programs play a major role in promoting the well-being of the American people. Through these programs, better medical care and treatment is made accessible, job opportunities are increased, the income of the aged and others not in the labor force is sustained, and the poor and needy are helped to become self-sufficient. In 1967, payments to the public for the Federal Government's health, labor, and welfare activities are estimated to increase by \$5.2 billion over 1966 to a total of \$39.3 billion. About three-fourths of these outlays will be made through trust funds financed by special taxes.

The increase in total payments in 1967 is mainly for the first year's cost of benefits under the programs of hospital insurance and other health services to older Americans enacted in 1965. The payments for these new programs will be made from a trust fund and are expected to total \$3.3 billion in 1967. Outlays from trust funds for social security and other income maintenance programs are estimated to rise by over \$1 billion. Additional increases totaling \$897 million will provide for expanded public health and vocational rehabilitation services and for a buildup in efforts to combat poverty.

Health services and research.—The first session of the 89th Congress enacted 12 major health measures, including provision of better health care for the aged and for needy children, expansion of health-related professional schools and medical libraries, improved treatment of various illnesses, and increased efforts to combat air and water pollution. The Department of Health, Education, and Welfare is taking steps to organize and administer these and other health programs effectively.

Total payments to the public for health services, research, training, and related activities, including trust fund outlays, are estimated to increase by \$3.6 billion over 1966 to a level of \$6.1 billion in 1967.

Health services for the aged: Public and private costs of medical services provided to the Nation's 19 million aged persons are estimated at \$8 billion in 1967. Almost one-half of these costs will be met by the new health insurance programs and by medical assistance to the aged provided under public assistance.

Outlays in 1967 from the hospital and supplementary medical insurance trust funds are estimated at \$2.4 billion for the new hospital insurance program and \$899 million for the supplementary medical insurance program, which is primarily for doctor bills. (120)

Administrative budget expenditures of \$833 million are estimated to be paid in 1967 to these trust funds, including: (1) \$283 million to provide hospital insurance for the aged who are not covered under the social security or railroad retirement systems and (2) \$550 million to match the \$3-per-month premium payments being made by aged persons who will enroll voluntarily by April 1, 1966, in the supplementary medical insurance program.

Medical assistance grants will be made to the States to help about 860,000 aged persons meet the required premiums or costs not covered by the new insurance. However, these grants are estimated to decline by \$75 million to a total of \$289 million in 1967.

The two new insurance programs will pay State and community hospitals for care provided to the aged. Legislation will be proposed to permit these insurance programs to make similar payments to Federal hospitals for care provided to beneficiaries.

Maternal and child health: Expenditures totaling \$215 million will be made in 1967 by the Children's Bureau to support State and local maternal and child health programs in selected areas. These programs will be expanded by \$41 million over 1966 principally to provide comprehensive medical diagnosis and treatment for expectant mothers, infants, and school-age children in families which cannot afford the cost of medical care.

In addition, some of the savings in the program for medical care for the needy aged will be used to increase and improve the extent and

quality of medical care provided to other needy people—particularly children.

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- 126) *Social security and public welfare.*—The 1965 Amendments to the Social Security Act increased the cash benefits provided under the system and extended its coverage. Now practically all workers and
 127) their families are provided protection against the loss of earnings due to death, total disability, or retirement either through the basic social security system or through the special systems for railroad and Federal workers.

Expenditures of \$24.9 billion are estimated for 1967 from the trust funds for old-age, survivors, and disability insurance; for railroad retirement; and for retirement programs for Federal employees. These expenditures reflect both the continued growth in numbers of beneficiaries of these programs and increases in benefits. The increase of \$1.2 billion estimated from 1966 to 1967 is smaller than would be expected, because nonrecurring payments of \$830 million were made in September 1965 to cover the 7% increase in social security benefits retroactive to January 1, 1965.

The protection provided by these systems is financed by payroll contributions shared by employers, employees, and also paid by the self-employed. Receipts of the retirement and disability trust funds in 1967 are estimated at \$27.7 billion, an increase of \$4.5 billion over 1966. Most of this rise is in the social security system, reflecting (1) the full year's effect of the January 1, 1966, increase in the wage base from \$4,800 to \$6,600 and in the combined payroll tax rate from 7.25% to 8.4%, and (2) a further increase in the combined payroll tax to 8.8%, scheduled for January 1, 1967. These new rates also cover the new hospital insurance program.

To help meet rising workloads more efficiently, the Social Security Administration will further extend the use of automatic data processing in its recordkeeping and computational operations in fiscal year 1967. About \$12 million will be saved by procedures which will automatically recompute individual benefit amounts based on changes in earnings after retirement.

Federal payments are made each year to the railroad retirement system to liquidate the Federal Government's obligation to that system for credits for past military service. This budget includes expenditures of \$17 million in 1967 for the third of 10 installments and \$105 million as the second of 50 installments to liquidate a similar obligation to the social security system.

- 128) *Public assistance:* As indicated earlier, Federal grants for medical assistance for the aged are expected to decline in 1967, reflecting the impact of the new health insurance programs. Similarly, greater benefit payments through our social security system will continue to reduce the number of aged persons requiring help from the Federal-State public assistance program—even though Federal legislation enacted in 1965 will extend assistance to some 18,000 aged in mental or tuberculosis institutions. The resulting savings will offset somewhat the increase needed to provide higher monthly cash assistance payments and more adequate medical care for other needy people—particularly 4.7 million in broken families. . .

