

TAX ADJUSTMENT ACT OF 1968

1881-1

HEARINGS
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
NINETIETH CONGRESS

SECOND SESSION

ON

H.R. 15414

AN ACT TO CONTINUE THE EXISTING EXCISE TAX RATES
ON COMMUNICATION SERVICES AND ON AUTOMOBILES,
AND TO APPLY MORE GENERALLY THE PROVISIONS
RELATING TO PAYMENTS OF ESTIMATED TAX BY
CORPORATIONS

S. 2902

AND

S. 2903

MARCH 12, 13, AND 14, 1968

Printed for the use of the Committee on Finance



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WASHINGTON : 1968

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TAX ADJUSTMENT ACT OF 1968

TUESDAY, MARCH 12, 1968

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Smathers, Anderson, Talmadge, Hartke, Williams, Bennett, Curtis, Morton, and Dirksen.

The CHAIRMAN. This hearing will come to order.

The bill before us presents a proposal to continue the excise tax rates on automobiles and telephone communications for an additional period. It also places corporations on a pay-as-you-go tax system closely approximating the system under which individuals pay an estimated tax currently as they earn their income.

This bill is important to the Federal budget. It will add over a billion dollars to the Government's income in this fiscal year and more than \$3 billion in fiscal 1969.

Since the present law provides for automatic deductions in the excise taxes on automobiles and communications beginning April 1, it is important that this bill be finally enacted before that date.

We are pleased and honored to have as our first witness today the Honorable Henry H. Fowler, the distinguished Secretary of the Treasury. Mr. Secretary, it has been a long time since you have visited with us on an administration tax proposal. The trip across the Hill from the House Committee on Ways and Means perhaps gives you some relief from your arduous task.

I hope we will not unduly delay you in getting this bill down the avenue to the White House, where its legislative journey will end.

We are also pleased to have the Honorable Charles J. Zwick, the new Director of the Bureau of the Budget, with us. He is making his first appearance before this committee in his new capacity, and I am certain he will make a constructive contribution to the record we will assemble here today.

(The committee press release announcing these hearings; bills H.R. 15414, S. 2902, S. 2903; and agency comments on S. 2902 and S. 2903 follow:)

EXCISE TAX EXTENSIONS—COMMITTEE HEARINGS

Chairman Russell B. Long (D., La.) today announced that on *Tuesday, March 5, 1968*,* the Committee would begin *public hearings on H.R. 15414*, the bill to (1) extend the present excise tax rates on automobiles and telephone service and (2) speed-up corporation income tax payments. He stressed the importance of prompt action on this bill, noting that under the present law, the excise tax rates involved would automatically be sharply reduced unless this legislation is enacted into law by March 31.

*Legislation under consideration on the floor of the Senate prevented the committee meeting on the announced date.

The Honorable Henry H. Fowler, Secretary of the Treasury is to present the Administration's case for the bill.

The Chairman also stated that there were indications within the Committee that the texts of S. 2902 and S. 2903 would be offered as amendments to the House bill. He said that for this reason he was requesting the Secretary to stand ready to answer questions with respect to these Senate bills. Similarly, statements on these matters would be received from public witnesses if they choose to submit them.

Those desiring to participate in this proceeding should make their request to Tom Vail, Chief Counsel, Committee on Finance, 2227 New Senate Office Building, no later than *Friday, March 1, 1968*. All statements should include a summary sheet and subject heading. Statements to be presented orally should be submitted to the Committee the day before the witness is to testify. Chairman Long urged persons desiring to contribute written statements to submit them no later than *Wednesday, March 6, 1968*.

80TH CONGRESS
2D SESSION

H. R. 15414

IN THE SENATE OF THE UNITED STATES

MARCH 1, 1968

Read twice and referred to the Committee on Finance

AN ACT

To continue the existing excise tax rates on communication services and on automobiles, and to apply more generally the provisions relating to payments of estimated tax by corporations.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE, ETC.**

4 (a) **SHORT TITLE.**—This Act may be cited as the “Tax
5 Adjustment Act of 1968”.

6 (b) **AMENDMENT OF EXISTING LAW.**—Except as
7 otherwise expressly provided, whenever in this Act an
8 amendment or repeal is expressed in terms of an amendment
9 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provision
2 of the Internal Revenue Code of 1954.

3 **SEC. 2. CONTINUATION OF EXCISE TAXES ON COMMUNI-**
4 **CATION SERVICES AND ON AUTOMOBILES.**

5 **(a) PASSENGER AUTOMOBILES.—**

6 **(1) IN GENERAL.—**Subparagraph (A) of section
7 4061 (a) (2) (relating to tax on passenger automobiles,
8 etc.) is amended to read as follows:

9 “(A) Articles enumerated in subparagraph (B)
10 are taxable at whichever of the following rates is
11 applicable:

“If the article is sold—	The tax rate is—
Before January 1, 1970.....	7 percent
During 1970.....	5 percent
During 1971.....	3 percent
During 1972.....	1 percent.

12 The tax imposed by this subsection shall not apply with
13 respect to articles enumerated in subparagraph (B)
14 which are sold by the manufacturer, producer, or im-
15 porter after December 31, 1972.”

16 **(2) CONFORMING AMENDMENT.—**Section 6412
17 (a) (1) (relating to floor stocks refunds on passenger
18 automobiles, etc.) is amended by striking out “April 1,
19 1968, or January 1, 1969,” and inserting in lieu thereof
20 “January 1, 1970, January 1, 1971, January 1, 1972,
21 or January 1, 1973.”

1 (b) COMMUNICATIONS SERVICES.—

2 (1) CONTINUATION OF TAX.—Paragraph (2) of
3 section 4251 (a) (relating to tax on certain communi-
4 cations services) is amended to read as follows:

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

“Amounts paid pursuant to bills first rendered—	Percent—
Before January 1, 1970.....	10
During 1970.....	5
During 1971.....	3
During 1972.....	1.”

7 (2) CONFORMING AMENDMENTS.—Subsection (b)
8 of section 4251 (relating to termination of tax) is
9 amended by striking out “January 1, 1969” and insert-
10 ing in lieu thereof “January 1, 1973”, and subsection
11 (c) of section 4251 is amended to read as follows:

12 “(c) SPECIAL RULE.—For purposes of subsections (a)
13 and (b), in the case of communications services rendered
14 before November 1 of a calendar year for which a bill has
15 not been rendered before the close of such year, a bill shall
16 be treated as having been first rendered on December 31 of
17 such year.”

18 (3) REPEAL OF SUBCHAPTER B OF CHAPTER 33.—
19 Effective with respect to amounts paid pursuant to bills
20 first rendered on or after January 1, 1973, subchapter B
21 of chapter 33 (relating to the tax on communications)

1 is repealed. For purposes of the preceding sentence, in
2 the case of communications services rendered before
3 November 1, 1972, for which a bill has not been rendered
4 before January 1, 1973, a bill shall be treated as having
5 been first rendered on December 31, 1972. Effective
6 January 1, 1973, the table of subchapters for chapter 33
7 is amended by striking out the item relating to such
8 subchapter B.

9 (c) **EFFECTIVE DATE.**—The amendments made by this
10 section shall take effect March 31, 1968.

11 **SEC. 3. PAYMENT OF ESTIMATED TAX BY CORPORATIONS.**

12 (a) **REPEAL OF REQUIREMENT OF DECLARATION.**—
13 Section 6016 (relating to declarations of estimated income
14 tax by corporations) and section 6074 (relating to time for
15 filing declarations of estimated income tax by corporations)
16 are repealed.

17 (b) **INSTALLMENT PAYMENTS OF ESTIMATED INCOME**
18 **TAX BY CORPORATIONS.**—Section 6154 (relating to install-
19 ment payments of estimated income tax by corporations) is
20 amended to read as follows:

21 **“SEC. 6154. INSTALLMENT PAYMENTS OF ESTIMATED IN-**
22 **COME TAX BY CORPORATIONS.**

23 **“(a) CORPORATIONS REQUIRED TO PAY ESTIMATED**
24 **INCOME TAX.**—Every corporation subject to taxation under
25 section 11 or 1201 (a), or subchapter L of chapter 1 (relat-

ing to insurance companies), shall make payments of estimated tax (as defined in subsection (c)) during its taxable year as provided in subsection (b) if its income tax imposed by section 11 or 1201 (a), or such subchapter I, for such taxable year, reduced by the credits against tax provided by part IV of subchapter A of chapter 1, can reasonably be expected to exceed \$40.

“(b) PAYMENT IN INSTALLMENTS.—Any corporation required under subsection (a) to make payments of estimated tax (as defined in subsection (c)) shall make such payments in installments as follows:

“If the requirements of subsection (a) are first met—	The following percentages of the estimated tax shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
Before the 1st day of the 4th month of the taxable year.....	25	25	25	25
After the last day of the 3d month and before the 1st day of the 6th month of the taxable year.....		33½	33½	33½
After the last day of the 5th month and before the 1st day of the 9th month of the taxable year.....			50	50
After the last day of the 8th month and before the 1st day of the 12th month of the taxable year.....				100

“(c) ESTIMATED TAX DEFINED.—

“(1) IN GENERAL.—For purposes of this title, in the case of a corporation the term ‘estimated tax’ means the excess of—

“(A) the amount which the corporation estimates as the amount of the income tax imposed by section 11 or 1201 (a), or subchapter L of chapter 1, whichever is applicable, over

“(B) the sum of—

1 “(i) the amount which the corporation
2 estimates as the sum of the credits against tax
3 provided by part IV of subchapter A of chap-
4 ter 1, and

5 “(ii) in the case of a taxable year begin-
6 ning after December 31, 1967, and before Jan-
7 uary 1, 1972, the amount of the corporation’s
8 transitional exemption for such year.

9 “(2) TRANSITIONAL EXEMPTION.—For purposes
10 of clause (ii) of paragraph (1) (B), the amount of a
11 corporation’s transitional exemption for a taxable year
12 equals the exclusion percentage (determined under para-
13 graph (3)) multiplied by the lesser of—

14 “(A) \$100,000, or

15 “(B) the excess determined under paragraph
16 (1) without regard to such clause (ii).

17 “(3) EXCLUSION PERCENTAGE.—For purposes of
18 paragraph (2) and section 6655 (e), the term ‘exclusion
19 percentage’ means—

“In the case of a taxable year beginning in—	The exclusion percentage is—
1968.....	80 percent
1969.....	60 percent
1970.....	40 percent
1971.....	20 percent.

20 “(d) RECOMPUTATION OF ESTIMATED TAX.—If, after
21 paying any installment of estimated tax, the taxpayer makes
22 a new estimate, the amount of each remaining installment

1 (if any) shall be the amount which would have been pay-
 2 able if the new estimate had been made when the first esti-
 3 mate for the taxable year was made, increased or decreased
 4 (as the case may be), by the amount computed by divid-
 5 ing—

6 “(1) the difference between—

7 “(A) the amount of estimated tax required to
 8 be paid before the date on which the new estimate
 9 is made, and

10 “(B) the amount of estimated tax which would
 11 have been required to be paid before such date if
 12 the new estimate had been made when the first
 13 estimate was made, by

14 “(2) the number of installments remaining to be
 15 paid on or after the date on which the new estimate is
 16 made.

17 “(e) APPLICATION TO SHORT TAXABLE YEAR.—The
 18 application of this section to taxable years of less than 12
 19 months shall be in accordance with regulations prescribed
 20 by the Secretary or his delegate.

21 “(f) INSTALLMENTS PAID IN ADVANCE.—At the elec-
 22 tion of the corporation, any installment of the estimated tax
 23 may be paid before the date prescribed for its payment.

24 “(g) CERTAIN FOREIGN CORPORATIONS.—For pur-

1 poses of this section and section 6655, in the case of a foreign
2 corporation subject to taxation under section 11 or 1201 (a),
3 or under subchapter L of chapter 1, the tax imposed by
4 section 881 shall be treated as a tax imposed by section 11.”

5 **(c) FAILURE BY CORPORATION TO PAY ESTIMATED**
6 **TAX.—**

7 **(1) RAISING 70 PERCENT REQUIREMENT TO 80**
8 **PERCENT.—**Subsections (b) and (d) (3) of section
9 6655 (relating to underpayments of estimated tax) are
10 ~~amended by striking out “70 percent” each place it ap-~~
11 ~~pears therein and inserting in lieu thereof “80 percent”.~~

12 **(2) DEFINITION OF TAX.—**Subsection (e) of sec-
13 tion 6655 (relating to definition of tax) is amended to
14 read as follows:

15 **“(e) DEFINITION OF TAX.—**

16 **“(1) IN GENERAL.—**For purposes of subsections
17 (b) and (d), the term ‘tax’ means the excess of—

18 **“(A) the tax imposed by section 11 or 1201**
19 **(a), or subchapter L of chapter 1, whichever is ap-**
20 **plicable, over**

21 **“(B) the sum of—**

22 **“(i) the credits against tax provided by**
23 **part IV of subchapter A of chapter 1, and**

24 **“(ii) in the case of a taxable year begin-**
25 **ning after December 31, 1967, and before Jan-**

1 uary 1, 1972, the amount of the corporation's
2 transitional exemption for such year.

3 “(2) TRANSITIONAL EXEMPTION.—For purposes
4 of clause (ii) of paragraph (1) (B), the amount of a
5 corporation's transitional exemption for a taxable year
6 equals the exclusion percentage (determined under sec-
7 tion 6154 (c) (3)) multiplied by the lesser of—

8 “(A) \$100,000, or

9 “(B) the excess determined under paragraph
10 (1) without regard to such clause (ii).

11 “(3) SPECIAL RULE FOR SUBSECTION (d) (1)
12 AND (2).—In applying this subsection for purposes of
13 subsection (d) (1) and (2), the exclusion percentage
14 shall be the percentage applicable to the taxable year
15 for which the underpayment is being determined.”

16 (d) ADJUSTMENT OF OVERPAYMENT.—

17 (1) ALLOWANCE OF ADJUSTMENT.—Subchapter
18 B of chapter 65 (relating to rules of special applica-
19 tion) is amended by adding at the end thereof the fol-
20 lowing new section:

21 “SEC. 6425. ADJUSTMENT OF OVERPAYMENT OF ESTI-
22 MATED INCOME TAX BY CORPORATION.

23 “(a) APPLICATION FOR ADJUSTMENT.—

24 “(1) TIME FOR FILING.—A corporation may, after

1 the close of the taxable year and on or before the 15th
 2 day of the third month thereafter, and before the
 3 day on which it files a return for such taxable year,
 4 file an application for an adjustment of an overpayment
 5 by it of estimated income tax for such taxable year.
 6 An application under this subsection shall not constitute
 7 a claim for credit or refund.

8 “(2) FORM OF APPLICATION, ETC.—An applica-
 9 tion under this subsection shall be verified in the manner
 10 prescribed by section 6065 in the case of a return of
 11 the taxpayer, and shall be filed in the manner and
 12 form required by regulations prescribed by the Secre-
 13 tary or his delegate. The application shall set forth—

14 “(A) the estimated income tax paid by the
 15 corporation during the taxable year,

16 “(B) the amount which, at the time of filing
 17 the application, the corporation estimates as its
 18 income tax liability for the taxable year,

19 “(C) the amount of the adjustment, and

20 “(D) such other information for purposes of
 21 carrying out the provisions of this section as may
 22 be required by such regulations.

23 “(b) ALLOWANCE OF ADJUSTMENT.—

24 “(1) LIMITED EXAMINATION OF APPLICATION.—

25 Within a period of 45 days from the date on which an

1 application for an adjustment is filed under subsection
2 (a), the Secretary or his delegate shall make, to the
3 extent he deems practicable in such period, a limited
4 examination of the application to discover omissions and
5 errors therein, and shall determine the amount of the
6 adjustment upon the basis of the application and the
7 examination; except that the Secretary or his delegate
8 may disallow, without further action, any application
9 which he finds contains material omissions or errors
10 which he deems cannot be corrected within such 45
11 days.

12 “(2) **ADJUSTMENT CREDITED OR REFUNDED.**—The
13 Secretary or his delegate, within the 45-day period
14 referred to in paragraph (1), may credit the amount
15 of the adjustment against any liability in respect of an
16 internal revenue tax on the part of the corporation and
17 shall refund the remainder to the corporation.

18 “(3) **LIMITATION.**—No application under this sec-
19 tion shall be allowed unless the amount of the adjustment
20 equals or exceeds (A) 5 percent of the amount esti-
21 mated by the corporation on its application as its income
22 tax liability for the taxable year, and (B) \$200.

23 “(4) **EFFECT OF ADJUSTMENT.**—For purposes of
24 this title (other than section 6655), any adjustment
25 under this section shall be treated as a reduction, in the

1 estimated income tax paid, made on the day the credit
2 is allowed or the refund is paid.

3 “(c) DEFINITIONS.—For purposes of this section and
4 section 6655 (g) (relating to excessive adjustment)—

5 “(1) The term ‘income tax liability’ means the ex-
6 cess of—

7 “(A) the tax imposed by section 11 or 1201
8 (a), or subchapter L of chapter 1, whichever is
9 applicable, over

10 “(B) the credits against tax provided by part
11 IV of subchapter A of chapter 1.

12 “(2) The amount of an adjustment under this
13 section is equal to the excess of—

14 “(A) the estimated income tax paid by the
15 corporation during the taxable year, over

16 “(B) the amount which, at the time of filing
17 the application, the corporation estimates as its
18 income tax liability for the taxable year.

19 “(d) CONSOLIDATED RETURNS.—If the corporation
20 seeking an adjustment under this section paid its estimated
21 income tax on a consolidated basis or expects to make a con-
22 solidated return for the taxable year, this section shall apply
23 only to such extent and subject to such conditions, limita-
24 tions, and exceptions as the Secretary or his delegate may
25 by regulations prescribe.”

1 (2) AMENDMENT OF SECTION 6655.—Section
2 6655 is amended by adding at the end thereof the
3 following new subsection:

4 “(g) EXCESSIVE ADJUSTMENT UNDER SECTION
5 6425.—

6 “(1) ADDITION TO TAX.—If the amount of an ad-
7 justment under section 6425 made before the 15th day
8 of the third month following the close of the taxable
9 year is excessive, there shall be added to the tax under
10 chapter 1 for the taxable year an amount determined at
11 the rate of 6 percent per annum upon the excessive
12 amount from the date on which the credit is allowed or
13 the refund is paid to such 15th day.

14 “(2) EXCESSIVE AMOUNT.—For purposes of para-
15 graph (1), the excessive amount is equal to the amount
16 of the adjustment or (if smaller) the amount by which—

17 “(A) the income tax liability (as defined in
18 section 6425 (c)) for the taxable year as shown on
19 the return for the taxable year, exceeds

20 “(B) the estimated income tax paid during
21 the taxable year, reduced by the amount of the
22 adjustment.”

23 (e) CONFORMING AMENDMENTS.—

24 (1) Section 6655 (d) (1) is amended by striking
25 out “reduced by \$100,000”.

1 (2) Section 243 (b) (3) (C) (v) is amended by
2 striking out "\$100,000 exemption" and inserting in lieu
3 thereof "\$100,000 amount under section 6154 (c) (2)
4 (A) and section 6655 (e) (2) (A)".

5 (3) Section 6020 (b) (1) is amended by striking
6 out "section 6015 or 6016)" and inserting in lieu
7 thereof "section 6015)".

8 (4) Section 6651 (d) is amended by striking out
9 "section 6015 or section 6016" and inserting in lieu
10 thereof "section 6015".

11 (5) Section 7203 is amended by striking out "sec-
12 tion 6015 or section 6016)," and inserting in lieu
13 thereof "section 6015),".

14 (6) Section 7701 (a) (34) (B) is amended by
15 striking out "section 6016 (b)" and inserting in lieu
16 thereof "section 6154 (e)".

17 (7) The table of sections for subpart B of part II
18 of subchapter A of chapter 61 is amended by striking
19 out the item relating to section 6016:

20 (8) The table of sections for part V of subchapter
21 A of chapter 61 is amended by striking out the item
22 relating to section 6074.

1 (9) The table of sections for subchapter B of
2 chapter 65 is amended by adding at the end thereof the
3 following:

"Sec. 6425. Adjustment of overpayment of estimated income
tax by corporation."

4 (f) **EFFECTIVE DATE.**—The amendments made by this
5 section shall apply with respect to taxable years beginning
6 after December 31, 1967.

7 **SEC. 4. TIMELY MAILING OF DEPOSITS.**

8 (a) **TIMELY MAILING TREATED AS TIMELY DE-**
9 **POSIT.**—Section 7502 (relating to timely mailing treated
10 as timely filing and paying) is amended by adding at the
11 end thereof the following new subsection:

12 “(e) **MAILING OF DEPOSITS.**—

13 “(1) **DATE OF DEPOSIT.**—If any deposit required
14 to be made (pursuant to regulations prescribed by the
15 Secretary or his delegate under section 6302 (c)) on or
16 before a prescribed date is, after such date, delivered
17 by the United States mail to the bank or trust company
18 authorized to receive such deposit, such deposit shall
19 be deemed received by such bank or trust company on
20 the date the deposit was mailed.

1 “(2) MAILING REQUIREMENTS.—Paragraph (1)
2 shall apply only if the person required to make the de-
3 posit establishes that—

4 “(A) the date of mailing falls on or before
5 the second day before the prescribed date for making
6 the deposit (including any extension of time granted
7 for making such deposit), and

8 “(B) the deposit was, on or before such second
9 day, mailed in the United States in an envelope
10 or other appropriate wrapper, postage prepaid,
11 properly addressed to the bank or trust company
12 authorized to receive such deposit.

13 In applying subsection (c) for purposes of this subsec-
14 tion, the term ‘payment’ includes ‘deposit’, and the
15 reference to the postmark date refers to the date of
16 mailing.”

17 (b) EFFECTIVE DATE.—The amendment made by sub-
18 section (a) shall apply only as to mailing occurring after the
19 date of the enactment of this Act.

Passed the House of Representatives February 29, 1968.

Attest:

W. PAT JENNINGS,

Olerk.

90TH CONGRESS
2D SESSION

S. 2902

IN THE SENATE OF THE UNITED STATES

JANUARY 31, 1968

Mr. WILLIAMS of Delaware introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To improve the balance of payments and protect the domestic economy of the United States.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Balance of Payments and
5 Domestic Economy Act of 1968".

6 **SEC. 2. ONE-YEAR POSTPONEMENT OF CERTAIN EXCISE**
7 **TAX RATE REDUCTIONS.**

8 (a) (1) Section 4061 (a) (2) (A) of the Internal Rev-
9 enue Code of 1954 (relating to tax on passenger automo-
10 biles) is amended to read as follows:

11 " (A) Articles enumerated in subparagraph (B)

1 are taxable at whichever of the following rates is appli-
2 cable:

3 "7 percent for the period beginning with the
4 day after the date of the enactment of the Tax Ad-
5 justment Act of 1966 through March 31, 1969.

6 "1 percent for the period after March 31, 1969."

7 (2) Section 6412(a)(1) of such Code (relating to
8 floor stocks refunds on passenger automobiles, etc.) is
9 amended by striking out "April 1, 1968, or January 1,
10 1969" and inserting in lieu thereof "or April 1, 1969".

11 (b) Section 4251 of the Internal Revenue Code of 1954
12 (relating to tax on communications) is amended—

13 (1) by striking out subsection (a)(2) and insert-
14 ing in lieu thereof the following:

15 "(2) The rate of tax referred to in paragraph (1)
16 is 10 percent of amounts paid pursuant to bills first ren-
17 dered before April 1, 1969.";

18 (2) by striking out "January 1, 1969" in subsec-
19 tion (b) and inserting in lieu thereof "April 1, 1969";
20 and

21 (3) by striking out subsection (c) and inserting in
22 lieu thereof the following:

23 "(c) SPECIAL RULE.—For purposes of subsections (a)
24 and (b), in the case of communications services rendered
25 after April 30, 1968, and before February 1, 1969, for

1 which a bill has not been rendered before April 1, 1969, a
2 bill shall be treated as having been first rendered on March
3 31, 1969."

4 (c) The amendments made by subsection (a) shall
5 apply with respect to articles sold on or after April 1, 1968.
6 The amendments made by subsection (b) shall apply to
7 amounts paid pursuant to bills first rendered on or after
8 April 1, 1968.

9 **SEC. 3. REDUCTION IN NUMBER OF CIVILIAN OFFICERS**
10 **AND EMPLOYEES IN THE EXECUTIVE BRANCH.**

11 (a) During any period in which the aggregate number
12 of full-time civilian officers and employees (including the
13 full-time equivalent of part-time employment) in the execu-
14 tive branch of the Government exceeds the aggregate number
15 employed on September 20, 1966, no vacancy in any office
16 or position in any department or agency in the executive
17 branch of the Government resulting from the resignation,
18 retirement, transfer, removal, or death of the incumbent of
19 such office or position shall be filled, except pursuant to a
20 determination of the Director of the Bureau of the Budget
21 (hereinafter referred to as the "Director") under subsection
22 (b).

23 (b) The Director shall make continuing studies of the
24 personnel needs of the various departments and agencies of
25 the Government during any period referred to in subsection

1 (a), and shall determine which of the vacancies occurring
2 in such departments and agencies may be filled. Such deter-
3 minations shall be so made that the aggregate number of
4 vacancies filled during any calendar quarter, beginning with
5 the quarter ending June 30, 1968, in the executive branch
6 of the Government, shall not exceed 25 percent of the aggre-
7 gate number of vacancies occurring during such quarter. The
8 determinations of the Director under this subsection shall be
9 made on the basis of the relative needs of the various depart-
10 ments and agencies for personnel, having in mind the impor-
11 tance to the national health, security, and welfare of their
12 respective functions and activities. Such determinations may
13 be made by such appropriation units or organization units
14 as the Director may deem appropriate.

15 (c) The Director shall maintain a continuous study of
16 all appropriations and contract authorizations in relation to
17 personnel employed and shall reserve from expenditure the
18 savings in salaries and wages resulting from the operation of
19 this section, and any savings in other categories of expense
20 which he determines will result from such operation.

21 (d) The departments and agencies in the executive
22 branch shall submit to the Director such information as may
23 be necessary to enable him to carry out his functions under
24 this section.

25 (e) The Director shall submit to the Senate and the

1 House of Representatives at the end of each calendar quarter,
2 beginning with the quarter ending June 30, 1968, a report
3 of his activities under this section.

4 (f) This section shall not apply to officers and employ-
5 ees in the Department of Defense, the postal field service,
6 and the Federal Bureau of Investigation, to casual employ-
7 ees, as defined by the Director, to employees employed with-
8 out compensation, to offices filled by appointment by the
9 President, by and with the advice and consent of the Senate,
10 or to offices or positions filled by transfer from another posi-
11 tion within the same or another department or agency,
12 except that such employees, offices, and positions shall be
13 taken into consideration in determining the aggregate num-
14 ber of officers and employees for the purposes of subsection
15 (a).

16 (g) Nothing in this section shall supersede or modify
17 the reemployment rights of any person under section 9 of the
18 Military Selective Service Act of 1967 or any other provision
19 of law conferring reemployment rights upon persons who
20 have performed active duty in the Armed Forces.

21 (h) This section shall take effect on April 1, 1968.

22 **SEC. 4. MORATORIUM ON PUBLIC WORKS PROJECTS.**

23 (a) (1) Notwithstanding any other provision of law,
24 no Federal department or agency shall, during the period in
25 which this section is in effect—

1 (A) initiate the planning or construction of any
2 public works project (including projects for recreational
3 facilities but excluding projects for highways), or

4 (B) make any grant to any State or local govern-
5 ment agency for initiating the planning or construction
6 of any such public works project.

7 (2) Upon request of the head of the Federal depart-
8 ment or agency concerned, the Director of the Office of Emer-
9 gency Planning shall investigate a public works project with
10 respect to which paragraph (1) applies for the purpose of
11 determining whether the delay in planning or construction
12 of such public works project required by paragraph (1) will
13 cause irreparable damage to the public health or welfare.
14 If with respect to any planning or construction of any such
15 public works project, the Director determines that such de-
16 lay will cause such irreparable damage, paragraph (1) shall
17 cease to apply with respect to such planning or construction
18 effective on the date on which the Director publishes such
19 determination.

20 (3) The Director shall report, from time to time, the
21 results of his investigations and determinations under para-
22 graph (2) to the President and the Congress.

23 (b) (1) The Director of the Office of Emergency Plan-
24 ning shall make an investigation of all public works projects

1 (including projects for recreational facilities but excluding
2 highway projects), the planning or construction of which has
3 been initiated on or before the date of the enactment of this
4 Act and is being carried out by a Federal department or
5 agency or by a State or local government agency with
6 Federal assistance, for the purpose of determining what
7 planning and construction on such public works projects
8 can be temporarily halted without causing irreparable dam-
9 age to the public health or welfare.

10 (2) Notwithstanding any other provision of law, no
11 Federal department or agency shall—

12 (A) continue any planning or construction, or

13 (B) make any grant (or payment of a grant pre-
14 viously made) to any State or local government agency
15 for continuing any planning or construction,

16 which the Director determines under paragraph (1) can be
17 so temporarily halted, during the remainder of the period
18 in which this section is in effect beginning with the day
19 after the date on which the Director publishes such determi-
20 nation.

21 (3) The Director shall, as soon as practicable, report the
22 results of his investigation and determinations under para-
23 graph (2) to the President and the Congress.

24 (c) This section shall apply during the period begin-

1 ning on the day after the date of the enactment of this Act
2 and ending on the last day on which the tax required to
3 be deducted and withheld on wages under section 3402 of
4 the Internal Revenue Code of 1954 includes any amount
5 attributable to the tax surcharge imposed by section 51 of
6 such Code.

7 **SEC. 5. LIMITATION ON EXPENDITURES DURING FISCAL**
8 **YEAR 1969.**

9 (a) Expenditures under the budget of the United
10 States (referred to in the 1968 state of the Union address
11 of the President as totaling \$186,000,000,000) during the
12 fiscal year ending June 30, 1969, shall not exceed \$178,-
13 000,000,000, except by those expenditures in excess of
14 \$25,000,000,000 that the President may determine are
15 necessary in behalf of our military effort in Southeast Asia.

16 (b) To effectuate the provisions of subsection (a), the
17 President shall reserve from expenditure such amounts from
18 such appropriations or other obligational authority, hereto-
19 fore or hereafter made available, as he may prescribe.

20 **SEC. 6. IMPOSITION OF TAX SURCHARGE.**

21 (a) Subchapter A of chapter 1 of the Internal Revenue
22 Code of 1954 (relating to determination of tax liability)
23 is amended by adding at the end thereof the following new
24 part:

1 **"PART V—TAX SURCHARGE**

"Sec. 51. Tax surcharge

2 **"SEC. 51. TAX SURCHARGE.**3 **"(a) IMPOSITION OF TAX.—**

4 **"(1) CALENDAR YEAR TAXPAYERS.—**In addition
5 to the other taxes imposed by this chapter, there is
6 hereby imposed on the income of every person whose
7 taxable year is the calendar year, a tax equal to the
8 percent of the adjusted tax (as defined in subsection
9 (b)) for the taxable year specified in the following
10 table:

Calendar year	Percent	
	Individuals	Corporations
1962.....	4.5	8
1969.....	3.0	4

11 **"(2) FISCAL YEAR TAXPAYERS.—**In addition to
12 the other taxes imposed by this chapter, in the case of
13 taxable years ending on or after the effective date of the
14 surcharge and beginning before July 1, 1969, there is
15 hereby imposed on the income of every person whose
16 taxable year is other than the calendar year, a tax equal
17 to—

18 **"(A) 6 percent of the adjusted tax for the tax-**
19 **able year, in the case of an individual, and 8 percent**

1 of the adjusted tax for the taxable year, in the case
2 of a corporation, multiplied by

3 “(B) a fraction, the numerator of which is the
4 number of days in the taxable year occurring on and
5 after the effective date of the surcharge and before
6 July 1, 1969, and the denominator of which is the
7 number of days in the entire taxable year.

8 “(3) EFFECTIVE DATE DEFINED.—For purposes of
9 paragraph (2), the ‘effective date of the surcharge’
10 means—

11 “(A) January 1, 1968, in the case of a corpo-
12 ration, and

13 “(B) April 1, 1968, in the case of an in-
14 dividual.

15 “(b) ADJUSTED TAX DEFINED.—For purposes of this
16 section, the adjusted tax for a taxable year means the tax
17 imposed by this chapter (other than by this section, section
18 871 (a), or section 881) for such taxable year, reduced by
19 any credit allowable for such year under section 37 (re-
20 lating to retirement income) computed without regard to
21 this section.

22 “(c) AUTHORITY TO PRESCRIBE COMPOSITE TAX
23 RATES AND TABLES.—The Secretary or his delegate may
24 determine, and require the use of, composite tax rates incor-
25 porating the tax imposed by this section and prescribe regu-

1 lations setting forth modified optional tax tables computed
2 upon the basis of such composite rates. The composite rates
3 so determined may be rounded to the nearest whole per-
4 centage point as determined under regulations prescribed by
5 the Secretary or his delegate. If, pursuant to this subsection,
6 the Secretary or his delegate prescribes regulations setting
7 forth modified optional tax tables for a taxable year, then,
8 notwithstanding section 144 (a), in the case of a taxpayer
9 to whom a credit is allowable for such taxable year under
10 section 37, the standard deduction may be elected regardless
11 of whether the taxpayer elects to pay the tax imposed by
12 section 3.

13 “(d) ESTIMATED TAX.—For purposes of applying the
14 provisions of this title with respect to declarations and pay-
15 ments of estimated income tax due more than 45 days (15
16 days in the case of a corporation) after the date of the
17 enactment of this section—

18 “(1) in the case of a corporation, so much of any
19 tax imposed by this section as is attributable to the tax
20 imposed by section 11 or 1201 (a) or subchapter L shall
21 be treated as a tax imposed by such section 11 or
22 1201 (a) or subchapter L;

23 “(2) the term ‘tax shown on the return of the in-
24 dividual for the preceding taxable year’, as used in sec-
25 tion 6054 (d) (1), shall mean the tax which would have

1 been shown on such return if the tax imposed by this
2 section were applicable to taxable years ending after
3 March 31, 1967, and beginning before April 1, 1968;
4 and

5 “(3) the term ‘tax shown on the return of the cor-
6 poration for the preceding taxable year’, as used in sec-
7 tion 6655 (d) (1), shall mean the tax which would have
8 been shown on such return if the tax imposed by this
9 section were applicable to taxable years ending after
10 December 31, 1966, and beginning before January 1,
11 1968.

12 “(e) WESTERN HEMISPHERE TRADE CORPORATIONS
13 AND DIVIDENDS ON CERTAIN PREFERRED STOCK.—In com-
14 puting, for a taxable year of a corporation, the fraction
15 described in—

16 “(1) section 244 (a) (2) (relating to deduction
17 with respect to dividends received on the preferred stock
18 of a public utility),

19 “(2) section 247 (a) (2) (relating to deduction
20 with respect to certain dividends paid by a public util-
21 ity), or

22 “(3) section 922 (2) (relating to special deduction
23 for Western Hemisphere trade corporations),

24 the denominator shall, under regulations prescribed by the
25 Secretary or his delegate, be increased to reflect the rate at

1 which tax is imposed under subsection (a) for such taxable
2 year.

3 “(f) WITHHOLDING ON WAGES.—In the case of wages
4 paid after March 31, 1968, and before July 1, 1969, the
5 amount required to be deducted and withheld under section
6 3402 shall be determined in accordance with the tables pre-
7 scribed by the Secretary or his delegate in lieu of the tables
8 set forth in section 3402 (a) or (c) (1).”

9 (b) Section 963 (b) of the Internal Revenue Code of
10 1954 (relating to receipt of minimum distributions by do-
11 mestic corporations) is amended—

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

14 “(2) TAXABLE YEARS BEGINNING IN 1963 AND
15 1968.—”, and

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

18 “(3) TAXABLE YEARS BEGINNING IN 1965, 1966,
19 1967, AND AFTER DECEMBER 31, 1968.—”.

20 (c) The table of parts of subchapter A of chapter 1 of
21 such Code is amended by adding at the end thereof the
22 following:

“Part V.—Tax surcharge.”

23 (d) The amendments made by this section shall apply—

24 (1) insofar as they relate to individuals, with

1 respect to taxable years ending after March 31, 1968,
2 and beginning before July 1, 1969, and

3 (2) insofar as they relate to corporations, with
4 respect to taxable years ending after December 31, 1967,
5 and beginning before July 1, 1969.

6 **SEC. 7. REMOVAL OF INTEREST LIMITATIONS ON GOV-**
7 **ERNMENT BONDS.**

8 (a) The first sentence of the second paragraph of the
9 first section of the Second Liberty Bond Act (31 U.S.C.
10 752) is amended by striking out "not exceeding four and
11 one-quarter per centum per annum,".

12 (b) The second sentence of section 22 (b) (1) of such
13 Act (31 U.S.C. 757c) is amended to read as follows: "Such
14 bonds and certificates may be sold at such price or prices,
15 bear such interest rate or afford such investment yield or
16 both, and be redeemed before maturity upon such terms and
17 conditions as the Secretary of the Treasury may prescribe."

18 (c) The second sentence of section 22A (b) (1) of such
19 Act (31 U.S.C. 757c-2) is amended to read as follows:
20 "Such bonds shall be sold at such price or prices, afford such
21 investment yield, and be redeemable before maturity upon
22 such terms and conditions as the Secretary of the Treasury
23 may prescribe."

24 (d) Section 25 of such Act (31 U.S.C. 757c-1) is
25 repealed.

1 **SEC. 8. TEMPORARY REDUCTION IN EXEMPTION FROM**
 2 **DUTY FOR RETURNING RESIDENTS.**

3 (a) Subpart B of part 1 of the appendix to the Tariff
 4 Schedules of the United States is amended by inserting after
 5 item 915.25 the following new item:

" 915.30	In lieu of the \$100 and \$200 exemptions provided in Item 813.31 for articles imported by or for the account of a person arriving in the United States who is a returning resident thereof, articles to which such Item otherwise applies not over \$25 in aggregate fair retail value in the country of acquisition.	Free	Free	For returning residents arriving on or before the date prescribed by section 4911(d) of the Internal Revenue Code of 1954 for termination of the Interest Equalization Tax imposed by section 4911(a) of such Code.	"
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6 (b) The headnotes for subpart B of part 1 of the
 7 appendix to the Tariff Schedules of the United States is
 8 amended by inserting "or item 915.30" after "item 915.25".

9 (c) The amendments made by subsections (a) and (b)
 10 shall apply with respect to persons arriving in the United
 11 States on or after April 1, 1968.

12 **SEC. 9. USE OF SURPLUS FOREIGN CURRENCIES.**

13 (a) In order to encourage the use of surplus foreign
 14 currencies by United States residents engaging in foreign
 15 travel, the Secretary of the Treasury shall, during the period
 16 in which this section is in effect, make such currencies avail-
 17 able to qualified individuals in exchange for dollars at rates
 18 under which the amount of any such currency received by
 19 an individual will be equal to 110 percent of the amount, as

1 determined by the Secretary, which the individual would
2 receive under rates of exchange otherwise applicable.

3 (b) For the purpose of this section—

4 (1) The term “surplus foreign currency” means
5 foreign currency owned by the United States which is
6 available, under applicable agreements with the foreign
7 country concerned, for the use of the United States
8 Government and which is determined by the Secretary
9 of the Treasury to be in excess of the normal require-
10 ments of departments and agencies of the United States
11 for such currency.

12 (2) The term “qualified individual” means a resi-
13 dent of the United States who furnishes the Secretary
14 of the Treasury with satisfactory assurances that foreign
15 currency of any country obtained under this section will
16 be used to pay the ordinary costs incurred by such indi-
17 vidual, or by a member of his family who is a resident
18 of the United States, in connection with foreign travel
19 no part of the itinerary of which includes travel in a
20 country the currency of which is not available under this
21 section (except for travel determined by the Secretary
22 to be reasonably necessary to reach and return from the
23 country the currency of which is obtained).

24 (c) Each agreement hereafter entered into, or hereafter
25 amended or extended, between the United States and any

1 foreign country under which currency of such country
2 accrues or will accrue for the use of the United States shall
3 include provisions permitting the use of such currency for
4 the purposes of this section.

5 (d) This section shall apply during the period begin-
6 ning on the day after the date of the enactment of this Act and
7 ending on the date prescribed by section 4911 (d) of the
8 Internal Revenue Code of 1954 for termination of the
9 interest equalization tax imposed by section 4911 (a) of
10 such Code.

11 **SEC. 10. LIMITATION ON FOREIGN TRAVEL BY GOVERN-**
12 **MENT OFFICERS AND EMPLOYEES.**

13 (a) No money appropriated or otherwise made avail-
14 able by Act of Congress shall be used to pay any costs of or
15 incident to travel in any foreign country during the period in
16 which this section is in effect by any civilian officer or em-
17 ployee in the executive, legislative, or judicial branch of the
18 Government, unless the authorization for such travel contains
19 or is accompanied by a certification by the proper certifying
20 officer that the travel in such foreign country is essential.

21 (b) Subsection (a) shall not apply to—

22 (1) travel in a foreign country by an officer or em-
23 ployee whose principal place of duty is in such foreign
24 country, or

1 (2) travel which is begun on or before the date of
2 the enactment of this Act.

3 (c) For the purposes of this section, the term "proper
4 certifying officer" means—

5 (1) the President of the United States, with respect
6 to the heads of the departments and agencies in the
7 executive branch, the President pro tempore of the
8 Senate, the Speaker of the House of Representatives, the
9 Chief Justice of the United States, the justices and
10 judges of the courts of the United States, and officers and
11 employees in the judicial branch;

12 (2) the head of a department or agency in the
13 executive branch, with respect to officers and employees
14 of such department or agency;

15 (3) the President pro tempore of the Senate, with
16 respect to Members, officers, and employees of the Sen-
17 ate; and

18 (4) the Speaker of the House of Representatives,
19 with respect to Members, officers, and employees of the
20 House of Representatives, and other officers and em-
21 ployees in the legislative branch (other officers and
22 employees of the Senate).

23 (d) This section shall apply during the period beginning
24 on the day after the date of the enactment of this Act and
25 ending on the date prescribed by section 4911 (d) of the

1 Internal Revenue Code of 1954 for termination of the inter-
2 est equalization tax imposed by section 4911 (a) of such
3 Code.