An economy with abundant job opportunity enhances the prospects for rehabilitating and successfully finding productive employment for some individuals on the public assistance rolls. Accordingly, legislation is being proposed to improve the role of programs giving assistance to unemployed parents of needy children by providing work experience, services, and training to equip them for regular employment.

New obligational authority of \$3.4 billion is recommended for 1967 for Federal grants—excluding grants for medical assistance for the aged. This is an increase of \$222 million over 1966. When matched with State and local funds, \$5.7 billion will be available in 1967 to provide necessary financial and medical assistance, and social services to 7.5 million of our poorest citizens. Federal expenditures, however, will rise by only \$65 million to \$3.3 billion because of a change in the scheduling of payments to the States.

This Nation is once again extending its welcome to refugees from Cuba who are fleeing oppression and tyranny. Federal expenditures to help resettle and absorb these refugees are expected to rise by \$8 million to \$46 million as the number granted asylum since October 1965 rises from 36,000 by July 1966 to 88,000 by July 1967.

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VETERANS BENEFITS AND SERVICES

Payments to the public for veterans programs are estimated to rise in 1967 by \$738 million from the 1966 level. This increase results mainly from (1) greater net expenditures for the housing loan programs because of a decline in offsetting receipts available from the sale of Government-held mortgages, as the inventory of these mortgages is substantially reduced in 1966, and (2) greater life insurance trust fund payments, largely because some dividends scheduled for payment in 1966 were paid in 1965. (135)

The 1967 budget proposals reflect the need to meet current requirements of veterans and their dependents. Legislation will be supported to provide education and training assistance for veterans of recent service to help ease readjustment to civilian life. On the other hand, as we continue to improve and broaden programs designed for the general populace we should place greater reliance on these programs for meeting veterans' needs not connected with their military service. Critical reappraisal of veterans' program which have persisted virtually unchanged since their inception over 40 years ago should eliminate those concepts which are no longer consistent with current medical knowledge. Additionally, those concepts which provide special advantages for favored groups of veterans not enjoyed by all veterans similarly situated should be eliminated or modified to equitably meet current requirements.

Service-connected compensation.—Compensation payments for death and disability resulting from military service are estimated at \$2.3 billion in 1967, about the same as in the current year. A slightly declining caseload will be nearly offset by higher average payments per case, in line with increased compensation rates provided by the 89th Congress and with the general advance in veterans' age and disabilities. Approximately 2,320,000 disabled veterans or their survivors will receive payments in 1967, about 40,000 less than this year. The

average annual payment in 1967 is estimated to be \$937 to disabled veterans and \$1,319 to survivors.

Non-service-connected pensions.—In 1967, pensions for disability and death not connected with military service are estimated at \$2.0 billion, a decrease of \$23 million from the current year. An increase in the number of World War II and Korean conflict veterans receiving pensions will be more than offset by the decreasing number of veterans of World War I and earlier wars, while the \$1,064 average payment per case will remain unchanged. The number of veterans' survivors receiving pensions is estimated to rise by 22,550 to a total of 980,085, with the average payment for these cases also remaining level at \$739.

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- 139) *Veterans life insurance trust fund.*—The national service and U.S. Government life insurance trust funds finance about 5 million life insurance policies, primarily for veterans of World Wars I and II. Receipts are chiefly from premiums and interest on investments; expenditures are mainly for death and disability claims and dividends. The expenditures of these trust funds are estimated to increase by \$129 million in fiscal year 1967, mainly because half of the total regular dividend payments due in 1966 were disbursed in January 1965.

Other veterans benefits and services.—Insurance and indemnity expenditures from administrative budget funds are estimated to decline in 1967 because (1) the scheduled 10-year payments for the servicemen's indemnity program are nearly completed, and (2) premiums, principally for special term insurance, will exceed benefit payments and administrative costs.

A new servicemen's group life insurance program enacted by the 89th Congress provides for each serviceman on active duty a commercially underwritten insurance coverage of up to \$10,000. The net cost to the Federal Government of this program in 1967 is estimated at \$6 million. For survivors not covered by the new life insurance program, a special gratuity was provided, resulting in a nonrecurring expenditure of \$40 million in 1966.

- 140) The costs of general administrative operations of the VA will continue to decline as a result of reductions in workload, recent reorganization of field installations, continuing improvements in productivity, and continued efforts to improve automatic data processing.

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GENERAL GOVERNMENT

Renegotiation Act.— * * *

- 144) The Renegotiation Act expires on June 30, 1966. This act should be extended in order to continue the Renegotiation Board's recovery of excessive profits on procurement for national defense and certain other programs.

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[Excerpts from the President's Economic Report]

ECONOMIC REPORT OF THE PRESIDENT

To the Congress of the United States:

ECONOMIC OUTLOOK FOR 1966

FISCAL AND MONETARY POLICY

(10)

The fiscal program I recommend for 1966 aims at full employment without inflation. It is a responsible program. It recognizes that vigorous private demand and required defense spending could upset the balance of supply and demand so diligently pursued by fiscal and monetary policies in recent years, and now so effectively achieved.

Until this year, pursuit of this balance has pointed fiscal policies toward the stimulation of demand. Now a stimulus is no longer appropriate. **(11)**

I have reviewed every program of Government to make room for the necessities of defense. I have sharply reduced or eliminated those civilian programs of lowest priority.

But, as I indicated in my State of the Union Message, I am unwilling to declare a moratorium on our progress toward the Great Society. My budget will add \$3.2 billion to our war against poverty, ignorance, and disease. Yet savings elsewhere will hold the rise in the Administrative Budget—apart from the added costs of Vietnam—to only \$600 million.

Moreover, I am asking the Congress to enact promptly a combination of proposals affecting tax payments in the year ahead:

- a rescheduling of the January 1, 1966, and later excise tax reduction enacted last June for automobiles and telephone service;

- a graduated withholding system that will improve the pay-as-you-go basis of our personal income taxes without increasing tax rates or tax liabilities;

- a corresponding speed-up in payments of corporate income taxes this year and next, also without increasing tax rates or tax liabilities; and

- a method of paying self-employment Social Security taxes on a current basis.

These measures will let us stay close to a high-level balance between the revenues that the Federal Government draws out of the economy and the expenditures that it puts back into the spending stream, and to a high-level balance between total demand and the economy's capacity to produce. It is my judgment that this budget provides the appropriate fiscal environment for the maintenance of basic price stability with continued growth.

I will also look to the Federal Reserve System to provide assistance in promoting the objectives we all share:

meeting the credit needs of a vigorous and growing economy, while

preventing excessive credit flows that could carry the pace of expansion beyond prudent speed limits.

THE UNCERTAINTIES

- (11) We have made the best economic judgments we can. This year, they were unusually difficult. If the tax measures I am now proposing, in conjunction with the moderating influence of monetary policy, do not hold total demand within bounds of the Nation's productive capacity, I will not hesitate to ask for further fiscal restraints on private spending. Nor will I hesitate to ask for such further fiscal action if additional defense requirements demand it during the year. And I will welcome the opportunity to alter my budget in the event that a relaxation of international tensions permits lower defense outlays than are now foreseen.

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INTERNATIONAL ECONOMIC POLICIES FOR 1966

BALANCE OF PAYMENTS

- (13) Decisive progress was made in 1965 toward reducing our balance of payments deficit. Though the results for 1965 are gratifying, we cannot afford to relax. We have not yet balanced our external accounts.
- (14) For 1966, external balance is our goal. It requires that
- Business continue to cooperate wholeheartedly in following the strengthened guidelines governing capital flows announced in December;
 - Banks and financial institutions maintain their excellent performance of last year;
 - Businesses sell even more abroad this year, in spite of full domestic order books;
 - Business and labor keep costs and prices stable in order to maintain the competitiveness of our goods and services in international markets;
 - Government work vigorously to minimize the dollar drain abroad of its aid and defense programs as well as all other activities;
 - The Congress pass the tax legislation I recommended last year to enhance opportunities for foreigners to invest in the United States;
 - We intensify our efforts to encourage our own citizens and foreigners to travel in the United States. I am directing that high priority be given to these efforts.

TRADE

The year 1966 is the year when the world can take a giant step forward in liberalizing international trade by successfully concluding the Kennedy Round of negotiations to reduce trade barriers on all

classes of products. The resulting growth of world trade and world income will benefit all countries, developing as well as industrial. The United States will bend every effort to get meaningful negotiations back on the track. This great venture in international cooperation must not fail.

We shall continue our efforts to improve the trade prospects of the developing countries by helping to stabilize commodity trade, by supporting regional integration among them where practicable, by providing access to markets, and by giving positive assistance to export promotion.

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TRANSPORTATION

The revolutionary changes in transportation technology of the past half century have not been matched by equal progress in our public policies or our Federal organization. (16)

I am recommending the creation of a Department of Transportation to manage the vast Federal promotional programs in highways, waterways, air travel, and maritime affairs, and to take leadership in the development of new transportation policies in accord with current realities.

I am proposing again this year increased user charges on highways and aviation and the introduction of nominal user charges on inland waterways. Such charges will improve efficiency in the use of resources, and reimburse the Federal Government for a part of its expenditures which directly benefit the users of these facilities.

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LABOR AND MANAGEMENT

UNEMPLOYMENT INSURANCE

Our system of Unemployment Insurance has not kept pace with our advancing economy. The time to modernize it is now, when unemployment is low and the cost of improved protection can be readily absorbed. We need a program that will provide more realistic benefits, including benefits for more workers and for longer periods of joblessness; that will correct abuses and assure efficient and responsible administration; and that will broaden the system's tax base and strengthen its financing. I urge the Congress to enact such a program. (17)

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TAX REFORM AND SIMPLIFICATION

- (18) Against a background calling for fiscal restraint, I cannot this year endorse any specific legislative measure, however meritorious, involving significant net tax reduction. The danger of inflation from increased demand would be too great, and any special tax reduction now would postpone the time when we can achieve a meaningful general tax reduction.

Although tax reduction is not feasible this year, improvement of our tax system is a continuing need which will concern this Administration and which deserves the support of all Americans.

One major goal must be simplification of the tax law. Another aim must be a more equitable distribution of the tax load. The great variation of tax liability among persons with equivalent income or wealth must be reduced. Further, when tax reduction once again becomes feasible, particular attention must be given to relief of those at or near poverty levels of income.

Finally, we must review special tax preferences. In a fully employed economy, special tax benefits to stimulate some activities or investments mean that we will have less of other activities. Benefits that the Government extends through direct expenditures are periodically reviewed and often altered in the budget-appropriation process, but too little attention is given to reviewing particular tax benefits. These benefits, like all other activities of Government, must stand up to the tests of efficiency and fairness.

We must constantly seek improvements in the tax code in the interests of equity and of sound economic policy.

I welcome the concern over these problems shown by the Chairmen of the tax committees of the Congress.

As a specific tax reform which can be accomplished this year, I call upon the Congress to deal with abuses of tax-exempt private foundations.