4 **SEC. 11. REMOVAL OF GOLD RESERVE REQUIREMENTS**
5 **FOR FEDERAL RESERVE NOTES, UNITED**
6 **STATES NOTES, AND TREASURY NOTES OF**
7 **1890.**

8 (a) Subsection (c) of section 11 of the Federal Reserve
9 Act (12 U.S.C. 248 (c)) is amended by striking both
10 provisos, and by striking the last sentence in such subsection.

11 (b) The first sentence of section 15 of the Federal
12 Reserve Act (12 U.S.C. 391) is amended by striking "and
13 the funds provided in this Act for the redemption of Federal
14 Reserve notes".

15 (c) That part of the third paragraph of section 16 of the
16 Federal Reserve Act (12 U.S.C. 413) which precedes the
17 last two sentences of such paragraph is amended to read:
18 "Federal Reserve notes shall bear upon their faces a distinc-
19 tive letter and serial number which shall be assigned by the
20 Board of Governors of the Federal Reserve System to each
21 Federal Reserve bank."

22 (d) (1) The first sentence of the fourth paragraph of
23 section 16 of the Federal Reserve Act (12 U.S.C. 414) is
24 repealed.

25 (2) The sentence which, prior to the repeal made by

1 this section, was the second sentence of such paragraph is
2 amended by inserting immediately after "The Board" the
3 following: "of Governors of the Federal Reserve System".

4 (e) The sixth paragraph of section 16 of the Federal
5 Reserve Act (12 U.S.C. 415) is repealed.

6 (f) The fourth sentence of the paragraph which, prior
7 to the amendments made by this Act, was the seventh para-
8 graph of section 16 of the Federal Reserve Act (12 U.S.C.
9 416) is repealed.

10 (g) The paragraph which, prior to the amendments
11 made by this Act, was the eighteenth paragraph of section
12 16 of the Federal Reserve Act (12 U.S.C. 467) is re-
13 pealed.

14 (h) Section 6 of the Gold Reserve Act of 1934 (31
15 U.S.C. 408a) is amended by striking in the second proviso
16 the phrases "the reserve for United States notes and for
17 Treasury notes of 1890, and" and ", and the reserve for
18 Federal Reserve notes shall be maintained in gold certifi-
19 cates, or in credits payable in gold certificates maintained
20 with the Treasurer of the United States under section 16 of
21 the Federal Reserve Act, as heretofore and by this Act
22 amended".

23 (i) There are hereby repealed the sentences of sub-
24 section (a) of section 43 of the Act of May 12, 1933 (48
25 Stat. 31, 52; 31 U.S.C. 821 (a)), which read: "No suspen-

1 sion of reserve requirements of the Federal Reserve banks,
2 under the terms of section 11 (c) of the Federal Reserve Act
3 necessitated by reason of operations under this section, shall
4 require the imposition of the graduated tax upon any defi-
5 ciency in reserves as provided in said section 11 (c). Nor
6 shall it require any automatic increase in the rates of interest
7 or discount charged by any Federal Reserve bank, as other-
8 wise specified in that section.”

9 (j) Section 2 of the Act of July 14, 1890 (26 Stat.
10 289), as amended (31 U.S.C. 408), is hereby repealed.

11 (k) Section 7 of the Act of January 30, 1934 (48—
12 Stat. 341, 31 U.S.C. 408b), is amended by striking the
13 phrase “and as a reserve for any United States notes and for
14 Treasury notes of 1890” and also by striking the phrase “as
15 a reserve for any United States notes and for Treasury notes
16 of 1890, and”.

90TH CONGRESS
2d Session

S. 2903

IN THE SENATE OF THE UNITED STATES

JANUARY 31, 1968

Mr. WILLIAMS of Delaware introduced the following bill; which was read twice
and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 to limit the maximum rate of percentage depletion to a rate of 20 percent.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That (a) section 613 (b) (1) of the Internal Revenue Code
4 of 1954 (relating to percentage depletion rate for oil and
5 gas wells) is amended—

6 (1) with respect to taxable years beginning in
7 1968, by striking out “27½ percent” and inserting in lieu
8 thereof “25 percent”:

9 (2) with respect to taxable years beginning in
10 1969, by striking out “25 percent” and inserting in lieu
11 thereof “22½ percent”; and

1 (3) with respect to taxable years beginning in 1970
2 and subsequent years, by striking out "22½ percent" and
3 inserting in lieu thereof "20 percent".

4 (b) Section 613 (b) (2) of the Internal Revenue Code
5 of 1954 (relating to percentage depletion rate for sulfur,
6 uranium, and certain other deposits) is amended—

7 (1) with respect to taxable years beginning in
8 1969, by striking out "23 percent" and inserting in lieu
9 thereof "22½ percent"; and

10 (2) with respect to taxable years beginning in
11 1970 and subsequent years, by striking out "22½ per-
12 cent" and inserting in lieu thereof "20 percent".

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, D.C., March 11, 1968.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your request for comments on S. 2902, a bill to improve the balance of payments and protect the domestic economy of the United States.

The bill contains a number of provisions, including a tax increase, constraints on expenditures, repeal of the gold reserve requirement on Federal Reserve and other notes, removal of the interest rate ceiling in U.S. Government bonds, and various provisions affecting U.S. international transactions. The Board has, on several occasions, expressed its support for repeal of the interest rate ceilings on U.S. Government bonds (section 7) and repeal of the gold cover requirement on Federal Reserve notes (section 11). The interest rate provision would enhance the flexibility of the U.S. Treasury in meeting the financial needs of the Government and in adapting debt management policies to economic and financial conditions. Repeal of the gold cover would assure that the entire U.S. gold stock is available to meet the country's international obligations.

The Board has also supported the need for fiscal restraint to combat inflationary pressures under current circumstances. At various times, the Board has indicated its support of a 10 percent surcharge on both corporations and individuals.

In this bill (section 6) a surtax of 8 percent on corporations and 6 percent on individuals is proposed. In addition, various other provisions would impose additional constraints on Federal spending. The effect of each of these steps would be to reduce net demands, both public and private, on our economic resources. The Board would like to take this occasion again to emphasize the need for a reduction in the prospective growth rate of aggregate demand in order to curb the inflationary pressures that are threatening the stability of the domestic economy and of our international financial position.

Sincerely,

J. L. ROBERTSON,
Vice Chairman.

TREASURY DEPARTMENT, WASHINGTON, D.C., MARCH 12, 1968

The attached material was a reply sent to Senator John Williams on March 4, 1968 in response to his request for the views of the Treasury Department on bills introduced by him with respect to various aspects of the fiscal picture, including tax increases, expenditure reduction, and balance of payments measures.

Senator Williams indicated that he intended to address questions to Administration officials on those bills when they testified in connection with the hearings on H. R. 15414 before the Senate Committee on Finance.

In order to provide Senator Williams and the Committee with a careful analysis of his bills, which could also provide a framework within which to respond to any questions on the bills, a reply containing such analysis by the Treasury Department and the Bureau of the Budget was sent to Senator Williams prior to the hearing.

THE SECRETARY OF THE TREASURY,
Washington, March 4, 1968.

HON. JOHN J. WILLIAMS,
U.S. Senate, New Senate Office Building,
Washington, D.C.

DEAR SENATOR WILLIAMS: This letter is in reply to your request for the views of the Treasury Department on your bills, S. 2902 "A Bill to improve the balance of payments and protect the domestic economy of the United States", and S. 2903 "A Bill to amend the Internal Revenue Code of 1954 to limit the maximum rate of percentage depletion to a rate of 20 percent."

Sections 3, 4, 5 and 10 of S. 2902 are within the direct purview of the Director of the Budget, dealing as they do with the number of civilian employees, the initiation of public works projects, budget expenditures generally, and foreign travel by Government officers and employees. I am therefore attaching a copy of a statement by Director Zwick commenting on these sections. As that statement indicates, the Administration strongly opposes the provisions of these sections.

The remaining provisions in these bills relate to matters within my area of responsibility, and I am commenting upon them in a statement attached to this letter. In addition to that statement, I would like to make a few overall observations on S. 2902.

The sections of S. 2902 within my area of responsibility cover matters which are the subject of proposals of the Administration presently before the Congress. The principal thrust of those sections is in the same direction as those proposals and I therefore welcome your support of our objectives. Moreover, for the most part the provisions of your bill dealing with these matters are substantively quite close to our own recommendations, so that in a number of instances the difference becomes one of detail. Thus, your recommendation in Section 2 of the bill for a continuation of existing automobile and communications excise taxes is quite close to our proposal in this area and to what has been already adopted by the House. Your recommendation in Section 8 of the bill relating to reductions in existing Customs exemptions is likewise close to the proposals I presented to the Committee on Ways and Means on February 5, and which have been the subject of recent hearings before that Committee. Your recommendation in Section 11 of the bill to repeal the gold reserve requirements for Federal Reserve Notes parallels legislation now before the Senate which we strongly support. The recommendation in Section 6 of the bill for a temporary surcharge on individuals and corporations adopts the same form for a temporary tax increase that we have been steadily and strongly urging.

Your recommendations in these sections thus deal directly with the basic objectives of our fiscal program—the reduction of the budgetary deficits that would otherwise prevail in fiscal year 1968 and 1969 to more manageable and acceptable levels, and a reduction in our balance of payments deficit. In these substantive areas I welcome and appreciate your support.

As respects Section 6 of your bill, where you recommend a temporary 8 percent surcharge on corporations and a 6 percent surcharge on individuals, I would of course strongly urge that we achieve the temporary surcharge at the 10 percent level recommended in the Budget. A surcharge at that level will add over \$½ billion in fiscal 1968 and over \$3 billion in fiscal 1969 to the revenues that would be obtained under the rates you suggest. I feel that this additional revenue is needed to achieve the reductions in the budget deficits that are desired.

The paramount need is that of achieving legislative enactment of the requisite revenue-producing measures. We should also secure that enactment as promptly as possible, so that delay does not cause us to see revenues keep draining away

that a prompt enactment would have put into the coffers of the Government. I must leave to the Congress the question of Congressional procedure involved in obtaining the desired legislation. Presumably that procedure is a matter to be worked out between the leaders of both Houses and the leaders of their Tax Committees.

Although we have major reservations with respect to the sections of your bill dealt with in Director Zwick's statement, again let me express my appreciation for your encouraging support of our tax and balance of payments objectives.

Sincerely yours,

HENRY H. FOWLER.

BUREAU OF THE BUDGET COMMENTS ON S. 2002

S. 2002, "Balance of Payments and Domestic Economy Act of 1968," contains a combination of tax measures and expenditure provisions "to improve the balance of payments and protect the domestic economy of the United States." Some sections of the bill are similar to proposals made or actions already underway by the Administration with the same objectives in mind. Other sections, however, represent unwise, inefficient, or impractical methods of accomplishing the desired purposes. In total they are a prescription for inefficient government.

The Bureau of the Budget is primarily concerned with Sections 3, 4, 5, and 10 of the bill; analyses of each of these sections are presented below. Sections 3, 4, and 5 are, in our view, particularly troublesome. These sections, taken together, are designed to accomplish an expenditure reduction of \$8 billion in fiscal year 1969. Section 3 calls for a freeze on civilian officers and employees in the executive branch at the September 20, 1966 level. Section 4 requires a moratorium on public works. Section 5 imposes an expenditure limit of \$178 billion in fiscal year 1969.

These sections are undesirable, from the point of view of both policy and administration. To summarize briefly, they would—

require an arbitrary, meat-axe approach to Government programs and services instead of careful and deliberate program-by-program review.

fall inequitably upon the activities which are relatively controllable, requiring, in many cases, crippling reductions.

cause considerable uncertainty since, if, as the year progressed, expenditures for uncontrollable programs were to increase over the estimates, the limited controllable portion of the budget would have to be cut more and more deeply to keep within the statutory ceiling on total expenditures.

transfer from the Congress to the Executive virtually all decision-making as to which programs to fund and staff, regardless of congressional action through the appropriations process.

Orderly, efficient Government requires explicit decisions—program by program—after consideration of needs and priorities by both the Executive and the Congress. Moreover, to be effective in these rapidly changing times, Government must have a degree of flexibility. A statutory expenditure limit, combined with a retroactive freeze on civilian employment and an across-the-board moratorium on public works, runs counter to both of these requirements.

ANALYSIS OF SECTIONS 3, 4, 5, AND 10

Section 3. Reduction in executive branch employment

Summary.—During any period in which employment in the executive branch exceeds the level of employment of September 20, 1966, no more than 25% of total vacancies occurring may be filled.

The Director of the Bureau of the Budget is required to determine which vacancies may be filled, reserve from expenditure the savings in salaries and wages and other categories of expense resulting from this action, and make quarterly reports to the Congress of his activities.

The section would not apply to employees in the Department of Defense, the postal field service, the Federal Bureau of Investigation, offices filled by appointment by the President with the advice and consent of the Senate, or to positions filled by transfer from the same or another agency. However, all such employees and offices would be counted in the aggregate number of employees employed September 20, 1966 and the number employed at any particular time.

This section would take effect April 1, 1968.

Comments.—Total Federal civilian employment in the executive branch at the end of September 1966 was 2,762,000. The Post Office and the Defense Depart-

ment accounted for 1,834,000 and all other agencies 928,000. The 1969 budget estimates of employment were based on careful review and determination of the minimum numbers of employees essential to support the proposed program levels. The estimates indicate an increase of 315,000 in June 1969 above the September 1966 level. Post Office and Defense will account for 207,000 of this increase and all other agencies will account for the balance of 108,000.

Since the provisions of section 5 about not filling 3 out of 4 vacancies do not apply to the Post Office and the Defense Department, but their numbers are included in the totals, employment in the rest of the Government agencies would have to be reduced *below* the level of September 20, 1966 to the extent that the Defense Department, the Post Office and the Federal Bureau of Investigation *exceed* their September 20, 1966 level. Therefore, the other Government agencies would have to reduce employment not only by the 108,000 by which they are estimated to increase, but also by the 207,000 that the Post Office and Defense Department are estimated to increase.

A reduction of some 315,000 employees in those agencies is in excess of 30% from the estimated June 1969 level and more than 200,000 below the September 1966 employment level which section 3 is designed to maintain! This would completely disrupt the functions of Government.

Section 3 appears to give discretion to the Director of the Bureau of the Budget as to which vacancies should be filled, but in reality the Director would have little or no discretion. Neither the President, the Congress, nor the public would want air safety jeopardized, for example. The choice would then be to limit air travel or to increase employment in the Federal Aviation Administration. The effect of section 3 would be that for each person added by the Federal Aviation Administration, four vacancies elsewhere would have to go unfilled. If employment were to be merely held level at FAA, all vacancies in FAA would be filled, and for each vacancy that occurred and was filled at FAA three vacancies must be left unfilled elsewhere.

Similarly, programs such as social security or Medicare must handle all of those who are eligible. Accordingly, maintaining or increasing employment in the Social Security Administration to cope with rising workloads would mean that four times the number of increases and three times the number of vacancies filled at the Social Security Administration would have to be left unfilled elsewhere in the Government.

Long before the Director could satisfy requirements of the Federal Aviation Administration, social security, and other important activities, such as law enforcement, veterans' hospital care, and civilian agency support for Vietnam operations, the number of vacancies that legally could be filled would undoubtedly be exhausted. The result would be that a large number of agencies would be forced to drastically curtail or eliminate services to the public.

Section 3 completely disregards the fact that demands for Government services are increasing and that there must be additional employees to handle the resulting increased workloads.

For example, it is estimated that the number of establishments requiring Federal meat inspectors will increase by 78% in 1969. The only alternative to permitting uninspected and perhaps unwholesome meat to pass to the consumer is to increase the number of inspectors. Similarly, additional employees are necessary for projected increased services in 1969 such as:

- Loans to small business—up 21%.
- New Federal manpower programs aimed at both the urban and rural disadvantaged—a 20% increase in program level.
- Maintenance of air travel safety while air traffic significantly increases—landings and takeoffs at airports with FAA towers will increase 15%.
- Processing of mortgage insurance applications to the Federal Housing Administration by prospective homeowners—expected to increase by 100,000.
- Disposition of 4% more patent applications in the Commerce Department.
- Handling of complaint applications concerning monopolistic and unfair trade practices—up 7%.
- Disposition of electric rate filings to the Federal Power Commission—up 4.4%.
- Adjudication of air carrier rate and fare cases—up 16%.
- Disposition of applications for motor carrier operating authority—up 8%.
- Mediation of unfair labor practice cases—up 7.5%.
- Handling of 112 million tax returns by the Internal Revenue Service—up almost 3 million.

In the face of these workload increases, it is apparent that appropriate action with regard to Federal employment is not to impose arbitrary and disruptive

decreases, but to limit increases to what is essential. This was the policy pursued by the President in his 1969 budget.

The selection of the month of September for the base period in section 3 would cripple the regular and special summer activities of the Government. These include programs to accommodate visitors to the national forests and parks, construction activities in agencies such as the Corps of Engineers and Tennessee Valley Authority, the President's summer program for disadvantaged youth, etc. Most temporary summer employees have left the rolls by September.

Section 3 requires the Director of the Bureau of the Budget to decide which vacancies should be filled. The number of vacancies occurring each year, apart from Defense and Post Office, is about 250,000. For the Director to carry out this function on any but a generalized basis would require a considerable increase in staff.

Employees of the executive branch of the Federal Government are hired to carry out the laws enacted by the Congress and at levels of activity determined by the Congress. The effect of section 3 would be to require the Director of the Bureau of the Budget to decide which of those laws should be ignored or only partially carried out. It would be more appropriate for the Congress itself to make those specific determinations through normal legislative processes.

Section 4. Moratorium on public works projects

Summary.—This section has four principal provisions:

From the date of enactment and during the time in which a tax surcharge is in effect, no Federal agency shall:

Initiate the planning or construction of any public works project (excluding highway projects), or

Make any grant to any State or local government agency for initiating planning or construction of any such projects.

Planning or construction of new projects may proceed only when the Director of the Office of Emergency Planning, after investigation, determines that a delay in planning or constructing such projects would cause irreparable damage to the "public health or welfare."

The Director of OEP is required to investigate all public works projects (except highway projects) being planned or constructed on the date of enactment to determine which projects can be temporarily halted without causing irreparable damage to the public health or welfare.

No Federal agency shall continue the planning or construction of Federal projects or make any grant for continuing planning or construction of State and local projects if the Director of OEP determines that such projects can be temporarily halted.

Comments.—The proposed moratorium on public works projects would be costly and difficult to administer. It would require uneconomic actions to stop many worthwhile projects already underway if large reductions in expenditures were to be achieved.

The intent of S. 2002 in restricting new public works construction starts may be only slightly more limiting than the President's recommendations in the 1969 budget. The budget proposes very few new direct Federal projects other than those essential to the national defense and health and welfare of the public and, holds going work to a minimum level.

The principal difference from the President's recommendations is the intent to halt going projects. In this respect, the bill goes far beyond actions taken in the Korean crisis, when contracts were generally allowed to be completed on less essential projects before placing the projects on a standby basis. The present bill would require cancellation of existing contracts.

More specifically, section 4 would create the following difficulties:

First, the proposal to stop projects under construction would be economically wasteful and costly to the Federal Government and to State and local governments. It would require additional costs to place projects on a standby basis and would subject the Federal agencies to damage claims for cancellation of construction contracts. The economic waste would apply also to Federal grant programs whenever additional grants would be necessary to complete a project already underway.

Second, the proposal to stop planning on projects (even though construction is not yet underway) would severely damage Federal and State and local construction programs with very little saving in Federal expenditures. Halting of planning work would result in the loss of highly skilled agency staff who could not easily be replaced when the Federal construction program was resumed. In

addition, deferral of planning could impair later effectiveness and timing of resumption of Federal public works construction if this were deemed desirable to facilitate postwar adjustments.

Third, determination of which projects could be undertaken within the phrase "essential to the public health or welfare" would be controversial and time-consuming. Without clear definitions, the bill would be difficult to administer fairly and efficiently.

Fourth, investigation of the projects being planned or under construction before a determination to stop a project would require a time-consuming investigation period. The application of the moratorium to all going projects could well take several years, by which time some of these projects would already be completed. If an investigation of going projects were to be required, it is questionable whether OEP is the proper agency to review the agencies' proposals and make the final determination as to what is "essential to the public health and welfare."

Fifth, there is no clear reason why the Federal highway construction program should be excluded from the moratorium, since in many cases highways could as well be delayed as public buildings, educational facilities, water resources projects, and other projects beneficial to the domestic economy. Moreover, the provisions of section 4 appear to limit the exclusion to direct Federal highway projects and do not mention the exclusion with reference to grants to States or local governments. Most of the highway program is, of course, financed through grants from the Highway Trust Fund.

Finally, section 4 has a number of other technical difficulties which would complicate its administration and in some cases raise serious questions as to equity in its application to Federal programs. For example, there is no definition of the word "project," although this term can be applied with considerably different effects in different construction programs. It also affects the determination of what is "new work" or "work underway". No mention is made of Federal loans to State or local governments, although projects similar to, or complementary to, projects financed by grants are also financed by Federal loans. Private or quasi-public institutions (e.g., educational and health) receive construction assistance through Federal grant programs, but the bill limits the moratorium to grants to State and local government agencies.

Section 5. Expenditure limitation

Summary.—This section of the bill would limit expenditures in fiscal year 1969 (using the new budget concept) to \$178 billion. This limit would not apply to expenditures in excess of \$25 billion for our military effort in Southeast Asia, if the President determines greater expenditures to be necessary for that purpose in 1969.

The limit on expenditures is to be accomplished by reserving amounts of obligational authority heretofore or hereafter made available.

Comments.—The Bureau of the Budget opposes attempting to hold budget expenditures to a legally set limit. Such an attempt presents many serious difficulties, both for the executive branch and the Congress.

First, the Congress provides appropriations which grant the Administration power to enter into contracts or obligate money. Expenditures are simply the process of paying off those contracts and honoring those obligations. Expenditures alone cannot be controlled; the initial contracts or obligations must be controlled. An expenditure ceiling does not face this fact—it is like locking the barn door after the horse has gone.

Second, an expenditure limitation makes no allowance for uncontrollable changes in expenditures. The President would, of course, have to make an initial round of program reductions. However, later in the fiscal year, expenditures could increase—and the Administration would be powerless to stop this—in such locked-in programs as interest on the public debt, CCC price supports, veterans' pensions, and Medicaid, for example. These increases would immediately require even further cuts in other programs which could be controlled—aid to education, airway safety, and health research, for example. As a matter of fact, if substantial uncontrollable expenditure increases took place late enough in the fiscal year, some vital programs might be crippled or might well have to shut down completely to offset the increases and stay within the legal ceiling.

Third, an expenditure limitation would require a whole new and cumbersome set of controls. The entire Federal accounting system is set up to control at the point where contracts or commitments are made. Expenditures are simply an estimate of how rapidly checks will be written as work progresses, planes are delivered, States draw their grant authorizations, and so forth. But with a legal limit on expenditures, all the agencies would have to set up a whole new and wasteful management system to control those expenditures.

Along with these very practical problems associated with a statutory expenditure limit, there are fundamental considerations involving the separation of powers and congressional processes.

An absolute ceiling on expenditures, as provided in section 5, would, in effect, transfer most of Congress' powers of the purse to the President by giving him *carte blanche* authority to reserve funds made available by the Congress. The President, not the Congress, would thereby have almost complete authority to decide whether new or old programs should be funded, and at what levels.

An absolute ceiling on expenditures, as provided in section 5, would also completely undercut the congressional appropriations process. The Appropriations Committees make a careful examination of individual programs. Agency witnesses are questioned closely and at length on each budget request. The specific appropriations are considered by the House and Senate as a whole, and normally by conference committees as well, before final action is taken. Section 5 would undo the results of this process before most appropriations for fiscal 1969 are even enacted, and would substitute a sweeping meat-axe approach—enacting obligating authority, on the one hand, while disregarding it on the other.

There can be no question that a reduction of \$8 billion from the estimated level of expenditures in fiscal 1969 *would* mean sweeping reductions in programs. To achieve a reduction of that magnitude would require cutting program levels by roughly double that amount—around \$16 billion. Where could reductions of that amount realistically or desirably be made?

As noted earlier, there are some programs which are relatively uncontrollable, under which payments are virtually fixed by statutory formula in the short term. These include social security, Medicare, and other social insurance trust funds; veterans' pensions; interest on the Federal debt; and public assistance grants. The Government is both legally and morally obliged to make the payments required for these types of programs, unless the authorizing legislation is changed. And these payments are often difficult to estimate, since they involve factors largely outside of Government actions.

Our defense needs outside of Southeast Asia were examined with great care in formulating the 1969 budget. It would not be possible to effect large cuts in national defense at this point in time without damage to our national security.

This leaves \$39.5 billion of relatively controllable civilian programs, *including* outlays from prior year contracts and obligations, to bear the full brunt of the reduction—which could require crippling and destructive cuts in—

- elementary and secondary education;
- research on cancer, heart disease, mental illness, and other health problems;
- loans for rural electrification, telephones, and housing;
- veterans' medical care;
- activities to combat crime;
- Internal Revenue Service audits of tax returns;
- grants for maternal and child health and welfare;
- school lunch, special milk, and food stamp programs;
- operation of airways by the Federal Aviation Administration;
- programs for Model Cities and urban transportation; and
- air and water pollution control.

This list could be extended, but the issue is clear. If we want reductions in these programs of the magnitudes involved in section 5, the Congress should say so in terms of the specific activities to be reduced.

The President's 1969 budget calls for tight controls on all programs—with selective expansions in some areas almost entirely offset by reductions in other controllable programs. The expenditure program in the budget is based on a strict review of national needs and objectives. Coupled with the President's tax program, it represents a responsible way of meeting our economic, fiscal, and program requirements.

Section 10. Limitation on foreign travel by Government employees

Summary.—Section 10 provides that no civilian officer or employee of any of the three branches of Government may travel in a foreign country unless the travel is certified as essential by a proper certifying officer.

The term "proper certifying officer" is defined as:

(1) The President, for the heads of departments and agencies in the executive branch, the President pro tempore of the Senate, the Speaker of the House, the Chief Justice of the United States, the Justices and Judges of Courts of the United States, and officers and employees in the Judicial branch.

- (2) Department and agency heads, for their officers and employees.
 (3) The President pro tempore of the Senate, for Members, officers, and employees of the Senate.
 (4) The Speaker of the House, for Members, officers, and employees of the House.

The section does not apply to travel in a foreign country by employees whose principal place of duty is in that foreign country.

The section would remain in effect until termination of the interest equalization tax.

Comments.—The provisions of section 10 are unnecessary for reducing foreign travel in view of the measures already undertaken in the executive branch. In a memorandum of January 18, 1968, the President directed the heads of departments and agencies to reduce official travel overseas to the minimum consistent with the orderly conduct of the Government's business abroad. On February 14, the Bureau of the Budget issued further instructions in Bulletin No. 68-8. Each agency head was asked to take as his objective reduction of 25 percent in all overseas travel to and from places outside the United States except travel inherent in permanently assigning personnel overseas.

Each agency is required to report to the President a plan covering all of its overseas travel through fiscal year 1969 including a statement describing the actions taken by the agency head to reduce overseas travel, the amount that travel is expected to be reduced by such actions, and recommendations as to any additional measures that might be taken.

In addition, agencies will make quarterly reports comparing actual overseas travel costs with the plan previously submitted.

The designations of "proper certifying officer" in section 10 present certain difficulties. It would be most improper, if not unconstitutional, for the President to determine whether or not foreign travel could be performed by the President pro tempore of the Senate, the Speaker of the House or all of the Justices, Judges, and officers and employees in the Judicial branch.

Moreover, the administrative burden required for some agency heads to certify personally the essentiality of foreign travel of all employees of their agencies could seriously interfere with their primary duties.

IEWS OF TREASURY DEPARTMENT ON S. 2902 (SECS. 2, 6, 7, 8, 9, AND 11) AND S. 2903 (INTRODUCED BY SENATOR WILLIAMS)

This memorandum sets forth the analysis and views of the Treasury Department on sections 2, 6, 7, 8, 9, and 11 of S. 2902, "A Bill To improve the balance of payments and protect the domestic economy of the United States", and on S. 2903, "A Bill To amend the Internal Revenue Code of 1954 to limit the maximum rate of percentage depletion to a rate of 20 percent," both introduced by Senator Williams.

S. 2902.

Section 2 of S. 2902 provides a one year postponement of the scheduled rate reductions for the automobile and communications excise taxes. Thus, the reduction from 7 percent to 2 percent of the excise tax on automobiles, now scheduled for April 1, 1968, would be postponed until April 1, 1969, after which the rate would drop to a permanent 1 percent. The tax on communications, now scheduled to drop from 10 percent to 1 percent on April 1, 1968, would be continued at a 10 percent rate until April 1, 1969, after which the tax would be repealed.

The Treasury, of course, favors postponement of the excise tax rate reductions now scheduled for April 1, 1969. We believe, however, that the provisions of H.R. 15414, "The Tax Adjustment Act of 1968," in this regard are more aptly suited to our revenue needs for fiscal year 1969 than the procedure adopted in S. 2902. Under this bill, which has been passed by the House, the scheduled excise tax reductions are postponed until December 31, 1969, after which date a schedule of gradual reductions eliminates these taxes by 1973. The continuance of the excise taxes in this manner produces an estimated \$2.7 billion of additional revenue in fiscal year 1969 over the revenue from these excise taxes if the reductions take effect as presently scheduled. Under section 2 of S. 2902, this revenue yield would be reduced by an estimated \$360 million.

In addition, a sudden large drop in the excise tax rate on automobiles, such as would occur under section 2, produces problems for the industry. H.R. 15414 provides for more gradual rate reductions in order to avoid a significant deferral of automobile purchases that might take place in the months immediately preceding a reduction date.

Section 6 of the bill imposes a 6 percent surcharge on individuals and an 8 percent surcharge on corporations. The surcharge would be effective April 1, 1968, for individuals (thus producing a 4.5 percent surcharge for calendar year taxpayers for 1968), and January 1, 1968, for corporations. The tax would terminate on July 1, 1969, for both corporations and individuals.

The Administration strongly supports a temporary surcharge. For the reasons indicated and more fully set forth in my statements before the House Ways and Means Committee, we believe that the surcharge rate should be set at 10 percent as proposed by the President. Reduction of the surcharge rate to 6 percent for individuals reduces the revenue yield from the Administration's proposal by \$370 million for fiscal year 1968 and by \$2.770 billion for fiscal year 1969. Reducing the corporate surcharge rate to 8 percent yields \$190 million less than the Administration proposal for fiscal year 1968, and \$580 million less for fiscal year 1969. Thus, the rates proposed in S. 2902 reduce the revenue yield from the proposed 10 percent surcharge by a total of \$560 million in fiscal year 1968 and \$3.350 billion in fiscal year 1969.

Section 7 of the bill provides for the removal of interest limitations on Government bonds. In 1967, the Treasury Department asked the Congress to redefine Treasury notes, which are not subject to the interest rate ceiling, to include maturities of up to 10 years, and to allow issuance of as much as \$2 billion of longer term bonds without regard to the ceiling. The Congress amended this request by restricting the term of notes to seven years and did not give the Treasury the authority to issue bonds without regard to the ceiling. We would naturally like to see the recommendations we made last year enacted into the law. While the Treasury would not want to issue a substantial amount of long-term bonds in the foreseeable future because of the current high level of interest rates and the problem of competing in the market for long-term mortgage funds, we would have no objection to removing the ceiling as proposed in section 7.

Section 8 of the bill would reduce temporarily the exemption from customs duty accorded to returning residents from the \$100 and \$200 provided in item 813.31 of the Tariff Schedules of the United States to \$25.

On February 5, 1968, I appeared before the Committee on Ways and Means to present certain legislative aspects to the President's balance of payments program. That program includes a recommendation that the tourist exemption of \$100 be reduced to \$10 for U.S. residents returning from countries other than Canada, and Mexico, and the Caribbean area. The \$10 duty-free gift privilege for articles arriving in the mails would be reduced to \$1. These changes (as well as that provided in section 8) would impose a heavy administrative burden with substantial increased costs on the Customs Service. It is therefore important to alleviate such problems by imposing a schedule of flat rates of duty. Thus, under the Treasury proposal, a flat 25 percent rate of duty plus any tax due would be assessed on all dutiable articles valued at \$500 or less imported by travelers for non-commercial purposes. Non-commercial mail parcels (and non-commercial commercial shipments arriving by other means) valued at \$250 or less and more than \$10 would be assessed a flat 25 percent duty rate plus any tax due. A \$2 charge would be imposed on all dutiable non-commercial parcels arriving by mail which are valued at \$10 or less retail. Articles valued at \$1 or less arriving in the mails or otherwise would continue to be duty free. These steps would achieve a balance of payments savings of about \$100 million. The Treasury, thus, supports the objective of section 8, but believes that the Administration proposals deal with the problem in a more comprehensive manner.

Section 9 would encourage the use of excess foreign currencies by offering them to American travelers at a 10 percent discount. However, this would not be available to a traveler who visited another foreign country unless such travel was reasonably necessary to reach the country in which the excess currency was available.

We are opposed to this provision for several reasons. It would do little to aid the problem since travel to excess currency countries is not significant,¹ and the amounts of currency available are limited by prior agreement. The United States is bound to obey the currency control laws and official practices of each country with respect to its own currency. The offering of a "bonus" upon conversion by a traveler would constitute unilateral devaluation of that country's currency with all the incident results to its economy. This would constitute a violation

¹ The U.S. on June 30, 1967, owned excess currencies in only ten countries: Burma, Ceylon, Guinea, India, Israel, Pakistan, Poland, Tunisia, the UAR, and Yugoslavia. Ninety percent of the total U.S. holdings of foreign currency of \$2.18 billion is in these ten countries, and sales are presently being made in seven of these. (See table attached.) While our currency holdings are large in these ten countries, only a proportionately small number of American tourists visit these countries.

of our IMF obligations with respect to another IMF member country. Further, it is likely that many of these countries would hesitate to enter into the P.L. 480 agreements if they were forced to agree to the discount arrangement for U.S. travelers. The resultant effects on our agricultural export program would be much more serious than any possible gain from the slight increase in the use of excess foreign currency.

Section 11 of the bill would repeal the gold reserve requirements for Federal Reserve Notes, United States Notes and Treasury Notes of 1890. The Administration supports the objective of this section. On January 22, 1968, the Treasury Department submitted to the Congress draft legislation to repeal the gold cover requirement which was introduced as S. 2857 and H.R. 14743. The House has passed H.R. 14743, with amendments, and the Senate Banking and Currency Committee has reported S. 2857.

S. 2903.

S. 2903 provides that the rate for percentage depletion for oil and gas would be reduced from 27½ percent to 20 percent over a 3-year period beginning in 1968. The present depletion allowance of 23 percent applicable to uranium, sulphur and other minerals would be reduced to 20 percent over a 2-year period beginning in 1969.

The depletion allowance is a part of this nation's overall energy policy. In his Message last year on Protecting Our Natural Heritage, the President directed the President's Science Advisor and his Office of Science and Technology to sponsor a study of our energy resources and to coordinate our energy policy on a government-wide basis. This study is underway and will include an examination of the tax rules regarding natural resources, including those covered by this bill. It would, I believe, be premature to comment directly on S. 2903 until the results of that study are completed and its recommendations have been considered.

SALES OF U.S.-OWNED FOREIGN CURRENCIES UNDER SECS. 104 (s), (t), AND (j) OF PUBLIC LAW 480 TO U.S. CITIZENS, 1963-DEC. 31, 1967

[In thousands of dollar equivalents]

Country	Amount sold through Dec. 31, 1967			Amount currently available for sale
	Tourists	U.S. citizens	Total	
Ceylon.....	11.4	0	11.4	79.1
Guinea.....	0	0	0	16,002.5
India.....	97.2	4,603.4	4,701.1	4,665.8
Israel.....	483.5	390.4	873.9	18,458.2
Pakistan.....	8.8	1,622.7	1,631.5	982.1
Tunisia.....	8.8	0	8.8	12,185.4
United Arab Republic.....	258.5	27.6	286.1	191,048.2
Total.....	868.2	6,644.6	7,512.8	113,421.3

¹ Includes currencies available for meeting U.S. Government official expenditures.

The CHAIRMAN. You are recognized.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY HON. CHARLES J. ZWICK, DIRECTOR, BUREAU OF THE BUDGET; AND STANLEY S. SURREY, ASSISTANT SECRETARY

Secretary FOWLER. Mr. Chairman, and members of the committee. It is a pleasure to get across the street for a change. I have been somewhat stalled on the other side of the Capitol and even though I am over here only with a partial package or one element of the package, it is nice to be here and I expect to be here on further occasions.

The CHAIRMAN. Well, we know the fact that you have been away so long has not been of your motion.

Secretary FOWLER. Not at all. I would like nothing better than to be here before this committee with the whole package.

Mr. Chairman, members of the committee, this bill contains two parts of the President's tax recommendations. These provisions which are incorporated in H.R. 15414 would extend the excise taxes on automobiles and telephone services beyond April 1 of this year, and carry out our recommendations for accelerating corporate income tax payments.

The administration is still strongly in favor of our full program, which would include, in addition, at this time, a temporary 10-percent income tax surcharge on both corporate and individual accounts.

The Ways and Means Committee took action on a bill limited to two aspects, without waiting on further decisions.

I quote from the report:

In view of the fact that the excise tax reductions, in the absence of this bill, would occur on April 1, and the fact that the corporate speed-up to be effective this year must occur before April 15 * * *

The report of the Committee on Ways and Means further stated that this action "is not intended to prejudice possible future action with respect to other tax recommendations which have been proposed by the administration."

On the floor of the House, Chairman Mills stated:

Let me emphasize to the Members of the House that, in reporting this bill, the committee does not intend to foreclose possible future action on the administration's surcharge proposal. The question remains before the committee and no decision has as yet been reached.

In addition to the excise tax and corporate acceleration provisions in H.R. 15414, the President's program includes, as I have noted, a temporary 10-percent surcharge on the income tax of individuals and corporations.

On individuals the 10-percent surcharge would be effective April 1, 1968, and continue through June 30, 1969. The effective rate on individuals in calendar year 1968 would be 7.5 percent of their present law tax. The surcharge would not apply to about 17 million individuals whose taxable income does not rise above the second bracket.

On corporations the surcharge would be effective January 1, 1968, and continue through June 30, 1969. This would give an effective rate of 10 percent for corporations in calendar year 1968.

The surcharge, I might emphasize, would be 10 percent of the present rate, not 10 percent of income. This is about one-half of the tax decrease for individuals enacted in 1964. While in effect, the increased tax on individuals would average about 1 percent of their income.

Speaking for the administration, I want to emphasize in the strongest possible terms that we continue to recommend and insist upon the enactment of this entire program. It is as fully called for in the light of recent events as it was by events prior to January. We want to see the surcharge adopted under whatever procedures the Congress chooses to utilize. Those procedures are not for us to determine. The end result should be prompt enactment of the surcharge.

H.R. 15514

I turn now to the specific bill, H.R. 15414. It would raise revenues compared to present law by \$1.1 billion in fiscal year 1968 and by

\$3.1 billion in fiscal year 1969. This is about one-fourth of the \$16 billion which we proposed to raise by the President's program in this timespan.

The attached table shows the details of the revenue effects compared to existing law. You will realize, of course, that the revenue gain from excise extensions could also be described as preventing a loss of revenue that would occur if the rates were permitted to fall below rates currently in effect. Moreover, the speedup in corporate tax payments does not involve the addition of new tax liabilities but rather the more current payment of existing liabilities.

(The table referred to follows:)

ESTIMATED EFFECT OF THE BILL ON BUDGET RECEIPTS

(In millions)

	Fiscal year 1968	Fiscal year 1969
Excise taxes, extension of present rates:		
Passenger automobiles.....	\$190	\$1,500
Telephone service.....	116	1,160
Total, excise extensions.....	306	2,660
Proposals for corporate estimated tax payments.....	800	400
Total.....	1,106	3,060

Secretary FOWLER. Presently the 7 percent manufacturers excise tax on automobiles is scheduled to drop as of April 1, 1968, to 2 percent and then on January 1, 1969, to 1 percent. The bill would continue the 7-percent rate to January 1, 1970, when it would be reduced to 5 percent. The bill would provide further reductions to 3 percent on January 1, 1971, to 1 percent on January 1, 1972, and repeal the tax on January 1, 1973.

The new schedule for reductions follows the pattern established in the Excise Tax Reduction Act of 1965 to limit prospective reductions at any one time to not over two points. This three-stage reduction program in the bill recognizes that, with anticipation by consumers of a sharp drop in the automobile excise tax rate, there is a high likelihood they will postpone purchases of cars. This could be highly disruptive of orderly production and employment.

The House bill also goes back to the 1965 decision to make the reduction of rates effective on January 1. Reductions at this time of year should have the least disruptive effect on sales. There is usually a rush of orders for new cars in the autumn, and dealers fall behind in meeting them. Orders come in more slowly in January so if some orders are postponed from the autumn to January it is likely to involve smoother rather than more disorderly production schedules.

The bill also deals with the tax on telephone service which is now 10 percent and is scheduled to be reduced to 1 percent April 1, 1968, and to be repealed on January 1, 1969. This tax would be extended at the 10-percent rate to January 1, 1970, reduced to 5 percent at that time, further reduced to 3 percent on January 1, 1971, to 1 percent on January 1, 1972, and repealed on January 1, 1973.

CURRENT PAYMENT BY CORPORATIONS

Now, as to the current payment by corporations. Another part of the President's program, which is embodied in H.R. 15414, is two

provisions which have the effect of placing corporations on the same basis of current tax payment that now applies to individuals.

Presently, individuals, including sole proprietors and partners, are required to pay in current quarterly payments 80 percent of their estimated tax liability. Corporations, however, need only make current quarterly payments on 70 percent of the estimated tax liability in excess of \$100,000.

The bill achieves equality between corporations and individuals in two steps:

(1) Effective with the quarterly payments due April 15, 1968, corporations will be required to make current payment on the basis of 80-percent estimates rather than 70-percent estimates.

(2) Effective with quarterly payments due April 15, 1968, corporations will take the first of five annual steps designed to eliminate the exemption from current tax payment on the first \$100,000 of estimated tax. This will be done by requiring that the 1968 current payment include 20 percent of the first \$100,000 of liability. The 1969 payments will include 40 percent of this first \$100,000, and so forth, until 1972 when corporations will be on the same basis as individuals.