We must always be prepared to meet quickly any problems that arise in the path of continued, stable economic growth, whether the problems call for fiscal stimulus or fiscal restraint. Background tax studies by both the Congress and Executive Branch should therefore be adequate to permit quick decisions and prompt action to accommodate short-run cyclical changes. If quick action is every needed, we should not have to begin a long debate on what the changes in taxes should be.

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CONCLUSION

- (20) To insure against the risk of inflationary pressures, I have asked Americans to pay their taxes on a more nearly current basis, and to postpone a scheduled tax cut. If it should turn out that additional insurance is needed, then I am convinced that we should levy higher taxes rather than accept inflation—which is the most unjust and capricious form of taxation.

We know that we do not need to put our growing economy into a straight jacket, or to throw it into reverse. But the extent of the fiscal or monetary restraint that will be needed to avoid inflationary pressures will depend directly on the restraint and moderation exercised by those who have power over wages and prices.

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LYNDON B. JOHNSON.

JANUARY 27, 1966.

THE ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS

THE CURRENT FISCAL PROGRAM

The strong advance of the economy over the past 2 years is reflected (52) in a remarkable rebound of Federal revenues following the 1964 tax reduction. From the close of 1963 to the final quarter of 1965, Federal revenues advanced by about \$9 billion; yet during this period, tax reductions of \$16 billion had taken effect through the Revenue Act of 1964 and the Excise Tax Reduction Act of 1965. As Federal expenditures grew very modestly in 1964 and early 1965, the budget on the national income accounts basis swung quickly into balance and showed a surplus exceeding \$3½ billion in the first half of 1965. Its subsequent retreat to a \$2½ billion deficit in the second half of the year resulted from several important deliberate stimulative measures plus the unforeseen rise in defense spending.

The impact of 1965 budget actions

The President proposed excise tax reduction in last January's budget; his specific recommendations were submitted to the Congress in May and the legislation was enacted 1 month later. The final act called for \$4.6 billion of reductions in several stages extending to 1969. The first stage took effect immediately in mid-June and reduced taxes by \$1½ billion (annual rate), mostly on consumer durable goods.

In line with recommendations by the President, the Social Security Act was amended by the Congress last July. In addition to the initiation of medical insurance for the aged, which will take effect this July, and increased payroll tax rates, effective January 1, 1966, the legislation provides for increased old-age benefits which were made effective retroactively to January 1, 1965. The retroactive portion of increased benefits, amounting to \$885 million, was disbursed in September. The liberalization raised transfer payments thereafter by more than \$2 billion annually.

Furthermore, once payments on 1964 tax liabilities were completed last spring, a final dividend of personal tax reduction provided by the Revenue Act of 1964 helped to lift disposable income in the second half of 1965. These measures, together with the unexpectedly strong rise of Federal purchases, provided expansionary actions totaling \$10½ billion (annual rate) in the second half of 1965. With normal semiannual revenue growth of a little more than \$3½ billion at high

employment, there was a net fiscal stimulus of about \$7 billion in the second half of 1965.

- (53) Scheduled tax changes are having a marked restrictive fiscal impact in the first half of 1966, as the rise in payroll taxes of nearly \$6 billion far outweighs the expansionary influence of the \$1½ billion "second-stage" of excise cuts that took effect at the start of 1966. On the other hand, further increases in defense expenditures will be stimulating the economy in this period, and will continue to do so throughout the next 18 months. The combined effect of budgeted expenditures, including the benefits that will begin under hospital insurance in July, and tax laws now in effect would be more stimulative than now seems appropriate for the period ahead.

Fiscal plans for 1966-67

The objective of promoting balance between over-all demand and productive capacity pointed to tax cuts in recent years when demand was inadequate. That same criterion now calls for tax action to moderate the growth of private spending. In line with these principles, the President has asked the Congress to enact promptly four measures affecting tax payments.

The first of these would reform the withholding system for individual income taxes and place the income tax more firmly on a "pay-as-you-go" basis. The present system, with a single 14 percent rate, overwithholds from some low-income individuals and underwithholds from many other taxpayers, requiring large final settlements the following year. The proposed graduated rate schedule and other modifications will reduce both under withholding and overwithholding. Once in effect, the new system will siphon off \$1.2 billion (annual rate) from disposable income for the rest of 1966.

The second proposal would place corporate tax payments also on a more nearly current basis. Under present law, corporations with tax liabilities exceeding \$100,000 are scheduled to pay only 68 percent of the estimated tax due on 1966 incomes by the end of the calendar year, with the remaining 32 percent not paid until the first half of 1967. There is already a formula under existing law that would move corporations to a current basis by 1970. It is now proposed to accelerate this step-up to achieve current payment status within 1967. This action would increase cash payments to the Treasury by an estimated \$1 billion this spring and \$3.2 billion in the spring of 1967, reducing the carry-over of unpaid liabilities into 1967 and 1968 by comparable amounts.

The rescheduling of corporate tax payments will not add to final tax liabilities nor will it alter after-tax profits in either business or national income accounting. It will nonetheless reduce the availability of internal funds for investment and should thus have a moderating influence on investment demands, particularly in the light of firmer credit conditions.

- (54) A third proposal to put tax payments on a more current basis affects the social security taxes of the self-employed. It calls for quarterly declarations, paralleling those of the individual income tax, instead of a single large payment at year end. It also more nearly parallels the treatment of wage earners, whose social security taxes are collected on a current basis through withholding. The proposal would increase revenues by \$100 million in each of the fiscal years

1966 and 1967. It will reduce disposable income by \$400 million (annual rate) in the second half of this calendar year.

The fourth proposal affects excise taxes. In view of the large revenue involved in the excise taxes on automobiles and telephone service, they were scheduled to be cut gradually in the Excise Tax Reduction Act of 1965. The Congress is being asked to reschedule the reduction to meet current economic needs. Each step in the present timetable, commencing with the January 1, 1966 instalment, would be shifted forward 2 years. The reinstatement will restore \$0.9 billion of revenues, and the postponement of the scheduled January 1967 cuts will avoid a further revenue drop of \$0.6 billion next year.

With these measures, both the actual and high-employment budgets on the national income accounts basis are expected to be approximately in balance in fiscal 1967. Over the full budget planning period to the first half of 1967, Federal expenditures are estimated to rise about \$17½ billion from their level in the second half of 1965. The increase includes \$6 billion in defense purchases, \$0½ billion in transfers, and \$3 billion in grants to States and localities. Normal revenue growth at high employment will total about \$11½ billion over this period. Meanwhile, tax measures that have already been enacted and those now proposed will result in a net addition of \$7 billion to Federal revenues.

The aim of fiscal policies in the next 18 months is to preserve the sound expansion enjoyed in 1965—to maintain a strong and healthy prosperity; to promote a cautious movement toward lower unemployment without moving so far or so fast that bottlenecks and inflationary pressures arise.

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HEALTH

Financing medical care

Private health insurance has made a major contribution to the better financing of health costs. The proportion of Americans with some form of private health insurance has risen from 9 percent in 1940 to 80 percent today. But gross benefits from such insurance covered only 25 percent of total expenditures for personal health needs in 1965. Furthermore, those most in need of assistance in meeting medical payments are frequently unable to buy insurance. Only about one-third of persons in families with annual incomes under \$2,000, and about one-half of all elderly persons, were covered by any type of private hospital insurance in 1963. Yet these groups spend a particularly large fraction of their low incomes for health. In 1961, average medical expenses amounted to 10 percent for families with annual incomes between \$1,000 and \$2,000, compared with 4 percent for families with incomes between \$10,000 and \$15,000. (106)

- 106) Among the most important actions of the 89th Congress was the provision of health insurance for the aged under Social Security. Medicare will protect families against the economic risk of major medical expenses in old age. Benefits for 17 million Social Security beneficiaries, plus benefits from general revenues for almost 2 million additional elderly persons not covered by Social Security, will amount to about \$3.5 billion in 1967 and will cover at least 40 percent of the total medical costs of the aged. The basic program consists of hospital insurance, extended care, and home health services for the aged, financed through a separate trust fund supported by employee and employer payroll taxes. A voluntary, supplementary program covers physicians' fees and other services and is financed through monthly premiums (currently \$3) by individuals over 65, which are matched equally by a general revenue contribution.
- 107) The legislation also greatly improved the quality and expanded the coverage of State medical assistance programs. The Kerr-Mills program for the aged was expanded to cover a total of about 8 million needy persons, including, for the first time, the blind, the disabled, and dependent children.

The 1965 Child Health amendments will make more health services available to expectant mothers, infants, and children, including crippled and retarded children. The progressive extension of crippled children's and child health services to youngsters throughout each State is required by 1975. Previously, these programs were aimed primarily at rural areas, but in the future they will provide equal assistance for low-income families in urban centers. Family planning services will also be strengthened.

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THE LESS DEVELOPED COUNTRIES: PROGRESS, PROBLEMS, AND POLICIES

Improving trade prospects

- (145) Liberal commercial policies by the developed countries will contribute to world economic development. A successful Kennedy Round will benefit the less developed as well as the developed countries. However, there will remain room for further tariff reductions and import liberalization of special significance for development. Many advanced countries could abolish or relax a number of import restrictions without causing economic dislocation. Recent studies indicate that general tariff reductions, even on those manufactures which are protected by low duties, might ultimately yield a significant increase in exports of less developed countries. The developed countries could also contribute to their own growth and that of the less developed countries by reducing agricultural protectionism. Moreover, non-tariff barriers to imports, such as quantitative restrictions and the high consumption taxes which some countries impose on tropical products (coffee, cocoa, and bananas) for purely fiscal reasons, frequently place a serious burden on the less developed countries.

RECENT CHANGE IN THE DEVELOPED COUNTRIES

The growth of international trade

(146)

As a result of all of these developments, international commerce has flourished. In the decade from 1954 to 1964, exports of the advanced industrial economies grew by an extraordinary 117 percent, and exports of the less developed areas rose by 59 percent.

To be sure, uncertainties within Europe are now having their impact both on further integration within the EEC and on the external relations of the EEC, including the current Kennedy Round of trade negotiations. The pace of integration and especially the movement toward more liberal world trade have been slowed. The Kennedy Round is at a virtual standstill.

The American commitment to the Kennedy Round—the boldest and most significant effort to liberalize the world trading structure yet undertaken—is as firm as ever. But the protracted internal crisis of the EEC has prevented any significant negotiations with that group of states since last summer. The longer this paralysis continues, the more uncertain are the prospects. The negotiating authority provided by the Trade Expansion Act expires in less than 18 months. If these important negotiations are to yield their full potential benefits, meaningful deliberations must resume, at the latest, early this spring. Were the Kennedy Round to fail, the world would have missed a unique opportunity for further reduction of trade barriers against both industrial and agricultural products and for a further widening of world markets to the benefit of both the developed and developing nations.