This change in corporate tax payment provisions will finally achieve an objective sought in a series of actions taken by the Congress dating back to 1950. The progressive steps in moving corporations toward the same payment basis applicable to individuals have been gradual so as to avoid sharp liquidity effects.

There is no reason to permit small and medium-sized corporations to defer all or a substantial portion of their tax while requiring current payment by unincorporated businesses. By far the overwhelming part of small business is made up of sole proprietorships or partnerships. In 1965, of the 8.6 million businesses with net incomes, 7.9 million were sole proprietorships and partnerships or subchapter S corporations (where taxes are paid currently by the shareholders).

A corporation with \$100,000 of tax liability, that is, one that gets full benefit of the current favoritism, would ordinarily have assets in the area of \$1 million. The striking inconsistency of the present law is implied by the fact that a moderately successful partnership or proprietorship can achieve a continuous postponement of virtually a full year's tax by the simple device of incorporating.

This measure achieves equal treatment between incorporated and unincorporated businesses by moving corporations to the basically sound system of keeping their tax accounts current. As the House committee report indicates, current payment is frequently a net advantage to a business firm which might have otherwise failed to make adequate provision for tax payments.

The House bill has several technical changes regarding tax payments: It makes provision for quick refunds for corporations after the end of the year in those cases where their estimated tax payments significantly exceed their tax liability; it eliminates declarations of estimated tax by corporations, leaving this entirely to the deposit system; and it prescribes rules regarding mailing of deposits.

THE GENERAL FISCAL SITUATION

Now, Mr. Chairman, to turn to the general fiscal situation. I believe it is appropriate to lay before you the general fiscal situation,

as the background for this bill, and to relate that situation to the entire fiscal program of the President of which the excise recommendations and the current tax payment recommendations are a part.

The U.S. economy—a mighty engine of production and distribution—is roaring down the road. It is entering the eighth year of a record-breaking advance, having weathered the inventory adjustment which slowed it to half speed in the first half of last year.

But the ride is neither smooth nor safe. Rising inflationary pressures and a disturbing deterioration in our international balance-of-payments signal a clear and present danger that the economy is overheating and running at an excessive rate of speed.

Given a high employment economy with heavy defense costs at home and abroad, some inescapable increasing costs of civilian government, and a private sector advancing on a wide front, the acceptance of enlarged deficits in the budget and deficits in the balance of payments is contrary to sound economic and financial policy—whether the wisdom is conventional or the new economics. Accordingly, the driver is trying to brake the vehicle to a safe cruising speed.

That is the meaning of the President's request last August for a substantial tax increase and a reduction in many Federal outlays for fiscal year 1968, his tough and courageous New Year's Day balance-of-payments action program, and the austere budget for fiscal year 1969 presented a month ago.

I want to express here a strong personal conviction. It is shared by the President, his entire administration, the Federal Reserve Board, and the vast preponderance of expert economic and financial opinion decisionmakers here and abroad—public and private.

That conviction is that this is a year in which economic and financial policy should be directed toward reversing decisively the trend in 1967 to increasing deficits in our internal budget and our international balance of payments. We should move back toward balance in our budget and our international payments—and thereby assure a balanced economy, properly poised and positioned, to discharge our national and international responsibilities—in war or peace—at home or abroad. With this Nation engaged in a costly conflict abroad, we must act at home so as to maintain the stability of the economy and the strength of the dollar.

A continued acceptance of these twin deficits in their current proportions under the surrounding circumstances is to forsake prudence, accept intolerable risks and refuse to accept the fiscal and monetary discipline essential to the preservation of a balanced, sustained prosperity.

These observations bring us hard up against the outlook for our Federal budget which will be the subject of comments by Mr. Zwick, Director of the Budget.

I would like to add, however, a few words of my own.

I share the general concern that the totals of budget expenditures are increasing. But I must point out that this fact does not diminish the desirability of a tax increase to help finance the war in Vietnam out of current revenues rather than borrowed money.

Our annual expenditures for our efforts in Vietnam amount to about 3 percent of our gross national product. Other outlays, exclusive of social insurance trust funds, have been declining as a share of the Nation's income and output in recent years. In 1969 they stand at 13.9 percent. In the last 3 years of the 1950's they were 16 percent.

In 1965 they were 14.6 percent. It is not the rise in regular budget outlays which requires a tax increase but the cost of Vietnam.

Of course, one can debate at length whether the budget outlays in the 1969 budget for controllable civilian programs should be substantially reduced. But we must remember as we keep debating, as we have been debating since last August 3, that time is still running, and every day that passes without the tax increase adds about \$33 million to the deficit.

The tax program now comes to \$16 billion over the fiscal years 1968 and 1969 and will reduce the deficit by that amount. With the changed dates from the President's original program to the presently proposed dates of April 1 for individuals and January 1 for corporations.

It should be passed promptly regardless of the outcome of the long-drawn-out debate on expenditures now beginning.

No amount of debate or budget cutting that is likely to emerge is a realistic alternative to a tax increase for meeting our obligations at home and abroad in that amount. And if there is any prospect for prudence to measure it would be that our obligations in that amount would tend to increase rather than decrease as we look ahead.

To sum up the budget for fiscal year 1969—it is a responsible financial plan placed on a base of expenditures for fiscal year 1968 rigidly scaled down by joint executive and congressional action as recently as December 1967. It represents a holddown in controllable expenditures in 1969; the revenues from the requested tax increase will contribute to the reduction in the deficit, not to rising expenditures; and it does give assurance that the tax increase will be temporary and can and will be removed when hostilities in Vietnam come to an end.

We must not forget that we are a nation involved in a war. This involvement has had its obvious and direct effect on the budget and in turn on the need for a tax increase. We cannot mistake the connection between the tax increase proposals and the costs of our efforts in Vietnam.

It is not the rise in regular budget outlays that requires a tax increase, but the cost of Vietnam. The increase in budget receipts from economic growth since fiscal year 1965 would alone more than cover the increase in non-Vietnam costs. What is left to be financed is the cost of Vietnam. In the January budget this was put at about \$26 billion for fiscal year 1969, and we are asking that one-half of this be met by tax increases. Meeting part of the cost of war through tax increases rather than just through borrowing is the path of fiscal responsibility, and this path we have followed in those troubled times in the past when we found ourselves at war.

So much for the principle. I want to turn now to the more specific discussion of the immediate situation, that without tax legislation we would have a deficit of about \$22.8 billion in fiscal year 1968 and \$20.9 billion in fiscal year 1969. Permitting this level of deficit—two \$20 billion deficits back to back—would incur intolerable risks for the United States in the light of—

Our present domestic economic conditions,
 Our financial situation, and
 Our balance-of-payments problem.
 I would like to comment on each of these.

ECONOMIC CONDITIONS

First, as to economic conditions. Deficits of over \$20 billion in each of fiscal year 1968 and fiscal year 1969 would involve intolerable risks of inflation in view of the current economic conditions.

During the fiscal year 1967, there was some slack in the private economy associated with a decline in inventory investment, a lower level of housing starts, and an interruption of the plant and equipment boom. Since the summer of 1967, however, these factors have been reversed, and the economy has been moving in very high gear. This is plainly evidenced by the rate of growth in output and prices in the last half of 1967 when real output grew by a 4½ percent annual rate, and the general level of prices rose at an annual rate of 3.8 percent, making the rate of growth in money terms in excess of 8 percent.

It is not a question of whether some economic indicator went up "only" half a point last month or even held steady, or whether some other indicator has dipped slightly below the record high it set last month. The important thing is the level and general direction of the total economy. The economy is operating at high levels of capacity and is generating high rates of quarterly growth of GNP, \$16 billion in each of the last two quarters of 1967, which will be exceeded, I venture to say, in the first quarter of 1968.

An obvious aspect of the overall economic level, in addition to the fact of sharp price increases in the last 8 months, is the rate of unemployment, which is the lowest it has been since the inflationary conditions of the Korean war.

If one looks at the unemployment situation, moreover, unemployment of men over 20 was 2.2 percent at the end of 1967. In the substantially full employment that existed in 1956, this rate was 3.4 percent. For 1953, when the total unemployment rate was 2.9 percent, the rate for men over 20 was 2.5 percent. What is clear is that at current levels of output we are making maximum use of our presently skilled work force.

What has been happening over these last 8 months is that demand has been fueled by a Federal deficit running at a rate which, without a tax bill, will bring it over \$20 billion for the fiscal year. This rate at which demand has been increasing for the last 8 months is simply too high for an economy in which unemployment is well under 4 percent.

Our fiscal program, including provisions for the revenues provided in the bill before you, plus the income tax surcharge of 10 percent, was designed to hold the growth of total GNP in 1968 to about \$60 billion. At that rate the increase in 1968, calendar year, will be only a little lower than it has been in the last half of 1967, but we will be able to get the trend of prices under control. We will be able to enter 1969 with a declining rate of price increase and not an increasing one. A substantial increase in fiscal restraint is thus necessary to move toward price stability in 1969. If the present rate of inflation is permitted to grow, this will sow the seeds for more inflation in 1969 as wages and everything else tries to catch up.

We must recognize the fact that we live in an uncertain world abroad and at home. Regardless of any international developments that might require increased Government expenditures, deficits over \$20 billion running 2 years in sequence do not represent fiscal responsibility.

FINANCIAL MARKETS

Now, as to the financial markets. Failure to enact the President's tax program will jeopardize the financial markets. Interest rates are generally at or above the peaks reached in the financial crunch of 1966, and at that time the Federal Government's credit demands were contributing very little to credit tightness.

The heavy sales of securities by the Federal Government were, however, a major factor in the rise in interest rates in 1967. In the last half of 1967, that is, the calendar year, the Federal sector borrowed from the private sector \$18 billion compared to the more normal \$5 billion in the last half of 1964, 1965, and 1966. In the first half of 1968, even with prompt action on the President's full program, we may have to borrow up to \$5 billion, whereas normally in the first half of a calendar year we are reducing the Federal debt.

Fortunately, the recent rises in interest rates have not yet led to the kind of large-scale withdrawals of funds from savings institutions as occurred in 1966. But currently available yields on marketable securities are close to the point where a further rise could trigger significant disintermediation and loss of funds for home construction.

The anticipation of continued heavy borrowing of the Federal Government can only serve to make mortgage lenders reluctant to increase commitments for future mortgage lending. Prompt fiscal action in the form of enactment of the President's tax proposals is the best assurance of continued opportunity for home financing and construction to avoid a repetition of 1966.

The high rate of economic activity will assure a high level of private and State and local demands for credit in the months ahead. Treasury borrowing demands involved in continued deficits of over \$20 billion involve a choice between permitting a larger rate of monetary growth than we would like to see or bidding up interest rates to levels that would foreclose substantial amounts of borrowing by those borrowers most sensitive to interest rate differentials and most affected by credit availability—homebuilders, State and local governments, and small business.

It is clear that the magnitude of Federal credit gains in fiscal year 1969 depends critically on enactment of the President's tax program. Without the tax program, budget deficits would be excessive both from the point of view of economic stabilization and credit markets. If there is no tax legislation, these borrowing needs would be about \$21 billion. H.R. 15414 would reduce them to about \$18 billion. The President's full program would reduce them to \$8 billion.

Failure to take adequate fiscal action and thereby leaving the burden of fighting inflation to monetary policy would be like enacting a special tax that would fall on home buyers, homebuilders and suppliers, the savings institutions, State and local governments, and small business.

THE BALANCE OF PAYMENTS

Now, as to balance of payments. Closely following the acceleration of business activity and the price inflation in our domestic economy that we have observed in the last half of 1967 has been a sharp deterioration of our international trade surplus which contributed to the return of our overall payments deficit to a critically high level. This

return to a large deficit in our own international payments, combined with the British devaluation and the subsequent period of heavy gold speculation, represented and represents a threat to the U.S. dollar and to the international monetary system as a whole requiring decisive corrective action.

Just as the tax increase is an indispensable element in our domestic financial plan for the year ahead, it is also the keystone of the balance-of-payments program announced by the President on January 1.

As the President said in his message to the Nation that day—and sometimes this is conveniently overlooked by those who say the direct measures are palliatives:

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

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

Failure to take action here involves a risk both of immediate further deterioration of our trade balance and of lasting further deterioration of our competitive price position internationally. It would threaten a floodtide of imports and a loss of export markets. Too rapid a growth in economic activity in the United States, giving Americans more money to spend, would cause a more than proportionate amount going directly or indirectly into increased purchases of imported goods.

With the addition of sharp price inflation, the consequences could substantially weaken the U.S. competitive trade position.

The importance of restoration of price stability in the United States to the maintenance of a functioning international economic community is recognized in Europe as well as here.

Last December, the OECD economic survey of the United States stated—that is the 20-nation body which concerns itself with economic cooperation:

An immediate concern of the authorities must be to avoid an excessive increase in demand, which would strengthen cost price pressures and aggravate the balance of payments problem. Given the likely strength of the expansion now developing, this can hardly be achieved without the tightening of fiscal policy proposed by the President.

I might say, members of the committee, this has been a constant refrain of advice and comment which we have received from financial authorities all over the free world, both in public positions and in private places.

CONCLUSION

I would like to conclude, Mr. Chairman, with these comments, that, when I appeared before the Ways and Means Committee last August, I warned, in general terms, that we would have an unwelcome acceleration in prices and deterioration in our balance of payments if the surcharge were not passed. If I had predicted that, in the absence of the surcharge, the general price level would rise at an annual rate of 3.8 percent during the last half of 1967, many people would have accused me of being an alarmist, and yet that is exactly how fast prices did rise.

Similarly, if I had predicted that imports would rise at an annual rate of over 16 percent and that exports would actually decline by 6 percent between the second and fourth quarters of 1967, this would

have seemed unduly pessimistic to many people, and yet that is exactly what did happen to our foreign trade.

Now, I cannot make a precise prediction as to how these or other variables will move in the next 6 months, but I do know that these rates of change are unacceptable and must be halted. The restoration of price stability in our domestic economy and the improvement in our trade position lie in enactment of the entire tax program of the President.

We face critical times. We are engaged in an expensive war. At home we face, and are determined to conquer, serious problems of poverty, ignorance, and urban blight. Under these circumstances, failure to meet more of our budget through tax revenues involves intolerable risks for the country to run.

Why must we run these risks? Why in a period of hostilities should our country weaken itself economically and financially at home and internationally? The fact is we know how these risks can be avoided; there is no obscurity about either the problems or their solutions. We at home see the answer as does the rest of the world. The answer is to reduce the deficit by raising revenues to pay for these wartime expenditures.

The temporary tax increase will give us the fiscal strength to avoid these risks. Our people are well able to bear the burdens involved. Even after the surcharge proposed, individuals will be paying tax at significantly lower rates than the rates in effect in 1963 before the reductions of the Revenue Act of 1964 and 1965; corporations will be paying at lower effective rates than they faced in 1961 before the investment credit and depreciation reform and the Revenue Act of 1964. And the low-income groups are exempt from the surcharge.

I stress the word "temporary." This administration has given, and this Congress has given, ample evidence of its desire to reduce tax burdens on the American people. There is no basis for predictions that a temporary surcharge will remain in effect after the disappearance of the defense needs that give rise to it. We have a tax system which will produce a growth in GNP of about 6 percent, which is consistent with an expected 4 percent—4½-percent growth in real output. Without the pressure of military demand, this will provide a large sum of additional revenues to meet our national goals.

I stress also that this temporary surcharge will give our domestic economy strength and stability and will not weaken us. The international monetary system on which the free world economy is based, will be strengthened as the strength of the dollar is assured.

The welfare of American citizens cannot be measured merely by the smallness of the tax they pay. It rests on the purchasing power of the income they have after taxes and the value of the services they get from their Government. Our citizens will be treated badly if their tax bills are held down but they are left with accelerating inflation, climbing interest rates, an unstable boom that could end in a bust, and a weakening of the international financial system which has been the basis for free world prosperity and development since World War II.

The Congress will serve the American people well if it pursues a wise fiscal policy of substantially reducing the prospective deficits in fiscal years 1968 and 1969 through enactment of the President's tax program.

Thank you.

The CHAIRMAN. I believe it might be well to let the Director of the Budget make his statement, if you have a prepared statement at this time, and then we will examine the two of you.

STATEMENT OF HON. CHARLES J. ZWICK, DIRECTOR, BUREAU OF THE BUDGET

Mr. ZWICK. Thank you, Mr. Chairman. I am delighted to be here. This is my first opportunity to appear before this distinguished committee as the Budget Director. I do have a prepared statement which overlaps to some degree with Secretary Fowler's. If satisfactory with you, I would just abstract a few of the key points and highlight a few points and submit the full statement for the record.

The CHAIRMAN. That is all right.

(Mr. Zwick's prepared statement, with attachments, follows:)

STATEMENT OF CHARLES J. ZWICK, DIRECTOR OF THE BUREAU OF THE BUDGET, BEFORE THE SENATE FINANCE COMMITTEE ON THE TAX ADJUSTMENT ACT OF 1968

Mr. Chairman and members of the committee, I welcome this opportunity to express my views on the bill before the committee, which would extend present excise tax rates on passenger automobiles and telephone services and provide for the acceleration of certain corporation income tax payments. The provisions of the bill, as passed by the House, are essentially the same as proposals made by the President in his Budget Message last January. As you know, these proposals were part of a broader fiscal program combining expenditure restraint and a number of tax measures—notably a temporary 10 percent income tax surcharge on individuals and corporations. Because the measures we are considering today are only one part of a larger proposal, I will discuss briefly the background and reasoning underlying the Administration's overall fiscal package and expand on the expenditure policy underlying the 1969 budget which Secretary Fowler highlighted for you.

Background of fiscal program proposed in the 1969 budget

The revenues and outlays in the 1969 budget were formulated with several economic and fiscal policy objectives in mind.

This month the American economy enters its eighth year of sustained expansion. Fiscal policy has played a central role in this unparalleled growth. It must continue to promote growth in the future. But it must also help assure that this growth is real—that it is not eroded by excessive price increases which constitute a tax on those least able to pay and which contribute to a worsening of our foreign trade balance. Moreover, fiscal and monetary policy together must seek to assure that sufficient credit is available at interest rates which do not cause undue burdens on those heavily dependent on capital markets.

Our economic performance in the past seven years has been remarkable.

Our total national output of goods and services has risen more than 40 percent.

Ten million more people are employed.

Per capita income after taxes has risen 29 percent, after adjusting for price changes.

More than 12 million people have moved out of the poverty category.

And unemployment fell to an average level of 3.8 percent in 1967 for the second year in a row, compared with 6.7 percent in 1961. In January of this year, unemployment dropped to 3.5 percent.

Between calendar years 1961 and 1965, we enjoyed relative price stability along with substantial economic growth. The annual increase in consumer prices was about 1½ percent. Wholesale industrial prices rose by only about ½ of 1 percent per year.

In the past two years, however, prices and interest rates have risen at unacceptable rates. The consumer price index has risen at an annual rate of 2.9 percent, and wholesale industrial prices at an annual rate of 1.8 percent. And the increase in prices is accelerating. In January 1968, the consumer price index rose by 0.3 percent for the fourth month in a row and was up 3.4 percent over January a year ago. Wholesale industrial prices were up 0.4 percent in February over the previous month.

Interest rates advanced sharply in 1966 and, following a short period of decline, rose again in 1967. The deficit in our balance of payments—which had dropped from \$3.9 billion in 1960 to \$1.4 billion in 1966—worsened substantially in 1967.

Last August, following a review of the budget outlook which indicated the prospect of a very large deficit, the President proposed a program of tax increases and expenditure reduction. The Administration asked the Congress to join in the effort to reduce spending, and legislation was enacted in December providing for a cutback in the obligations Federal agencies could incur in fiscal year 1968 from appropriated funds for controllable programs; as a result, obligations for these programs have been reduced by \$10 billion, with related reductions of \$4.3 billion in expenditures, below the budgeted estimates. But Congress failed to take action on the tax measures.

In preparing both the FY 1968 and FY 1969 budgets, it was our view that overall fiscal policy should be directed toward—

- reducing inflationary pressures,
- improving the balance of payments, and
- stemming the upward pressure on interest rates.

The 1969 budget was designed to accomplish these objectives through a tightened rein on outlays, coupled with a renewed request for a temporary tax increase, with a resulting substantially reduced budget deficit.

The 1969 budget totals

Before I proceed to discuss the budget totals, I would like to say just a few words about the main features of the new budget concept adopted in accordance with the recommendations of the President's Commission on Budget Concepts in its report of October 1967. The new concept departs from the old administrative budget in four major respects:

First, the 1969 budget carried out the Concepts Commission recommendation that the budget be comprehensive of all programs of the Federal Government and its agencies, including those operated through trust funds, and that no attention be given to a surplus or deficit calculated on the basis of the administrative budget alone. The intent of this recommendation is to enable us both to see more clearly the full scope of Federal activities and to assess their impact on the economy. The Commission also called for continuing to report trust fund activities in a way which preserves the identity and integrity of trust fund transactions and balances, and we have done this in the 1969 budget.

Second, the new budget is divided between an expenditure account and a loan account, in view of the difference in economic impact between the two types of transactions.

Third, the new budget offsets against related expenditures certain receipts of the Government which derive from business-type or market-oriented activities, in order to highlight the *net* cost to the taxpayer.

Finally, sales of participation certificates are no longer treated as an offset to expenditure, but are considered to be a means of financing the deficit, similar to Treasury securities.

A fuller explanation of the new budget is attached to my statement.

Turning now to the budget totals, these are given in Table 1, which follows:

TABLE 1.—BUDGET TOTALS
[Fiscal years; billions of dollars]

	1967 actual	1968 estimate	1969 estimate
Total budget:			
Receipts.....	149.6	155.8	178.1
Outlays (expenditures and net lending).....	158.4	175.6	186.1
Budget deficit.....	-8.8	-19.8	-8.0
Of which:			
Expenditure account:			
Receipts.....	149.6	155.8	178.1
Expenditures.....	153.2	169.9	182.8
Expenditure deficit.....	-3.6	-14.0	-4.7
Loan account:			
Disbursements.....	17.8	20.9	20.4
Repayments.....	-12.6	-15.1	-17.1
Net lending.....	5.2	5.8	3.3

As the table shows, total outlays in fiscal year 1969 are estimated at \$186.1 billion, of which \$182.8 billion is spending and \$3.3 billion is net lending. Revenues, including \$12.9 billion estimated to be raised through enactment of all the proposed tax measures, are estimated at \$178.1 billion, leaving an overall deficit of \$8.0 billion. This compares with an estimated deficit in the current fiscal year of \$19.8 billion, so that the deficit would be reduced by \$11.8 billion from 1968 to 1969.

The major portion of the revenues estimated from the tax proposals would come from the income tax recommendations—a temporary 10 percent surcharge on individual income taxes to be effective as of April 1, 1968, and a similar surcharge on corporate income taxes effective January 1, 1968. These surcharges would yield an additional \$1.9 billion in 1968 and \$9.8 billion in 1969. The proposals in the bill before you—to accelerate certain corporation tax payments and extend the present excise tax rates on automobiles and telephones beyond April 1, 1968, would bring in \$1.1 billion in 1968 and \$3.1 billion in 1969. In addition, the budget proposes a number of new and increased user charges, particularly in the field of transportation, which will shift the burden of financing Government services from the general taxpayer to the specific beneficiaries. In addition to relieving the general taxpayer of these burdens, the user charges would make the provision of these services dependent upon the willingness of the users to pay for them. Revenues from these user charges would amount to \$0.3 billion in 1969.

The budget outlays of \$186.1 billion represent an increase of \$10.4 billion over the current fiscal year. Controllable outlays have been held just about level by offsetting urgently needed increases with proposed reductions and program modifications affecting almost every major agency. Virtually all of the increase in outlays in 1969 will be for national defense programs and for expenses which are mandatory under present law in the coming year.

The estimated rise in total outlays is significantly lower than in 1968 or in 1967. Outlays rose by \$23.8 billion in 1967 and \$17.2 billion in 1968, compared with the \$10.4 billion increase expected for 1969. Excluding national defense, the comparable increases are \$10½ billion in 1967, \$11 billion in 1968, and \$7 billion in 1969. And the increase in 1969 is measured from a 1968 base which has been reduced as a result of the legislation proposed by the Administration and enacted last December, to which I referred earlier.

The added taxes we have requested should be needed only for a temporary period. Our special outlays for Vietnam come to about 3 percent of the gross national product. The largely self-financing social insurance trust funds—for social security, Medicare, unemployment insurance and other retirement programs—have been rising more rapidly than the GNP. As shown in Table 2, other outlays have been declining as a share of the GNP in recent years.

TABLE 2.—BUDGET OUTLAYS AS A PERCENTAGE OF GROSS NATIONAL PRODUCT

[Fiscal years; percent]

	Average 1958-60 actual	1965 actual	1968 estimate	1969 estimate
Total outlays:				
Vietnam.....		(1)	3.1	3.0
Social insurance trust funds.....	3	3.4	4.2	4.4
Other outlays.....	16	14.6	14.2	13.9

¹ Less than 0.05 percent.

The temporary expenditure add-on for Vietnam is estimated at about \$26 billion in 1969—25 percent more than the sum of \$12.9 billion yield from the proposed tax measures and the remaining \$8 billion budget deficit. This is another indication that the added taxes will not be needed once peace is attained in Vietnam.

To sum up, the 1969 budget—

requests a temporary and modest tax increase to help pay the cost of Vietnam responsibly,

reflects efforts by both the Congress and the Administration to cut back on outlays in 1968,

calls for a tight holddown on outlays in 1969, which will also require the cooperation of the Congress, and

promotes sustained real growth at home and increased confidence in the dollar abroad.

Program implications of the 1969 budget

As I have noted, the outlays included in the budget have been put to strict tests of priority. This is indicated in the program content of the budget, which I would now like to discuss briefly.

The estimated \$10.4 billion increase in outlays between 1968 and 1969 can be seen in Table 3.

TABLE 3.—CONTROLLABILITY OF BUDGET OUTLAYS

(Fiscal years; In billions)

Type of controllability	1967 actual	1968 estimate	1969 estimate	Change 1968-69
National defense.....	\$70.1	\$76.5	\$79.8	+\$3.3
Relatively uncontrollable civilian programs:				
Open-ended programs and fixed costs:				
Social security, medicare, and other social insurance trust funds.....	30.3	34.3	38.5	+4.2
Interest.....	12.5	13.5	14.4	+.9
Civilian and military pay increase.....			1.6	+1.6
Veterans pensions, compensation, and insurance.....	4.9	5.1	5.2	+.1
Public assistance grants.....	4.2	5.2	5.7	+.5
Farm price supports (Commodity Credit Corporation).....	1.7	2.8	2.9	+.1
Postal operations.....	.8	.7	.3	-.4
Legislative and judiciary.....	.3	.4	.4	(1)
Other.....	2.4	2.7	2.8	+.1
Subtotal, relatively uncontrollable civilian programs.....	57.1	64.7	71.8	+7.1
Relatively controllable civilian programs, including outlays from prior year contracts and obligations.....	35.2	39.0	39.5	+.5
Undistributed intragovernmental payments (-).....	-4.0	-4.6	-5.0	-.5
Total budget outlays.....	158.4	175.6	186.1	+10.4

¹ Less than \$50,000,000.

Of the total increase—

\$3.3 billion is for national defense, including the Department of Defense and the military assistance program; the Atomic Energy Commission, which will have added expenditures for nuclear weapons; and certain other defense-related activities. The budget allows for the possibility of a continuation of hostilities in Vietnam beyond the end of the coming fiscal year. The amounts provided for defense also cover the pay increase which became effective last October, and will permit selective improvements in our strategic and general purpose forces.

\$4.2 billion of the increase is for the largely self-financed social insurance programs of the Federal Government, chiefly social security and Medicare.

\$1.6 billion will be needed for the second step of the pay increase for Federal civilian and military personnel, scheduled to take effect on July 1, 1968, under the pay legislation enacted last year.

\$1.3 billion is for other relatively fixed charges, such as interest on the Federal debt, public assistance grants, and veterans' compensation and pensions.

This leaves an increase of \$0.5 billion for relatively controllable civilian programs from 1968 to 1969. Within this relatively stable total, however, there are a number of significant increases and decreases. These are based essentially on three kinds of actions, as noted by the President in the Budget Message.

First, there are selective expansions of existing programs and proposed new programs, only as necessary to meet those urgent requirements whose fulfillment cannot be delayed.

Second, delays and deferments have been proposed wherever possible without sacrificing vital national objectives.

Third, the budget sets forth recommendations for basic changes, reforms, or reductions which will lower the budgetary costs of a number of Federal programs.

The overall increase in controllable civilian outlays is made up of increases totaling \$3 billion and decreases totaling \$2.5 billion. A portion of the increase is required for last October's pay raise, which will be in effect for the entire fiscal year in 1969 instead of for only three-quarters of the fiscal year, as in fiscal 1968.

In addition to this increase which had to be provided for, selective increases are included in the budget for certain activities of high urgency and priority.

Some of these activities expand merely by virtue of increased workloads brought on by a growing population with rising incomes. A few other areas are being expanded selectively in response to the most urgent needs in the Nation—the elimination of poverty, improvement in the quality of our environment, and services related to maintaining public order.

Among the more important increases provided are:

\$231 million for expanded manpower training efforts, emphasizing cooperation with industry to provide on-the-job training for the hard-core unemployed.

\$81 million for stepped-up efforts to control crime.

\$436 million for enlarged programs to attack urban blight through the new Model Cities program and greater urban renewal activity.

\$179 million for increases for family planning, and expanded programs to reduce infant mortality through better health care for mothers and infants.

\$89 million for air and water pollution control.

Table 4 illustrates the pattern of the total budget, including both uncontrollable and controllable outlays, in terms of selective program changes such as I have just mentioned.

TABLE 4.—BUDGET OUTLAYS—SELECTIVE PROGRAM CHANGES

[Fiscal years, in billions]

Description	1967 actual	1968 estimate	1969 estimate	Change, 1968-69
National defense.....	\$70.1	\$76.5	\$79.8	+\$3.3
Social security, medicare, and other social insurance trust funds.....	30.3	34.4	38.6	+4.2
Other major social programs:				
Education.....	4.0	4.5	4.7	+ .2
Health (excluding medicare).....	3.4	4.3	4.8	+ .5
Labor and manpower.....	1.1	1.3	1.5	+ .2
Economic opportunity programs.....	1.5	1.9	2.0	+ .1
Welfare.....	3.9	4.6	4.9	+ .3
Urban community development, and low and moderate income housing.....	1.1	1.9	2.3	+ .4
Regional development.....	.2	.4	.5	+ .1
Interest.....	12.5	13.5	14.4	+ .9
Pay increases for military and civilian employees.....			1.6	+1.6
All other.....	34.2	36.9	36.0	-.8
Undistributed Intragovernmental payments (-).....	-4.0	-4.6	-5.0	-.5
Total, budget outlays.....	158.4	175.6	186.1	+10.4

The increases in controllable outlays were offset by reductions elsewhere. A substantial decrease is estimated in the outlays of the Federal National Mortgage Association trust fund for its secondary market operations through proposals designed to increase the supply of private mortgage money. In addition, two kinds of measures are recommended in the budget to reduce Federal outlays, as shown in Table 5, attached to my statement. These are spelled out in detail in the Budget Message, but I will summarize them for you here.

First, we are proposing reductions in program levels which do not substantially alter the character of the programs involved, but which primarily reflect a ranking of priorities in a period of budget stringency. These reductions represent cuts in the levels of obligations, commitments, or contracts totaling \$1.6 billion in 1969 below the 1968 appropriated levels. A major area of reduction is in construction programs—both direct Federal construction and construction grant programs—which we believe can appropriately be deferred in an inflationary period when construction costs are rising sharply—5 percent in 1966 and 6 percent in 1967.

Second, reforms and modifications are recommended in a number of programs to increase their effectiveness and reduce their cost to the taxpayer over time. Some of these programs have become outmoded in their present form and need to be brought into line with current conditions. In other instances, the proposals call for the rising costs of certain essential programs to be borne increasingly by the direct beneficiaries rather than the taxpayer—the transportation user charge proposals are an example.

Adoption of the reform proposals would reduce the budgetary burden in 1969 for the programs involved by \$1.2 billion below the current-year levels. In 1970, the corresponding reduction is estimated at \$1.4 billion.

Most of the proposed reforms will require congressional approval and will be difficult to achieve. But a budget reflecting contemporary priorities requires their enactment.

Conclusion

The program offered in the 1969 budget is, in my view, an appropriate and responsible way of enabling us to sustain the economic advance of the last seven years and move ahead with our most urgent program objectives.

The President stated in his Budget Message that "Even after a rigorous screening of priorities . . . the cost of meeting our most pressing defense and civilian requirements cannot be responsibly financed without a temporary tax increase." The bill before you provides a portion of the tax increase he has requested. The Administration supports its enactment. The House Ways and Means Committee Report on the bill states that "Action on these matters is not intended to prejudice possible future action with respect to other tax changes. . . ."

I would also like to reaffirm the Administration's belief that the proposed temporary income tax increase—which averages about one additional penny on each dollar of our income—is also needed to finance the added cost of Vietnam. With its enactment, we can sharply reduce the Government's deficit, start back on the road to price stability, and restrain increases in interest rates.

The budget calls for tight controls on all programs—with selective expansions in some areas almost entirely offset by reductions in others. The Congress, in its appropriations process may see fit to reduce individual programs still further. However, having participated in a careful and painstaking review of the individual agency proposals, I believe it is unrealistic to expect reductions in outlays sufficiently below those already in the budget to reduce the deficit to more manageable proportions without the income tax increase.

Accordingly, while I favor enactment of the present bill, I urge that the other aspects of the Administration's budget proposals also be supported by the Congress.

TABLE 5.—BUDGET PROGRAM REDUCTIONS AND REFORMS

(Fiscal years, in millions)

Program	Cuts below 1968 program level, as funded, 1969	
	1969	1970
Budget reductions:		
NASA (manned space flight and other).....	-\$447	
Education programs (mainly books and equipment and college facility grants).....	-361	
Agriculture (loan programs and other).....	-197	
Ship construction subsidies and research.....	-163	
General Services Administration (construction).....	-143	
Small Business Administration (loan programs).....	-90	
Interior (construction).....	-61	
Health facilities (research and medical library).....	-39	
Atomic energy programs (special nuclear materials and other).....	-36	
Other reductions.....	-95	
Total, budget reductions.....	-1,632	
Program reforms:		
Private housing, place greater reliance on the private market.....	-\$669	-\$669
Transportation, charge users for benefits received.....	-286	-319
Education, tie impacted aid more closely to Federal burden.....	-100	-100
Veterans, eliminate overlapping and outmoded benefits.....	-107	-107
Agricultural conservation program, limit to long-term benefits.....	-120	-120
SBA disaster loans, employ more equitable and rigorous criteria.....	-50	-50
Water resources projects, raise the interest rate used for evaluation projects.....	(1)	(1)
Other reforms.....	-3	-3
Total, program reforms.....	-1,235	-1,368
Grand total, budget program reductions and reforms, 1969.....	-2,867	

¹ No immediate savings are realized, but long-term effect could be substantial.

ATTACHMENT B

The new budget concept

The President, in March of 1967, established a bipartisan Commission to review the concepts, format, and presentation of the Federal budget. The Commission was made up of 16 distinguished citizens, including the chairmen and ranking minority members of the Appropriations Committees of the Congress.

Its Chairman was Mr. David M. Kennedy, Chairman of the Board of the Continental Illinois National Bank and Trust Company of Chicago.

The objective of the Commission's work was to make recommendations for improving and clarifying the budget itself and increasing public and congressional understanding of this important document. This was the first time that a Presidential Commission reviewed the basic concepts underlying the budget since passage of the Budget and Accounting Act of 1921.

The report of the Commission was presented to the President on October 10, 1967. The 1969 budget incorporated the major recommendations in that report, as follows:

First, a single unified budget format is used in place of the three different concepts highlighted in the past—the "administrative," "cash," and "national income accounts" budgets. For comparability purposes, the detailed budget data for 1967 and 1968 have also been compiled on the new basis and summary budget information has been carried back to 1958 using the new concept.

Budget data consistent with the national income accounts (NIA) framework have also been calculated and will continue to be useful since they tie directly into the gross national product statistics of the Department of Commerce. However, the NIA data are not presented in the basic budget summary: they are shown in Special Analysis B toward the back of the budget document (pages 473-482). In addition, during this period of transition to the new concept, the budget provides information on the old administrative and cash budgets, in Special Analysis A (pages 464-472).

Second, the new budget stresses comprehensive coverage of all programs of the Federal Government, including the receipts and expenditures of the social security, medicare, highway, and other trust funds. Outlays of the trust funds in fiscal 1969 are estimated at about \$47 billion, thereby raising significantly the level of the new budget compared with the traditional administrative budget.

The Commission's report noted that exclusion of trust fund transactions has been the major reason for increasing dissatisfaction with the administrative budget concept. It gave several reasons for proposing that the budget include transactions of trust funds, apart from the basic point that *all* programs of the Federal Government should be covered:

Over the years, trust fund activities have become larger in both absolute and relative magnitude in the total picture of Federal Government receipts and expenditures.

Current surpluses of trust funds must be considered in calculating the effect of Federal Government activities on the level of income and employment, in managing Treasury cash balances, in deciding on Treasury cash borrowing needs, and in program evaluation.

There is no question of the Federal Government's responsibility for determining the size and shape of major trust fund programs; in fact, legislative changes affecting trust fund revenues and expenditures occur almost every year.

The surplus or deficit in the administrative budget is a misleading guide for measuring the fiscal impact of the budget on the economy; the administrative budget does not portray or price out the President's full program, nor accurately measure congressional action on the President's requests.

(The Commission further recommended that trust fund data continue to be made available separately and that control and accountability of trust funds be maintained. The new budget follows this recommendation.)

Third, the new budget is divided between an expenditure account and a loan account, in recognition of the difference in economic impact between these two types of transactions. When the Federal Government makes a repayable loan, an exchange of financial assets is involved. When an outright expenditure is made, on the other hand—for military hardware, or a bridge, or retirement benefits, or a grant to a State—this is a direct addition to the income of the recipient. Accordingly, the Commission on Budget Concepts recommended—and the 1969 budget shows—that "spending" be separated from "lending." Also following the Commission's recommendation, the budget shows a separate calculation of the deficit on expenditure account totals alone, in addition to the overall budget deficit which includes net lending.

Certain loans are included in the expenditure account rather than being treated as "lending"—again, in line with the recommendations of the Commission. These comprise (a) foreign loans made largely on noncommercial terms, such as those of the Agency for International Development, and (b) other loans where the terms of the loan contract make repayment in certain cases contingent rather than mandatory. The loans included in both accounts are shown in Special Analysis E of the budget (pages 514-528).

Fourth, the new budget offsets against related expenditures certain receipts of the Government which derive from business-like or market-oriented activities, in order to highlight the net cost to the taxpayer. Examples of such activities are sale of property and products, interest, charges for nonregulatory services, and rents and royalties. The new treatment eliminates the inconsistent handling of these receipts in the old administrative budget, but does not alter the deficit since it affects receipts and expenditures equally.

Finally, sales of participation certificates are no longer treated as an offset to expenditures, but are handled as a means of financing the deficit, similar to Treasury securities. Seigniorage is also now considered a means of financing.

Two other major recommendations were made by the Commission for later adoption. These are, first, the use of an accrual basis for accounting for expenditures and revenues, and, second, a separate identification of the interest subsidy element in Federal loan programs in the expenditure account. These changes involve major adjustments in the Government's accounting system. They are now being studied, but it will be a few years before they can be put into effect.

Mr. Zwick. I welcome the opportunity to express my views on H.R. 15414. The provisions of the bill, as passed by the House, are essentially the same as proposals made by the President in his budget message last January. As you know, these proposals were part of a broader fiscal program combining expenditure restraint, on the one hand, and a number of tax measures—notably a temporary 10 percent income tax surcharge on individuals and corporations. Because the measures we are considering today are only one part of that larger fiscal package, I will discuss the expenditure policy incorporated in the 1969 budget.

Before discussing the budget totals, I would like to say a few words about the new budget concept which was adopted in accordance with the recommendations of the President's Commission on Budget Concepts in its report of October 1967. The new concept departs from the old administrative budget in four major respects:

First, the 1969 budget carried out the Concepts Commission recommendation that the budget be comprehensive; that is, that all programs of the Federal Government and its agencies be included, including those operated through trust funds, and that no attention be given to a surplus or deficit calculated on the basis of the administrative budget alone. The intent of this recommendation is to enable us both to see more clearly the full scope of Federal activities and to assess their impact on the economy. The Commission also called for continuing to report trust fund activities in a way which preserves the identity and integrity of trust fund transactions and balances, and we have done this in the 1969 budget.

Second, the new budget is divided between an expenditure account and a loan account, in view of the difference in economic impact between the two types of transactions.

Third, the new budget offsets against related expenditures certain receipts of the Government which derive from business-type or market-oriented activities. This highlights the net cost to the taxpayer.

Finally, sales of participation certificates are no longer treated as an offset to expenditure, but are considered to be a means of financing the deficit, similar to Treasury securities.

A fuller explanation of the new budget is attached to my prepared statement.

I would like to turn now to the budget totals. Total outlays in fiscal year 1969 are estimated at \$186.1 billion, of which \$182.8 billion is spending and \$3.3 billion is net lending. Revenues, including \$12.9 billion estimated to be raised through enactment of all the proposed

tax measures, are estimated at \$178.1 billion, leaving an overall deficit of \$8 billion. This compares with an estimated deficit in the current fiscal year of \$19.8 billion, so that the deficit would be reduced by \$11.8 billion from 1968 to 1969.

The budget outlays of \$186.1 billion represent an increase of \$10.4 billion over the current fiscal year. Controllable outlays have been held just about level by offsetting urgently needed increases with proposed reductions and program modifications affecting almost every major agency. Virtually all of the increase in outlays in 1969 will be for national defense programs and for expenses which are mandatory under present law in the coming year.

The estimated rise in total outlays is significantly lower than in 1968 or in 1967. Outlays rose by \$23.8 billion in 1967 and \$17.2 billion in 1968, and these compare with the \$10.4 billion increase we are expecting for 1969. If we exclude national defense from those increases, because 1967 was the year when Vietnam built up very rapidly, the following comparisons result: 1967 was up \$10½ billion over 1966; 1968 was up \$11 billion over 1967; and 1969 will be up \$7 billion over 1968. So, either way you measure it, the increase in expenditures we are forecasting is significantly less in 1969 than in recent years.

The outlays included in the budget have been put to strict tests of priority. This is indicated in the program content of the budget, which I would like to discuss briefly with you.

Of the total \$10.4 billion increase between 1968 and 1969, the following are the major items:

First, a \$3.3 billion increase is for national defense, including the Department of Defense and the military assistance program; the Atomic Energy Commission budget, mainly for its defense activities; and certain defense-related activities. The budget allows for the possibility of a continuation of hostilities in Vietnam beyond the end of this coming fiscal year. The amounts provided for defense also cover the pay increase which was effective last October, and will permit selective improvement in our strategic and general purposes forces.

Second, \$4.2 billion of the increase is for the largely self-financed social insurance programs of the Federal Government, chiefly social security and medicare. Of that \$4.2 billion increase, \$2.5 billion results from enactment of last year's social security bill and \$1.7 billion is the normal growth in those trust funds.

Third, \$1.6 billion will be needed for the second step of the pay increase for Federal civilian and military personnel scheduled to take effect July 1, 1968, under the pay legislation enacted last year.

Then, \$1.3 billion is for other relatively fixed charges, such as interest on Federal debt, public assistance grants, and veterans' compensation and pensions.

This leaves an increase of \$0.5 billion for relatively controllable civilian programs from 1968 to 1969. Within this relatively stable total, though, there are a number of significant increases and decreases. These are based essentially on three kinds of actions, as noted by the President in the budget message:

First, there are selective expansions of existing programs and proposed new programs, only as necessary to meet those urgent requirements whose fulfillment cannot be delayed.

Second, delays and deferments have been proposed wherever possible without sacrificing vital national objectives.

Third, the budget sets forth recommendations for basic changes, reforms, or reductions which will lower the budgetary costs of a number of Federal programs.

The overall increase in controllable civilian outlays is made up of increases totaling \$3 billion and decreases totaling \$2.5 billion. So, if you subtract the \$2.5 billion from the \$3 billion, you get the net increase of a half billion dollars between fiscal 1968 and 1969. A portion of the increase is required for last October's pay raise, which will be in effect for the entire fiscal year in 1969 instead of for only three-quarters of the fiscal year, as in fiscal 1968.

In addition to this increase, which had to be provided for, selective increases are included in the budget for certain activities of high urgency and priority.

Some of these activities expand merely by virtue of increased workloads brought on by a growing population with rising incomes. A few other areas are being expanded selectively in response to the most urgent needs in the Nation—the elimination of poverty, improvement in the quality of our environment, and services related to maintaining public order.

Among the more important increases provided are the following:

\$231 million for expanded manpower training efforts, emphasizing cooperation with industry to provide on-the-job training for the hard-core unemployed.

\$81 million for stepped-up efforts to control crime.

\$436 million for enlarged programs to attack urban blight through the new model cities program and greater urban renewal activity.

\$179 million for increases for family planning, and expanded programs to reduce infant mortality through better health care for mothers and infants.

\$89 million for air and water pollution control.

These, then, are the major increases that you will find in outlays in the fiscal year 1969 budget.

In conclusion, the program offered in the 1969 budget is, in my view, an appropriate and responsible way of enabling us to sustain the economic advance of the last 7 years and move ahead with our most urgent program objectives. The bill before you provides a portion of the tax increase that the President has requested. The administration supports its enactment. The House Ways and Means Committee report on the bill states that: "Action on these matters is not intended to prejudice possible future action with respect to other tax changes * * *"

I would also like to reaffirm the administration's belief that the proposed temporary income tax increase—which averages about one additional penny for each dollar of income—is also needed to finance the added cost of Vietnam. With its enactment, we can sharply reduce the Government deficit, start back on the road to price stability, and restrain increases in interest rates.

The budget calls for tight controls on all programs, with selective expansions in some areas almost entirely offset by reductions in others. The Congress, in its appropriations process, may see fit to reduce individual programs still further. However, having participated in a careful and painstaking review of the individual agency proposals, I believe it is unrealistic to expect reductions in outlays sufficiently below the ones already submitted in the budget to reduce the deficit to more manageable proportions without the surcharge tax increase.

Accordingly, while I favor enactment of the present bill, I urge that the other aspects of the administration's budget proposals also be supported by the Congress.

Thank you very much.

The CHAIRMAN. Mr. Secretary, and Mr. Zwick, I appreciate the statements that you have made. I urged the Secretary last week to be prepared to testify with regard to amendments proposed by the Senator from Delaware, Mr. Williams, and we will ask some questions before the day is out with regard to a matter that we voted on in the Senate yesterday having to do with these industrial development bonds issued by State and local governments.

Mr. Secretary, I appreciate your statement. I think you enjoy the admiration and respect of this entire committee. I say, as the chairman of the committee, that it has been both an honor and a pleasure to work with you on problems of this Government.

I noticed that your statement is, by and large, directed toward the overall problem, not just the continuation of these excise taxes. You are aware, are you not, that these taxes that you are testifying for expire on April 1?

Secretary FOWLER. That is correct.

The CHAIRMAN. What problems do we face in the event that this bill is not acted on by April 1?

Secretary FOWLER. In the case of passenger automobiles there would be some real risk that, if a period of time loomed ahead in which excise taxes on passenger automobiles would be reduced substantially, we would be confronted by some risk of delay in purchase during the intervening period. There would obviously be very great administrative inconvenience in both the marketing of automobiles and in the handling of billing for telephone service if there was a break in which the rates went down, and then at some later time they were restored to the level that preexisted April 1.

If the delay went beyond April 15, the measures for effecting the corporate acceleration and making available revenue for this fiscal year that would accrue as a result of those two measures would be at some risk. So I would say that there are very real management and administrative reasons both from the standpoint of the Treasury and the industries affected for having prompt action well in advance of April 1.

The CHAIRMAN. You would think it essential that this measure be on the President's desk by April 1 so he could sign it by that date?

Secretary FOWLER. Preferably somewhat in advance of that so that the element of doubt about it would not affect market actions and consumer buying in the passenger car field, and cause the concerns affected to make two sets of plans.

The CHAIRMAN. I am going to ask that on the first round of questions Senators limit themselves to 10 minutes and I assume about 4 minutes of mine are gone, so I will instruct the staff to charge me with 4 minutes and leave me 6. In that way, by 12:00 o'clock or 12:15 we hope to reach the end of the table. Then those who want to ask more questions can go into these matters in greater depth.

Mr. Secretary, you discussed this matter of foreign trade and the trade deficit which, of course, is relevant. We have the gold cover bill before the Senate today.

You are aware, are you not, that there is very substantial support for some measures which would improve this Nation's balance of

payments that the administration is not recommending. I have particularly in mind some of these quota bills which the administration witnesses very strongly opposed last year. They indicated that they were opposed to anything along that line, even though there is very substantial support for some of them up here. In fact, some of them have enough sponsors to constitute a majority of the Senate.

What is the administration's attitude toward the views of Congress with regard to whether this balance-of-payments problem could be met in ways that tend to advantage domestic industries that the Senators representing States with those industries are particularly interested in?

Secretary FOWLER. The administration's position is the same as it was when the witnesses appeared before this committee last fall, that the measures and the means that should be employed to restore and rebuild our trade surplus to a much healthier position should be compatible with the avoidance of restrictive measures unilaterally imposed on imports, and secondly, that the measures to restore our trade surplus should be those that employ the competitive thrust of American business and industry in international competition because it is that kind of gain in a trade surplus that one is likely to be able to maintain and not have canceled out by retaliatory devices.

This is the emphasis in the President's balance-of-payments program insofar as our trade surplus is concerned. I will take this opportunity to say that the Treasury Department has made available to members of this committee what we call the bluebook on "Maintaining the Strength of the United States Dollar in a Strong Free World Economy." In chapter 4 of that book, there is a detailed description of the view of the administration and this Department and certainly the witness before you. There is a prescription for an intensified effort to achieve and maintain a healthy United States trade surplus.

Now, soundly managing the U.S. economy to keep it competitive and stable is the fundamental and the first priority element. That includes a number of things in addition to the tax proposals I have mentioned. It includes a strong emphasis on voluntary wage and price decisions that are more related to increases in productivity than those we have been witnessing in the past year. It includes great stress on effort during the next couple of years, through management and labor and with the help and assistance such as can be provided by the Secretaries of Labor and Commerce, to avoid work stoppages that vitally affect exports or imports in a significant way, and it includes as a second point beyond soundly managing the economy the concept of keeping world markets open.

We think that the unilateral imposition of trade quotas on specific products would move in the opposite direction and would undoubtedly call for retaliatory action which would end up by a constriction of world markets, whereas if our industry is healthy and competitive and our economy is healthy and competitive, we can expect through, you might say, natural competitive forces to return to the trade surplus of the magnitude we had in 1963 and 1964 which was about \$5 to \$6 billion.

The CHAIRMAN. Let me make my position clear, Mr. Secretary. I expect to vote for the House bill. I believe that this committee will pay great heed to your suggestions. We repeatedly amended measures that have come here from the House, some measures you recommended

and some that you did not, but I simply want to make it clear that we feel that cooperation is a two-way street and that while we try to give every consideration to your suggestions, we would like to make it clear that we also have the right to offer ours. We propose to go the extra mile with you when we can and we hope that you can do the same thing with regard to our suggestions.

Secretary FOWLER. I would certainly feel that I was not doing my job if I did not urge upon this committee, however, the importance of, in this particular time, in this particular season, in this particular environment in which we live, the importance of giving priority treatment to revenue raising measures that will deal promptly and adequately with this enormous deficit with which we are confronted. Believe me, there is no single measure or group of measures that are more important not only to our own economy but to the world economy of which we are a part than measures that are designed to sharply reduce this deficit. I do not think that job can be done without the measure that is before you today and without effective and early action to increase income taxes, and I hope, with all due respect and due regard to the other interests and concerns of the committee, that those types of measures be given the right-of-way for early enactment.

Senator WILLIAMS. Will the chairman yield that I might thank him for the endorsement of my bill?

Secretary FOWLER. Senator Williams, I am very much—

Senator WILLIAMS. We will discuss that on my time. I just want to thank you for your endorsement.

Secretary FOWLER. I would just like to take your own or somebody's time by making it abundantly clear that whoever is for increasing those income taxes today and whatever the motion is and whatever the means of achieving it, I am like the young lawyer who was sent down to court one day without instructions as to the nature of the case but only told that when the docket was called and the case of Smith versus Jones was called, he should stand up and say, "for the motion." He did not know what the nature of it was, so he went to court and the case was called and he stood up to his 6 feet 4 and said, "If Your Honor please, counsel for the plaintiff Smith versus Jones, for the motion." The judge said, "What is the motion?" He paused a moment and said, "I do not know what the motion is, Your Honor, but whatever it is I am for it." [Laughter.]

So, any way that anybody can help get more revenues at this stage of the game or help reduce this deficit, I am inclined to be for it.

The CHAIRMAN. May I say that I am somewhat in the position of the proprietor of the barroom. His employee came back, from attending bar and said, "Old Joe Boudreau is out there and he wants some beer on credit again. Shall we give him the credit?" The proprietor said, "has he had the beer?" He said, "Yes." "Then give him the credit." [Laughter.]

While I did not yield for that purpose, the Senator got his point across. My time has expired. Senator Smathers?

Senator SMATHERS. You remind me of the fellow who went to court and was found guilty and the judge said to him, "Do you have anything to say?" and he said, "No, I do not," and the judge said, "In that case I sentence you to 20 years in the State prison at hard labor.

Do you have anything to say now?" He said, "Yes, sir, Judge, you sure are generous with my time." [Laughter.] I hope you will concede me some time.

Mr. Secretary, first, I want to congratulate you on a splendid statement this morning, very clear and logical, and I think portraying properly the urgency of the fiscal problems which are before us and the need for doing something about them. I want to take another minute of my time to also commend you on relating more specifically than has thus far been done, for the need of the 10 percent tax increase which I am for and have been for, but relating that to the cost of the Vietnam war.

It has been my belief that every time we talk about the need of the tax surcharge and you talk about it only in terms of meeting inflation, all that happens is that you set off a debate where six economists agree with you and six economists disagree with you.

But secondly, you make it very difficult for Congressmen and Senators to go back to their constituency now and say to the people I want to help you by increasing your taxes because this really puts money in your pocket in the long run. It is very difficult for Members of Congress to do that, but they can go back to their people and talk to them about the cost of the war in Vietnam and the sacrifice which the boys are making there, and ask the people in turn to sacrifice by reaching in their pockets and paying for it. I believe you will find most of the people will be very pleased and happy to make some sacrifice in that connection. So, again, I say it is a fine statement.

Let me ask you this question. In your statement you mentioned the deterioration of our trade surplus in 1967. Can you tell us briefly what made this so dramatic? What were the causes of it?

Secretary FOWLER. Yes. Senator Smathers, with regard to your earlier comments, I should like to ask for an opportunity to place in the record in connection with your remarks both the series of statements that have been made by the President from August 3 on relating the needs for taxes to the war in Vietnam, and also statements I myself have made.

In the opening statement before the House Ways and Means Committee on last August 3, after thanking the committee for the opportunity to appear, I said:

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

We are engaged in a costly conflict in Southeast Asia with no clear prospects of any early ending but it is a temporary cost and surely one day will terminate when the enemies of freedom conclude that the price of aggression is too high. This unusual and temporary cost must be financed in a manner consistent with preserving sound balanced economic growth without inflation at home.

Fiscal responsibility means different things in different circumstances. In a wartime context it must include the courage and willingness to raise the money that is as necessary as the guns, planes and material needs of our forces in Southeast Asia. In current circumstances fiscal responsibility means that in financing the special and temporary costs of Vietnam, we should obtain as much from temporary tax revenues as economic conditions permit.

(Following is a series of quotations from statements by the President in which he has explicitly linked his proposed tax increase to the cost of the war:)

"If left untended (the) deficit could cause * * * an unequal and unjust distribution of the cost of supporting our men in Vietnam * * *." (Message to Congress, Aug. 3, 1967.)

"For three out of every four American families, the burden of this increase will be between a few cents and \$9 a month. That is a small burden, a small inconvenience compared to what is borne by our men in arms who put their lives on the line in Vietnam." (Message to Congress, Aug. 3, 1967.)

"A failure to raise taxes would not avoid the burdens of financing a war. For these burdens are inescapable. But, instead of sharing those burdens equitably and responsibility * * * as an income tax surcharge would do * * * inflation, tight money and shortages would tax the American people cruelly and capriciously * * *. Some may hear in this message a call to sacrifice. In truth it is a call to the sense of obligation felt by all Americans." (Message to Congress, Aug. 3, 1967.)

"I know it is not a popular thing for a President to do * * * to ask anyone for a penny out of a dollar to pay for a war that is not popular either * * *. We believe, on the best information we can get from every source, that as unpleasant as this is that both of these things must be faced up to." (Remarks to FHLB System officials, Oct. 6, 1967.)

"I know it doesn't add to your polls and your popularity to say we have to have additional taxes to fight this war abroad * * *." (News Conference, Nov. 17, 1967.)

"The war in Vietnam is costing us about \$25 billion and we are asking for about \$12 billion in taxes * * *." (State of the Union, Jan. 17, 1968.)

"It is not the rise in regular budget outlays which requires a tax increase, but the cost of Vietnam * * *." (Budget Message, Jan. 29, 1968.)

"Our *ability* to act as a great nation is not at issue. It is our *will* that is being tested. Are we willing to tax our incomes an additional penny on the dollar to finance the cost of Vietnam responsibility?" (Budget Message, Jan. 29, 1968.)

"The American people are giving their sons and brothers to fight for freedom abroad. At home we must support their sacrifice by preserving a sound economy. I believe the American people will accept the cost of doing that by paying an extra cent of each dollar of income in taxes * * *." (Economic Report, Feb. 1, 1968.)

"As we have long emphasized, the first order of business is the prompt enactment by the Congress of the penny on the dollar tax increase that we will need to pay for part of our extraordinary defense costs * * *." (Swearing-in of M. J. Peck, Feb. 15, 1968.)

EXCERPTS FROM REMARKS OF SECRETARY FOWLER LINKING THE SURCHARGE AND THE VIETNAM WAR

February 6, 1967, statement before the Joint Economic Committee:

"The President has recommended a 6 percent surcharge on both corporate and individual income taxes to be effective at midyear and *to last for two years or for so long as the unusual expenditures associated with our efforts in Vietnam continue.*"

On the same day, in a supplementary statement to the JEC, the Secretary, alluding to his March 23 speech at the National Press Club, said:

"I stressed the uncertainties of Vietnam, saying that 'no one can predict whether we will need to schedule additional expenditures—expenditures beyond those contemplated in the fiscal 1966 and 1967 budgets—to meet our commitments in Vietnam. And Vietnam remains, therefore, an inevitable element of uncertainty in our budgetary as in our overall economic picture.'"

February 14, 1967, responding to a question from Congressman Conte of the House Appropriations Committee on the effect of the war on the budget deficit:

"Thus, Federal revenues would have been just as high (apart from tax legislation attributable to the war), and Federal expenditures much lower."

August 14, 1967, statement before the House Ways and Means Committee:

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

August 23, 1967, speech before Representatives of City and County Organizations:

"First, the cost of our military operations in Southeast Asia is now in excess of \$22 billion per year. These costs call, under the conventional economics or the new economics or any kind of economics, for some financing of those additional temporary costs from additional temporary current tax revenues.

"In short, *the situation calls for a temporary surcharge of as much as economic conditions will permit for the period in which these special and temporary costs impose an extra burden.*"

"In recommending the tax program, the President said: 'There are times in a nation's life when its armies must be equipped and fed and the nation's business must go on. For America, that time is now.'"

November 29, 1967, statement before the House Ways and Means Committee:
 "The prompt enactment of this proposal at this session of Congress would:

* * * * *

Reverse the trend toward increased deficit financing which began with our increased participation in hostilities in Southeast Asia in the Fiscal Year 1966."

January 22, 1968, statement before the House Ways and Means Committee:

"In international security affairs *we have committed ourselves to repelling Communist aggression in Southeast Asia.* Hundreds of thousands of our young men have accepted the burdens of carrying this commitment on the battlefields. It remains for the rest of the population, through the Congress, to accept *temporarily increased taxes as the most desirable means of financing a portion of this national effort.*"

"As to termination of this surcharge, *it will be keyed to our ability to reduce substantially expenditures in Vietnam following a cessation of large scale hostilities.* If it occurs before June 30, 1969, the President will recommend early termination of the surcharge."

January 25, 1968, speech before the Annual Harvard-Yale-Princeton Club Luncheon:

"On Monday, the Congress will be presented a budget which does include substantial expenditure reductions in 1968, which does represent a tight hold-down in expenditures in 1969, which does devote the requested tax increase to deficit reduction—not to rising expenditures—and which does assure that *the tax increase is truly temporary, needed only so long as the fighting in Vietnam requires it.*"

"They say tax increases will halt our economic expansion and push the economy into a stall or perhaps worse. There are those who fear that "temporary" means permanent and that the surcharge will become a permanent factor of the Federal tax structure. But given the specific termination, the circumstances and setting of the tax and *the need for measures of tax reduction in the wake of cessation of hostilities* to stimulate the economy to utilize the resources released by the coming of peace, give assurance that this tax will be temporary."

Secretary FOWLER. I just want to make it clear that I thoroughly accord with your position. There has been no disposition on my part to keep this discussion limited to the pros and cons of cost push inflation and excessive demands inflation, et cetera. I think it is a very simple problem. We have got a war and we have to finance it and we usually finance it by increasing taxes.

Senator SMATHERS. And we did finance the war in Korea, did we not, with an increase in taxes?

Secretary FOWLER. Every one that I ever had any familiarity with.

Now, to come to your other question about the dramatic shift in our trade surplus which gave rise to my comments about the relationship of this tax bill to our balance of payments.

In the first three-quarters of calendar 1967, we were looking at an improving of the trade surplus from the calendar year 1966, and at the end of the third quarter we felt that we would have a trade surplus of about \$4.5 billion at the end of the calendar year 1967. But as had been feared and as had been presented in connection with the early discussion of the surcharge, the sharply rising tide of economic activity beginning in the third quarter, in August and September, and carrying on through the end of the year, brought with it what might be termed

a floodtide of imports, and reduced the rate of increase in exports, so that for the fourth quarter, which is the quarter when the most marked and alarming deterioration in our balance of payments took place, instead of having a trade surplus of a little over a billion dollars, which was characteristic of the preceding three-quarters, our trade surplus for the fourth quarter was around \$300 million. In other words, a dramatic decline from in excess of a billion dollars to less than \$300 million. And most of this was a sharp expansion in our imports.

There was some decline in exports. There were some special factors such as the copper strike which contributed to the deterioration but there was an overall input of imported goods which we normally associate with an economy where the rate of growth in money terms is in excess of 8 percent.

Senator SMATHERS. Thank you, Mr. Chairman. I have time for two quick questions and my time is up in 2 minutes.

The first question is this. In light of the urgency of this 10-percent surtax, would you or do you recommend this committee consider amending this particular bill by offering an amendment to it which would increase the surtax as recommended by the administration?

Secretary FOWLER. As I said in my opening statement, Senator Smathers, and I think I had better stand on this, we feel in the strongest possible terms that the prompt enactment of the surcharge is vitally necessary, fully called for by past events, current events, present outlook. We want to see it adopted under whatever procedures the Congress chooses to utilize. I think those procedures are a matter to be determined between the leadership of the two Houses and between the chairman and ranking minority member of this committee and chairman and ranking minority member of the House Ways and Means Committee. You are familiar with the—

Senator SMATHERS. You would have no objection, then, if we did it by offering an amendment, so long as it is done?

Secretary FOWLER. I would applaud any move that promised an early enactment of this tax proposal.

Senator SMATHERS. One more brief question and then my time is up. Do you know how much money we would save the Government if we were able to bring home our troops in Europe, or half of them?

Secretary FOWLER. In budgetary terms?

Senator SMATHERS. Yes.

Secretary FOWLER. I cannot give you the budgetary estimate. Perhaps Mr. Zwick could reply to that. I can give you balance-of-payments estimates.

Senator SMATHERS. All right. The balance of payments. We would be interested either way.

Mr. ZWICK. Over the longer pull you would save several billions of dollars, assuming you bring them back and also reduce the size of the Armed Forces. In fiscal 1969, I think a major redeployment would actually, if anything, increase costs because when you are involved in bringing back troops, this means transportation costs, closing out facilities, etc. So, in the long pull you are talking about several billion dollars, but in fiscal 1969, it is quite clear you are talking about zero savings, and perhaps even an increase in costs.

Senator SMATHERS. But, you are clear that it would save money and stop considerably the outflow of gold, would it not?

Mr. ZWICK. Yes. It certainly would stop an outflow of gold over time, but the point I am making is that in the very short run you would not save money. And in the longer run, it really depends on whether, when you bring them home, you reduce the size of the Armed Forces or open up new camps to accommodate them when they get back.

Secretary FOWLER. That is the budgetary picture. On the balance-of-payments side I will talk in calendar year terms and talk in general approximations rather than precise figures because of the nature of the question. When one takes into account the military expenditures we make in Western Europe, and that includes the entire area, and one also takes into account the receipts that we receive from those countries for sale of military goods and services—one does not know what the repercussions of the pull back would be on that—but our net deficit that we look at in terms of the calendar year 1968 would be about \$1 billion and we are trying to reduce that net deficit by the type of measures which are described in the—

Senator SMATHERS. Mr. Secretary, I will have to stop. My time is up, unless Senator Williams wants this answer to be on his time, because it is his turn.

Secretary FOWLER. I would just like to—

Senator SMATHERS. Put it on the Secretary's.

Secretary FOWLER. I will borrow 30 seconds from Senator Williams' time to say that the President in his balance-of-payments message on New Year's Day directed the Secretary of State to initiate prompt negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Europe. Our allies can help in a number of ways, and that was the essence of the statement.

Senator SMATHERS. All right, sir, thank you.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Chairman, with your permission I am going to pass. I think Senator Curtis wants to ask a few questions about this prospective ruling, and I understand Mr. Surrey will be the one to answer them, so—

Senator CURTIS. I have a direct question on this income tax.

The CHAIRMAN. May I just interrupt long enough to ask this question? While we have a substantial number of members here, let me say that it does not appear that we can get through this morning, Mr. Secretary. I anticipate that there would be some feeling on the committee that we should be on the floor while the gold cover bill is being considered. Some members are very much interested in that. Could you be available at 9 o'clock tomorrow morning before the committee if the—

Secretary FOWLER. Yes.

The CHAIRMAN. Then, we will plan in terms of meeting at 9 just on the off chance that the Senate might go in early.

Senator CURTIS. My first question is on the basis of a full calendar year, What would the 10-percent surtax recommended raise on individuals?

Secretary FOWLER. \$6.9 billion is the correct figure.

Senator CURTIS. And how much on corporations? Full calendar year.

Secretary FOWLER. About 2.9.

Senator CURTIS. Now, how much—

Secretary FOWLER. Senator Curtis, I am giving you figures for the fiscal year 1969.

Senator CURTIS. 12-month year.

Secretary FOWLER. In other words, I am giving you figures that represent the revenues that will come to the Treasury from July 1, 1968, to June 30, 1969.

Senator CURTIS. All right. On a similar period how much revenue would be raised by an increase of 1 percentage point on individual rates?

Secretary FOWLER. A 1-percentage-point increase, that is, the revenue from an increase of 1 point in rates across the board for individuals would yield \$3.4 billion.

Senator CURTIS. And how much would it yield on corporations?

Secretary FOWLER. That is assuming it was in effect for the whole year?

Senator CURTIS. Yes.

Secretary FOWLER. \$800 million.

Senator CURTIS. \$800 million. A raise of 2 percentage points on individuals would raise more than the 10-percent surtax?

Secretary FOWLER. \$6.8 billion which would be about the same as the 10-percent surcharge.

Senator CURTIS. All right. Now, because of the limitations of time, I will go to another matter. Mr. Surrey, can you tell us, when did the Treasury first approve as tax-free revenue bonds issued by governmental subdivisions where it was known they were going to be used for industrial expansion?

Mr. SURREY. I think the first published ruling came out about 1954. There may have been earlier private rulings, but my recollection is that the first published ruling was in 1954.

Senator CURTIS. Has not Mississippi been doing it since the 1930's?

Mr. SURREY. Yes, sir; and, as I said, there may have been private rulings issued. The first public position of the Internal Revenue Service, I believe, was 1954.

Senator CURTIS. But the private rulings have been consistent since the thirties; is that not right?

Mr. SURREY. I am not sure when private rulings were first issued, but, as far as I know they have been consistent.

Senator CURTIS. And they have been consistent all the way through?

Mr. SURREY. The Service has been following its published position.

Senator CURTIS. Well, it has been following its unpublished position, has it not?

Mr. SURREY. Yes, sir.

Senator CURTIS. Since the 1930's. Under what section of the statute—

Mr. SURREY. Section 103 of the Internal Revenue Code that exempts the interest on obligations of a State or political subdivision.

Senator CURTIS. And this published regulation in 1954—do you remember what month it was?

Mr. SURREY. Public ruling?

Senator CURTIS. Ruling. Do you remember what month it was?

Mr. SURREY. I do not know the month.

Senator CURTIS. The section 103 was substantially reenacted in the code of 1954, was it not?

Mr. SURREY. Yes, sir.

Senator CURTIS. So when the Congress reenacted it in 1954, they reenacted it as then interpreted.

Mr. SURREY. That, I think, is a question that can't be answered. Whether their reenactment goes to every outstanding ruling of the Internal Revenue Service, I will not venture to say.

Senator CURTIS. Well, I will not try to find some isolated ruling, but the point is these bonds have been held tax exempt since 19— in the 1930's. There has been a published ruling since 1954. The statute was reenacted in 1954 and the Congress did not change that.

Mr. SURREY. There have been some other developments, of course, that I would want to refer to in that history. For example, in 1966 various States and localities asked what our position would be on so-called arbitrage bonds. These are bonds which would be issued by a State or municipality, and the proceeds would be invested in Federal securities. The point of the exercise would be that a State or a city or a county would issue a bond carrying an interest rate of $3\frac{1}{2}$ or 4 percent, invest the proceeds in our obligations, which would carry a rate of $4\frac{3}{4}$ percent, and the difference would inure to the benefit of the locality. The difference would arise from the fact that interest on Federal bonds is taxable and that on municipals is exempt.

Various State and local governments indicated they would ask for rulings on whether these were obligations of a State or local government within the meaning of section 103 of the Internal Revenue Code. Internal Revenue Service announced that it would not issue favorable rulings in this situation, because these obligations would not be the obligations of the State or local government; rather, the State or local government would merely be acting as a conduit to the investment of the funds in Federal obligations.

Nobody protested that pronouncement. Nobody quarreled with it as an interpretation of section 103 of the Internal Revenue Code.

(The IRS ruling referred to above follows:)

TECHNICAL INFORMATION RELEASE OF THE U.S. TREASURY DEPARTMENT, INTERNAL REVENUE SERVICE, PUBLIC INFORMATION DIVISION, AUGUST 11, 1966

The U.S. Internal Revenue Service today announced details of its policy of *declining* to issue rulings that the interest on certain obligations is exempt from Federal income taxation under Section 103 of the Internal Revenue Code of 1954.

The policy will continue in effect, pending the conclusion of a study to determine whether such obligations should be considered obligations of States, Territories, possessions, their political subdivisions or the District of Columbia. The study will be directed at obligations issued by these governmental units where a principal purpose is to invest the proceeds of the tax-exempt obligations in taxable obligations, generally United States Government securities, bearing a higher interest yield. The profit received by the governmental units on the difference between the interest paid on the exempt obligations and the interest earned on the taxable obligations is in the nature of arbitrage. The study will not affect obligations issued prior to the date of this release.

More specifically, this ruling policy will apply to obligations falling within either of the following two categories:

1. Where all or a substantial part of the proceeds of the issue (other than normal contingency reserves such as debt service reserves) are only to be invested in taxable obligations which are, in turn, to be held as security for the retirement of the obligations of the governmental unit.

2. Where the proceeds of the issue are to be used to refund outstanding obligations which are first callable more than five years in the future, and in the interim, are to be invested in taxable obligations held as security for the satisfaction of either the current issue or the issue to be refunded.

The following are *examples* of transactions with respect to which no ruling will be issued:

First, a State may issue obligations and invest the entire proceeds in United States bonds with similar maturities bearing a higher interest yield. The United States bonds are then placed in escrow to secure payments of interest and principal on the States obligations. The profit on the interest spread accrues to the State over the period of time that these obligations are outstanding.

Second, a municipality may immediately realize the present value of the arbitrage profits to be derived over the future by casting the transaction in the following form: It may issue obligations in the amount of \$100 million, use \$20 million to build schools or for some other governmental purpose, and invest the balance, \$80 million, in United States bonds which bear a higher interest yield. The United States bonds are escrowed to secure payment of interest and principal on the municipal obligations. The interest differential is sufficiently large so that the interest and principal received from the United States bonds are sufficient to pay the interest on the municipal obligations as well as to retire them at maturity.

Third, a municipality may issue obligations for the stated purpose of refunding outstanding obligations first callable more than five years in the future. During the interim before the outstanding obligations are redeemed the proceeds of the advance refunding issue are invested in United States bonds bearing a higher interest yield, and such bonds are escrowed as security for the payment of either of the issues of municipal obligations. During that interim period, arbitrage profits based on the interest spread inure to the municipality.

The Service made clear that this announcement covers only obligations falling within the two categories described above. Thus, for example it does not cover an issue of obligations where the proceeds are intended to be used to construct a facility even though the proceeds are initially placed in a trust for the security of the bond holders, and invested in taxable obligations, pending their use to meet the construction costs as they occur. Nor does it cover an issue of obligations merely because a portion of the proceeds is invested in taxable obligations and held solely to meet interest payments on the obligations pending the availability of other revenues.

Mr. SURREY. The next development in this situation was a statement by Senator Ribicoff, in introducing his legislation on this subject, which called attention to the ruling in the arbitrage case. He said that in his opinion the industrial revenue bond ruling could not stand consistently with the arbitrage ruling and that he could not see why the Internal Revenue Service was continuing to grant rulings under section 103 on industrial revenue bonds. In his opinion, the original interpretation of the IRS was simply wrong as its later arbitrage ruling indicated.

(Senator Ribicoff's statement, referred to above, follows:)

[From the Congressional Record, Nov. 8, 1967]

PROPOSED LEGISLATION RELATING TO AMENDMENT OF INTERNAL REVENUE CODE

Mr. RIBICOFF. Mr. President, I introduce for appropriate reference, a bill to amend the Internal Revenue Code of 1954 to provide that industrial development bonds are not to be considered obligations of States and local governments, the interest on which is exempt from Federal income tax, and a bill to amend the Internal Revenue Code to provide that arbitrage bonds are not to be considered obligations of States and local governments, the interest on which is exempt from Federal income tax.

Mr. President, for over 50 years our State and local governments have benefited in financing their governmental functions from the Federal income tax exemption of the interest on their bonds. Because of this exemption investors have been willing to accept a lower rate of interest on school bonds, water and sewer bonds, and other similar State and local obligations than they would demand if, like the bonds of the Federal Government, our State and local bonds were fully subject to Federal income tax.

However, recent abuses of the tax-exempt borrowing privilege are undermining the usefulness of this method of helping our State and local governments finance their legitimate functions at the lowest possible cost. These abuses, which are becoming more prevalent every day, represent an intolerable waste of our Federal tax dollars and a real and immediate threat to the ability of our State and local governments to borrow funds at reasonable interest rates to meet their expanding obligations.

The most widespread and well-known abuse of the tax-exempt borrowing privilege is the practice of issuing so-called industrial development bonds. These bonds have permitted some of our largest corporations to issue tax-exempt bonds to the detriment of the best interests of both the Federal Government and the State and local governments.

A typical case might involve a municipality which agrees to issue bonds to finance the building of a factory for a private corporation. The corporation in turn agrees to "rent" the factory for the exact amount needed to pay the interest and amortize the principal of the bonds. The bonds are generally revenue bonds payable only out of the rent and the municipality assumes no obligation, direct or indirect, for repayment of either principal or interest on the bonds. Thus, we are really confronted with bonds of a private corporation. But, because the municipality allows its name to appear on the bonds, it claims and passes on to the private corporation the full benefit of the lower interest rate. This rate stems from the Federal tax exemption of interest on legitimate State and local bonds.

These are truly corporate bonds and the local governments' involvement is often little more than a sham. This was graphically demonstrated last year. The 35 eligible voters of one small town were asked to approve a bond issue of \$20 million in order to finance a plant for a prominent textile company. Indeed, the largest industrial bond issue ever announced, \$140 million for a Japanese aluminum company, is to be issued by Port of Astoria, Ore.—a town of less than 30,000 people.

The Federal Government's concern is obvious. The benefits received by the private corporation in the form of lower rental payments represent nothing more than an unauthorized Federal subsidy to private industry. The total cost of this subsidy—which is exclusively attributable to the interest exemption intended to help our State and local governments—is borne by other Federal taxpayers. However, viewed as a subsidy, industrial development bonds are totally unjustified. The benefit of such financing frequently goes to private corporations who do nothing different than they would have done without the use of industrial development bonds and in all cases the cost to the Federal Government in lost tax revenues considerably exceeds the financial benefits to the private corporations involved.

Unlike most Federal programs, the Federal expenditure is not a part of the Federal budget, was never passed on by Congress, and is not even subject to review by a Federal agency. The sole decision as to whether a private corporation shall receive the benefits of tax-exempt financing depends upon whether a local government will permit the use of its name on what are in reality corporate bonds. Moreover, because an agreement to permit the use of its name costs a governmental unit nothing, there is no apparent reason why any governmental unit would withhold its approval of any particular bond issue and of any subsidy.

However, the problem presented by industrial development bonds today is far more than just a problem of wasted Federal revenues. It has become a very serious problem for our State and local governments themselves. The benefit our State and local governments receive by the exemptions of the interest on their bonds is dependent on the fact that tax-exempt bonds are a unique exception and that most bonds—both corporate and Federal—are fully subject to Federal income tax. As more and more tax-exempt bonds are issued the interest rate on all tax-exempt bonds, including school bonds, water and sewer bonds, will increase in order to make the total supply of exemption bonds attractive to lower bracket taxpayers. Thus, the cost of local government goes up.

Moreover, in recent years some of the largest industrial corporations in the Nation have used industrial development bonds and many of our smaller State and local governments increasingly find themselves handicapped when they are forced to compete for funds in the same limited market against these corporate giants.

For example, in recent years bonds have been issued or announced on behalf of Armco Steel Corp., Firestone Tire & Rubber Co., Litton Industries, Sinclair Oil, and United Fruit Co. The entry of many of our most prominent corporations into the tax-exempt bond market is also reflected by the dramatic increase in the average size of new public issues in recent years as well as in the geometric growth rate of the total of new issues.

In view of this situation one might well ask why our State and local governments continue to tolerate this abuse of a provision which was designed to help them meet their legitimate needs. The answer is that historically these bonds developed in such a manner that today, even though they pose a serious threat to the borrowing ability of our State and local governments, those same State and local governments are virtually powerless to stop them.

This type of financing was originally developed in 1936 in order to attract relatively small industrial concerns to rural areas. Even as late as 1960 only 13 States authorized industrial development bonds and the data available with respect to public issues in that year indicates that only \$70 million in such bonds were issued. However, as interest rates rose States that did not authorize this form of financing found themselves at a handicap in retaining or attracting industry and were forced to authorize industrial development bonds as a competitive measure.

Today over 40 States sanction some form of this abuse and new public issues this year are expected to involve over \$1 billion. In addition the private placement of such bonds, as to which no reliable data is available, may involve more than twice the amount of publicly sold issues this year.

Connecticut does not authorize industrial development bonds. As a consequence we have seen corporations which by all logic should have built new plants or expanded existing facilities in Connecticut lured to other areas.

The officials in my State recognize that industrial development bonds are a costly abuse of the tax exemption. It is an abuse that runs directly counter to the best interests of all the States in this country. Yet unless some meaningful action is taken soon, Connecticut will probably be forced, as a matter of self defense, to join the other States in authorizing and perpetuating this waste of Federal and local resources.

These facts explain the dilemma confronting all our State and local governments today. On one hand, since a corporation seeking tax-exempt financing has over 40 States to choose from, it is clear that industrial development bonds no longer serve as a method of attracting industry to any particular State. On the other hand, since an agreement by a State or local government to allow a private corporation to use its tax-exempt borrowing privilege costs the State or local government nothing, no governmental unit can afford by itself to end this abuse in its area for fear of losing industry to another locality.

This means that the use of industrial development bonds will continue to grow even though they have lost their advantage to the issuing State and local governments and have in fact become a detriment by driving up the interest costs for providing legitimate State and local services.

Thus we are confronted with the type of ludicrous situation which recently led one State to enact a law authorizing industrial development bonds throughout the State and simultaneously pass a resolution calling upon the Federal Government to deny the tax-exempt status of interest on industrial development bonds.

The rapid increase in industrial development bonds is today reaching crisis proportions. Occurring as it does at a time when our State and local governments are confronted with larger and larger demands to provide services and facilities for their citizens and when our Federal Government is confronted with an ever-increasing need for revenue, the use of industrial development bonds has presented us with a situation that can no longer be tolerated.

The Federal Government and the States must join together in eliminating this situation which threatens to undermine their own best interest. And because no State can be expected to end industrial development financing on its own while other States continue to permit such financing, the responsibility for action lies with Congress as the only body with power to enact legislation that can be uniform and simultaneous throughout the 50 States.

In addition to industrial development bonds, another abuse of the tax exemption afforded State and local bonds has gained prominence within the last few years. I am referring to the so-called arbitrage bonds where a local government invests the proceeds of its tax-exempt issue in U.S. bonds which in turn secure the bonds issued. In effect the investor has a certificate evidencing an interest in Federal bonds, but the suggestion is made that the interest received is exempt because the funds pass through the hands of a local government unit.

The local government seeks to make a profit from the difference in interest rates that would arise, since interest on Federal bonds is taxable and the interest paid by the local government is claimed to be exempt. And this profit is claimed on the sole ground that the local government lends its name to a security—without assuming any risk, or responsibility, or work, or anything else.

It takes but little imagination to see that the unchecked spread of arbitrage bonds would pose as great a threat to the Federal revenues and the financing costs of State and local governments as industrial development bonds. From the investors standpoint arbitrage bonds are as secure as Federal bonds and any municipality in the country, no matter how small, could issue unlimited amounts of arbitrage bonds.

In theory the only limit on the amount of arbitrage bonds that could be added to the normal volume of tax-exempt bonds is determined by the amount of Federal obligations that are outstanding. However, the existence of arbitrage bonds on any sizable scale would drastically increase the cost of State and local government borrowings to finance legitimate governmental functions.

Last year the Internal Revenue Service announced that it would not rule on extending the interest exemption to arbitrage transactions under existing law. I am convinced that this action was correct. In essence, the issuing government which engages in an arbitrage transaction is nothing more than a trustee for the bondbuyers who are purchasing—not the obligations of a State or local government—but the obligation of the Federal Government.

I fail to see how an agreement by a locality to act as a conduit for passing interest on Federal bonds to private individuals can be considered the type of "obligation" of a State arising from the exercise of its borrowing power that is encompassed by existing law. To extend the interest exemption to these bonds seems to be outside both the purpose and the literal language of the law which exempts interest on obligations of a State or local government from tax but does not exempt interest on Federal bonds from tax.

A pertinent point here is that this same rationale also casts doubt on the validity of exempting the interest on industrial development bonds.

An examination of most industrial development issues makes it clear that the only real obligor is the private company for whose benefit the bonds are issued. However, the Internal Revenue Service has, for many years, been issuing rulings holding interest on these bonds tax exempt. That position was adopted when the magnitude of these offerings was small and the problems which now loom so clearly were difficult to perceive. I am sure that if the clock were set back the Service would, knowing what it now knows, rule differently.

On the other hand, facing the industrial development situation as it now exists, I feel a legislative solution to this facet of the problem is preferable to administrative action.

To this end, I am introducing a bill which will put a stop to the costly and self-defeating situation which the proliferation of industrial development bonds has brought about. In addition, even though I believe the Treasury Department's position on arbitrage bonds is correct under existing law, to avoid any misunderstandings I am also introducing a separate bill on this subject.