The United States is also giving increased attention to the lowering of barriers to trade with the countries of the Soviet bloc. For both political and economic reasons, this country has not fully participated in the steady expansion of East-West trade during the past decade. U.S. trade with the Soviet bloc amounted to barely 1 percent of total U.S. foreign commerce in 1964. Last year, the President's Special Committee on U.S. Trade Relations with East European Countries and the Soviet Union recommended an expansion of peaceful trade with the European Communist countries and urged that the President be given discretionary authority to remove trade restrictions against those countries.

The President has indicated that he will ask Congress for selective authority to grant most-favored-nation treatment to imports from the countries of Eastern Europe, including the U.S.S.R. While no sudden expansion of trade is likely, the opportunities for increased trade may prove significant for individual firms and products.

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U.S. BALANCE OF PAYMENTS

The U.S. balance of payments moved significantly closer to equilibrium in 1965. In considerable part, this reflected the effects of the President's program announced in February. The improvement was primarily manifested in a substantially reduced outflow of private capital, which more than offset a drop in the trade surplus. (160)

Measures of deficit or surplus

(160) In a fundamental sense, a country's external payments cannot be in satisfactory equilibrium unless the domestic economy is in reasonable balance and its basic national and international economic objectives are being met. In a more immediate sense, however, equilibrium in external payments relates to a country's international reserve position and to its ability to maintain the value of its currency in international transactions. Statistics on a country's international transactions, summarized in its balance of payments accounts, bear only on the more immediate concept of equilibrium.

Balance of payments accounts summarize a system of double-entry bookkeeping. The total of debits equals the total of credits; the net difference is zero. Thus any positive or negative balance—a surplus or deficit—includes only selected payments and receipts. A variety of such measures has been used in recent years, including among others the “basic balance,” the “balance on regular transactions,” the “liquidity balance,” and the “balance on official reserve transactions” (“official settlements”). No single concept is best for all analyses. The measure that is most appropriate for one country at one time may be less appropriate under other circumstances.

All definitions of the balance of payments surplus or deficit relate to changes in a country's reserve assets. By any definition, a contribution to surplus is recorded whenever the reserve holdings of our monetary authorities are increased by gains in gold, claims on the IMF, or liquid assets in convertible currencies. But the measures of balance also take into account changes in certain claims that could be exercised against our reserves.

Various types of assets differ in the extent and directness of their claim on U.S. reserves. Liquid claims on the United States held by foreign monetary authorities may at any time be presented for gold, and thus directly expose us to the possibility of reserve losses. Privately held liquid U.S. assets of foreigners can readily be turned into official claims. And nonliquid dollar assets held by foreigners can be sold and thus converted into liquid holdings. Indeed, in a world of convertible currencies, any marketable claim held abroad is to some degree a potential claim on our reserves. Dollar holdings of Americans could even flow abroad in a crisis and flow back as a demand for gold. It is difficult to select the group of assets that should count as claims on our reserves (with an increase contributing to a U.S. deficit). It is mainly on this point that the alternative measures of the deficit or surplus divide.

In 1965, after a careful review of its present and foreseeable situation, the U.S. Government decided to place primary stress on two measures of its general balance of payments performance—the “liquidity balance” and the “balance on official reserve transactions” (“official settlements”).

The liquidity balance spotlights the liquid claims of foreigners, both private and official, against the United States. The potential exposure of the United States is measured by the volume of such liquid claims, and any increase in them (not offset by a growth of reserve assets) is recorded as a U.S. deficit. Thus, the line is drawn between liquid and nonliquid foreign dollar holdings.

The official settlements balance, however, draws the line between the dollar holdings of foreign monetary authorities (whether liquid or non-liquid) and those of private foreign holders. If privately held foreign liquid claims on the United States increase (and there are no other offsetting transactions), this is treated as an inflow of private capital, rather than as an addition to the deficit, which it is under the liquidity definition. The official settlements concept, in other words, concentrates on the dollar claims that foreign monetary authorities have acquired (or relinquished)—usually in the process of maintaining the parity of their currencies.

After years of sizable deficits on liquidity balance, averaging \$3 billion between 1958 and 1964, the U.S. deficit appears to have been reduced to about \$1½ billion in 1965. The deficit as measured by official settlements moved from an average of about \$2 billion in the early 1960's to \$1.2 billion in 1964 and remained at approximately that level in 1965.

Gold purchases from the United States in 1965 bore little direct relationship to the U.S. deficit in that year. New sales of U.S. gold jumped from \$0.1 billion in 1964 to nearly \$1.7 billion in 1965. About \$260 million represented a transfer to the IMF in connection with the enlargement of our quota. Primarily, however, these sales resulted from decisions on the part of a few countries to convert dollars accumulated in earlier years and a concentration of payments surpluses in countries that do not wish to increase their dollar holdings. More than half of the total could be attributed to the purchases of one country—France—although Spain and Austria also completed sizable purchase programs.

During 1958-64, the official settlements deficit was, on the average nearly \$1 billion lower than the liquidity measure, reflecting the growth in private foreign liquid claims on the United States. The two measures were very close in 1965 when private dollar holdings did not advance as rapidly. The behavior of private demands for dollars in the years ahead will provide additional evidence as to the relative significance that should be attached to the liquidity and official settlements measures in guiding the United States to a sustained external payments equilibrium.

Developments and policies in the 1960's

When the Kennedy Administration took office in 1961, the United States had just recorded the largest payments deficit of any year in the postwar period. The country was losing gold rapidly and incurring as large buildup of liquid claims abroad that threatened further losses. Action was imperative. The result has been a series of measures of increasing severity and scope, to meet a problem that proved more intractable than was believed earlier. The measures taken through 1964 were fully reviewed in earlier Reports of the Council. Further significant measures—discussed below—were taken in February and December of 1965.