Mr. President, I ask unanimous consent that there be printed in the Record at this point a memorandum on trends in industrial bond financing prepared by the Treasury Department, followed by a letter and material from the Investment Bankers Association of America, a statement by the AFL-CIO executive council, and the text of the bills with a technical explanation of each.

The ACTING PRESIDENT pro tempore. The bills will be received and appropriately referred; and, without objection, the memorandum, letter, material, statement, bills, and technical explanations will be printed in the Record.

Senator CURTIS. But right or wrong, the Congress reenacted it in 1954.

Mr. SURREY. That is correct. Congress did reenact the statutory language. As I say, nobody protested our arbitrage ruling, which was inconsistent with the industrial ruling. The two rulings could not stand consistently. One or the other would be wrong, either the 1954 ruling or the arbitrage ruling.

In reporting on Senator Ribicoff's bill to this committee, the Treasury Department called attention to the fact that it was reconsidering the question. It called attention to the fact that it had noted Senator Ribicoff's observations and stated to this committee that the question has been raised whether rulings of the Internal Revenue Service, which hold that the interest on industrial development bonds is exempt from Federal income tax, are correct interpretations of section 103. It pointed out that the exemption provided by section 103 is limited to interest on obligations of the State or local government, and a careful analysis of the type of industrial revenue bonds that are currently being issued tends to suggest that the only true obligor on the bonds is the private corporation. In most cases the State or

local government does not even guarantee the bonds in the event there is a default.

(The report referred to above follows:)

TREASURY DEPARTMENT,
Washington, D.C., January 23, 1968.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is to inform you of the views of the Treasury Department on S. 2635 entitled "A bill to amend the Internal Revenue Code of 1954 to provide that industrial development bonds are not to be considered obligations of States and local governments, the interest on which is exempt from Federal income tax." In addition, the present report is intended to encompass S. 1282 and S. 1283, each of which is concerned with the subject of industrial development bonds.

S. 2635 would amend section 103 of the Internal Revenue Code of 1954 to exclude from the general tax exemption accorded interest paid on State and local bonds the interest paid on industrial development bonds issued after December 31, 1967. The bill defines an industrial development bond as any obligation the payment of principal and interest on which is either—(1) secured by an interest in property of a character subject to an allowance for depreciation or, (2) secured by (or to be derived primarily from) payments to be made with respect to money or property of a character subject to an allowance for depreciation—which is or will be used, under a lease, sale or loan arrangement, for industrial or commercial purposes. Thus, the bill would exclude from the interest exemption extended by section 103 any State or local obligation secured in a manner which demonstrates that the obligation is issued on behalf of a private industrial or commercial enterprise. By limiting the property involved to cash loans and leases or sales of depreciable property the bill excepts transactions, such as industrial parks, which involve unimproved land exclusively. In addition, specific exceptions exclude from the definition of an industrial development bond obligations issued to finance transportation facilities, recreation facilities and certain other utility properties leased or sold for industrial or commercial purposes. The bill also makes it clear that obligations issued to finance any property used in an active business owned and operated by a State or local government is not an industrial development bond. A detailed technical explanation of S. 2635 was reproduced in the Congressional Record (Vol. 113, Cong. Rec. pp. S. 16022-S. 16023) on November 8, 1967, the date the bill was introduced.

The Treasury Department strongly supports S. 2635 as well as the objective of S. 1282 and S. 1283. Each of these bills seeks to curb the future use of industrial development bonds. However, because certain technical problems presented by S. 1282 and S. 1283 do not exist in the case of S. 2635 the Treasury Department urges the adoption of the approach taken by S. 2635.

Thus, S. 1283 defines industrial or commercial facilities in terms which primarily relate to manufacturing enterprises and enterprises selling manufactured products and it is unclear whether that definition would encompass facilities used by service-type industries such as banks and insurance companies. Also, the bill might permit the avoidance of its provisions through the medium of secured or unsecured cash loans to private enterprises. S. 1282 seeks to curb the use of industrial development bonds by denying any deduction on account of rent or interest paid by a private corporation on a facility financed with industrial development bonds. In general this approach to the problem would impose a penalty that bears no relation to the interest saving (attributable to the tax exemption) which is passed on to the private corporation as a result of the transaction. Moreover, the application of this approach poses difficult problems in determining the amount of interest to be disallowed in any case in which a sale contract does not call for interest payments (or calls for extremely low interest payments). In addition, S. 1282 presents the same definitional questions discussed above.

In considering S. 2635 we have taken note of the fact that even though the bill is prospective in that it only applies to interest payments received in taxable years following enactment, some have questioned the provision in the bill that makes it applicable, after enactment, to all bonds issued after a specified date. In this connection experience has indicated that the very consideration of legislation to end this abuse prompts a significant growth in new bond issues as corporations rush to take advantage of the present situation before Congress can act. Since most of

these bond issues will be outstanding for 15 or 20 years after they are issued, the growth of new issues that will be caused by Congressional consideration of this matter will create serious financial consequences for all state and local governments and will also significantly affect Federal income tax revenues. For this reason we believe the announcement of a fixed cut-off date is a desirable prelude to Congressional consideration to forestall a rush of new issues while the matter is under consideration. The selection of a fixed cut-off date in S. 2635 adequately meets this situation.

Finally, it should be noted that the question has been raised whether rulings of the Internal Revenue Service which hold that the interest on industrial development bonds are exempt from Federal income tax are correct interpretations of section 103 of existing law. It is pointed out that the exemption provided by section 103 is limited to interest on "obligations" of a state or local government and a careful analysis of the type of industrial development bonds that are currently being issued tends to suggest that the only true obligor on the bond is the private corporation that is benefited by the bond issue. In most cases the state or local government does not even guarantee the bond and generally assumes no obligation for payment of either interest or principal in the event that the corporate beneficiary defaults on its payments to the governmental unit involved. (See, e.g., statement of Senator Ribicoff, Vol. 113 Cong. Rep. pp. S 16022-16023, November 8, 1967). Although this question is under study by the Treasury Department, clearly a legislative solution to this problem would avoid any future misunderstanding and render the question moot.

The Treasury Department urges the consideration and enactment of S. 2635. A memorandum discussing, in relevant detail, the nature of industrial development bonds and elaborating upon the reasons we believe such bonds should be excluded from the general tax exemption accorded interest on State and local bonds is attached.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the Administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

THE TAX EXEMPTION OF INTEREST ON INDUSTRIAL DEVELOPMENT BONDS

An industrial development bond is a debt obligation issued under the name of a State or local government for the benefit of a private industrial corporation. The typical case involves a municipality which issues bonds to finance the building of a factory for a private corporation which in turn pays "rent" for the factory set at the precise amount needed to pay the interest and amortize the principal of the bonds.¹ Characteristically the bonds are revenue bonds payable only out of the rent and the municipality assumes no obligation, direct or indirect, for their payment. Thus, such bonds really represent bonds of a private corporation, but because the municipality places its name on the bonds, it claims and passes on to the private corporation the full benefit of the lower interest rate attributable to the Federal tax exemption of interest on state and municipal bonds.

In most instances the industrial development bonds are secured only by the earnings of the private corporation and bond buyers generally look only to the credit rating of the lessee corporation in assessing the merits of the bonds as an investment. In frank recognition of the economic reality of the transaction state courts generally agree that industrial development revenue bonds are not debts of the issuing government unit for purposes of applying the debt ceiling or similar state law restrictions on municipal financing. In some less prevalent situations general obligation bonds secured by the lease revenues are used, so that the municipality assumes a subordinate role as a guarantor of the corporate obligation. However, the lease revenues are regarded as the principal security behind the bonds and the use of general obligation bonds does not materially alter the abuses that flow from the transaction.

In all cases the exemption of interest on industrial development bonds from Federal income tax is simply a Federal subsidy to private corporations. The lower interest rates—which are passed on to the private corporations in the form of lower rental charges—are only possible because of the tax exempt status of the

¹ In some situations the transaction takes the form of a deferred payment sale of the property to the industrial user. The payments made on the note and mortgage securing the sale proceeds are used to make the payments on the bonds.

interest in the hands of the bondholders. Therefore, the full benefit derived by private industry is achieved only at the expense of a loss of Federal tax revenues. Moreover, it is a forced Federal subsidy. The amount of the subsidy, the beneficiary of the subsidy, or the use to which the borrowed funds are put are not considered in any way by the Federal Government. The sole decision as to whether or not to benefit a private corporation rests with the various State and local governments and, since industrial revenue financing imposes no direct costs on the issuing governmental units, there is no agency that has any effective interest in assessing the merits of extending Federal tax benefits to any particular private corporate beneficiary.

In addition, industrial development financing represents a most inefficient and uneconomic means of subsidizing private industry. The cost to the Federal Government in lost tax revenues substantially exceeds the financial benefits that corporations realize through their ability to borrow funds at lower interest rates. As the attached table illustrates it would not be unusual for a transaction involving a highly rated corporation to annually cost the Federal Government almost three times as much in lost tax revenues as the benefit the corporation gets from the transaction. Moreover, the cost to the Federal Government will constantly increase as the volume of tax exempt bonds grows larger and interest rates for all tax exempt obligations rise in order to elicit more demand, particularly from relatively lower bracket taxpayers.

From the standpoint of the State and local governments, the industrial development financing technique was originally developed as a means of attracting industry to low income and labor surplus communities. Before 1961 these bonds were primarily used to finance small manufacturing firms locating in rural areas. Recently, however, multimillion dollar revenue bond issues have financed a number of industrial projects for some of our major industrial concerns. Moreover, as the attached table indicates, the growth of this financing device has tended to parallel the shift in the use of such bonds. Thus, in 1960 when only 13 States authorized industrial development bonds, the total of new issues sold to the public in that year amounted to only \$70 million. By the end of 1966 the number of States authorizing such bonds had increased to 35 and publicly issued new bonds in that year involved over \$500 million. Indicative of the trend towards use of such bonds by our largest corporations is the fact that the eight largest issues in 1966 accounted for \$344 million, over 60 percent of the estimated \$500 million in new public issues for that year. Finally, it should be noted that this geometric growth rate is continuing. Over 40 States authorize industrial development bonds today and although final data is not available for 1967, preliminary tabulations indicate that well over \$1 billion industrial development bonds were publicly marketed last year.

Figures are generally available only for bonds marketed to the public. In many cases the issues are privately placed with banks, other lenders or the company itself. No reliable data are available as to the amount of privately placed issues but they may involve more than twice the amount of publicly sold issues.

Although this practice is defended as a means of attracting new industry, many have questioned whether the availability of industrial development financing was ever a significant incentive to locate in a particular area. They point out that a commitment to move a substantial enterprise into a totally new locality for a long period of time is such a serious decision that the benefit of low cost financing is a rather minor factor when compared to such economic considerations as the corporation's access to raw materials or to its existing and potential markets. However, to whatever extent the use of industrial development bonds has been a significant factor leading to the dispersion of industry in the past, it seems clear that in present circumstances, with an ever increasing number of states authorizing such bonds, the utility of industrial development financing as an incentive to attract industry is rapidly disappearing. Since the issuance of industrial development revenue bonds involves neither risk nor direct cost to the issuing locality, there is little reason for any locality to deny a corporate request. Thus, even assuming that such funds are an important factor influencing the selection of a relocation or expansion site, a private corporation embarking on an expansion program today has over 40 states to choose from. This total is actually larger because even in states which do not authorize such issues, political subdivisions may be engaged in this practice. Once all fifty states are forced by competitive considerations to authorize industrial development financing the ability to attract industry through the use of such bonds will be totally nonexistent. Thus, the continued proliferation of such bonds will merely increase the Federal revenue loss without any appreciable economic benefit to the Nation or the State and local governments.

Moreover, not only is the basic objective of industrial development financing to attract industry essentially self-defeating, but the rapid growth in the dollar volume of such bonds works to the positive detriment of all State and local governments. The benefits State and local governments receive because of the Federal tax exemption of the interest on their bonds is dependent on the fact that tax-exempt bonds are a unique exception and that most bonds—both corporate and Federal—are fully subject to Federal income tax. As more industrial development bonds are issued the interest rate on all tax-exempt bonds must increase in order to make the total supply of exempt bonds attractive to lower bracket taxpayers.² Moreover, in recent years some of the largest industrial corporations in the Nation have used industrial development bonds and many of our smaller State and local governments find themselves severely handicapped when they are forced to compete for funds in the same limited market against these corporations. (See, e.g., statement of Senator Ribicoff, Vol. 113 Cong. Rec. pp. S 16022-16023, November 8, 1967. See also the attached table of large (over \$10 million) industrial development bond issues in 1967.)

It has been estimated that in recent years the increase in normal State and local government bonds outstanding has been growing at the rate of \$6.5 billion annually. In 1967 over \$1 billion of industrial development bonds were added to the demand for new funds with the obvious result that the interest rates that State and local governments had to pay on bonds issued to finance governmental functions were higher than they need be. For example, the Finance Administrator of New York City in testimony before the Joint Economic Committee on December 5, 1967, estimated that the existence of industrial development bonds increased New York City's borrowing rate by $\frac{3}{8}$ of one percent and increased the city's debt service cost by almost \$2 million last year. This type of market effect was not confined to one city, it affected all State and local governments that borrowed funds last year. This, of course, means increased property taxes, sales taxes and State income taxes. Thus, it is clear that industrial development bonds, while imposing no direct costs on the issuing governmental unit, are not cost free to State and local governments. In fact they are very expensive and their cost is mounting dramatically each year—a cost which must be borne by all State and local governments not just those that issue the bonds.

In sum it seems evident that the use of industrial development bonds is ceasing to have any meaning as a device to attract industry to a given State or locality. Instead, these bonds are rapidly becoming a self-defeating device that will inevitably work against the long range best interests of all States. However, even when all States authorize industrial financing and it thereby becomes a completely meaningless attraction for industry—completely meaningless because any corporation knows that wherever it decides to locate it can ask for and receive the benefit of tax exempt borrowing—it is unlikely that we will see a decline in industrial development issues. The reason is simply that since such financing imposes no direct cost on a municipality, no single municipality can afford to withhold its approval of any issue even though the participation of all municipalities works to the very real detriment of municipalities generally. The question will not be one of attracting industry but rather one of losing an industry for failure to issue the bond—an industrial corporation will simply say it will not even consider a particular locality unless the local government assures the use of industrial development bond financing. Therefore, it seems clear that if this abuse is to be curtailed the impetus will have to come from the Federal Government. Moreover, in view of the recent growth of such financing and the significant cost of the Federal subsidy involved, it would seem appropriate to correct the situation as soon as possible.

² If there were only a few tax-exempt bonds in existence they would be purchased by the few high rate taxpayers who would benefit most by the tax exemption. There are an appreciable number of individual taxpayers facing a marginal rate of 70 percent. Thus, if we had only a few tax-exempt bonds, the competition between buyers would drive interest rates on these bonds down sharply, probably to a level close to 70 percent below rates on comparable quality taxable issues. But in fact there are over \$100 billion of tax-exempt bonds in the market, and the issuers have therefore had to turn to buyers with much lower marginal tax rates than 70 percent. The marginal buyer in a lower tax bracket thus determines the market differential between comparable quality taxable and tax-exempt bonds. Tax-exempt bonds carry, therefore, a much lower discount compared to taxable bonds than would occur if there were only a few exempt bonds. Recent estimates of this discount or differential indicate that it is approximately 30 percent. Thus, the addition of a significant volume of industrial development bonds in this limited market necessarily decreases the discount which all tax-exempts carry and thus increases borrowing costs for traditional State and local functions. As indicated later in the text, the effect on the discount becomes even clearer when the flow of industrial development bonds is compared to the amount of traditional state and local bonds annually issued.

FEDERAL REVENUE LOSS AND CORPORATE REVENUE ADVANTAGE RESULTING FROM A TYPICAL INDUSTRIAL DEVELOPMENT BOND TRANSACTION

A corporation that is able to borrow for its own purposes at a 6 percent rate of interest may be able to borrow the same amount at only 4½ percent interest through the use of industrial development bonds. If we assume a purchaser of the bond is in a 50 percent tax bracket the corporation's benefit from the lower interest rate will amount to only \$.78 on each \$100 of borrowed capital. The Federal government, however, will lose \$2.28 in tax revenue for each \$100 borrowed capital.

This result is demonstrated by the following comparison which in each case assumes that the corporation earns the same amount (\$10) on each \$100 of borrowed capital.

	Taxable bonds		Industrial development bonds	
	Corporate profit	Federal tax revenue	Corporate profit	Federal tax revenue
Gross earnings.....	\$10.00		\$10.00	
Less interest.....	6.00	† \$3.00	4.50	----- 10
Net before taxes.....	4.00		5.50	
Less corporate income tax.....	1.92	1.92	2.64	----- \$2.64
Total.....	2.08	4.92	2.86	2.64

† Income tax on bond buyer

Note.—Corporate gain from tax-exempt borrowing: \$2.86 less \$2.08=\$.78. Federal revenue loss from tax-exempt borrowing: \$4.92 less \$2.64=\$2.28.

TRENDS IN INDUSTRIAL DEVELOPMENT BOND FINANCING

Generally, each industrial development bond issued by a governmental unit serves to finance a single project for a specific corporation. It is therefore possible to discern a trend in the size of firms acquiring facilities financed by these tax-exempt bonds by examining the changes in the average value of industrial development bond issues.

Prior to 1960, the estimated total value of industrial development bond debt outstanding was just above \$100 million. In the seven years 1960-66, the dollar value of new industrial development bonds increased by an estimated \$1.2 billion.¹ This absolute growth in the volume of industrial development bonds issued since 1960 is partly explained by the increase in the number of states permitting local units to borrow for this purpose. However, the increase in the number of states authorizing industrial development bonds has coincided with a marked rise in the size of projects financed.

Table I shows the estimated value of publicly issued industrial development bonds for the years 1956-66, the number of issues and the average amounts borrowed to finance projects in each year. The number of projects in each year is approximately equivalent to the number of issues shown in Column 2. Between 1956-60, 217 projects were financed and the average issue size ranged between \$267,541-\$742,797. Since 1961, the average amounts borrowed to finance industrial projects has ranged between \$1.0-\$3.0 million.

The growth in average value of projects financed since 1961, is due to the sharp increase in the number of large-scale projects financed, that is, projects in excess of \$1 million. In Table II, the number of issues exceeding \$1 million since 1956 is shown. Prior to 1961, the largest industrial development bond issue was \$9.5 million; however, between 1961-66, 19 single issues in excess of \$20.0 million were floated. In 1966 alone the 8 largest issues accounted for \$334 million, more than 60 percent of the estimated \$500 million in new public issues for that year. Finally, the preliminary 1967 data involving large issues reveals that new public issues last year can be expected to substantially exceed \$1 billion.

¹ The material discussed in this memorandum is drawn primarily from data involving publicly offered industrial development bonds. In addition, there is a large volume of privately placed industrial development bonds which are not reflected in the above estimates. Commentators have estimated that the actual amount of industrial development bonds outstanding may be two to three times larger than estimates based on public offerings would indicate. See e.g., Bridges, *State & Local Inducements for Industry*, 18 National Tax Journal, 7, 8 (1965).

TABLE I.—ESTIMATED VALUE OF PUBLICLY ISSUED INDUSTRIAL DEVELOPMENT BONDS¹ BY LOCAL UNITS, NUMBER OF ISSUES REPORTED, AND AVERAGE ISSUE SIZE, 1956-66

Year	Total amount of bonds issued (thousands)	Number of issues	Average size of issue
1956.....	\$6,421	24	267,541
1957.....	7,328	22	346,000
1958.....	12,746	47	271,000
1959.....	22,096	50	458,920
1960.....	56,383	74	742,797
1961.....	57,201	42	1,361,900
1962.....	77,877	64	1,216,800
1963.....	135,225	67	2,018,300
1964.....	201,571	82	2,458,200
1965.....	191,717	78	2,457,900
1966.....	504,460	133	3,792,932

¹ See e.g., Bridges, "State and Local Inducements for Industry," 18 National Tax Journal, 7, 8 (1965).

TABLE II.—Number of industrial development bonds issued in excess of \$1,000,000, 1956-66

	Number		Number
1956.....	1	1962.....	14
1957.....	1	1963.....	16
1958.....	2	1964.....	25
1959.....	1	1965.....	28
1960.....	9	1966.....	46
1961.....	5		

TABLE III.—INDUSTRIAL DEVELOPMENT BONDS ISSUED IN 1967 (LARGE ISSUES ONLY)¹

Date	Amount (millions)	Corporation	Municipality
1967			
January.....	\$15.0	Arkansas-Louisiana Gas Co.....	Helena, Ark.
February.....	82.5	Armco Steel Corp.....	Middletown, Ohio.
March.....	14.0	Cooper Tire & Rubber Co.....	Texarkana, Ark.
April.....	12.0	Firestone Tire & Rubber Co.....	Cecil County, Md.
Do.....	12.5	Beech-Nut Life Savers, Inc.....	Holland, Mich.
May.....	13.5	Bibb Manufacturing Co.....	Monroe County, Ga.
Do.....	60.0	Sinclair Petro-Chemicals (a subsidiary of Sinclair Oil Co.).....	Fort Madison, Iowa.
June.....	10.0	Crawe Co.....	Washington, Iowa.
Do.....	30.0	Firestone Tire & Rubber Co.....	Warren County, Ky.
Do.....	33.0	Allied Stores.....	Livonia, Mich.
Do.....	12.5	Control Data Corp.....	Douglas County, Nebr.
July.....	80.0	West Virginia Pulp & Paper Co.....	Wickliffe, Ky.
August.....	15.0	Swift Manufacturing Co.....	Phenix City, Ala.
September.....	75.0	Georgia-Pacific.....	Crossett, Ark.
October.....	12.5	Carrier Corp.....	Warren County, Tenn.
Do.....	20.0	Wycon Chemical Corp.....	Cheyenne, Wyo.
November.....	85.0	U.S. Plywood-Champion Paper.....	Courtland, Ala.
Do.....	53.0	Firestone Tire & Rubber Co.....	Albany, Ga.
Do.....	10.5	Pittsburgh Activated Carbon Co.....	Ashland, Ky.
Do.....	25.0	Hercules, Inc.....	Iberville Parish, La.
Do.....	130.0	Litton Industries (Ingalls Shipbuilding).....	Mississippi.
Do.....	13.5	Olin Mathieson Chemical Corp.....	Bradley County, Tenn.
December.....	18.0	Automatic Electric Co.....	Huntsville, Ala.
Do.....	97.0	Revere Copper & Brass.....	Scottsboro, Ala.
Do.....	35.0	Hystran Fibers Inc. (Hercules and Farberwenke Hocht A.G.).....	Spartanburg, S.C.
Do.....	46.0	Goodyear Tire & Rubber.....	Union City, Tenn.
Total.....	1,010.5		

¹ Final data concerning publicly issued industrial development bonds in 1967 are not presently available. On Nov. 8, 1967, Senator Ribicoff introduced in the Congressional Record information concerning certain large issues either pending or completed in 1967. (See vol. 113, Congressional Record, pp. S16023 and S16024.) The instant table is primarily drawn from the information introduced by Senator Ribicoff but has been revised and limited to reflect those large issues actually sold in 1967.

TREASURY DEPARTMENT,
Washington, D.C., January 23, 1968.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is to inform you of the views of the Treasury Department on S. 2636 entitled "A bill to amend the Internal Revenue Code of 1954 to provide that arbitrage bonds are not to be considered obligations of States and local governments the interest on which is exempt from Federal income tax."

S. 2636 would amend section 103 of the Internal Revenue Code of 1954 to exclude from the general tax exemption accorded interest paid on State and local bonds the interest paid on arbitrage bonds. The bill defines an arbitrage bond as any obligation (1) under the terms of the issue of which the State or local government may invest the proceeds of the issue in taxable obligations yielding a higher rate if interest than the issue in question, and (2) the portion of the proceeds so so invested is required to be held as security for the payment of the issue in question or any other bond issue the interest payments on which are exempt from Federal income tax.

Specific exceptions exclude from the definition certain common situations which entail only a limited or temporary investment of the proceeds of an issue in taxable securities yielding a higher rate of interest. For example, the general exception for bonds which limit the reinvestment to a period of two years or less would allow the temporary investment of the proceeds of a new issue intended to replace an outstanding issue that is approaching maturity. Similarly, if the purpose of a new issue is to raise funds for the construction of a facility, the temporary investment of the proceeds for up to five years (for example, during the period before they are needed to meet construction costs) will not cause the bonds to be classified as arbitrage bonds. In addition, bond issues would be excluded from the definition even if a portion of the proceeds are required to be invested in taxable securities as a debt service reserve so long as this amount does not exceed the amount needed to meet interest and principal payments during successive two-year periods after the date of issue. Finally, if abnormal situations prompt the issuance of bonds requiring a reinvestment of the proceeds for periods exceeding the specified limitations, the bill would authorize the Secretary of the Treasury to provide for the issuance of special Federal obligations at yields which would prevent an arbitrage profit from arising if the municipality was unable to purchase Federal obligations yielding the same or lower interest rates than the issue in question on the open market. A detailed technical explanation of S. 2636 was included in the Congressional Record (Vol. 113, Cong. Rec., p. S 16027) on November 8, 1967, the date the bill was introduced.

The Treasury Department strongly supports S. 2636.

The tax exemption afforded interest paid on State and local bonds permits the State and local governments to market obligations bearing a lower rate of interest than would be the case if, like the bonds of the United States, the interest on State and local obligations were subject to Federal income tax. As a consequence it is possible for a State or local government to realize a profit by reinvesting the proceeds of an exempt issue in taxable securities such as Federal bonds. This profit is, of course, at the expense of the Federal government since it is exclusively attributable to the tax exemption of the State and local bond interest.

The operational aspects of such a transaction are relatively simple. A State or local government could issue bonds and agree to invest the proceeds in Federal bonds which would be held in escrow for the payment of interest and principal on the State and local bonds. The investor in such obligations would have a certificate representing an interest in Federal Bonds, but because the interest payments made by the Federal government would pass through the hands of the State or local government, it may be argued that the interest is exempt. A local government engaging in such transaction would seek to make a profit from the interest differential existing between the taxable Federal securities and the non-taxable securities which it purports to issue. It could then use this profit for any purpose it deemed desirable.

A similar but more complicated form of arbitrage transaction arises in the context of so-called advance refunding transactions. In this situation a State or local government with bonds outstanding that are not presently callable could

issue a new series of bonds to "refund" the old bonds by using the proceeds of the new issue to purchase Federal government securities which are then placed in escrow for payment of either the outstanding bonds or the new issue until such time as the outstanding bonds are callable. In such cases the State or local government could seek and use the profit from the differential between the interest on its new issue and the return on the Federal securities to reduce its debt service costs.

From the standpoint of the Federal government arbitrage transactions undertaken to earn a profit on the interest differential between taxable and non-taxable securities represent a clear distortion of the basic purpose of the interest exemption. That exemption is accorded State and local governments to permit them to finance their governmental functions at a reduced interest cost. The Treasury Department is unable to perceive of any conceivable justification for extending the tax exemption to bonds that are issued primarily to realize a profit from the interest differential between taxable securities and exempt securities. Even viewed as a subsidy to State and local governments such cases represent an intolerable waste of Federal funds. The Federal government loses many times more in tax revenues than the profit the municipality is able to realize from such transactions.

It should also be noted that if the characterization of arbitrage bonds as exempt obligations of the issuing State and local government were accepted, the resulting proliferation of such bonds would have disastrous consequences on the ability of State and local governments to finance their normal government functions. This would occur because the capacity of the tax-exempt market to absorb a large volume of new issues secured by Federal obligations without a sizeable increase in the interest rate demanded of bonds that are not so secured is limited. In this connection, every advance refunding transaction engaged in by a governmental unit tends to double the number of outstanding bonds of that unit during the period in which the old bonds are not callable. Moreover, since from the investor's standpoint arbitrage bonds are as secure as Federal bonds, any municipality in the country, no matter how small, could issue "pure" arbitrage bonds (*i.e.*, unconnected with an advance refunding) without limit. In theory the only limit on the amount of arbitrage bonds that could be added to the normal volume of tax-exempt bonds would be determined by the amount of Federal obligations that are outstanding. It is, therefore, evident that the existence of arbitrage bonds on any sizeable scale would drastically increase the cost of State and local government borrowings to finance traditional governmental functions.

In 1966, The Treasury Department and Internal Revenue Service, after a preliminary study of this matter, announced in Technical Information Release 8 that no rulings would be issued as to the exempt status of interest on certain arbitrage bonds. Although this Department is convinced that existing law is adequate to deal with these arbitrage transactions, it appears appropriate to amend section 103 of the law to codify this result so that misunderstandings may be avoided.

For these reasons it is recommended that S. 2636 be enacted.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the Administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

Mr. SURREY. Shortly thereafter, the Securities and Exchange Commission which had not previously taken the position that these obligations had to be registered because State or local obligations are exempt from registration issued a proposed regulation that these instruments were essentially private obligations and, therefore, had to be registered. Our industrial revenue bond rulings were then inconsistent with this action as well as with our arbitrage ruling.

(The regulation referred to above follows:)

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., February 1, 1968.

Securities Act of 1933, Release No. 4896.
Securities Exchange Act of 1934, Release No. 8248.

NOTICE OF PROPOSED RULE 131 UNDER THE SECURITIES ACT OF 1933 AND PROPOSED RULE 3b-5 UNDER THE SECURITIES EXCHANGE ACT OF 1934

Notice is hereby given that the Securities and Exchange Commission has under consideration a proposal to adopt two new rules relating to "industrial revenue bonds": Rule 131 under the Securities Act of 1933 and Rule 3b-5 under the Securities Exchange Act of 1934. "Industrial revenue bonds" generally are instruments issued in the name of a government or its instrumentality to finance the acquisition of a revenue producing facility which is leased to a private commercial or industrial company, to whose specifications the facility is usually created. The principal and interest on the bonds are payable from the proceeds of the lease, and the bonds are not backed by the taxing power and general credit of the governmental instrumentality in whose name they are issued. Such a bond is an instrument that represents: (1) an obligation on the part of a government or its instrumentality to perform certain acts, usually to collect the rental under the lease and to use it to discharge interest, sinking fund and other monetary obligations contained in the instrument; and (2) an interest in the obligation of the private company to make payments under the lease in order to provide funds for payment by the governmental instrumentality in whose name the bond is issued of principal and interest on the bond. Since the purchaser of an industrial revenue bond looks principally, if not entirely, to the lease payments for the payment of principal and interest on the bond, he is in reality purchasing an interest in the lease obligation of the private company. The new rules are proposed for the purpose of identifying the interest in the obligation of the private company as a separate "security" issued by the private company. These rules do not relate to, and have no effect on, the obligation of the government or its instrumentality nor do they require registration by the government or instrumentality. The purpose of the rules is to provide prospective investors with adequate information concerning the nature of the obligation of the private lessee and sufficient information about the lessee and its business as well as the terms, nature and identity of the persons involved in the distribution to enable investors to make informed investment judgments.

Since the typical industrial revenue bond financing plan represents a financing by a private company, investors should be given information concerning the business, prior experience, fiscal responsibilities and earnings of the company that has leased the facility, as well as the terms and conditions of the lease arrangement, in order to assess the worth of such investment. The municipality or other governmental unit usually has no significant obligation under the bond, except to the extent of applying lease payments received from the private company to the payment of principal and interest. The investor cannot look to the municipality for interest payments or repayment of the principal; he can look only to the possibility of success or failure of the private company. The municipality serves as a conduit through which the amounts payable under the lease arrangement flow from the private company to the bondholder. In these circumstances, the investor is offered an interest in an obligation of the private company which is a "security" within the meaning of the securities acts and should have the benefit of the disclosures required by the Securities Act of 1933 and the Securities Exchange Act of 1934 when applicable.

The proposed rules do not question the availability of the exemption, provided in Section 3(a)(2) of the Securities Act, to the obligations of municipalities or of the states or their political subdivisions or instrumentalities. Such exemption is not available, however, to the separate security issued by the private company. Absent an exemption under the Act, the securities of the private company will be subject to the registration and prospectus delivery requirements of Section 5 of the Securities Act. Registration will not be required by the municipality or other political subdivision or instrumentality.

On the basis of available information, it appears that substantial amounts of these bonds have been sold to the public. Accordingly, the Commission believes that the proposed rules are appropriate to inform persons who may be issuers of securities identified by the rules, as well as persons offering, selling, distributing or dealing in such securities, as to their obligations under the securities acts.

Consideration should also be given to the applicability of the Trust Indenture Act of 1939 to the securities identified in the rules. It should be emphasized that the application of the registration requirements of the Securities Act to the securities of private companies which are identified in the proposed rules is intended to provide investors with material financial and other information concerning the private company and the nature and limitations of its obligations. The rules are not intended to affect the determination whether to utilize financing plans involving the issuance of industrial revenue bonds.

PROPOSED RULE 131

Under paragraph (a) of the proposed rule, any part of an obligation evidenced by any bond, note, debenture, or other evidence of indebtedness issued by any state or territory of the United States, any political subdivision of a state or territory, or any agency or instrumentality of one or more states, territories or political subdivisions thereof, which is payable from rentals received in respect to property which will be used under a lease by or for industrial or commercial enterprises, shall be deemed to be a separate security issued by the lessee under the lease. In addition, as essentially the same kind of financing plan could be carried out by a governmental body or instrumentality loaning the proceeds of the bonds to private enterprise or selling the revenue producing facilities to private enterprise on a deferred payment basis, paragraph (a) provides that any part of the obligation evidenced by any bond, etc. which is payable from payments received under a loan or sale arrangement, shall be deemed to be a separate security issued by the obligor under such loan or sale arrangement.

The proposed rule is directed to financing plans in which any part of the principal and/or interest on a bond, note, debenture or evidence of indebtedness issued in the name of a government or its instrumentality is payable from payments which are to be made under a lease, sale or loan arrangement by private enterprise for property or money to be used by industrial or commercial enterprises. The rule does not apply to revenue bonds issued by a state, a political subdivision, a municipality or a public instrumentality to finance a revenue producing public project operated by such issuer, such as toll roads, municipal water systems, transportation systems or municipal recreational facilities. The rule also is not intended to apply to financing plans involving the issuances of revenue bonds which are to be funded by payments under a lease, sale or loan arrangement if the user of the facility or property is a state or a political subdivision or public instrumentality of a state or a municipality which is the lessee or obligor.

The Commission is aware that for many years issuers of the securities identified in this rule have not considered their obligations to be separate securities and that they have acted in reliance on the view, which they believed to be the view of the Commission, that registration under the Securities Act was not required. Under the circumstances the Commission does not believe that such issuers are subject to any penalty or other damages resulting from entering into such arrangements in the past. Paragraph (b) provides that the rule shall apply to transactions of the character described in paragraph (a) only with respect to bonds or other evidences of indebtedness issued after the adoption of the rule.

The text of the proposed rule is as follows:

"RULE 131. DEFINITION OF SECURITY ISSUED UNDER GOVERNMENTAL OBLIGATIONS

"(a) Any part of an obligation evidenced by any bond, note, debenture, or other evidence of indebtedness issued by any State or Territory of the United States, any political subdivision of a State or Territory, or any agency or instrumentality of one or more States, Territories or political subdivisions thereof, which is payable from payments to be made in respect of property or money which is or will be used, under a lease, sale, or loan arrangement, by or for industrial or commercial enterprises, shall be deemed to be a separate "security" within the meaning of Section 2(1) of the Act, issued by the lessee or obligor under the lease, sale or loan arrangement.

"(b) This rule shall apply to transactions of the character described in paragraph (a) only with respect to bonds, notes, debentures or other evidences of indebtedness issued after the year 1968."

PROPOSED RULE 3b-5

The Commission believes that it is appropriate to adopt proposed Rule 3b-5 to make it clear that securities identified under Rule 131 are also "securities" within the meaning of Section 3(a)(10) of the Securities Exchange Act of 1934. The provisions of the proposed rule correspond to those of Rule 131. The proposed rule is intended to inform brokers and dealers who deal in industrial revenue bonds, that consideration should be given to the existence of separate securities issued in connection with the issuance of industrial revenue bonds, in determining their obligations under the Securities Exchange Act, where any part of the obligation evidenced by any bond, note, debenture or other evidence of indebtedness is payable from payments made in respect of property or money which is or will be used under a lease, sale or loan arrangement by or for industrial or commercial enterprises. Such separate securities ordinarily would not be exempted securities within the meaning of Section 3(a)(12) of the Act.

The text of the proposed rule is as follows:

"RULE 3b-5. NON-EXEMPT SECURITIES ISSUED UNDER GOVERNMENTAL OBLIGATIONS.

"(a) Any part of an obligation evidenced by any bond, note, debenture, or other evidence of indebtedness issued by any State or Territory of the United States, any political subdivision of a State or Territory, or any agency or instrumentality of one or more States, Territories or political subdivisions thereof, which is payable from payments to be made in respect of property or money which is or will be used, under a lease, sale or loan arrangement, by or for industrial or commercial enterprises, shall be deemed to be a 'separate' security within the meaning of Section 3(a)(10) of the Act, issued by the lessee or obligor under the lease, sale or loan arrangement.

"(b) This rule shall apply to transactions of the character described in paragraph (a) only with respect to bonds, notes, debentures or other evidences of indebtedness issued after , 1968."

All interested persons are invited to submit their views and comments on the proposed rules, in writing, to the Securities and Exchange Commission, Washington, D.C. 20549, on or before March 29, 1968. Except where it is requested that such communications not be disclosed, they will be considered available for public inspection.

By the Commission:

ORVAL L. DuBois, *Secretary.*

Mr. SURREY. Under these circumstances we continued our study as we had indicated.

We have come to the conclusion, as we announced, that our earlier rulings were simply wrong and that since this entire structure rests upon an erroneous view of the Internal Revenue Code as interpreted by the Internal Revenue Service, there was responsibility to change it. Only a ruling was involved earlier. We concluded, therefore, that we should announce the change and then proceed with the proposed regulation. This proposed regulation will be the subject of notice and hearing.

(The announcement by the Internal Revenue Service referred to above follows:)

TECHNICAL INFORMATION RELEASE OF THE U.S. TREASURY DEPARTMENT, INTERNAL REVENUE SERVICE, PUBLIC INFORMATION DIVISION, MARCH 6, 1968

The Treasury Department today announced that it is reconsidering its position on the tax exempt status, under section 103 of the Internal Revenue Code, of interest paid on so-called industrial development bonds.

Generally, the bonds are issued by a municipality or other political subdivision; however, the debtor, in reality, is the private corporation which will use the facility constructed with the proceeds of the bond issue.

The present position is set forth in Revenue Ruling 54-106, C.B. 1954-1, 28, Revenue Ruling 57-187, C.B. 1957-1, 65, and Revenue Ruling 63-20, C.B. 1963-1, 24.

On or about March 15, 1968, a proposed regulation concerning so-called industrial development bonds will be published in the Federal Register. Interested parties will be afforded an opportunity to submit written comments and a public hearing will be held.

The proposed regulations, when issued, will provide that such bonds will not be considered to be obligations of a State, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia within the meaning of section 103(a)(1) of the Internal Revenue Code.

These regulations will only apply to such bonds sold after March 15, 1968. In applying the March 15 effective date, bonds will be considered sold on the date on which a buyer or underwriter enters into a binding contract with the issuer to purchase the bonds at a fixed price.

Accordingly, the Internal Revenue Service will publish a Revenue Ruling revoking Revenue Rulings 54-106 and 57-187, effective with respect to so-called industrial development bonds sold after March 15, 1968. In addition, it will appropriately modify Revenue Ruling 63-20 with respect to such bonds sold after March 15, 1968.

The principles contained in Revenue Rulings 54-106, 57-187 and 63-20 will apply to so-called industrial development bonds sold on or before March 15, 1968. However, these Revenue Rulings do not take into account the effect of provisions making the redemption of such bonds mandatory in the event that legislation is enacted, a regulation is promulgated, or a Revenue Ruling is issued affecting the tax exempt status of interest paid on such bonds.

The Revenue Service announced that it is now studying the effect of mandatory provisions of this general nature on the tax exempt status of interest paid on such bonds under section 103 of the Code and the Revenue Rulings thereunder.

The Revenue Service also announced today that it will no longer issue ruling letters with respect to so-called industrial development bonds. However, ruling requests received before the close of business on March 6, 1968, will be processed. Where such requests involve mandatory redemption provisions, favorable rulings will not be issued.

Mr. SURREY. The matter came up at the Governors' conference and the Governors' conference took note of the fact that the Treasury Department was reconsidering its position. The tax committee of the Governors' conference noted that they had been informed the Internal Revenue Department may soon promulgate regulations eliminating the tax-exempt feature of these bonds. The panel noted there have been abuses associated with such securities and urged that Treasury officials seek the participation of interested State and local groups in the formulation of any departure from the present policy of tax exemption.

Those consultations were held with interested State and local groups before any announcement was made, and there was consultation with the groups that represent the various governmental units in the United States before the announcement was made.

I might say that we were faced with a very difficult situation, and I think the State and local communities recognized this. Last year there was \$1.3 billion worth of these bonds publicly issued. The market nearly broke last December because of the vast outpouring in that month. We have been informed that the bond calendars indicate potential issues this year, identified at this time, of between a billion and a half and \$2 billion.

Senator CURTIS. Mr. Surrey, you do not feel the amount involved in any way relates to the question as to whether or not taxing of these bonds must be done by Congress or—

Mr. SURREY. No.

Senator CURTIS (continuing). Or by the Treasury, do you?

Mr. SURREY. No, I do not.

Senator CURTIS. That has nothing to do with it?

Mr. SURREY. Not with the legal situation. It does, however, have relevance to the way in which the Treasury has to act once deciding that its position is wrong. In other words, we were in consultation with the State and local governments. The State and local governments had noted that last year, as a result of the very large outpouring of these industrial revenue bonds, their interest costs under various calculations, rose by a quarter to one-half percent on their regular bonds issued to finance schools, water districts and the like.

Senator CURRIS. That does not relate-----

Mr. SURREY. It does not relate to the legal situation, sir.

Senator CURRIS (continuing). Whether or not it should be reached by statute or by the Treasury.

Mr. SURREY. No. It relates to the way in which we acted. There was great apprehension of what would happen if a large amount of these bonds came on the market. We had concluded we were wrong in our ruling and, therefore, we were going to reverse our position.

The question then was of the mechanics to be used to implement our decision to correct our prior erroneous interpretation of the law. We announced the proposed regulations would be issued and we announced a cutoff date of March 15. We did two things. We announced that any regulation would not be retroactive. The Secretary has the authority to do that under existing legislation. The proposed regulation would not be retroactive as to any prior bonds. We then cleared every ruling request pending in the Internal Revenue Service. We cleared them all out and granted favorable rulings consistent with our earlier published ruling.

The result was that everyone who filed a request with the Internal Revenue Service had that request acted on at the time of our announcement.

Now, in the interim period we have consulted with people whose obligations or whose transactions are in the pipeline. There has been some misunderstanding which has been corrected. For example, there are certain bonds in which the underwriters have signed a contract but the bond is subject to approval by an election of the various districts concerned. We have indicated that since a firm underwriting contract has been signed, the issue has been sold within our understanding. The fact that it sold subject to a condition such as an election is immaterial as to whether the contract is binding.

There has also been some misunderstanding with respect to airport bonds and the like. Our proposed regulation, which we hope to have out by the end of the week will indicate the dividing line between industrial revenue bonds and airport bonds, water bonds, and other revenue bonds, which are obligations of the municipalities because the municipality stands back of them and is the owner and operator of the facility. We are in consultation with State and local governments on these questions. That is one reason the regulation did not come out immediately. We have said we will cooperate with them and we are going over the details with their authorized representatives.

Now, there are transactions that are in the pipeline. There are some transactions which might be consummated within the next 60 days or so. In many of these cases the parties have indicated that alternative methods of financing are available. We have been in consultation with investment banking houses who have indicated to us that, in their judgment, alternative methods of financing are available in most of these cases.

That goes to the question from our standpoint of hardship resulting from our particular action. We have said we would like to have the facts of particular cases. In other words, where is the transaction? To what extent has it moved along? What are alternative methods of financing? The companies involved have been most cooperative with us. They have recognized that, when we get all the facts, we want to deal fairly with the people that are involved under our announcement. It is difficult to deal fairly and deal with equities until one sees the varying situations that can occur. Remember there are \$2 billion of bonds involved here. Some issues, of course, are just gleams in somebody's eyes but others have been down the road and maybe construction has started in some cases.

These cases are coming in to us and they are under consideration within our ruling authority.

Now, I mentioned these matters of amounts outstanding and effects on State and local bond interest rates not as bearing on the legality of our action but rather as bearing on the manner in which we implement our decision. If we do reverse our position, which is a serious matter because the ruling has been outstanding for a great many years, we should go about it in an orderly way, and that is what we think we are doing.

As to the merits of the matter, let me reiterate that the whole situation of these bonds does rest on an Internal Revenue Service ruling. That Internal Revenue Service ruling was issued under circumstances far different from today. We have had a number of indications that our ruling is wrong. We have studied it, as we have indicated, and we have come to the conclusion it is wrong. When we issued our arbitrage ruling, nobody protested that. And let me indicate why they did not protest it, Senator Curtis. I think they realized if we had ruled the other way there would have been a complete collapse of the bond market because there would be nothing to prevent any municipality from issuing hundreds of millions of dollars of its obligations, then turning around and investing the proceeds in Federal securities. The limits would have been the amount of Federal securities we were issuing and you could see what that would have done to normal State and local tax-exempt obligations.

Our position on arbitrage was based on our conclusion that the words "obligation of a State," et cetera, as used in section 103 of the Internal Revenue Code do not include arbitrage bonds even though the name of a city is printed on a piece of paper. The instrument is not an obligation of that city if all the city does is take the money and invest it into our bonds. All it has done is give the investor who bought that piece of paper a ticket to our bonds.

Senator Ribicoff and others have pointed out that the subject is identical in the case of industrial revenue bonds. Industrial revenue bonds are merely tickets to the investor who buys them to whatever company is back of the lease. The two rulings cannot stand consistently.

We were faced with this problem--we had our 1954 revenue ruling outstanding and we had our arbitrage position outstanding. The two were inconsistent, but the arbitrage position was not questioned by anybody when it came out.

That is the background of the matter.

Senator CURTIS. Mr. Chairman, I realize we are under limited time. I do not mean this as critical of Mr. SURREY. His remarks have been interesting but my question deals with the legality or with some facts that might point to it and I ask unanimous consent that I can just ask two or three brief questions.

Senator ANDERSON (now presiding). He has had double time already. Go ahead and make them brief.

Senator CURTIS. I am sorry. I did not anticipate a response such as this.

Did the 1954 ruling which made public what had long been the ruling of the IRS, come out before the 1954 code became law?

Mr. SURREY. Yes; the ruling was issued March 22, 1954, and the code became law August 16, 1954.

Senator CURTIS. Now, one other brief question. I have the highest regard for the Committee on Ways and Means. I think it is probably the top committee on the Hill, but I point out historically that action by the Committee on Ways and Means is not essential to tax legislation, and I call attention to the fact that in the Eisenhower administration, the excess profits tax was extended for 6 months when no bill had been reported out of the Committee on Ways and Means, and my question is what has the current administration done to advance its request for a tax increase?

Secretary FOWLER. Senator Curtis, I appeared before the Ways and Means Committee in public sessions in August for 2 days accompanied by the Director of the Budget and the Chairman of the Council of Economic Advisers. Again, at their request, on November 29 and 30, at that time accompanied by those two officials and also the Chairman of the Federal Reserve Board. Again, on January 22, again accompanied by the Chairman of the Council of Economic Advisers and the Director of the Budget and the Chairman of the Federal Reserve Board.

I have repeatedly visited most of the members of that committee individually, not all but most of them, and tried to explain the need for this action informally with all sincerity and facts and opinions that I could summon.

As you know, the President after the submission of his message on August 3 had briefings at the White House with all of the Democratic Members of the House and about 50 or 60 Republican members. Prior to the submission of the message there were discussions with leading Members, the chairman and ranking minority members of the committee. I have tried to make available to that committee both formally and informally all of the pertinent information and developments, both domestically and internationally, and to give them both our opinion and other informed opinion as to the relationship of various events to the situation.

I cannot tell you the hours and days and efforts that have been expended in what I consider to be my responsibility as an advocate for this measure. I have here—of course, these things do not weigh very much—in this folder here, the polite and passionate statements I have made about the importance of this to our national and international financial position.

Senator CURTIS. Well, in the case I just cited, the chairman of the Ways and Means Committee refused to even call a meeting but it was enacted. With the most kindly feeling toward that committee

and with the greatest respect for it, I point out that the legislative history is such that the action of the committee is not necessary to enactment of a tax increase, and there are people in the country that are wondering whether or not a tax increase is really sought.

That is all.

Senator ANDERSON. Mr. Secretary, one line of your statement, page 12: "We must remember as we keep debating that time is still running, and every day that passes without the tax increase adds \$33 million to the deficit."

It is your position very strongly that you would like to have the surtax done now?

Secretary FOWLER. Yes, sir; I would like to have it done. I point out to add to that, that had the law been enacted and the dates originally proposed been effective as of those originally proposed dates, revenues estimated at \$4½ billion in this fiscal year would have been flowing into the Treasury that are not now flowing. And again, if the present dates are not met, for each day beyond those dates we will lose \$33 million a day. So I am for prompt action, Senator Anderson.

Senator ANDERSON. There are some people who would like to have the bill passed, I among them. We ought to do it as quickly as we can. These \$4 billion would help; \$33 million a day is a frightening figure. We had a little argument yesterday on the floor of the Senate on a bill which costs \$25 million and it lost and then got tied and then got untied and we had considerable activity about that. Here is \$33 million a day that is being lost to the Treasury now. I am going to make sure we are going to be batting for you if we can.

Also in your statement on page 14 you say the Vietnam cost is about \$26 billion for this fiscal year 1969, half of this to be met by tax increases. This is a reasonable amount, when you think about it.

Secretary FOWLER. Yes, sir.

Senator ANDERSON. You can support that figure, can you not?

Secretary FOWLER. Very definitely.

Senator ANDERSON. Have we not also had quite a bit of stock market activity and bond activity in the last week, and so forth?

Secretary FOWLER. We have, indeed. I would say the situation on the foreign exchange markets and the gold markets and the financial markets are all very disturbing and I think there is a very definite relationship between the disturbed condition in these markets and the failure of the Congress of the United States to take action up to this time, with the serious situation that has confronted us, been known to us, been the subject of a Presidential message since August 3, and has been constantly reiterated. This has been a disturbing factor in the markets.

Senator ANDERSON. I have been carrying around an article "Bonds Versus Stocks" in the U.S. News & World Report, December 18 I think they say some very good things. We have had some investment policy changes. A few months ago people were recommending that we buy three-fourths of the bonds and one-fourth of stocks, now it seems to be the reverse, and these people are competent advisers. They are worried about it. I am hopeful that you are going to keep on worrying about it.

Secretary FOWLER. I do not think I have ever seen an economic or financial question, Senator Anderson, on which there has been such a heavy majority of opinion as the question of whether or not it is wise for

Congress to enact a substantial increase in income taxes. I will not say unanimous—none of these questions are ever unanimous. There are always two points of view and there are always a variety of reasons, but I have never in my experience seen an important key economic and financial question of this sort in which the overwhelming preponderance of opinion both here and abroad, both in business circles and financial circles has been that the stability and preservation of a prosperous economy and a functioning industrial international monetary system depends upon positive response of the Congress at this session to these tax proposals.

Senator ANDERSON. Well, I am not going to take time to do it but you refer in your statement to bidding up interest rates. Have we not been doing that right along?

Secretary FOWLER. Yes, we have, and there was a short temporary lull in the early months of last year in which short-term rates declined very, very substantially and long-term rates also declined somewhat. However, that decline bottomed out in the early summer. Short-term rates started moving back up and there has been a very considerable movement in both short-term and long-term interest rates since August 3, the date of the President's tax message, and most of those interest rates, particularly in the long-term field, are at the level, or above the level in many cases, of the highest peak yield in the summer of 1966.

For example, in 10-year Treasury bonds, the peak yield in August and September was 5.51. On March 8 it was 5.75. Twenty-year bonds, 5.12 in 1966 at the peak, March 8, 1968, 5.61.

The municipal bonds that we were just discussing a moment ago at their peak in August-September 1966 were 4.24. They are today, March 8, 4.49.

Senator ANDERSON. Mr. Secretary, I saw a report within the last month that a person with a fairly adequate income could buy these tax-exempt bonds and actually get a constructive return of 9.2 percent, with the increasing prices, of course. It is a great rate for the investor. Do you not feel it is important to try to get this one thing settled, the tax-increase picture, quickly?

Secretary FOWLER. I do indeed, sir.

Senator ANDERSON. Thank you.

The CHAIRMAN (now presiding). Senator Morton?

Senator MORTON. A few brief points. I think I do not know whether my complaint should be addressed to you, Mr. Secretary, or to the distinguished chairman of this committee, but I was watching television last night and I saw the most distinguished committee of all before television. I put my Sunday suit on and came down here today and I do not see any cameras and I do not know whether to send the cleaning bill to you or to the chairman of the committee.

The CHAIRMAN. If you had asked for the television I would have invited them in.

Senator WILLIAMS. You would have had better attendance.

The CHAIRMAN. If I had known you had a suit pressed for the occasion I would have invited them in.

Senator MORTON. You spoke, Mr. Secretary, and I can sympathize with your position, of the desire for additional-revenue through the 10-percent surcharge or some other method. The possibility has been

brought up here of attaching it to this bill, on excise taxes. I think from a matter of pragmatic politics we had better go ahead with this excise tax for the cogent reasons you have pointed out and get it done quickly rather than getting ourselves into a long conference with the House or a long debate on the floor on these extraneous matters, even though I am inclined to agree with you that we do have a pressing need for additional revenues.

I ask for no response from you. I give that as a suggestion.

Secretary FOWLER. Senator Morton, I will reiterate again that these matters of procedure between the two Houses involving their respective places and functions both under the Constitution and in the light of tradition are areas into which with all my other problems I would rather not intrude.

Senator MORTON. All right, sir. Now, just one question. I have been somewhat disturbed by the argument that is used by the administration, a persuasive argument indeed, but one that I question; namely, that an increase in taxes will bring about a reduction in interest rates. I hope this would happen. I read yesterday in the Wall Street Journal that the plant expansion planned by American industry is 5.8 percent greater for 1968, calendar year, than 1967. I understand that 1967 was some 1.6 percent above 1966.

Now, if a company goes through with its planned expansion, some of the money has to be borrowed, some of it will be taken from earnings. If we put a 10-percent surtax on these earnings, would it not increase the borrowing necessity and with the shortage of capital today, the shortage of funds today which leads to these higher interest rates, would not the pressures for borrowing and, therefore, for higher interest rates or sustained interest rates negate any reduction in interest that might accrue from an increment in taxes?

Secretary FOWLER. The corporate tax increase would have, I think, a minor factor of impact such as you described. There might not be the same full measure of relief in terms of supply-demand on the capital market. The factor that you mentioned might cancel out some portion of the benefit to be derived in the corporate tax increase.

However, with regard to the individual tax increase, I think that to provide the funds out of current revenues rather than borrowed money would greatly relieve the supply-demand crunch that will exist if all of the Treasury and agency debt has to be financed, that will be coming due, that will have to be financed by borrowing rather than current revenues. This is a supply-demand picture which is quite astounding.

I am going to give you some figures that are not my figures. They are figures of a very well-known financial house which has over the years kept these kinds of estimates, Salomon Bros. & Hutzler, and their current summary of the supply and demand for credit indicates that an estimated total demand to be satisfied for 1968 is \$73.8 billion, around \$74 billion. And of that demand, real estate mortgages they estimate will be up slightly. Corporate bonds will be down quite substantially this year as compared to last year. Foreign bonds down somewhat. Bank loans up somewhat. But Treasury and agency debt would go up from \$6.3 billion in calendar 1967 to \$18 billion in calendar 1968, triple the demand from the Federal Treasury and agency debt.

Now, looking at the supply side, the implications of that are very serious because the supply side would call, if that demand is going to be met by supply, would call for taking from individual and miscellaneous investors about \$13 billion whereas normally in 1964 and 1965 you drew out \$7 or \$8 billion from that area. So the \$13 billion that would be drawn in 1968 would be roughly equivalent to the \$13 billion that was drawn from private and miscellaneous investors in 1966, which was a bad year in this area.

So, we have got a supply and demand situation in which the Federal Treasury and agency debt part is just pushing everybody else off the edge of the bench, and one of our fellows describes it, and the only way you can bring this supply-demand picture into any kind of healthy relationship where there will not be this excess of pressure on the individual miscellaneous investor, which means increasing rates so he will transfer his funds from normal savings into securities, the only way you are going to do that is to pass a tax bill and raise that money that you have to raise out of current revenues rather than borrowings.

Senator MORTON. In other words—

Secretary FOWLER. With a corporation you do have a point there. There would be some canceling out.

Senator MORTON. In other words, by relieving the Federal Government of having to go into this limited supply—

Secretary FOWLER. Limited market.

Senator MORTON (continuing). Will more than offset by far, in your judgment, what would happen with the corporation or the individual who has a home that is half built and if his taxes go up, he had planned to put in so much of his earnings, he might have to borrow a little more.

Secretary FOWLER. Particularly that is so, Senator Morton, in view of the very high savings rate that has been characterizing this period.

Senator MORTON. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. Mr. Secretary, if this tax is enacted and if the Vietnam troop commitment is increased by 40 percent by the roughly 200,000 which is being speculated in the press, is it anticipated it will be necessary to have either credit, wage, or price controls?

Secretary FOWLER. Senator Hartke, I would like to answer your question very carefully and particularly, and say that so far as I can see both the current prospects and the near prospects, I do not believe that there will be any need for direct wage and price controls. I have not cranked out any particular figures on this because no particular figures are yet available. The deliberations that are now attending the reports that were brought back by General Wheeler from the theater in Vietnam—these reports are under intensive review, as Secretary Rusk has outlined before the Senate Foreign Relations Committee, and I am not in any position to anticipate the outcome of these deliberations.

Therefore, my answer to your question is that so far as I can see and am knowledgeable about it, I see no need for direct wage and price controls.

Senator HARTKE. What about credit controls?

Secretary FOWLER. No. Not at this time under present conditions because there is, as I have indicated to Senator Morton, a fairly high rate of savings of disposable income, extraordinarily high rate, I might say. Consumer credit and installment credit, while they are increasing, they are increasing in very modest proportions and what is going on in the market for consumer durable goods or for real estate is not an abnormal supply picture in any sense of the word that would call for the invocation of credit controls.

Let me say the only credit controls, Senator Hartke, that I advocate now is a control of Federal credit demand, and that you can only achieve, as I indicated to Senator Morton, by passing the tax bill. That is the only credit control that I can see that would produce a desirable result at this time.

Senator HARTKE. Do you have an estimate which is available here on the general overall cost, say, of 50,000 troops or 100,000 troops?

Secretary FOWLER. I do not, Senator Hartke, since—

Senator HARTKE. Does the Budget Director have that?

Secretary FOWLER. I was just going to say that since the Bureau of the Budget was transferred to the Executive Office of the President in 1939 we have no such staff that cranks these things out.

Senator HARTKE. Well, I would be willing to vote for more staff for the Secretary.

Mr. ZWICK. Senator Hartke, it depends on what deployment you are talking about. We use as a rule of thumb a little more than \$10,000 per person in the United States. If you are talking about overseas, that may go up another 20 percent. If you are talking about in-place in Southeast Asia, it could be \$20,000 to \$30,000 per person.

Senator HARTKE. \$20,000. If you increase, then, by 100,000 men—I will let you do the arithmetic, I usually get in trouble when I try that—what would 100,000 men cost in-place in South Vietnam?

Mr. ZWICK. Well, I will give you two answers. \$20,000 per person multiplied by 100,000 men is \$2 billion. The second answer is that you just cannot estimate that by rule of thumb, you have to talk about bases and logistics backup. But if you calculate it at \$20,000 per man, it is \$2 billion.

Senator HARTKE. That is for the manpower itself. But is it not also a fair rule of thumb that for every 100,000 men—including the additional cost—that you estimate it will cost the Government \$5 billion?

Mr. ZWICK. No, sir.

Senator HARTKE. That is not right?

Mr. ZWICK. No, sir.

Senator HARTKE. You take \$2 billion for the actual manpower itself and—

Mr. ZWICK. No. That is incorrect. That is total cost. Perhaps one of the figures you are using to get at this is that we have said the cost of Vietnam special support is \$25.8 billion for fiscal 1969. You have got built into that figure a major base infrastructure in Southeast Asia. You have got a deployment figure of 525,000, plus other troops in Southeast Asia. So that the total cost per person now out there is in the order of \$40,000 or so. But when you add additional troops you do not expect to replace the whole Guam complex, the whole—

Senator HARTKE. Let us assume, then, that the 200,000 which is speculated in the press goes into place. According to your estimates, then, this would add approximately \$4 billion to the cost of the war in Vietnam; is that right?

Mr. ZWICK. No, sir. That is not my estimate. I said that is the figure if you assume \$20,000 per man. I cannot sit here and estimate the cost because you have to go back and see what would actually be involved.

Senator HARTKE. This is remarkable. You mean the Budget Bureau cannot estimate the cost of additional troops?

Mr. ZWICK. No, sir, I did not say that. I said my estimate was not \$4 billion. We can estimate it, if you give us a base structure.

Senator HARTKE. All right. Let me start again. If the 200,000 additional men are sent to Vietnam as speculated in the press, what is the increase in the cost of the war in Vietnam occasioned by that additional utilization of troops?

Mr. ZWICK. I am trying to say that I cannot answer that question—nor can anybody else—in the abstract, without knowing how they are going to be deployed, how this would add to the training requirements in the United States, and other factors.

The CHAIRMAN. May I just get in on this enough to try to help the Senator get an answer to his question. It seems to me that you say, "Well, if you do it this way, that then it would cost this amount. If you do it the other way it would cost another amount." It seems to me that you ought to answer the question by making the assumption which seems most logical. You would perhaps have some increase in ship berthing but you would not be building a whole new harbor. If you just make reasonable assumption, it seems to me, you ought to have some rule of thumb. Certainly, somebody in your Department has run off some estimates; have they not?

Mr. ZWICK. Yes, sir.

The CHAIRMAN. Did you not give the low range and high?

Mr. ZWICK. I gave you the range. I said if you look now at the cost of manpower in Southeast Asia it is around \$40,000 per man. If you assume infrastructure is already there, your cost is \$20,000 per man.

The CHAIRMAN. Let me interrupt for a minute to try to get the answer to this question. Take one assumption or the other, which assumption is more logical, the \$20,000 or the \$40,000; or do you want to strike a figure in between and let us say \$25,000?

Mr. ZWICK. I would assume closer to the \$20,000, sir, but all I am trying to say is that, given a set of assumptions that the infrastructure is there, you are talking about \$20,000. I think it would be unfair to imply that I have looked at a deployment plan which makes one estimate more likely than the other. I think a \$20,000 figure is the more reasonable.

The CHAIRMAN. \$20,000 multiplied by the number of men. How many men, 100,000 or 200,000?

Senator HARTKE. I would like to have 100,000 and 200,000.

Mr. ZWICK. Between \$2 billion and \$4 billion.

Senator HARTKE. For 100,000 men \$2 billion will be added to the cost; for 200,000, \$4 billion will be added to the cost of Vietnam.

Mr. ZWICK. Right.

Senator HARTKE. That is not taken into consideration in your present budget estimates.

Mr. ZWICK. Correct.

Senator HARTKE. And that was not taken into consideration when you presented your testimony here today?

Mr. ZWICK. That is correct.

Senator HARTKE. As a result, will you be coming back to us and asking us for additional taxes beyond the 10-percent surcharge, beyond the excise taxes, and the acceleration of the collection of corporate taxes, if this additional \$2 billion or \$4 billion is requested?

Mr. ZWICK. Senator Hartke, I would like to reiterate what Secretary Fowler has already said. As of this moment this is under intensive review.

Senator HARTKE. But as of this moment we are dealing with the fact that everybody in this whole country is wondering what is going to happen and they anticipate there is going to be some increase. We can put it down to \$1 billion if, as I understand it, using your rule of thumb, there are 50,000 troops. In other words, for every 50,000 men we add a billion to the cost of war.

What I am asking you is that if we increase the troops would you have to come and ask for additional increases in surtax or any other taxes?

Mr. ZWICK. If our budget expenditures are exceeded for any reason, including Southeast Asia, or other assistance, we always go through a review of the budget. And we would have to—on the basis of new decisions—come back with a new fiscal package which might include more taxes, more expenditure reductions. In other words, this is under constant review.

For example, we sent up yesterday to the Congress a supplemental package. That supplemental package had in it items that were carried in the January budget. We reduced the administration estimates quite significantly between January and what we sent up yesterday. We have a continuing review process underway, and, based on decisions about any expenditure increase, we have to go back and look at our tax and expenditure postures.

Senator HARTKE. So, it is fair to assume if there is a substantial buildup in Vietnam of the magnitude which is presently being speculated in the press, that we are also faced with prospect of additional new tax requests.

Secretary FOWLER. Senator Hartke, let me answer that question.

Senator HARTKE. I do not care who answers it. The people would like to have an answer.

Secretary FOWLER. It would be the attitude of the Secretary of the Treasury in that event that compensatory action should be taken with reference to the budget that would include a consideration of both further increases in taxes and further reductions in expenditures so that as a result of measures that have occurred and steps that are taken or decisions that were taken since the January budget figures, that we take the necessary compensatory steps to hold the deficit down to the figures that were presented in the January budget. I do not think we can afford any more of a deficit.

Senator HARTKE. All right.

What you are saying is that you would advocate compensatory action in the other parts of the budget. In what area would that compensatory action take place?

Secretary FOWLER. As Director Zwick has indicated, we are in no position to anticipate the outcome of these deliberations. Generally, one would be taking a look at the revenue situation and at the expenditure situation.

Senator HARTKE. So, it is fair to assume, that one of two things will happen, that part of the request of administration in the domestic side of the budget would be cut if there is a substantial buildup in Vietnam.

Secretary FOWLER. Either that or increased taxes or a combination of both.

Senator HARTKE. All right. In substance, this is a recognition of the fact by the administration that you cannot have guns and butter.

Secretary FOWLER. It is a recognition of the fact that the fiscal program that was presented to the Congress in the January budget is as far as is prudent to go in entertaining any continued deficit. I am giving you my judgment, Senator Hartke. In my judgment, we cannot afford to allow the deficit in that budget to go above the deficit that was projected in the budget.

Senator HARTKE. I understand.

I have just been notified my time has expired.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Chairman, I understand the Secretary will be back with us tomorrow, and a group of us have a meeting with Chairman Martin at 12:30. So, I am going to forgo my questioning until tomorrow. I would like, though, Mr. Secretary, to leave with you just one thought, and I quote from your statement a couple or three sentences appearing on pages 9 and 10:

The United States economy—a mighty engine of production and distribution—is roaring down the road * * *. But the ride is neither smooth nor safe. Rising inflationary pressures and a disturbing deterioration in our international balance of payments signal a clear and present danger that the economy is overheating and running at an excessive rate of speed. * * * Accordingly, the driver is trying to brake the vehicle to a safe cruising speed.

Now, if that is a good example, would not the first action of a good, intelligent, and safe driver be to take his foot off the accelerator and reduce the gas feeding into that engine before he applies his brakes, especially when he is running down the road at an excessive rate of speed?

Secretary FOWLER. I think that in this case, Senator Williams, in view of the way the car is moving, that he has had his foot off of the accelerator some months and the car is still zooming along at an excessively high rate of speed, and it is time to pass the tax bill and apply the brakes.

Senator WILLIAMS. But you still admit that a good, safe driver, one that is capable of holding a driver's license, would first make sure that he takes his foot off the accelerator and reduces the gas feeding into that engine. Whether that has been done heretofore or not, that would be the No. 1 step, would it not, if that driver was capable of maintaining and holding his license?

Secretary FOWLER. I would answer that by saying that I think that title II of the tax proposal that was presented to the House Ways and Means Committee—

Senator WILLIAMS. I am not talking about taxes. I am talking about that safe driver.

Secretary FOWLER. Your analogies are—

Senator WILLIAMS. They are your analogies. They are your analogies, and I am talking about this safe driver and—

Secretary FOWLER. And I want to bring my analogies back to a concrete situation by saying that the action proposed in title II of

reducing expenditures which became the action of the Congress in the Continuing Appropriations Act in December and provided a base for the January budget, plus all the appropriations actions that were taken from August until the end of the session, resulted in the reduction of appropriations of around \$10 billion and the reductions in expenditures of about \$4.3 billion. It is now time to begin to apply the brakes by passing the tax bill, which is the sure way of getting a quick, positive, effective result, and let us deal with the expenditure problem as we go along. Blessings on you if you can cut the deficit further as far as I am concerned.

Senator WILLIAMS. Oh, I am going to do it with your help. You are speaking about actions that were taken last year, I am speaking about your statement here this morning where this mighty engine is roaring down the road at an excessive rate of speed and the driver is trying to brake the vehicle to safe cruising speed. Now, this is today. If the engine is still roaring down the road at an excessive rate of speed we had better take a little more gas out.

Secretary FOWLER. The next paragraph. Read the next paragraph.

Senator WILLIAMS. I read your whole statement, and you have read it twice.

Secretary FOWLER. Then, let me read it.

Senator WILLIAMS. I am familiar with it, but I just want to say——

Secretary FOWLER (reading):

That is the meaning of the President's request last August for a substantial tax increase and a reduction in many Federal outlays for fiscal 1968, his tough and courageous New Year's Day Balance of Payments Action Program, and the austere budget for fiscal year 1969 presented a month ago.

Senator WILLIAMS. Well, we will have to adjourn now; I shall discuss this tomorrow.

Senator CURTIS. Mr. Chairman, may I submit a couple of questions in writing?

The CHAIRMAN. If you want to ask another question——

Senator CURTIS. No, just submit these in writing.

The CHAIRMAN. That is fine. I would like to ask another question. Senator Hartke might have a few more questions, also.

Senator Curtis is addressing a couple of questions in writing that you can provide the answers for tomorrow if you want to or, if you want to, you can provide them today.

I would like to——

Senator CURTIS. Tomorrow is all right.

(The questions, with replies from the Department, follow:)

Question: In what Treasury reports on proposed legislation to make tax-free revenue bonds issued by governmental subdivisions for industrial expansion taxable did the Treasury Department advise that legislation was not necessary?

Answer: We specifically noted in our reports on pending legislation to the Senate Finance Committee and the House Ways and Means Committee on January 23, 1968, that the validity of outstanding rulings was under study. A copy of the report to the Senate Finance Committee appears at page 84.

Question: Has the Treasury Department ever asked Congress for legislation to make such bonds taxable? If so when?

Answer: No; not to my knowledge.

The CHAIRMAN. I would like to ask one or two things about this revenue-bond situation. But first let me insert at this point in the record the text of a press release by the Committee on Ways and Means, publishing your letter of yesterday with respect to this matter.

[Press release, Tuesday, March 12, 1968]

COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C.

Chairman Wilbur D. Mills (D., Ark.), House Committee on Ways and Means, today released a letter which he had received from Assistant Treasury Secretary Stanley S. Surrey, clarifying certain points with reference to TIR-972 relating to the issuance of regulations governing the tax status of interest on industrial development bonds. The text of the letter follows:

TREASURY DEPARTMENT,
Washington, D.C., March 11, 1968.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: We understand that there have been some questions raised concerning the definition of sale in Technical Information Release 972, issued on March 6, 1968. TIR-972 announced that regulations will be promulgated governing the tax status of interest on industrial development bonds sold after March 15, 1968. TIR-972 further announced that persons may rely on the previous published rulings of the Internal Revenue Service in the case of bonds sold on or before March 15, 1968. The TIR stated that "bonds will be considered sold on the date on which a buyer or underwriter enters into a binding contract with the issuer to purchase the bonds at a fixed price."

The term sale as used in the TIR is intended to refer to a contract between the underwriter or buyer and the issuer which is binding on the respective parties even though the contract may be conditioned on factors beyond the control of either of the parties and such conditions have not yet occurred. For example, if a contract between an underwriter or buyer and an issuer were signed on or before March 15, 1968, subject to voter approval, the bonds would be considered as sold on the date the contract was signed irrespective of whether the election took place before or after March 15, 1968.

If you have any further questions in this regard please do not hesitate to call upon me.

Sincerely yours,

(S) STANLEY S. SURREY,
Assistant Secretary.

The CHAIRMAN. How do you measure the budgetary impact? How much money is it costing the Federal Government in revenue loss to have these taxfree industrial development bonds?

Mr. SURREY. We have estimates that run somewhere between \$50 and \$100 million annually. The difficulty is, Senator, that the figures are available only on the amount of these bonds that are publicly marketed. In other words, when I say last year there was about \$1.3 billion issued that means \$1.3 billion publicly marketed. There are many people that think there is at least a similar amount that is marketed through private placements and of which nobody has any overall record. It is therefore difficult to make an estimate.

The CHAIRMAN. So the cost is \$50 to \$100 million as far as the revenue—

Mr. SURREY. It has grown.

Secretary FOWLER. The real problem, the comment I would like to make is that this is the part of the iceberg now appearing above the surface, but it is the prospect of the greatly increasing volume of these bonds and revenue impact in years to come that one would have to take into account.

The CHAIRMAN. This thing started as an issue, as I understand it, in some of the poorer, less developed States. Was not Mississippi one of the leaders in starting this?

Mr. SURREY. That is correct, Senator. It started in some of the Southern States and the issues were really very small when it started.

The average size of the issues in the late 1950's, even, was less than \$250,000. Even as late as 1959 there was only one public-bond issue of over a million dollars. If you look at the calendar of the bonds today, Senator, you will find one issue of \$140 million, one of \$150 million, and so forth. These are major issues. There are bonds being issued now of \$80, \$100, \$140, and \$150 million, but up to 1960, you had only one or two annually of over a million dollars.

The CHAIRMAN. Well, now, as you know, there is a great interest in the Senate—I guess you noted the vote yesterday.

Mr. SURREY. Yes.

The CHAIRMAN. There is very great interest in the Senate for continuing the existing situation until Congress passes on the matter one way or the other.

Initially, I am not sure I could criticize development-land financing. It started out in relatively poor States; that is, States with low per capita income. They were using this to help get some industry into those States, a sort of do-it-yourself Appalachia program. They would undertake to use the State's leverage and the State's borrowing power in such a way as to exempt the bonds from having to carry the burden of the income tax in the hands of the holders.

Now, have you considered some legislative recommendation, and I do not think that you can do it by your own regulations, to permit the relatively less developed States, those with low per capita income, to continue to use the device? Have you explored something along that line to see what it might work out to in the event that someone wanted to consider that approach?

Mr. SURREY. We are considering, Senator, the problem that you mention. I think there are a number of ways in which it could be approached and if called upon at an appropriate time, we could have suggestions. For example, it may not necessarily be appropriate to use the exact practice used today. There may be other methods of financing that could meet objectives you suggest more efficiently than the use of tax-exempt bonds.

The CHAIRMAN. Well, my impression was, for example, in the State of Mississippi the per capita income was about 60 percent of the national average. Is that about what your recollection is, or would it be less? That is just a guess.

Mr. SURREY. I do not have information on that with me. However, I can recognize that in Mississippi and in other States there is a real need for some method of achieving industrial development; a need to attract industry to offset unemployment and help establish a balanced local economy. My point is that there may be more efficient and less expensive methods of obtaining this objective.

The CHAIRMAN. Now, I understand that 40 States are now using this industrial-development bond deal and there are about three States that are using it in part; they have authorized some agency or some particular community to use it. Is that right?

Mr. SURREY. Yes, so, therefore, you got between 40 and 45 States authorizing these bonds.

The CHAIRMAN. Now, when you get to the point that all 50 States of the Union are doing it, all you have done is just to put industry in a position to arrange a tax concession for its bondholders that otherwise would not be justified, I take it.

Mr. SURREY. Yes, and you are doing something even more than that, Senator. When a major industrial concern uses this route and maybe it shaves a point off of its interest costs—for example, when a major steel company goes in and shaves a point off of its interest costs—what is really happening is that all the cities throughout the land on their regular bonds are adding to their interest costs. What is shaved off the interest costs of Armeo, U.S. Steel, or any of the other companies that come out with big issues, to mention just a few, is being added on to the interest costs of communities throughout the Nation borrowing to finance their traditional governmental functions. The fact that corporations were able to save some money by issuing exempt bonds last year has meant that there has been up to \$20, or \$30 million in various States in added interest costs to States and local governments. You can go right down the list of States and show what each State will pay out in amounts like that over the life of the legitimate bonds they issued last year in added interest because 1.3 billion of corporate "tax exempts" were thrown on the municipal bond market last year.

Each year there has been an increase of \$6 or \$7 billion of regular State and local bonds outstanding. If you add to that market another \$2 or \$3 billion of industrial development bonds, the State and local bond market cannot stand it. Interest rates have to go up because you are transferring the load that would be channeled to the regular corporate markets into this relatively narrow tax exempt market. That market cannot absorb this burden at present rates. This is what happened last year. Moreover, the number of industrial development bonds that can be issued is relatively open-ended. As you pointed out, when all the States are using these bonds the practice will continue because no State can afford to stop. The resulting pressure on the market will quickly go beyond the point at which the regular State issues can be sold at reasonable rates. That is the underlying fact.

The CHAIRMAN. Louisiana did not start that procedure but we saw ourselves competing with States in our area which were using it. The State felt we could no longer afford not to use it. So, we now have the same procedure as other States to utilize these industrial development bonds on a nontax basis. Some of these major companies when they were considering Louisiana—I am sure the same thing works elsewhere—say, well, now, if we go to Kentucky or Mississippi or go somewhere else, we get this deal, and we want to know if Louisiana will make it available to us. So, once you have as many as 40 States doing it, the others almost have to do that in order to compete, do they not?

Mr. SURREY. Yes.

Secretary FOWLER. It has to be like water supply and electric power. If it is not there you do not get the plant location.

The CHAIRMAN. That being the case, does it not tend to work out that any advantage one State gets by using this device completely neutralizes itself once every State in the Union finds it necessary to meet competition by doing the same thing.

Mr. SURREY. That is correct. It no longer becomes a force in attracting anything anywhere because everybody is going to do it. However, no State could afford to stop unilaterally for fear of losing a plant to another State.

The CHAIRMAN. Now, furthermore, you find that in many instances even now that we are giving the tax—this tax exemption, the corporation would have come there anyhow.

Mr. SURREY. I think that is so. I think you will find that many of these companies, in all candor, will say that we do not like to use this financing device. We think it is wrong. But as long as it is available, we cannot justify to our shareholders not going ahead and using it. The major companies who started to use it simply on those grounds say they were going to locate where they did anyway. They admit they can raise the money in the regular financial markets, but they cannot justify turning down low-cost financing.

The CHAIRMAN. Was there a time when the major investment houses tried to adopt some sort of restraint against the buying and selling of these kinds of bonds?

Mr. SURREY. I think the Investment Bankers Association itself as an organization does not like these bonds and are on record as opposed to this practice. A number of investment houses have not dealt with these bonds until very recently. They point out, however, if this is the way the market is going, they have to go with it. I also think there are some houses who probably from the start have liked this practice.

The organization as a whole is opposed to it.

The CHAIRMAN. But as an organization, in other words, speaking for the majority—

Mr. SURREY. They are opposed to it.

The CHAIRMAN. The investment houses feel this is not proper and that this is not how you ought to go about doing your financing and, therefore, they have been reluctant to handle them and some refuse to handle them at all.

Mr. SURREY. That is correct, sir.

The CHAIRMAN. Now, did I understand that you are exploring a number of different approaches to this problem, some of which would go beyond what you could do in terms of regulation?

Mr. SURREY. Yes. I think, as a matter of fact, the information that we are getting as a result of our announcement and with respect to our proposed regulations will give us a lot of information really not available on the use of these bonds, especially private placements and smaller issues. That information will assist us in seeing if we can formulate a legislative recommendation dealing with the matter that you were discussing.

The CHAIRMAN. Do you have in mind some other suggestions that might be made in this area that you would propose to consider in terms of legislative recommendations prior to the time that you do submit to us what your position is going to be on it and prior to the time that you actually reach a final decision on changing the regulations?

Mr. SURREY. We will not reach a final decision on change of regulations for some time. We hope to go out next week on our proposed regulations. We then allow at least 30 days, maybe 45 days, depending on what people ask us, and then hold a hearing on the matter. During that time and based on the knowledge we get, we will both be able to assist in forming our regulations precisely to the dividing line between what is and what is not an industrial development bond.

In addition we expect to gain necessary information that will permit us to formulate, after consideration within the administration, of what may be appropriate recommendations in this area.

The CHAIRMAN. Well, here is one of the strongest arguments that has been made and will be made. That is, that there are communities that held a referendum, submitted it to the people and voted for the bond issue and they cannot sell their bonds because of your ruling.

Now, in another situation where election is not required, the governing body was in the process of approving something or perhaps had approved it but the bonds had not been sold and, therefore, they are not under that March 15 deadline.

Now, what would your thoughts be as to something that might be done to meet those situations and relieve Senators as well as those areas that they represent?

Mr. SURREY. I do not know whether you were in the room or not, Senator, when I commented on this earlier. Those cases are now coming to our attention. In some cases, as I indicated, they are well within our announcement even though the election is yet to be held because in a number of these cases, the contracts have been signed with the underwriter and the election is either to approve the deal or not. In those cases, since the underwriter has a firm commitment, the bonds have been sold prior to March 15 within the purview of the announcement. In other cases, where plans are pretty well along, they are obviously the first companies that come down and want to talk to Treasury and present their situation, and we have said present us with your situation; tell us the facts, tell us what the alternatives are, and we will within a reasonably short period of time, I think, have a view of what the varying situations are. It is our intention, as always when there is a change in pronouncements, to deal fairly with the situation. But as I said, to deal fairly with the situation requires you to wait a bit until you get a feeling as to the range of situations as to which fairness should be exercised. We are in that process now of gaining understanding of some of the problems. The companies that have come down to us have been most cooperative in explaining their situation to us and getting us the necessary facts, and we are in a position to act with respect to these cases where there is hardship or otherwise under our ruling policy.

The CHAIRMAN. Does this amount to a discrimination in favor of new industries and against old industries, discrimination in favor of new investments and against old investments which were made prior to the time States started using these devices?

Mr. SURREY. There is a feeling in many States, which have recently gone over to this practice in self-defense, that one of the factors pulling the States the other way was the fact that there would be this discrimination against existing industries. In the debates that have gone on at the State and local level, that factor of discrimination has been an important factor. It has not been able, however, to keep a State back for fear if it does not join its neighbors, it is in an unfortunate position because it just cannot compete when people say—when a company comes to it and says—“We can go here or there, and they are giving us a bond. Are you going to give us a bond?” That factor of discrimination against existing businesses while present has not been able to override the fears of States that they just will not be able to hand out bonds for new plants.

The CHAIRMAN. In the last analysis, though, if the States are going to subsidize industries to come to their States, is it not somewhat subject to criticism that they subsidize industry in a way that really does not cost the States anything.

Mr. SURREY. That is right.

The CHAIRMAN. It adopts a procedure where the State immunizes the investments from Federal taxation. Therefore, the State loses nothing but the Federal Government loses money.

Mr. SURREY. That is right, and I might put that one step further. As indicated in the report we sent to this committee, if a corporation saves, let us say, a point and a half in interest, its net saving after tax is only one-half of that because interest is deductible from Federal taxes. So, let us say it is saving 75 cents on every \$100 of capital. The 75 cents that a corporation saves costs the Federal Government \$2.28.

It would be a lot cheaper if the States would call us up and simply say, pay out the interest saving to this particular corporation. It would cost us one-third of what we are losing today in many cases if they just asked us to pay out the subsidy outright to these corporations.

The CHAIRMAN. That is something I have not heard before. Would you mind repeating those figures and explaining why it costs you so much to subsidize interest costs in that fashion. First, how much does it cost you on the average?

Mr. SURREY. It costs us on the average of about \$2.28 on each \$100 of capital.

The CHAIRMAN. How much did you say?

Mr. SURREY. \$2.28 on each \$100, on the assumption that the buyer is in the 50-percent bracket. If the buyer of the bond is in the 50-percent bracket, that will be our tax loss. If the buyer is in a lower bracket it will cost us a little less. If he is in the higher brackets it will cost us more but the range is so great, as I indicated the revenue loss would be much less—if they would simply call us up and tell us to pay out 78 cents to the Armco Steel Co. on each \$100 of bonds.

The CHAIRMAN. I do not understand why it is that way. Why would the Federal Government lose so much when industry gains so little?