As a result of these measures, and of other developments, the U.S. payments position strengthened. The basic trading position and earnings on investments improved especially. Over this period, the surplus on nonmilitary goods and services increased from \$6.8 billion in 1960 to \$9.1 billion in 1965 (Table 23). Despite rising prices and wages abroad, drastic economies were achieved in military expendi-

tures abroad, and offsetting sales of military equipment were increased sharply; these improvements were sufficient to offset the net increase in Government grants and capital outflows. Moreover, such grants and capital outflows are now almost completely tied to the export of U.S. goods and services.

Growth of private capital outflows

The outflow of U.S. private capital rose from \$3.9 billion in 1960 to \$6.5 billion in 1964. Through this outflow, the United States was acquiring a large volume of foreign assets and adding rapidly to its net international ownership position as well as to its future receipts of interest, dividends, and remitted profits. But the assets acquired through this investment were largely illiquid, and were obtained by parting with liquid assets that added to both private and official claims against us. The U.S. reserve position declined continually.

The growth of U.S. private capital outflow is not difficult to explain. As market integration has progressed and as individuals and businesses have become increasingly familiar with international financial operations, there has been a natural tendency for capital to become more mobile, and more responsive to market forces.

U.S. corporations have shown an increasing interest in business operations overseas and have been sending a rising flow of funds abroad to build and equip new plants and distribution facilities. The extremely rapid growth of incomes, particularly in Europe, Canada, and Japan, has greatly expanded consumer demand, especially for manufactured goods. Wage rates generally are lower abroad, and when American management and technology are exported the productivity of foreign labor is frequently brought close to the U.S. level, making American enterprises in other countries often extremely profitable. The virtual disappearance of internal tariffs in the EEC and EFTA, while external tariffs are retained, has created a large and expanded market which can be readily served by large-scale production in Europe. Of course, direct investment abroad is also made for the purpose of developing or expanding sources of raw materials, often for use in the firm's operations in the United States or elsewhere.

With few exceptions, U.S. money and capital markets are much better developed and freer from restrictions than those abroad, and this attracts foreign borrowers. In part because of this better organization, interest rates and flotation costs are considerably lower in this country. Consequently, there is a tendency for foreigners seeking capital to look to U.S. markets and for interest-sensitive funds to move abroad in search of higher returns.

Long-standing interest rate differentials, and the growing mobility of capital, were important factors in the spurt of long-term portfolio lending that occurred in 1962 and 1963. New foreign security issues in the U.S. market doubled from 1961 to 1962, and the acceleration continued in early 1963. This growth was arrested by the introduction in mid-1963 of the Interest Equalization Tax (IET), which raised the effective interest rate for most foreign borrowing here. Meanwhile, other capital flows began to accelerate, offsetting much or all of the gains from the IET. Bank loans rose sharply, from \$1.5 billion in 1963 to \$2.5 billion in 1964. Direct U.S. investment abroad also accelerated in 1963 and 1964.

The February 1965 program

At the beginning of 1965, it was evident that the rapid rise in capital outflows was creating growing problems for the U.S. balance of payments. Accordingly, the program announced by the President on February 10 applied the IET to most bank loans with a duration of a year or more to borrowers in developed countries, asked for a 2-year extension of the IET, and attempted in other ways to stem the outflow of private capital through the voluntary cooperation of American business.

U.S. banks and other financial institutions were asked to observe appropriate "guidelines" with respect to their foreign operations in 1965. Banks were asked by the Federal Reserve System to limit the increase in their claims on foreigners in 1965 to 5 percent of the value of their outstanding foreign credits as of December 31, 1964. Top priority was to be assigned to *bona fide* export credits, and second priority to credits to less developed countries. A related program was applied to credits and investments abroad by nonbank financial institutions.

Under the part of the program administered by the Department of Commerce, about 500 large nonfinancial corporations were asked to make a maximum effort to expand the net balance of (a) their exports of goods and services plus (b) their repatriation of earnings from the developed countries less (c) their capital outflows to such countries. They were also asked to bring liquid funds back to the United States.

Although considerable skepticism was initially expressed—particularly abroad—regarding the effectiveness of a voluntary program, it is now clear that the response was excellent. The net outflow of U.S. private capital declined from \$6.5 billion in 1964 (and an annual rate of \$8.9 billion in the fourth quarter) to an annual rate of \$3.6 billion in the first three quarters of 1965. Short-term capital—both bank and nonbank—accounted for a great part of this dramatic shift: the movement of such funds changed from a net outflow of \$2.1 billion in 1964 to a net inflow at an annual rate of \$1.0 billion in the first three quarters of 1965. The success of the voluntary program in shifting the movement of short-term funds was reinforced by the intensified demand for funds in the domestic market, as a result both of sharply rising activity and some tightening of monetary policy.

The U.S. payments deficit in 1965 was adversely affected by certain unusual transactions of the United Kingdom. As a part of the U.K. program to protect the pound, the British authorities converted certain holdings of U.S. securities. Together with the deferment of payments on intergovernmental debts, these transactions reduced U.S. net receipts by well over \$½ billion, on both the official settlements and the liquidity basis.

Despite good over-all results of the payments program, the volume of U.S. direct investment outflows were at a record high in 1965. In the first three quarters, they reached an annual rate of \$3.4 billion, compared with a 1964 total of \$2.4 billion. However, they declined substantially during the course of 1965. Since such outflows are usually planned long in advance, and businesses were not asked to interrupt projects already underway, a lag in the response to the February program was expected. Nevertheless, there was disquieting

evidence that plans for direct investment in 1966 remained at a high level. With the sharp reversal in the trend of bank lending abroad, direct investment became the primary area of concern.