Mr. SURREY. Well, because, you see, to begin with the corporation, saving is reduced by one-half to start with. When they save a point and a half on interest, that is only the gross saving. Interest is deductible to this corporation. Therefore, if it had to pay out a dollar and a half more in interest, it would cost only 75 cents under a 50-percent corporate tax. So what looks like a saving of a dollar and a half is only a saving of 75 cents to the corporation.

Now, then, on the other hand, when the person who would ordinarily receive taxable interest buys the tax-exempt bond, he switches from paying a complete tax on the interest to paying absolutely nothing because it is a tax-exempt bond. So, he switches completely out of the taxable category into the tax-exempt category and we lose that. The corporation only is going to cut its savings by one-half because it is paying out a lower amount.

Let me put it this way. I did not make it clear before. When you switch from a taxable to a tax-exempt bond, the corporation saves just on the spread, right?

The CHAIRMAN. Yes.

Mr. SURREY. The difference between what its rate would be—

The CHAIRMAN. It saves 50 percent of the difference on the spread.

Mr. SURREY. On that spread, right?

The CHAIRMAN. Right.

Mr. SURREY. But the revenue loss is based on the entire interest because the bondholder pays no tax on all of this interest and not just the spread. At an interest rate of, say, 6½ percent taxable, we lose everything on the 6½ percent. But the corporation only saves one-half of the spread from 6½ to, say, 4 percent, and that is the difference that amounts to the figures that I give you.

The CHAIRMAN. Well, assuming that you want to approve one of these things, then I take it that you could tell a—if you wanted to have a program where the Federal Government could sign a contract with the States that want to issue these industrial development bonds, if your thought it was desirable, you could in effect sign a contract where the Federal Government would make up what the difference is as far as the State is concerned, make up the difference to them plus 50 percent, and still save 50 percent of what you lose on these deals.

Mr. SURREY. That is right and that is why I said there may be better ways of handling this than the present system. As you pointed out, there are more efficient and cheaper ways for this to come out rationally all the way around.

Senator WILLIAMS. I follow your reasoning, and I do not altogether disagree with it: but is it not a fact that the same argument could be extended to all tax-exempt bonds? I do not think you are suggesting that we repeal that statute.

Mr. SURREY. No. Quite clearly we are not suggesting it, and I do not think anybody that has worked in this area has suggested it. The corporations using this method of financing have another alternative, but the municipalities themselves and the school districts do not have another alternative.

The CHAIRMAN. Frankly, that reminds me of this exemption we give the Virgin Islands on watches they put together. The last I looked at it, it seemed to me if you look at their gross payroll which would include all overhead, all salaries, all profits and all wages, and any incidental expenses, including the State, local, and Federal taxes that they pay, just look at their gross, it looked to me as if we just paid those people for putting those watches together down there five times what their gross is, we would actually make money, compared to what we lose in the tariff laws by letting them have that particular exemption. The last time I looked at it, it looked to me that you could actually afford to pay them five times their gross and still make money if you just collected the tariff on those watches. That indicates it is a very inefficient way to subsidize someone. I did not understand in the beginning but I think I understand it now. I think if you will give us a memo that points it out as clearly as you and your assistant can do it, that this form of subsidy to an industry going into a State actually is so inefficient that the Federal Government would be better off just to give it directly.

(The following was compiled and submitted by the Department at the request of the chairman:)

FEDERAL REVENUE LOSS AND CORPORATE REVENUE ADVANTAGE RESULTING FROM A TYPICAL INDUSTRIAL DEVELOPMENT BOND TRANSACTION

A corporation that is able to borrow for its own purposes at a 6 percent rate of interest may be able to borrow the same amount at only 4½ percent interest through the use of industrial development bonds. As the example illustrates,

since interest is deductible, the net saving realized by a corporation in the 48 percent marginal tax bracket would amount to only \$.78 on each \$100 of funds borrowed with industrial development bonds.

	Exempt bonds	Taxable bonds
Gross earnings.....	\$10.00	\$10.00
Less interest.....	4.50	6.00
Net before taxes.....	5.50	4.00
Less corporate income tax.....	2.64	1.92
Total.....	2.86	2.08

Corporate gain from tax-exempt borrowing

\$2.86 less \$2.08 = \$.78

Since the corporate interest deduction is less when tax-exempt bonds are issued corporate income and therefore corporate tax is increased (\$.72 in the above example). However, this gain is more than offset by the fact that the Federal revenue loss on the buyer's side of the transaction is not confined to the 1½ percent differential in interest rates between taxable and non-taxable securities which is attributable to the tax exemption. The Federal revenue loss arises with respect to the full interest payment made by the corporation since no portion of the interest paid on industrial development bonds was subject to tax.

Thus, if the 4½ percent industrial development bond is purchased by an individual in the 50 percent tax bracket who normally invests in taxable obligations bearing a six percent return the Federal Government receives no tax on the \$4.50 interest received by that individual whereas the individual, had he continued to invest in taxable securities, would have paid \$3. in tax on each \$6. of interest received.

In the context of the above example the Federal revenue loss would be \$2.28 (\$3. tax lost from individual less \$.72 increased corporate tax) and the corporate benefit would have been only \$.78. If the individual were in a lower tax bracket the Federal loss would be less and if the individual were in a higher tax bracket the Federal loss would be greater. However, the important factor bearing on the inefficiency of this method of benefiting corporations is that the corporate benefit is confined to the interest differential attributable to the exemption whereas the Federal revenue loss is attributable to the fact that the tax on the entire interest payment is lost when tax-exempt bonds are issued. The analysis is the same when a corporation buys an industrial development bond, except the Federal revenue loss is determined by the tax rate of the corporation which in most cases is 48 percent.

Secretary FOWLER. The other incidental benefit which you do not want to lose sight of, which I think is a major factor, is the side effect this has on the cost to the city or the town, or the county or the township, in financing its roads, its schools, and whatever else is truly municipal and public activity.

The CHAIRMAN. Here is the point you are saying, as I understand it. Now, this note was handed to me by one of our staff assistants. Assume that a bond is issued at 4 percent instead of 5 percent interest because of the tax-exempt status of the bond. The amount taken out of taxable income is the full 4 percent interest charge. The gain to the industry is the difference between 5 percent and 4 percent, or a 1-percent gain to the industry.

Now, if that person holding the bond is in a 50-percent bracket, then the Federal Government would be losing 2 percent of that 4—

Mr. SURREY. The 5 percent interest.

The CHAIRMAN. Actually, it would be 2½ of the 5.

Mr. SURREY. 2½ of the 5 we lose because the 5 percent taxable becomes 4 percent nontaxable and therefore is not subject to tax. If the person that would have had a taxable bond or other investment yielding that amount is in the 50-percent bracket, we lose \$2.50.

The CHAIRMAN. So, you lose \$2.50 in order to save that 1 point at interest, but now the industry does not save the 1 point. They only save one-half of 1 point.

Mr. SURREY. That is right. You have it perfectly.

The CHAIRMAN. So, in that instance, the Federal Government would appear to have lost five times what the industry gained if you are looking in terms of nets.

Senator CURTIS. Would you yield right there? Suppose there is a rural county that has only 7,000 people, and I know such a case. They used the revenue, tax-free revenue bond route to build a meat-packing plant. It is a new company that never existed before. They employ 30 or 40 people. They provide a competitive market. Had they not used this route, there is no one that ever contends any existing packing company would have built a packing plant there.

What was the loss to the Treasury of the United States by the building of that plant?

Mr. SURREY. Well—

Senator CURTIS. Under this route.

Mr. SURREY. You said they would not have built a plant there.

Senator CURTIS. Any place. The company did not exist. It came into being.

Mr. SURREY. But, Senator, there are \$2 billion of these bonds that are on the calendar and I do not think anybody will say that the companies which are financing in this way are going to drop that expansion. There are companies that we have talked to.

Senator CURTIS. I am talking about companies that are not in being.

Mr. SURREY. Well, the plants are not in being but that does not prove in any way that they will not or cannot get regular financing. The question is whether these plants would never have been built in the United States.

Now, it is quite clear that the industrial expansion being financed in this way is still expansion that is going to go ahead and people will tell you that.

Senator CURTIS. I do not think you can assume that premise. I think there are many areas in, say, Mississippi or my State where that expansion would not have taken place, and your calculation of the loss of revenue allows for no offset of increased revenue, of payroll taxes and income taxes, and the corporate taxes that the new entity pays.

Secretary FOWLER. I think what Mr. Surrey is saying is that some other facility and some other workers and some other income and some other revenue will result because that meat would have been packed in some other facility. The fact that this may occur in that particular location, under that particular management, does not mean that it was lost to the economy.

Mr. SURREY. And that capital would have gone somewhere in the United States, so the economy will have the capital.

Now, this is the difficult question that Senator Long put. It may be that a company may say: I will go to State X if they give me this financing, and I will go to State Y if they give me this financing, and I will see which one gives me the best financing. When there are only a few States that would give him this financing, then some companies might have gone to one of these States. Some would have gone anyway.

But now, when a company can look at every one of 50 States and say we guess our choice is going to be you if you give this financing, they all say yes, because they are all authorized to issue these bonds.

Secretary FOWLER. He looks at water supply, electricity, labor, source of water material and markets and all the other plant locations factors and picks out the best place in terms of those factors and then he puts his plant there. If that State doesn't issue these bonds, he might have a different judgment to make. But we are rapidly approaching the position where the plant is going to be located regardless of this factor, but everybody is going to have—

Senator CURTIS. Of course, I think that is an assumption that cannot be maintained. I do not think that you can assume that all this expansion would have taken place. I do not think that you can write off the proposition that this gimmick has increased productivity in the country. It has increased income, it has increased payroll, it has increased corporate tax.

Now, how much increase would have taken place anyway might be debatable but I do not think that you can assume that it did not increase capacity and production and income, personal income and corporate income, to some extent, and if it does to some extent, then your loss to the Treasury has to be modified.

Mr. SURREY. Yes, but on the other hand, the people who have bought the industrial revenue bonds have capital to invest and they will invest that capital in some other activity in the United States. It may be that they will turn around, as I say, and buy taxable bonds or they might increase the competition for tax exempt bonds, in which case genuine tax exempt bonds will return to lower rates, but the capital is in the United States and it is going to be invested. You have to remember that when all this is taking place, it is simply the investment of the resources of the country in an industrial expansion. This industrial expansion is proceeding at a somewhat lower cost to our major companies, but that lower charge to our major companies, industrial companies, has become an added burden to every city that wants to finance its schools and its police department and its fire department and its water facilities. Every time that U.S. Steel shaves a few points off its marketing of bonds, some city is shaving teachers off of its rolls or some policemen off of its rolls because its interest rates have come up. As the city of New York testified, when they had a hearing on this point, these industrial bonds simply mean the cost to the city of New York of financing its regular bonds has gone up and that means shaving policemen and shaving teachers and others off their rolls and that is what happens when some points get shaved off for United States Steel or Armco Steel.

Senator CURTIS. I am not contending that this is a one-sided case. I do contend any correction must be by legislation, not regulation. An area which has a heavy relief load may decide to use their municipal credit to finance a plant, and it is in the public interest.

Mr. SURREY. Not their municipal credit, Senator. It is not their municipal credit. The person who buys this bond buys an investment in the company. If you look at these bonds, Senator, there is nothing about the credit of the city. The only thing you look at is the credit of the company.

Senator CURTIS. The investor, even though they only pledge the revenue from the facility, the investors would not make the investment if the local government was totally irresponsible.

Mr. SURREY. Senator, there have been towns with 15 people in them, 20 people in them, issuing bonds. Now, there is nothing in the town. There are 15 or 20 people in the area. The town issues the bonds. How do they market the bonds? Although the top line of the prospectus reads, town of so and so; the rest of the prospectus tells you all about the company that is obligated on the lease.

Now, this town of 15 or 20 people is not by any fantastic stretch of the imagination in a position to borrow the sums on their own credit. It's solely the companies credit involved.

Senator CURTIS. I come back to this hypothetical case. Suppose there is a given area, they have a heavy relief load. Somebody conceives a new activity that does not exist any place else. A new company is brought into being that is not going to expand some place else and they use the revenue tax free bonds to make that a reality and they create employment and they even create profit for the operating company.

Does not that alter the estimates as to the loss or gain by the Treasury by reason of the transaction?

Mr. SURREY. I do not think it alters the estimates, Senator. I think it goes to another point really. There may be situations in which a company—and this is what the Economic Development Administration does—there may be a company in which, looking at a particular community, and there is unemployment and the like in the community, it may not be the most desirable from the standpoint of industrial location, but the company would be willing to locate there if its added costs of location there could somehow be met. This is a plant that has to locate some place.

Now, in those circumstances, as our Economic Development Administration does, the bond does give financial assistance to those cases to meet the added costs of coming down here to an area which may not be the most desirable location.

Now, I think there may be cases of relatively small companies that have no access to the capital markets where these bonds played a part in getting a plant that would not have been built. It may be an important part. I think Senator Long was emphasizing that earlier. But, it is really a very distinct and minor part. The original idea back of this has been lost and submerged. Our major corporate financing is going in this direction and what was originally the situation has been completely lost sight of. Instead, just as in the arbitrage bond case, when all Federal bonds could have been swept into the State and local markets, so in this particular situation all corporate plant expansion is being swept under the umbrella of the financing of the State and local bonds. This development has completely submerged the kind of case I think you have in mind. That is perhaps the unfortunate part of all this, the major plants and facilities combined with the inefficiency of the subsidy, as I pointed out to Senator Long, and the fact that these bonds here meant added interest costs for all our States and municipalities, has created a disastrous situation that overshadows the few cases of the kind you mentioned. I think that is an accurate picture.

Senator WILLIAMS. Would the Senator yield?

Senator CURTIS. I yield the floor. I think the only issue we have here is whether or not these bonds be made taxable by Treasury edict or by law.

Mr. SURREY. We made them exempt by our ruling in the first place.

Senator CURTIS. And after you had so ruled for years and years the Congress reenacted the statute as an expression of the existing law.

Mr. SURREY. Well, we often find, Senator, when a case goes to court and they want to uphold the original ruling, they say, "we note that the Congress reenacted the law" and if the court decides it does not want to uphold the original ruling and wants to uphold the new ruling, they say, "Well, reenactment of the law is no clear expression of the intention of the Congress as to this particular ruling which was not involved expressly in the reenactment." You pick your quotation from the court decisions after the result has been reached.

Senator WILLIAMS. In order to close this out with a spirit of harmony, as I understand it, you recognize in the circumstances we started out with noble objectives but that they have developed into a substantial abuse of tax laws, a major loop hole somewhat comparable to the depletion allowance, both of which should be given our attention and correction.

Senator HARTKE. Can I—

The CHAIRMAN. That requires no comment.

Senator Hartke?

Senator HARTKE. Let me ask this one simple question.

Since we have a deficit in our balance-of-payments account, would not the better judgment be to permit the reduction on the excise taxes in regard to foreign sales to go into effect and to provide only for the extension of the excise taxes on the domestic market? Would this not be 100 percent in line with the President's statement as of December 31, 1967?

Secretary FOWLER. We rebate the manufacturer's tax on cars.

Senator HARTKE. Pardon?

Secretary FOWLER. The manufacturer's tax on cars.

Senator HARTKE. At the present time?

Senator FOWLER. We rebate at the present time.

Mr. SURREY. It does not apply to exports.

Senator HARTKE. It does not apply to exports. Well, I lost that one.

The CHAIRMAN. Thank you very much, Mr. Secretary, Mr. Director, and Mr. Surrey. We appreciate very much your advice on this matter and we look forward to seeing you at 9:00 o'clock tomorrow.

(Whereupon, at 1:15 p.m., the hearing was recessed, to reconvene at 9:00 a.m., Wednesday, March 13, 1968.)

TAX ADJUSTMENT ACT OF 1968

WEDNESDAY, MARCH 13, 1968

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 9 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Smathers, Anderson, Talmadge, Hartke, Williams, Carlson, and Curtis.

The CHAIRMAN. The hearing will come to order.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY, ACCOMPANIED BY HON. CHARLES J. ZWICK, DIRECTOR, BUREAU OF THE BUDGET, AND STANLEY S. SURREY, ASSISTANT SECRETARY (Resumed)

The CHAIRMAN. Mr. Secretary, Senator Williams is here, and I am going to yield to him at this time. He wants to ask you about some matters he has in mind.

Senator WILLIAMS. Mr. Secretary, yesterday in your testimony you placed great emphasis upon the fact that the overwhelming sentiment of American industry was in support of a tax increase, and that it was supporting your proposal. Is it not also true that this overwhelming support has been qualified with an endorsement of a reduction in expenditures accompanying the tax increase?

Secretary FOWLER. Yes, sir, I would not say qualified. I would say supplemented, and both aspects of fiscal restraint have been equally emphasized.

Senator WILLIAMS. That is the point.

Now, you are familiar, I know, with the package which I introduced on January 31, a copy of which I sent to you. As I stated at the time I introduced it, that may not be a perfect formula, nor the perfect method by which to approach the problem, but it did carry out the principle that there would be corresponding reduction in expenditures in the same bill that provided for a tax increase. Since that time I have had several conferences with you, and I am wondering if you could support that principle.

Secretary FOWLER. What do you mean by the word "corresponding"?

Senator WILLIAMS. The package that—this bill.

Secretary FOWLER. No. You said a corresponding reduction. Do you mean a dollar for dollar?

Senator WILLIAMS. Oh, no, not exactly. Not exactly a dollar for dollar. This package that I introduced proposed an \$8 billion overall

reduction in expenditures. It provided for extension of the excise taxes which would be \$2.9 billion, and it provided for \$6.5 billion increase in income taxes which totals \$9.4 billion. So altogether the bill that I introduced provided for \$9.4 billion additional revenue and \$8 billion reduction in expenditures which would total \$17 billion toward balancing the budget. The principle is that there would be reduction in expenditures at the same time as an increase in taxes.

Secretary FOWLER. Senator Williams, I would support any combination of measures in the field of tax increases and expenditure reductions that would reduce the projected deficit to the level of \$8 billion as projected in the President's budget. I believe and I have tried to make clear that one of the two fundamental tasks and responsibilities of the administration and the Congress this year is to bring that deficit in our internal budget down from the \$20 billion level that is characterizing this fiscal year to something in the neighborhood of \$8 billion, in other words, well on the way in the direction of balance. I think we must make that substantial change in direction from the movement of the deficit upward which has characterized the last few years, and I would support any combination of measures that would be designed to achieve that substantial reduction in the projected deficit to bring the deficit into more manageable proportions.

It is my conviction that the major instrument to achieve that result promptly, quickly, effectively, before the American financial community and the international financial community is prompt action on the tax proposals that are pending and have been pending for months before the Congress.

Any supplementary action to that proposal in the way of further reductions in expenditures I would support in an effort to bring the deficit down from its \$20 billion and upward trajectory today to a level of \$8 billion or less. The President has submitted in the January budget message his proposals. Events have occurred since the submission of that message in the military field. Events have occurred and will continue to occur in the domestic field as the appropriation processes of the Congress carry through in their normal pattern, and just what the end result will be in terms of tax increases and appropriation reductions which will cause and make necessary expenditure reductions I cannot now predict, but I do say to you that I think prompt and decisive action indicating the will and intention of the Congress to act through these two fiscal tools, to bring this deficit down into at least the \$8 billion level that was projected in the President's budget is an indispensable element in the financial health of this economy and the preservation of the international monetary system as we have known it.

Senator WILLIAMS. Well, Mr. Secretary, I could not agree with you more. We have, as you know, the proposal to remove the gold cover, but the point is that the removal of the gold cover will not solve our problem because our problem is not necessarily caused by the cover on gold.

Secretary FOWLER. No. And the case has never been made out—

Senator WILLIAMS. I know it has not.

Secretary FOWLER (continuing). That the gold cover is a substantive solution.

Senator WILLIAMS. That is correct. The problem is the international loss of confidence in the American dollar, and that is based primarily

upon the loss of confidence in our fortitude here in Congress and the administration to bring our own fiscal position under control. This will require a control over expenditures, curtailment of some projects and programs which may have a lot of merit but which can be postponed, and equally important, and I put equal emphasis on it, a tax increase. As you know, I have long been a supporter of this proposal. I know that I as well as a few others suggested a tax increase as far back as August 1966 because the economy was overheating. When the President suggested his tax increase in January a year ago I reaffirmed my position, stating that I thought it a step in the right direction.

But, there is no use quarreling over what might have happened. We are at this point today, and I think that we have no choice but to deal with the gold cover, which is a symbol. I think we have an even greater responsibility to deal with the causes of the present situation. The cause is excessive spending, and the cure will require a reduction in spending and at the same time a tax increase. I think that you will agree that a substantial percentage of the endorsement of a tax increase by industry and by people outside of Government has been contingent upon corresponding action toward the field of reduction in expenditures. Many of us—and I for one feel very strongly about this—I would not support your tax increase unless it is accompanied by some program that spells out a bona fide reduction in expenditures. I made that clear on January 31. I do not think you stand a chance of a snowball of getting a tax increase through this Congress unless Congress and the administration join together in a bonafide realistic control over expenditures, which will at least achieve a part of the objective of reaching a balanced budget through reduction in expenditures. We must establish some set of priorities.

Now, as I stated before, I do not say that this bill I offered is the one and only. I have made that clear on repeated occasions. But there must be some program which would put a legal control over spending so that both the Congress and the administration would be on notice that we have to live within that budget.

Secretary FOWLER. Senator Williams, I would like to make three comments on this. No. 1, as the outside world looks at what has been going on since August in dealing with this fiscal problem they have heard a great many speeches, they have seen a great many votes, they have seen a plethora of statements about expenditure reduction. They have seen the Congress of the United States pass on all the appropriation bills for the fiscal year 1968. They have seen a specific effort to carve out \$9 billion of reductions in obligation authority and \$4 billion of reductions in specific expenditures in November and December of last year. And yet with the enactment of all the appropriation bills in the light of the financial crisis that was presented by the President in August in his message, in the light of the general across-the-board action taken in the Continuing Appropriation Act, the deficit for 1968 fiscal year is still around \$20 billion, and the failure of the Congress to take the decisive step, the meaningful step of increasing taxes leaves the rest of the world largely unconvinced as to whether or not a solution to the fiscal problem can be achieved by the reliance and emphasis that has been placed almost totally by those advocating expenditure reductions, ignoring the other hand which is tax increase. Now, I

welcome your emphasis on the importance of a tax increase and your allegiance to it and I, too would believe and have advocated that both of these measures, both of these approaches to the fiscal problem, are necessary and should go together. We have reduced specific expenditures since last August 3 by a total of \$4.3 billion in the fiscal 1968 budget. All during that time and all during that process nothing has happened on the tax increase.

Now, it seems to me that the one significant real decision that can be taken and taken quickly and promptly to deal with this problem is to pass the tax bill. This debate as to whether or not the budget outlays in the 1969 budget for controllable civilian programs should be substantially reduced is going to continue until this session of Congress is over and in the interim until the election is over and be resumed next January, but as I said to Senator Anderson yesterday, we must remember that as this debate has gone on all the way through August up to this date, we have lost \$4½ billion of additional revenues which would have reduced this 1968 budget substantially and we will continue to lose \$33 million a day and increase the deficit in that amount as long as we delay.

Now, the tax program, the bill before you, and the President's income tax increase, will bring in \$16 billion over this fiscal year and the next fiscal year and reduce those deficits by that amount. It should be passed promptly, regardless of the outcome of the long drawn out debate on expenditures now beginning, because no amount of debate and no amount of budget cutting that is likely to emerge from this debate is a realistic alternative to a tax increase for meeting these obligations.

I should like, Mr. Chairman, to put in the record and call attention of the committee to the text of a statement which was issued yesterday afternoon by the Advisory Committee on International Monetary Arrangements to the Department of the Treasury which is chaired by Douglas Dillon and includes on its membership, David Rockefeller, the president of the Chase Manhattan Bank; Edward Bernstein, noted economist on international monetary affairs; Kermit Gordon, the president of Brookings; Mr. Francis Bator, former Presidential adviser, now with Harvard; Walter W. Heller, former Chairman of the Council of Economic Advisers; Andre Meyer, senior partner of Lazard Freres, the international investment banking firm; former Under Secretary Robert Roosa; and Frazier Wilde, the chairman emeritus of Connecticut General Life Insurance Co. and Chairman of the CED.

The text of this statement appears this morning in the New York Times. It was released yesterday and I should like to read two paragraphs of it.

The tax surcharge has been publicly debated for more than a year. It has been supported by an almost unprecedented consensus of businessmen, bankers and economists, both at home and abroad. It would provide the necessary signal that the United States is now moving firmly and forcefully to limit the inflationary effects of too much overall demand and thus to maintain and improve this country's competitive performance in the world economy.

Cuts in Federal expenditures cannot substitute for the enactment of the tax surcharge—this alternative is illusory. The President's budget has already imposed severe restraint on foreign aid and programs dealing with the critical problems of our cities, education, health, poverty, manpower training, housing and pollution. We fear that any substantial reduction in Federal spending would

come in large part at the expense of these programs of compelling national importance. Some savings can and should be realized by a further stretch out in such programs as space, highways and public works—but such savings clearly would be insufficient.

There is no need to hold back from tax action in fear of too much restraint. The risks are heavily weighted in the opposite direction.

Secretary FOWLER. The rest of the statement deals with the international financial situation and the need for confidence.

(The statement referred to follows:)

STATEMENT ON THE SURTAX BY MEMBERS OF THE ADVISORY COMMITTEE TO THE U.S. TREASURY ON INTERNATIONAL MONETARY ARRANGEMENTS

The balance of payments position of the United States requires prompt enactment of the temporary 10% surcharge on income taxes.

As the Treasury's advisors on international monetary problems, we feel impelled to make this public statement of the position we have just reaffirmed to the Secretary of the Treasury.

The tax surcharge has been publicly debated for more than a year. It has been supported by an almost unprecedented consensus of businessmen, bankers and economists. Both at home and abroad, it would provide the necessary signal that the United States is now moving firmly and forcefully to limit the inflationary effects of too much over-all demand, and thus to maintain and improve this country's competitive performance in the world economy.

Cuts in Federal expenditures cannot substitute for the enactment of the tax surcharge—this alternative is illusory. The President's budget has already imposed severe restraint on foreign aid and programs dealing with the critical problems of our cities—education, health, poverty, manpower training, housing and pollution. We fear that any substantial further reductions in Federal spending would come in large part at the expense of these programs of compelling national importance. Some savings can and should be realized by a further stretch-out in such programs as space, highways, and public works—but such savings clearly would be insufficient.

There is no need to hold back from tax action in fear of too much restraint. The risks are heavily weighted in the opposite direction. An inflationary spiral aggravated by an excessive Federal deficit is already underway; left unchecked the consequences will be damaging to domestic stability as well as to our trade position. Moreover, a surcharge is the most readily reversible tax measure, ideally suited for prompt withdrawal once the danger of overheating has passed.

The President's January 1st balance of payments program does not remove the need for the surcharge; nor would further expenditure cuts within the range of practicability and desirability remove that need. There is no feasible substitute for tax action to curtail the inflationary excesses in domestic demand that are spilling over into imports—a major factor in the sharp deterioration of the nation's trade position that occurred in the final quarter of 1967. Rising prices and costs are also hurting our exports. This setback in our competitive trade position must be checked before it gets any worse.

Failure to act would endanger worldwide confidence in the dollar and would invite a repetition of flare-ups in the gold markets. It would risk a serious upheaval in the international monetary system. The Congress should keep in mind the grave consequences of inaction to our international trade and financial position.

We are convinced that, in the interests of our nation's economic strength and stability, enactment of the surcharge must be delayed no longer.

Secretary FOWLER. I will conclude with my last comment by saying to Senator Williams what I have said to the Joint Economic Committee. I think the first and the primary responsibility of the Congress is to deal with this tax increase at least in the dimensions that the President has proposed, the 10-percent surcharge or an equivalent measure. I think along with that the Congress of the United States, in the various processes and procedures that are normally available to it through

the appropriation procedures, should screen out and reduce expenditures wherever it can find any means of doing so that is not damaging to the security of the country. I welcome further address to this problem and I do think that the package that emerges ought to be a combination of tax increases and expenditure control, expenditure restraint, expenditure reduction. I cannot tell in what proportions that should emerge as a result of this session of Congress until there has been a reestimate of the military expenditure situation which was adverted to yesterday.

Senator WILLIAMS. Mr. Secretary, as I stated before, this overwhelming support for the tax increase to which you refer is 99 percent contingent upon being accompanied by a reduction in expenditures. We agree on that.

Secretary FOWLER. It is not made so contingent.

Senator WILLIAMS. Well—

Secretary FOWLER. I think that is overstating it, Senator Williams. The people that are encouraging a tax increase are also encouraging a reduction in expenditures.

Senator WILLIAMS. That is right. Some think the reduction of expenditures can solve it alone, some think tax increase can solve it alone, but I happen to think that it takes a combination of both.

Secretary FOWLER. I think the overwhelming opinion is that it takes a combination of both.

Senator WILLIAMS. That is correct. I say there are a few on each side, but I think it takes both.

I am not excusing Congress one bit of its responsibility. I led the drive last year on a series of votes trying to hold down expenditures. As you know, we lost out on it, but at the same time, accepting responsibility for Congress, for you cannot spend any money which we do not appropriate. I again remind you that it does not cost any more to buy a pen to veto a spending bill than it does to sign it and the President likewise has some responsibility. Far too often, on those occasions when Congress has tried to hold down these spending programs the criticism which we have gotten from the White House was not for spending too much but for spending too little. You and I both sat in a meeting in the White House last fall at which time we were discussing this very problem, and again reference was made to the built-in costs in programs that were enacted by Congress—built-in costs over which the Executive had no control. At that meeting I reminded you, you will remember, that they were not all built-in and that the next day the Senate would be acting on the social security bill, a proposal to add \$3 billion over and above the House bill, and I appealed to the administration to support some of us in our efforts to hold this down to a realistic level. We did not get that support. The bill was reduced in conference.

Secretary FOWLER. Got some support in conference, I think.

Senator WILLIAMS. Not from the administration.

SECRETARY FOWLER. It was their—

Senator WILLIAMS (continuing). Only criticism. I will accept a correction—if you will tell me the administration was behind the scenes helping us I will accept that and thank you for it. But if the administration was helping us behind the scenes they were criticizing us publicly, and that to me is sheer hypocrisy, which has happened too often.

I get somewhat impatient with the administration acting behind the scenes and urging us to hold down expenditures as they did in this instance, and you know that they did, and at the same time publicly denouncing us for having reduced the cost. We want support publicly. As to this tax increase, Congress is not altogether to blame for the lack of action. When you proposed a 6-percent tax increase last year I supported it; I was one of the first ones to do so. But 6 weeks later you were down here asking for a tax reduction, and at that time I said you were making a tragic mistake to reduce taxes in the midst of an appeal to raise them. That was a mistake. As late as June last year you were advocating to this committee a plan to let these automobile and telephone excise taxes lapse on April of this year.

Secretary FOWLER. That is an overstatement. I was not advocating that, Senator Williams. I said at that time that we were not prepared to make any final decisions about the excise tax matter. And also the repeal of the suspension of investment credit was not for the purpose of reducing taxes. It was to restore an incentive that had been suspended with the commitment by this committee and the Ways and Means Committee and the President that when the highly specialized boom that characterized the plant and equipment industry in 1966 had abated, we would lift the suspension, and that was not put forward as a measure of a tax increase. It was put forward to fulfill the commitment that had been made in September of 1966 at the time the investment credit was suspended.

Senator WILLIAMS. I will not debate the points but it did result in a \$2 billion annual loss of revenue, and a \$2 billion loss in revenue is a tax reduction. To get back to this package which I have introduced, I would like to take up the first three sections which deal with expenditures.

Secretary FOWLER. Yes, sir. Could I before you turn to those specific sections, just make one observation, that in the President's budget message this year, I would like to call the attention of the committee to pages 20 to 22, which is a table listing a large number of proposed program reductions and reforms which affect most of the major agencies and departments of the Government, and would result in reductions of expenditures from existing levels. They touch a large number of programs in the entire range of the budget and one of the first orders of business, if I may say so, Senator Williams, in achieving expenditure reductions would be to develop and execute these recommendations that appear on pages 20 and 22 which provide the beginnings of a program of getting our expenditures under control, because as we take care of new needs that emerge and demands upon the Government, we must be equally successful in eliminating or reducing the obsolete programs that no longer deserve the high priority that they once had when they became part of our system. I commend to you the statement in the President's budget message, and I quote from page 22:

There have been suggestions for a long-range study of Federal programs, evaluating their effectiveness and proposing reforms. Clearly more study potential program reforms is needed. My proposals this year represent a first step on which we can and should act now. Throughout the years it has been easier to discuss the need to restructure older Government programs than actually to change them. I urge the Congress to take prompt and favorable action in support of these proposals to cull out lower priority programs.

He was referring to the 50-odd programs on the preceding three pages.

Senator WILLIAMS. I accept that as a constructive suggestion. I am familiar with that part in the budget. That can be a part of the \$8 billion reduction which I am seeking. Before I proceed I know that some of the members have not had a chance to raise questions and, Mr. Chairman, I do not want to monopolize the time. I do have further questions I want to ask, but if some of the other Senators want to proceed I will withhold and pursue this later.

The CHAIRMAN. Senator Smathers?

Senator SMATHERS. I yield to the Senator from Georgia.

Senator WILLIAMS. I do have some other questions but I want to discuss that particular bill in detail.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. I just have one or two questions, Mr. Secretary. I think there is no doubt but what the financial picture makes it absolutely necessary to extend these excise taxes. I do have some concern, however, about this speedup of corporate taxes of these small businesses. I have had some experience in that regard and I know how someone can start with very, very limited capital, with accounts receivable and inventory, and things of that type, almost go bankrupt in the process of making a profit.

Let us look into this situation just briefly. Take the case of a small business and, Mr. Surrey, you might want to get your pencil and a piece of paper and check with me as I go.

Let us take a small business that has a taxable income of \$25,000. That would put it in the 22-percent range if I understand the tax law, provided that is the only corporation involved.

Now, as I understand it, under present circumstances, assuming they earn \$25,000, taxable income of \$25,000, in the calendar year 1967—we will assume this corporation is on a calendar year basis, their Federal income taxes would be \$5,500 payable in two installments of \$2,750 each on March 15 and June 15 of this year. Is that not correct?

As I understand the proposal that has been suggested in the bill that came over from the House, that will be substantially accelerated until the year 1973. In other words, this taxpayer instead of paying \$5,500 this year on last year's earned income, will have to pay \$6,380 this year, is that not correct?

Mr. SURREY. You have another \$880 added to the \$5,500.

Senator TALMADGE. That is my understanding, yes. In other words, he will pay this year—

Mr. SURREY. That is right.

Senator TALMADGE (continuing). At a rate of 25.52 percent instead of 22 percent on last year's taxable income.

Secretary FOWLER. Always having in mind that this is a liability that he owes and in keeping his books and keeping his accounts properly, and taking his liabilities into account, his liabilities have not increased one wit.

Senator TALMADGE. You are collecting taxes this year on what he hopes he is going to earn this year and on what he did last year, as I understand it.

Secretary FOWLER. Just the way it is done for every unincorporated business with which he is competing.

Senator TALMADGE. I am aware of that but I did want to get the facts straight as to exactly what we are doing because I have great sympathy for these small-business people. I have seen some of them almost go bankrupt for the lack of capitalization and lack of credit. Many of them have gone bankrupt, not because they were not earning a profit but because they were overextended and overcommitted and did not have the financial resources to take care of the current obligations.

Now, let us proceed to the year 1969. As I understand it, the same thing would be true that year. He would pay \$6,380 and assuming that his taxable income was the same, \$25,000, so that would also be at a rate of 25.52 instead of 22 percent. Go to the year 1970. The same thing would be true there. He would pay \$6,380 in lieu of \$5,500 which would be at the taxable rate of 25.52, is that correct?

Mr. SURREY. Yes. It continues throughout.

Senator TALMADGE. Also it would continue through 1971 and through 1972 at the same rate.

Mr. SURREY. Yes, sir.

Senator TALMADGE. Then in 1973, 5 years hence, he would be on a current basis of \$5,500 a year, the same as he would be now if that plan were not proposed.

Mr. SURREY. Yes, sir.

Senator TALMADGE. So for 5 years in the future, instead of paying at the rate of 22 percent on his earnings, he will be paying at an effective rate of 25.52?

Mr. SURREY. Yes. But to put it that way, as the Secretary said, may not in a sense be portraying the actual situation for these corporations. In this year he owes a tax liability for his prior year taxes. He is also, as the year is going through, incurring obligations as the Secretary said, to the United States for taxes. Most firms accrue obligations of this nature. They fully realize that these are debts that are owing and the Government will seek payment. Smaller corporations as well as large ones do accrue these liabilities. You find, for example, that a very large number of corporations, the bulk of the small corporations, do not even exercise their option to pay in two installments under the present system, and the bulk of the liabilities of these corporations are paid in the first installment in March.

Senator TALMADGE. I am sure that would be true of any corporation that was not living from pillar to post.

Mr. SURREY. That is right. But as a matter of fact, the Ways and Means Committee used the situation of the corporation living from pillar to post as an affirmative argument for the wisdom of their provision because they said there is danger and harm in illusion, in living from pillar to post and assuming that a tax obligation need not be met. They thought that the realism that would be injected by the responsibility of current payment would be helpful to small business, and that point appears in the Ways and Means Committee report.

Senator TALMADGE. I do not know that I am opposed to this particular plan but I did want to know exactly what the proposal was.

Mr. SURREY. Yes.

Senator TALMADGE. What we are doing is creating an existing liability 12 months in the future that does not exist at the present time.

Mr. SURREY. The liability exists. The payment of the—

Senator TALMADGE. The payment date is—

Mr. SURREY. The payment date is changed but the liability exists.

Senator TALMADGE. Thank you very much, Mr. Secretary.

I have no further questions, Mr. Chairman.

The CHAIRMAN. Senator Anderson?

Senator Carlson?

Senator CARLSON. Mr. Chairman, I shall not take much time. I regret I was absent yesterday. I have no doubt the Secretary discussed all the problems that I may come up with at the present time.

As I understand it, Mr. Secretary, you are here urging approval of the bill that passed the House on excise taxes but you are also suggesting that we have a surtax increase at the present time.

Secretary FOWLER. Senator Carlson, in my presentation yesterday I felt it would be incomplete if I did not portray the entire fiscal situation as I saw it, to which the excise tax bill is only a partial response. I reaffirmed in my statement in the strongest possible terms, the urgency I feel, and the administration feels, that the full program including the income tax increase should be enacted. I said, however, specifically in emphasizing in the strongest possible terms enactment of the entire program, the procedures, whatever procedures Congress chooses to utilize to deal with this problem were for the Congress to determine. I would hope that the end result of whatever procedures are worked out between the House and the Senate, between this committee and the Ways and Means Committee, between the majority and minority sides and the leadership, would result in a prompt enactment of the surcharge. As to the particular procedure that should be followed, I would have no view.

Senator CARLSON. I take it that you feel it is necessary that we have this surtax increase, first, for revenue, and second, to be of some assistance in the inflationary pressures, is that correct?

Secretary FOWLER. Well, that and a third and a very important reason, Senator Carlson. I think it is needed to provide the confidence in the international financial situation that we, and I use it collectively, the United States, the executive branch, and the Congress, working together, are going to reverse the policy of increasing deficits that has characterized our situation since the costs of war in Vietnam have mounted in recent years and that we are going to make a very substantial reversal of that policy by moving back very substantially in the direction of a balanced budget. As a former junior Senator from Virginia expressed it at one point the direction in which you are moving is very important and the direction in which we have been moving, which was arrested last summer at around a \$20-billion-deficit level, must be changed. We must now move back very substantially and significantly in the direction of balance if the dollar is to remain strong and enjoy the confidence that it must have as the keystone in the international monetary system. So there are in addition to the ordinary conventional good sense of trying to finance a temporary expenditure such as the war in Vietnam out of current revenues, a practice we have always tended to follow, in addition to the economic arguments that you have alluded to, there is the third and important point of protecting our balance of payments and maintaining confidence in the dollar.

Senator CARLSON. Mr. Secretary, on this last point I share with you your concern regarding our international monetary situation. I think

it is very critical. I have no question about that. I have read some of the hearings before the House Ways and Means Committee, I have not read them all, but I was interested in a statement from the Council of Economic Advisers in regard to the effect of tax increase on inflation. It is their thought that if we have a surtax increase, prices in this country would rise by about 3 percent in 1968 and, in their opinion, it would not have any effect on reducing prices in 1968. Have you any comment on that?

Secretary FOWLER. Yes, Senator Carlson, I do. The thrust of the point made by the Council is that you cannot change a situation which is characterized by price inflation under the current circumstances, you cannot change it overnight by any action in the field of fiscal restraint. But by applying fiscal restraint now in timely fashion, the continued spiral of inflation in which a 3-percent rate of increase in prices might become next year a 4-percent rate of increase, you can reverse that spiral and begin to move back. In fact, Senator Carlson, in the last 6 months of calendar year 1967, prices were increasing at a rate of 3.8 percent or nearly 4 percent and the important point the Council was making is that if you are going to effect a reversal of that direction in which we have been moving, particularly in the last two quarters of 1967, that we must take action now. We must not expect miracles to happen and suddenly all price increases to abate, but we will be moving in the right direction if we take this action. If we do not take this action, we run the risk of an ever-increasing spiral of inflation which can go beyond the current levels.

Now, we started talking about this problem of arresting the movement of prices last August and at that time we were looking upon a rate of price increase in the first two quarters of the year, of 2.3 percent. Now, it has moved up, it moved up so that for calendar year 1967 it appeared to be around 3 percent. But, that calendar year figure disguised the very important fact that it was gathering momentum in the last two quarters of the year. It is important to arrest that momentum and begin to turn the situation around so that come 1969 as the Council forecast, we can be moving back toward the price stability that characterized the early years of this decade.

Senator CARLSON. Is it not a fact that this scheduled surtax is supposed to expire on June 30, 1969?

Secretary FOWLER. That is right. The Congress would then in the winter and spring of 1969, have another opportunity to determine in the light of the international situation, militarily and elsewhere, in the light of the domestic situation, whether or not the tax increase should expire.

Senator CARLSON. In other words, it is one of these temporary taxes?