Program for 1966

By the autumn of 1965, it was clear that the February program had been successful and that a substantial improvement in the balance of payments had been achieved. Nevertheless, even further improvement was necessary if payments equilibrium was to be attained. Consequently, decisions were announced in December to reinforce and renew the existing programs for 1966. Further attention was placed on encouraging U.S. exports, on promoting foreign tourism and foreign investment in the United States, and on minimizing the effect on the balance of payments of Government transactions. But the principal focus of the supplementary steps had to be on the further containment of direct investment outflows.

Consequently, new guidelines for direct investment were developed for nonfinancial corporations. Each of about 900 individual corporations was asked to hold its combined 1965 and 1966 direct investment outflows (plus earnings retained abroad) in specified advanced countries and mineral exporting nations to no more than 90 percent of the total of these items in the years 1962-64. This will permit an increase of about 35 percent in the average annual outflow of direct investments in 1965-66 over the average annual rate in the 1962-64 base period. A joint target was set for the years 1965 and 1966 in order not to penalize firms which had cut back in 1965, and in order to seek greater restraint by those which had invested more heavily last year. Direct investment in 1966 under the program would be lower than in 1965, though it would remain high relative to outflows of earlier years.

Financial institutions were given guidelines for 1966 that permitted about the same outflow as had been suggested for 1965. The guidelines provided for nonbank institutions were somewhat more detailed than those for 1965. New arrangements with the Canadian authorities were announced on the understanding that continued exemption from the IET would not threaten the goals of the U.S. program.

Efforts to reduce even further the impact of Government activities on the balance of payments will continue in 1966. Net overseas defense expenditures have been quite successfully reduced since 1960. Unfortunately, expanding defense needs will prevent further reduction in 1966. The bulk of Government aid will continue either to be given "in kind," with no dollar flows, or tied to procurement in the United States.

U.S. trade position

The outstanding performance of U.S. trade in the 1960's has been strongly supported by our excellent price record, as well as by the rapid expansion of output and incomes abroad. However, the slowdown of economic expansion in Europe and Japan contributed to a reduced trade surplus in 1965. The January-March dock strike not only redistributed the time pattern of sales (somewhat inflating the 1964 level), but also caused a sizable loss of export sales.

Imports showed an unusually large gain in 1965; both manufacturing goods and raw materials rose substantially. Only agricultural imports declined, primarily because of lower prices for such commodities as coffee, sugar, and cocoa. Many U.S. firms, fearing a possible steel strike, turned in part to foreign suppliers in 1965, raising steel imports to about \$1.2 billion—an all-time high. In addition, the rapid expansion of the U.S. economy in 1965 brought a larger rise in our imports than in previous years. The boom in the home market may also in some cases have reduced the interest of American producers in finding or serving markets overseas, particularly where their production made full use of existing capacity or labor. (168)

The 1965 decline in the trade surplus was not the result of any basic deterioration in our competitive position. Our price performance in 1965 continued to match that of our major trading partners, so that we retained the relative advantage achieved in earlier years.

Conclusion

Over the longer run, the policies required to assure equilibrium in the U.S. balance of payments will be influenced by many factors, including—among others—the growth rate of our major trading partners throughout the world, the extent to which European nations learn to rely actively on fiscal as well as monetary policy as a means of adjusting over-all demand, the development of capital markets in Europe, changes in the indispensable foreign exchange costs of national security, our rate of technological innovation, our record of productivity growth and price stability, and the progress of improvements in international financial machinery.

If our current account surplus continues to expand, a renewed growth of capital outflows could be compatible with over-all payments equilibrium. For the present, however, the volume of capital outflows likely to occur in the absence of any measures to moderate them would clearly be inconsistent with equilibrium in our external payments. Given that private capital outflows must be contained, the selective measures currently in use seem, for the present, an essential component of our policy. Compared with reliance solely on restrictive general monetary measures that might conceivably hold down capital flows to the same extent, the selective credit techniques have the obvious advantage of allowing monetary policy to respond to the needs for domestic credit, as well as to affect the 5-10 percent of total credit that flows abroad.

The selective approach is consistent with an appropriate composition of the private capital outflow. The exemptions in the IET and the priorities established in the voluntary programs protect the access of less developed countries to U.S. capital. The Federal Reserve program, moreover, gives priority to export financing, which could be squeezed under a highly restrictive monetary policy. By increasing the cost of borrowing in the United States, the IET contains its own escape valve; countries in urgent need of new U.S. capital issues are still free to enter our markets, the less urgent needs are screened out. The guideline approach of the voluntary programs tends to permit the business firms and banks themselves to select the most attractive investment opportunities; the investments foregone would yield a smaller return than the average for all new U.S. foreign investments.

The voluntary program continues to permit growth in both the ownership of U.S. productive facilities abroad and of the U.S. loans outstanding abroad. But it keeps that growth within the bounds permitted by the U.S. current surplus and the cost of essential defense and aid. The voluntary program remains the foundation of improvement in the U.S. balance of payments this year.

Our efforts to achieve full equilibrium in 1966 should also benefit from the improved situation for sterling; in 1965, special transactions by the United Kingdom accounted for roughly half of our deficit. Prospects are also strengthened by recent understandings established with Canada on the handling of its capital needs from the United States. Strong domestic expansion will continue to increase imports this year, and defense expenditures abroad will have to rise in 1966. Nevertheless, the United States has the determination and the means to continue the sharp improvement effected last year in bringing its balance of payments into equilibrium.

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