Secretary FOWLER. It is very clearly associated, Senator Carlson, with the war and it has been made abundantly clear in the hearings before the Ways and Means Committee, and I certainly restated it yesterday and I will restate it again, that in its concept and in its presentation, it is a temporary measure to defray a portion of the very unusual military expenditures that are associated with our operations in Southeast Asia.

Senator CARLSON. Is it your recommendation to this committee that we make an effort to add the surtax provisions to the pending excise tax bill?

Secretary FOWLER. I have not made any recommendation as to the procedure that this committee should follow.

Senator CARLSON. Would you approve of that action if the committee took it?

Secretary FOWLER. I do not think I can add to my statement. I am for a prompt enactment of the surtax by whatever the procedures the Congress and the two House may concert together to achieve that result.

Senator CARLSON. Well, as one member of this committee I think I fully appreciate the fiscal problems, internationally and domestically, but I would be one member that would vigorously oppose any addition of surtaxes to the pending bill for two reasons. One is I served as a member of the House Ways and Means Committee for a good many years and I know their feeling on their prerogatives. I know the feeling that that committee should initiate taxes generally. As a matter of fact, every member of this committee that is on a conference knows the difficulty we have every time we add tax matters to a House-passed bill and I have helped do it so I am guilty myself. If we should add this, I think, first, it would really endanger the comity between the House and Senate when it comes to future tax matters. This is not the last tax bill. We are going to have many of them in the future. Second, I should not support just a tax increase without some assurance and some definite commitments on a reduction in expenditures as the distinguished Senator from Delaware stated.

I sat through the hearings for 2 days with Secretary Rusk on our international situation and from time to time he was asked if this administration would not come up with some priority when it comes to dealing with expenditures on war, on our domestic program, and he would not, and I gather this morning that the Secretary of the Treasury is not ready to come up with priorities.

Secretary FOWLER. The Secretary of the Treasury has just pointed out to the Congress one set of priorities appearing on pages 20 to 22 of the budget which would call for budget program reductions and reforms in about 50-odd existing programs, and the Secretary of the Treasury has pointed out as the President points out in this message that we think this is only a beginning and that a great deal more needs to be done in culling out these low priority programs. So, if you want to see what the Budget Director and the President think are low priority programs that should be cut, look on pages 20 to 22 of the budget.

I would like to also to say that this is a process which should be encouraged in a much more intensive way. In the statement before the House on November 29, I observed that, in addition to the specific cuts proposed there, the President is prepared to establish a special bipartisan task force of outstanding Americans to take a look at long-range Federal program priorities. This task force would examine, one, the effectiveness of each such program or activity in the context of its present and projected costs. Two, whether and at what level the program or activity should be contained, and three, the relative priority it should be assigned in the allocation of Federal funds. I am very much in favor of bringing to bear the process of priorities. I must say that I do not think that the current processes as we watched them in the last several years, have achieved adequate results in this field.

Senator CARLSON. Mr. Secretary, is it not a fact that after you make these recommendations we still increase our deficit by about \$10 billion?

Secretary FOWLER. The point is that these things that are controllable are a limited phase of the budget, as Mr. Zwick will explain to you. Some others are uncontrollable payments that have to be made by law, and the Secretary of the Treasury has no option as to whether he can make the payment or honor the check. You have voted it. It is in the law. And the CCC payment or the grant-in-aid payment must be made. The modification of those hitherto uncontrollable programs which will result in culling out lower priority expenditures is a very fundamental direction in which we must move, and, frankly, in the last several years, the administration and the Congress acting together, have not been able to whittle them away.

You take these programs that are listed on pages 20 to 22 of the budget and you will recognize in them programs in which repeatedly the Congress will vote to add to them and to the President's recommendation. You will also find others in there that I think have been pointed out repeatedly as involving programs that could be dispensed with without any damage to the national interest, and yet they continue to be fed and nourished at the expense of increasing deficit or at the expense of new and more compelling needs that are not sufficiently honored.

Senator CARLSON. Mr. Secretary, here I get back to the hearings of the House. I wonder if these figures are not correct as I have taken them and I think if the Budget Director will follow through maybe I can get a comment from him on it.

Comparing the budget figures for fiscal year 1968 and 1969, it was indicated that receipts are projected to increase \$118.6 billion to \$135.6 billion and that assumes a 10-percent tax increase.

Now, as I understand it, these are on administrative budget basis but if one eliminates the tax increase and sale of participation certificates, the deficit for fiscal 1968 would be \$25.2 billion and the deficit for 1969 would be even higher, \$25.4. Is that a correct statement?

Mr. Zwick. Yes, sir. Let me make several comments on that. It depends on how you handle participation certificates.

The CHAIRMAN. Let me interject here that the Secretary has to leave in just a few minutes. These questions to the Bureau of the Budget can be filled in after the Secretary has departed because we will continue to examine—

Mr. Zwick. I would like to.

The CHAIRMAN. If that is all right with you.

Senator CARLSON. Not only all right, but I am through. Thank you very much.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. No questions at this moment.

The CHAIRMAN. Mr. Secretary, just one thing. The House bill undertakes to completely repeal the tax on automobiles. The Senate had kept 1 percent on the statute books on the theory that it might be needed to dispose of junkyards or provide highway beautification or something else in connection with highways. Does the administration have any judgment one way or the other on that?

Secretary FOWLER. We do not have any judgment on that at this time. I think that is something that could be handled down the road 2 or 3 years from now because the excise tax on automobiles under the House bill would not finally expire until 1971.

The CHAIRMAN. All you are concerned about right now is that you need all the revenue that it brings and you cannot afford to do without it.

Secretary FOWLER. Cannot afford to lose a dollar.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Secretary, I understand you are leaving. Could you come back again, tomorrow?

Secretary FOWLER. Yes, so far as I know, Senator. I have been scheduled to appear in executive session before the Ways and Means Committee.

Senator WILLIAMS. I understand that.

Secretary FOWLER. And, I will be at your disposal tomorrow.

Senator WILLIAMS. I realize we want to move along, but I wanted a clearcut position of the Department on these various sections so that when we go to the floor we will know exactly where the administration stands, and I do not want to delay the hearings. I am sorry we could not get started on these hearings a week ago last Friday because the Senate was out of session that day, and we could have had a full day Friday and Monday. But it did not suit the Department, and I can understand that. I was hoping, however, we could finish today.

The CHAIRMAN. Might I just ask this question. Mr. Secretary, the Senate goes in at 12 and during the morning hour the committee may meet. I wonder if you could try to arrange your affairs with the Committee on Ways and Means that you could return here at 12 o'clock and let Senator Williams ask the additional questions he has in mind. Perhaps we might finish this matter today if we could. I think the rest of us have asked all the questions we know of.

Senator WILLIAMS. I have no objection to procedure.

The CHAIRMAN. We will plan, then, to be here tomorrow morning at 9 o'clock so Senator Williams can get the information he seeks from the Secretary. Senator Anderson, I believe, wants to have some additional information. The Director of the Budget can stay here with us.

Mr. ZWICK. Yes.

The CHAIRMAN. I suggest now you complete your answer to Senator Carlson's question and then anyone who wants to direct any additional questions to the Director of the Budget may do it now.

Mr. ZWICK. Yes, sir. Let me start out with a response in terms of the public record of the President on expenditure restraints, which seemed to run through your questions, Senator Carlson, and yours, Senator Williams. I think the record is quite clear and it ought to be on the table at this point. In his message of August 3, last summer, the President, when he came up with his surcharge proposal, proposed additional expenditure restraints both in the civilian area and non-Southeast Asian defense expenditures. In the fall, a target of \$2 billion of expenditure reduction in the civilian area was arrived at. He asked Secretary McNamara during that time to look at whatever expenditure reductions he could make in the non-Southeast Asian defense area, and a target of \$2 billion was one informally used during this period in that area also. As the fall went on, there was some question as to

whether or not we were going to get the tax bill, and whether the reductions were promises or whether they would really be delivered. As a result, the administration proposed as part of the tax bill that we write into law an obligation cutback, and that was enacted into law, Public Law 90-218, which did in fact bring about obligation reductions of approximately \$10 billion and expenditure reductions of \$4.3 billion. I want to be clear that that is the type of approach the President was talking about in his August 3 message.

Once that happened the dialog then moved on to the point that the Congress wanted a better look at the 1969 budget before enacting the tax increase. And what were the objective criteria established for judging the 1969 budget? One criterion was that the increase between 1968 and 1969 ought to be less than the expenditure increases we have had in recent years. And we have met that criterion. The increase in 1969 over 1968 is \$10.4 billion. It was \$17.2 billion in 1968 over 1967 and \$23.8 billion in 1967 over 1966. So, we met that criterion that we were given last fall.

Another criterion is that as a percentage of gross national product, budget outlays should go down. And if you look at the budget on page 12 you will find that outside of the special costs of Vietnam and the self-financed social insurance trust funds, the total Federal budget as a percentage of gross national products stands at 13.9 percent in 1969, less than in 1968, and significantly less than the 16 percent it was in the late 1950's. So, we met that test.

Another test was that controllable expenditures should be held down and we held the increase in 1969 controllable expenditures down to roughly a half billion dollars. There was a request that we set priorities, and we did set priorities. They are reflected in the 1969 budget, and you can see them, as Secretary of the Treasury Fowler has said, on pages 20 through 22.

So now we come, and apparently all the objective tests that were given to us last fall were not sufficient, and now we are hearing we must couple expenditure control with a tax increase. I am not quite sure when we get off this dialog and when we get on to the tax increase part of it. We sent up an urgent supplemental several weeks ago and I am the gentleman who took the heat from the various agencies when we kept it to only mandatory increases. It passed the House and as you know, Monday it passed the Senate with additions put on. We sent up a program supplemental several days ago, Monday, and again I cut back on the program supplemental items that were in the January budget. So, I think the President's public record—not a question of what he said here or there—but his public record starting last August has been quite clear. He has promised and he has delivered expenditure restraint.

Now, reasonable men can disagree on how much restraint is needed, but I think there is no doubt in any simple reading of the record that he has promised and delivered on expenditure restraints and the first order of business now is the tax increase.

Senator CARLSON. Just one thing. You mentioned——

The CHAIRMAN. I am not sure I have it all straight. What percentage of gross national product does the entire budget represent as of this coming fiscal year?

Mr. ZWICK. The entire budget, including Vietnam and everything, is about 21 percent of the gross national product.

The CHAIRMAN. Twenty-one percent.

Mr. ZWICK. Yes, sir.

The CHAIRMAN. What was it on the other base periods you are comparing? You are comparing—

Mr. ZWICK. We have three breakouts. If you take the special costs of Vietnam, they are roughly 3 percent. The social insurance trust funds are 4.4 percent, and then all other outlays are 13.9 percent, so that that adds up to your 21 percent. Now, for all other outlays, leaving aside Vietnam and the social insurance trust funds, that 13.9 percent in 1969 contrasts with the 16 percent in the late fifties.

The CHAIRMAN. Now, in the late fifties, if you put everything in what would you get?

Mr. ZWICK. Roughly 18 to 19 percent.

The CHAIRMAN. So, if you add the war in Vietnam to it you are coming up with—you said 21?

Mr. ZWICK. Twenty-one percent, which was about where we were during the Korean war. In the late fifties it was about 19 percent. If you take out the current 3 percent for Vietnam you get about 18 percent, so for everything other than Vietnam, we are down slightly from the late fifties. If you take out the self-financed social insurance trust funds, we are down significantly from the late fifties. And if you put everything in, you get up to 21 percent which is basically where we were during the Korean war.

The CHAIRMAN. Thank you.

Senator CARLSON. I yield.

Senator WILLIAMS. You speak of the action in the Senate—

The CHAIRMAN. Why do you not let Senator Curtis—

Senator CURTIS. I do not go out of turn.

Senator WILLIAMS. You speak of the action in the Senate yesterday on the supplemental bill. You are correct, the Senate added \$189 million more than was recommended by the budget. Twenty-five million of that was added on a rollcall vote, which was a tie vote in the Senate but which the Vice President, who is a part of the executive branch, broke in favor of that addition, and the money was provided. But the bill does carry \$189 million more than was recommended by the budget, which is approximately 15 percent increase. I am not excusing the Senate of having done that, and I know that that is above what is recommended by the budget and by the President. My question is, Will you recommend that the President veto that bill?

Mr. ZWICK. No. We have to pay the claims and judgments against the Government. We have public assistance payments which must be made. We have a problem here of meeting our commitments in an orderly way. The issue is running the Government in an orderly fashion. I do not think that a President could responsibly fail to meet the claims of States and local communities under the laws. The issue you are raising is the issue of expenditure control. One of the items that you added to the supplemental was the impacted area school aid. Now, if you carry into fiscal year 1969 the full funding of that added impact area aid, you are adding about \$160 million to the fiscal year 1969 budget of the President. So, it is not only what you added to the 1968 budget but the implied commitment to the 1969 budget that results from that action.

Senator WILLIAMS. And that is the reason we would rather the President use a veto pen occasionally; it would help some of us. There is not this 24-hour emergency. This particular bill laid on the Senate calendar for 2 weeks before action was taken so it was not so urgent.

Mr. ZWICK. It is true that the Department of Labor, for example, is running out of money to pay unemployment benefits to veterans now.

Senator WILLIAMS. It is true, but they were running out 2 weeks ago, too, and the—

Mr. ZWICK. It would be very difficult to veto such a bill.

Senator WILLIAMS. You and I know these payments will be made.

Now, you speak of the recommended cutbacks in this budget. As I stated, I welcome the support of the Executive wherever we can get it in holding back these expenditures; but is it not true that when you speak of the cutbacks in the budget this year by the executive branch, as compared to last year, you are comparing what you asked for this year with what you asked for last year and not with what you got last year?

Mr. ZWICK. No, sir. What we compared was what we asked for this year with what Congress gave us through its appropriations actions last year, but before the 2-10 cutback in Public Law 90-218—not what we asked last year but what was appropriated. We thought that was valid. That is a reflection of what Congress is asking the administration to carry out. We thought that was the appropriate yardstick, not the arbitrary 2-10 cutback.

Senator WILLIAMS. Is it not true that every agency of the Government under the 1969 budget will carry an increase, that is every single department is asking for more money than it did last year?

Mr. ZWICK. I suspect that could be true.

Senator WILLIAMS. Except, I think, one exception, Selective Service System.

Mr. ZWICK. I would have to check and see if it is true for every last agency but I would suspect it is true for most, sir. But let us recognize this country is bigger.

Senator WILLIAMS. The country is bigger, and the budget and deficit are bigger. The deficit is bigger than either the country or the budget.

Mr. ZWICK. But as a percentage of the GNP the Federal sector is smaller than it was last year and smaller than it was in the late fifties, and we cannot wave away that fact of life. Senator Talmadge was asking about the small business. Just in fiscal 1969 alone, the number of loans to small business will be up 21 percent, takeoffs and landings at airports with FAA towers are going to be up 15 percent. I do not think we want to suggest that we do not provide adequate air-traffic control and not service small business. As the country gets bigger or workloads go up, patent applications go up. Certainly we must service the patent applications of the country.

Senator WILLIAMS. That is a good statement. You forgot motherhood—

Mr. ZWICK. We have got to recognize as we become a bigger country we have bigger workloads and, therefore, you should expect bigger budgets. The question is whether they are prudent budgets given the size of the economy we are dealing with.

Senator WILLIAMS. We do, and that is an excellent statement. You should also include in it that we have more mothers; we want to

recognize motherhood. But to get back to the point of these things that can and cannot be cut, to be specific, we have more golf courses than we had before. Just a few weeks ago there was a \$250,000 grant in my State for a golf course, and there are similar grants scattered all over the country.

Now, surely these are things that may have merit but they are programs that can be done without at a time when we are running a \$28 billion deficit. I think you will agree with me that when the actual deficit projected for 1968 is not \$8 billion as many people think, and I do not mean that you personally claim that, but without any tax increase at all, by normal computations, there is a \$28 billion deficit confronting us in 1969. You speak of the \$20 billion deficit, \$22 billion, I think it is, for fiscal 1968, but are you counting the sale of participation certificates. Are you counting the sales of participation certificates in line with the new unified budget for 1968?

Mr. Zwick. In the 1969 budget, we are using the new budget concept for both 1968 and 1969, and in both of these cases, therefore, the participation certificates are treated as means of financing and are, therefore, irrelevant for this.

Senator WILLIAMS. But, you are also counting in these trust fund receipts.

Mr. Zwick. Yes, sir.

Senator WILLIAMS. Now, do you think that it is proper to include trust fund receipts, the accumulation in the trust funds, in reporting the deficit to the American people? Now, I realize they must be counted when you figure on the expenditures. They affect the economy. But these are trust funds. The Government is only the trustee of, for example, the unemployment trust fund. You cannot spend that money routinely, and at that Congress cannot even appropriate it. The only way you can spend it is to issue Government notes and then spend it: but why count those toward reducing the deficit?

Mr. Zwick. Senator Williams, let me give you two answers. First, we followed the recommendations of the distinguished bipartisan Commission on Budget Concepts. As you know, this Commission included the chairman and the ranking minority member of both the House and Senate Appropriations Committees.

Senator WILLIAMS. I am familiar with the commission.

Mr. Zwick. They looked at this and unanimously recommended treating it this way. Since you raised the question and since it has been raised by Congressman Curtis, I asked the Chairman of the bipartisan Commission, Mr. Kennedy, from the Continental Illinois National Bank & Trust Co., to comment on that. He has written me a letter. I would like to submit that letter for the record and I would like to read to you some excerpts from that letter at this point. This is a letter from David Kennedy to me:

The Commission specifically considered at great length the problems involved in various types of transactions which, although outside the old administrative budget format, nevertheless involved the exercise of power by the Congress to establish programs, to prescribe payments of benefits and other expenditures under these programs, and to provide for their financing, either through taxes or borrowing. Particularly, the Commission felt that the new budget must include the activities of the trust funds and Federal loan programs. Exclusion of either would destroy the whole idea of a unified and comprehensive budget.

Throughout its discussions the Commission made it abundantly clear that the inclusion of trust funds in overall budget summary data was strictly for aggregative purposes and in no way should be construed as reflecting on the sanctity of the individual trust funds. The identity of these trust funds must be preserved in every detail. No trust fund asset, liability, receipt, expenditure, or net surplus or deficit would be stated differently under the new unified concept than the way it had been shown before for the same data or period of time. Thus, the Commission was acutely conscious of the Government's responsibilities to the American people to guard jealously the sanctity of its fiduciary relationship to these trust funds.

It is true, of course, that no bank would think of intermingling its own assets with assets which it holds for others in the exercise of a fiduciary responsibility. Nor is any purpose served by a bank's publishing income or balance sheet totals reflecting both types of activity. These fiduciary accounts are not created by the bank, but rather by individuals and corporations seeking to employ the bank's services.

In the case of the Federal Government, however, the trust funds are created by the Government itself. Their individual identity should remain just as inviolate as in the case of the bank trusteeship. But their aggregate effect has just as much influence on the overall Federal fiscal picture as other Federal programs.

The Commission was extremely careful in preparing its report to the President that these fiduciary responsibilities should be preserved. As a matter of fact, the Commission was of the firm opinion that one of the major reasons for the inclusion of the trust funds as an integral part of the unified budget was to help preserve these fiduciary principles by relieving the pressure existing in the old administrative budget format to create new trust funds to accomplish purposes which belonged in the regular budget, or to use the trust funds in a non-fiduciary capacity to provide a shelter for increased benefit programs without having them counted in the budget. The same reasoning applies to pressures in the old administrative (and national income) budget format to exclude certain expenditure programs from the budget by converting them into loan programs. The unified budget removes these challenges to the budget integrity.

I hope these comments will be helpful in your efforts to promote understanding of the new budget format.

Senator WILLIAMS. I appreciate that, and if Mr. Kennedy wishes to testify I shall be glad to see him. If you have more letters to read, I ask you to read them and then answer the question of what you think of—

Mr. ZWICK. Think of what?

Senator WILLIAMS. I thought you would forget the question by that time.

Mr. ZWICK. No. I remember it.

Senator WILLIAMS. Do you think it is proper to report that we have only an \$8 billion deficit by using \$7½ billion accumulation of trust funds. Do you think that is proper?

Mr. ZWICK. The question of a deficit calculation depends on what purpose you are using it for. If you are talking about borrowing from the public and the impact of the Federal deficit on financial markets an issue that the Secretary of the Treasury developed in detail yesterday, yes, sir. The key issue is borrowing from the public, how much pressure the Treasury will be putting on the financial markets of this country, and therefore, you do not want a misleading number. It would be a misleading number if you just took the deficit without the trust funds. The total deficit which includes the trust funds is more meaningful. In this case trust fund operations are in surplus, but in another case they could have a deficit.

Senator WILLIAMS. But the point I am getting at is that the President referred to the fact of the \$8 billion deficit. Secretary Fowler referred

to that. The \$8 billion deficit is contingent upon counting the \$7.4 billion accumulation of trust funds, but without counting that \$7.4 billion it would be \$15.4 billion.

Mr. Zwick. But there is a deficit in the expenditure account of \$4.7 billion, so you have all sorts of deficit calculations and the only point I am making that the one you use depends on your purpose. No one aggregate number can be reflective of all purposes. If you are interested in the economic impact, you look at the \$4.7 billion deficit. If you want to measure the impact of Federal activities on the financial market, you ought to look at the \$8 billion deficit. If you have some other purpose in mind maybe you want to look at a \$15.4 billion deficit, but I do not know quite what the purpose would be.

Senator WILLIAMS. Secretary Fowler referred to it, time and time again, in his statement here before this committee yesterday and today as an \$8 billion deficit.

Mr. Zwick. That is correct.

Senator WILLIAMS. Now, this \$8 billion is based upon the premise that you include \$7.4 billion trust funds, in other words—

Mr. Zwick. That is right.

Senator WILLIAMS. In other words, if we do not include it the deficit reported for 1969 projected would be \$15.4 billion?

Mr. Zwick. That is correct, if that is the only change you make in the Commission's recommendations.

Senator WILLIAMS. Now, the \$15.4 billion is also based upon the premise that we will enact a \$12.9 billion tax increase.

Mr. Zwick. That is correct.

Senator WILLIAMS. And—

Mr. Zwick. It is really \$13.2 billion if you put the user charge proposals in the budget.

Senator WILLIAMS. That is correct, but \$12.9 billion, I think, is what he referred to in his budget. So we start out on this basis of \$28.3 billion deficit. It would be reduced by the President's tax proposal by \$12.9 billion. If we enact his tax program as recommended that would bring it back to \$15.4 billion.

Mr. Zwick. That is correct.

Senator WILLIAMS. Then, you take the \$7.4 billion from the trust funds and bring it back to \$8 billion and we are told that this is sound accounting.

My next question is this. Suppose this does not affect the security of the trust funds and they are just as safe, and suppose it is accurately reporting it to the American people. We both agree first, that it would be important to be able to report a balanced budget; do we not?

Mr. Zwick. Yes, sir.

Senator WILLIAMS. On this line of reasoning, why not take this \$12 billion tax increase which the President is proposing, put it over into one of the trust funds? It would make the trust fund more sound. You would still end up with an \$8 billion deficit. Or carrying the point further, why not take the whole \$80 billion we are raising in revenue and put that into various trust funds, building them up, say, for a long time to come. The President would, under this procedure, still report an \$8 billion deficit even though he had no money at all to spend other than what he borrowed from the trust funds, is that not so?

Mr. Zwick. Other than what he borrows from the trust funds. But what are the trust funds going to do with this surplus? They are going

to invest in Treasury notes, which means, therefore, the Treasury has cash available to pay its bills, whether they are for medicare, public assistance, farmer's home loans, or what.

Senator WILLIAMS. Conceivably it would be possible under this line of accounting for the administration to report a balanced budget for 10 years straight and to bankrupt the trust funds at the same time by spending all the trust funds through various programs.

Mr. ZWICK. No, sir; as Mr. Kennedy said in his letter to me, and as I think the budget concept report is quite clear on, and as we have been quite clear on in our testimony, the trust funds are inviolate. When they need cash, they will cash in the Treasury notes. If you are implying that the Treasury would not honor its notes at that time and give the trust funds their cash, then they would be bankrupt. The only impression must be that the U.S. Government is not good for its notes.

Senator WILLIAMS. That is correct. I agree with that but there would be such a thing as the value of this dollar when they cash them in.

Now, these trust funds are nothing new. The government is a trustee. Most every corporation has its pension fund, and I am going to read to you just a note on one of the financial statements of one of our major corporations:

The pension fund is not the property of the company or its subsidiaries and, therefore, is not included in the consolidated financial statement. The aggregate market value of all investment of funds is substantially more than the cost thereof.

The point is that these corporations report their trust funds to their stockholders for information purposes, but the pension accounts are treated as trust funds. If any corporation included the net growth of that pension fund in its report to the stockholders as though it were increasing its surplus or reducing its deficit the Security and Exchange Commission and Department of Justice would be on them tomorrow morning.

Mr. ZWICK. Yes, sir.

Senator WILLIAMS. And that is exactly what the Government is doing today.

Mr. ZWICK. I thought Mr. Kennedy's letter adequately pointed out the distinction between how a bank keeps its books and how the Federal Government keeps its books. What is sound and sensible for a bank and what is sound and sensible for the Government are different.

The CHAIRMAN. I just want to ask that that letter be put in the record.

(The letter referred to follows:)

CONTINENTAL ILLINOIS NATIONAL
BANK & TRUST CO. OF CHICAGO,
Chicago, Ill., March 5, 1968.

Mr. CHARLES J. ZWICK,
Director, Executive Office of the President,
Bureau of the Budget, Washington, D.C.

DEAR CHARLIE: I have your request for any comments I might wish to make as Chairman of the President's Commission on Budget Concepts with regard to the reasoning behind the Commission's recommendation to include trust funds in the new unified budget. I am glad to respond to that request.

From the very beginning of its deliberations, the Commission was unanimous in its feeling that the budget process should encompass the full scope of programs and transactions within the Federal sector of the economy that are not subject

to the economic discipline of the market place. We concluded, therefore, that as a general rule the budget must be comprehensive of the entire range of Federal activities. This comprehensiveness is critical to the understanding of the budget by Congress, the financial community, business men generally, and the public. It is the only practical answer to the increasing confusion caused by the use of several different concepts of the budget in recent years.

The Commission specifically considered at great length the problems involved in various types of transactions which, although outside the old administrative budget format, nevertheless involved the exercise of power by the Congress to establish programs, to prescribe payment of benefits and other expenditures under these programs, and to provide for their financing, either through taxes or borrowing. Particularly, the Commission felt that the new budget must include the activities of the trust funds and Federal loan programs. Exclusion of either would destroy the whole idea of a unified and comprehensive budget.

Throughout its discussions the Commission made it abundantly clear that the inclusion of trust funds in over-all budget summary data was strictly for aggregative purposes and in no way should be construed as reflecting on the sanctity of the individual trust funds. The identity of these trust funds must be preserved in every detail. No trust fund asset, liability, receipt, expenditure, or net surplus or deficit would be stated differently under the new unified concept than the way it had been shown before for the same date or period of time. Thus, the Commission was acutely conscious of the government's responsibilities to the American people to guard jealously the sanctity of its fiduciary relationship to these trust funds.

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I hope these comments will be helpful in your efforts to promote understanding of the new budget format. I share your favorable reaction as to the reception the new budget presentation has received. The Bureau of the Budget staff has done a tremendous job of integrating the Commission's recommendations into the budget presentation in a very short period of time. All of you are to be congratulated.

Sincerely,

DAVID M. KENNEDY.

(The following was later submitted and is inserted in the record at the request of the Director of the Bureau of the Budget:)

A STATEMENT ON THE REPORT OF THE PRESIDENT'S COMMISSION ON BUDGET CONCEPTS

(By the Executive Committee of the American Institute of Certified Public Accountants)

The Executive Committee of the American Institute of Certified Public Accountants recommends that the Federal Government adopt, at the earliest

practical moment, the modern and progressive budget principles contained in the Report of the President's Commission on Budget Concepts.

The Executive Committee agrees with the President's Commission that adoption of these recommendations would make the budget of the United States Government a more understandable and useful instrument of public policy and financial planning. The Executive Committee believes also that the recommended concepts are in accord with sound financial planning and decision making processes.

The Report of the President's Commission cites confusion now existing because of the use of at least three competing budget concepts. In this move toward one unified summary budget statement, there is a parallel in the private sector where the AICPA has been working toward improved corporate financial reporting through better disclosure standards and the elimination of undesirable alternative accounting principles. The consistent use of the recommended budget statement would greatly improve public understanding of the Federal budget, which is necessarily a brief summary of an immensely complex underlying financial system.

Some aspects of the budget concepts recommended in the Commission's report might well find applicability in budgeting for state and local governments. Uniform budget systems throughout government should prove useful in decision making and should aid the people in understanding budgets as an instrument of government at all levels.

Reporting budget expenditures and receipts on an accrual basis is one of the more significant recommendations of the President's Commission. In recent years, many government agencies have abandoned the cash basis of accounting, which long had been traditional, and have adopted modern accrual accounting with integrated cost accounting systems. It is only logical that the government take advantage of these improved accounting systems in its overall financial planning.

Because the Report of the President's Commission does not call for the accrual of future commitments for items such as social security benefits and veterans pensions, the Executive Committee believes that the budget document should contain summary disclosure of the amounts of these commitments.

The Executive Committee recommends that the concepts set forth in the Report of the Commission be translated into government policy and practice promptly so that the budget for the coming fiscal year will reflect as many of those concepts as possible. The Committee also respectfully suggests that the Executive Branch report periodically to the Congress and the people on progress in implementing the Commission's recommendations.

NOVEMBER 27, 1967.

Senator CURTIS. Mr. Zwick, referring to pages 20, 21, and 22 of the budget, do I understand that that is a list of suggested cuts that the Budget and the President support?

Mr. ZWICK. Yes, sir.

Senator CURTIS. Do I find any cut in there in foreign aid?

Mr. ZWICK. No. This is a cut—

Senator CURTIS. Is there any in there in foreign aid?

Mr. ZWICK. In the sense of a holdback from last year's appropriation; no.

Senator CURTIS. Any cut in foreign aid? Is there an item there?

Mr. ZWICK. Not in that list.

Senator CURTIS. All right. Now, is there anything in there suggesting a cut in the war on poverty?

Mr. ZWICK. No, sir.

Senator CURTIS. Now, we have talked about these golf courses. A colleague of—

Mr. ZWICK. I would like to know—

Senator CURTIS. A colleague of ours told us that in his area there is an air base. The school has a terrific load, is dependent upon money for impacted areas, that that was cut and then he discovered that the Federal Government came in and spent money in six figures to build a golf course.

Now, is there anything on these pages to stop that sort of thing?

Mr. Zwick. Two points, Senator Curtis. I checked with the Defense Establishment recently on that issue and they did not know of any golf course being built with Federal moneys in the last year or two.

Senator CURTIS. All right. I will tell you about it.

Mr. Zwick. And the other one, Senator Williams—

Senator CURTIS. In one of my counties, unbeknown to me, unbeknown to my Congressman, the Federal Government came in and spent \$140,000 for a golf course. The local people say there is no chance of ever paying the \$7,000 a year interest that they must pay.

Mr. Zwick. You are talking about a loan, not a Defense Department expenditure.

Senator CURTIS. I do not care where it comes from.

Mr. Zwick. I think it came—

Senator CURTIS. I am talking about the public.

Mr. Zwick. It came out of another agency as a loan.

Senator CURTIS. Anything to stop that?

Mr. Zwick. We are holding back loan programs as part of this over-all reduction and reform program.

Senator CURTIS. Is there anything in there to stop that?

Mr. Zwick. We are holding back loan programs. I notice in the recent action by the Senate on the supplemental, one of the things you added was additional money for the Farmers Home Administration's direct loans.

Senator CURTIS. Is there anything in there to stop those unnecessary loans when we are in a time of war?

Mr. Zwick. We have cut back on loan programs and on construction programs, and we have put out guidelines to the agencies to use strict criteria of need in making these loans.

Senator CURTIS. Now, you referred to controllable expenditures, assuming that there are noncontrollable expenditures. Would not not be fair to say this? There are controllable expenditures that can be controlled right now and there are some that the control is in the long run and others—

Mr. Zwick. That is correct. Nearly everything is controllable over a matter of several years with changes in existing laws, that is true.

Senator CURTIS. Yes. Now, where did the idea of medicaid that is costing billions of dollars originate, in the Congress or in the executive?

Mr. Zwick. I think this is an idea that has been around and discussed since the end of World War II.

Senator CURTIS. It was in the executive and it is coming out of the general fund and it was presented to this committee at about a fifth of what it actually cost.

Now, there is a controllable expenditure. There is nothing in here that says anything about it.

Mr. Zwick. I am sorry on that, Senator. We did enact in the public assistance law last year an attempt to reduce the costs of these programs with the administration's support.

Senator CURTIS. I know. There was quite a revolt in Congress because they felt the executive deceived them, and I say that advisedly, on the cost of medicaid. It was slipped in here as more or less of a sleeper and an estimate made that was totally unrealistic and billions of dollars below what it should be. And—

Mr. ZWICK. Senator Curtis, I would like to correct the record on that in two senses. One, the medicaid estimate was off by \$568 million, not billions, this fiscal year.

Senator CURTIS. I think it was developed right here in the testimony.

Mr. ZWICK. And secondly, I would like to submit for the record the detailed procedure whereby we got our medicaid estimate, which is based essentially on State estimates of what their costs were going to be. I think it is quite true, and I am not here to argue that anybody did a good job.

Senator CURTIS. The figures were developed right here.

Senator WILLIAMS. The first estimate of the cost of medicaid was \$238 million, and Congress approved it on that basis. Later the administration came back to Congress, and they were shocked to find it was going to cost about a billion and a quarter to a billion and a half. Something had to be done, but nothing was done for months. Finally they came up with a proposal at the end of 1967 to roll these expenditures back to \$2 billion because they said it would be \$3½ billion without action. Last year Congress did enact a proposal curtailing the expenditures, but the estimated cost after curtailment of this program today is still around \$1½ to \$1¾ billion per year when it gets to full financing. That still leaves a billion and a half to a billion and three quarters cost for a program that was sold to Congress as costing \$238 million to begin with.

Senator CURTIS. There is nothing personal in this.

Senator WILLIAMS. This was another Department.

Senator CURTIS. I realize you have just been in the Budget a little while but billion dollar program after billion dollar program has been presented to the American people by the present administration. It has been held out to the people and pretty soon there is a demand for it. And as I say in medicaid we were deceived. It costs seven times what they said it would, and then when cuts are suggested, they are very carefully selected cuts that everybody knows cannot be maintained. And the secret of holding down Federal expenditures is to hold down the expansion of the Federal Government, and there has been none of that whatever.

Mr. ZWICK. Sir, may I make two comments?

Senator CURTIS. Yes.

Mr. ZWICK. One, I disagree with the last statement. As I have already indicated, outlays of the Federal Government other than for Vietnam and social insurance trust funds are 13.9 percent of GNP and they were 16 percent in the late fifties, so that statistics indicate that the budget has been held down.

Senator CURTIS. That indicates that we have got inflation and furthermore, you know that social security taxes are taxes and they come out of the economy and they come out of the paycheck and they are a burden of Government, are they not?

Mr. ZWICK. I find that more congenial than Senator Williams' treatment of them.

Senator CURTIS. All right. And also it is true that the House of Representatives passed a bill which increased those around \$3 billion or a little more and the administration came in here and pressured for a \$6 billion program that ultimately grew to \$7 billion.

Mr. ZWICK. All I am saying is that no matter how you measure it, even including the trust funds, still the Federal sector excluding Viet-

nam is 18 percent of GNP now and was 19 percent in the late fifties.

The other point I would like to make concerns the idea that these reductions were purposely selected because they are difficult. They are all difficult, Senator. These represent a conscious policy to hold back in two areas. Construction across the Government was held back for 1969, and loans which would lead to constructions were held back.

Senator CURTIS. Has Congress ever passed a pay raise that has not been urged by the administration?

Mr. ZWICK. I doubt that.

Senator CURTIS. And the President has never vetoed any.

Mr. ZWICK. No, sir.

Senator CURTIS. And those things run in billions of dollars.

Mr. ZWICK. Yes, sir.

Senator CURTIS. This is in no sense personal as to you. You have got one of the toughest problems in the world. But there is a growing number of Members of Congress, and I told another Cabinet member this yesterday, there is a growing feeling among a number of Congressmen and Senators who have fought for years for responsibility in Government financing that the executive is less than forthright and they are most unhappy about it. They put a Senator in a position of penalizing the school district that is dependent upon a Federal grant for a long time and then he picks up his paper and he finds that the Government has spent that sort of money on a golf course, not for the public, but for a few people that belong to the club. Those things are happening right along and I would guess that you have included in your category as uncontrollable expenditures medicare. The point is the control was a little longer, a few years longer, and the executive came in and told us that it was about a quarter of a billion dollars. It is seven times it.

Mr. ZWICK. On this issue of forthrightness, sir, I do not know how to deal with that, except that all I can say on the restlessness of feeling of Congress about expenditure control is to repeat what I said earlier—that last fall we were given specific objective tests to be met in the 1969 budget. We met those specific tests. The increase in 1969 over 1968 is less than it was in previous years. We were told that if the budget were to come in with an increase which is greater than the fiscal dividend, that is, the normal growth in revenues, that we could not get the tax increase. We brought in a budget with an increase that is less than the normal growth in revenues and then the response is, "Well, you did not do enough."

I can only react to objective data, objective statements, and I think our record is forthright and very good in those terms.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. I do not have any great questions today but in this 20 to 22 pages you referred to earlier, about cuts I see \$447 million cut in space administration.

Mr. ZWICK. Yes, sir.

Senator ANDERSON. That is tying up the space program. Did you fight the \$25 million that was put through the Senate yesterday?

Mr. ZWICK. What was that, sir?

Senator ANDERSON. We had an appropriation item of Senator Williams' of \$25 million.

Mr. ZWICK. Yes, sir.

Senator ANDERSON. Added to it. Did anybody object to that?

Mr. ZWICK. Yes; we did not ask for it. We sent up the urgent supplemental with only four items in it. Three of them were mandatory by law and the fourth item was for the Vocational Rehabilitation Service which had already reallocated money from other States on a promise that they would get it back. The President quizzed me at great length and finally decided we were otherwise going to lose \$5 million worth of investment which States—in good faith and based on congressional action last fall—had already put to good use. We had already put that \$5 million in for vocational rehabilitation and—without the supplemental requested—it will be wasted.

We came up with four items. We fought off all sorts of pressures for additional items in that supplemental. Three are mandatory, and the fourth was just plain prudent government. We thought that was the appropriate action to take in these times and we still believe that was the appropriate action to take.

We have also submitted, on Monday of this week, a program supplemental which picks up the other program items that we are going to send up this spring. We think the Congress ought to look at them in the normal appropriation process, rather than tacking something on here and something on there. We think the urgent supplemental really should go through with only the four urgent items in it.

Senator ANDERSON. I watched this \$25 million item because the motion was lost in the initial stages, but then another vote was switched, another paired, and they finally got it to the point where the Vice President could break a tie and pass it. Here we have all these other items that are cut down. I think you cut too deep on certain things and do not cut at all on something else.

The CHAIRMAN. I just want to say this. Frankly, I gain the impression that your present budget concept is correct. If you collect more money in social security taxes than you pay out in social security benefits, whether you collect that as a tax or as interest on the money in the fund, to that extent you are ahead of the hounds and that being the case, the budget ought to reflect it.

Mr. ZWICK. If it did need it, it would.

The CHAIRMAN. As a matter of fact, when the Government thinks in terms of how much it is going to borrow from the private sector, that calculation has to be done after you see how much you are going to borrow from the social security fund because invariably you borrow any surplus funds that are there before you go to the private market, do you not?

Mr. ZWICK. That is exactly right.

The CHAIRMAN. The calculations use it the other way around. The money in the fund must go into Federal Government loans—there is no provision in law that lets you go anywhere else.

Mr. ZWICK. You can invest in agency paper or in Treasury notes. That is the only thing you can invest it in.

The CHAIRMAN. So, to the extent you have money as a surplus flowing into the social security fund, the Government is exerting a restraint on the economy and the fund is just that much further ahead on payment of social security taxes. If you want to look at it from the

point of view of how long can you pay benefits, you can go just that much longer without raising social security tax payments.

Mr. ZWICK. That is right.

The CHAIRMAN. Now, the same thing is true in one respect or another with regard to these other Government-held trust funds.

Mr. ZWICK. Surely.

The CHAIRMAN. So when you think in terms of what the Government situation is, it is true you have enormous contingent liabilities but if you look at your ability to meet the liabilities that you have presently facing you to the extent that you increase the surplus in those funds, then the Government financing is just in that much better shape.

Mr. ZWICK. That is correct, and on the other side of the ledger we have this large stockpile of paper that we used to sell our participation certificates against. Those are liabilities that somebody else has to the Federal Government. There is over \$30 billion worth of those. We will be getting receipts in the future from that paper, which will show up as receipts, and therefore, you know, you have got to talk about both our contingent liabilities and the contingent liabilities and direct liabilities of other people to the Federal Government, if you want to play this game out through the years.

So I think the way you stated it is correct. We look at total flow of dollars into the trust funds and general revenues, and then we look at the total cash needs of the Federal Government, and the difference between these two is what we have to go to the private financial markets for to raise the money we need.

Senator WILLIAMS. I was associated with my brothers for 25 years in business before I came to Washington, and we thought we were making a little money, but you know, we were not operating our business the way I guess it should have been. We did not quite understand some of these new accounting procedures the Government is using today.

Now, to get back, here is this company that sets up a pension fund. It is true it must report it to its stockholders. It must take into consideration the cost of these pension funds out of its earnings. But, here is this pension fund, and we will say it is accumulating a surplus each year, as are our trust funds. The pension can be set up this way where its sole investment is in the security of the company which is controlling the pension fund—

Mr. ZWICK. That is correct.

Senator WILLIAMS. Investing in the bonds of this corporation in its entirety. Suppose the corporation for 30 out of the past 36 years has been operating in the red. It is operating in the red to an even greater extent today than ever before in this history of the corporation. Now, it is financing itself by borrowing the money from its pension fund, and it does not have to go to the banks. Would this make the corporation solvent and the pension fund solvent? I don't understand it.

Mr. ZWICK. Sir—

Senator WILLIAMS. Is it not true that these pensioners are dependent upon the security of this corporation and its ability to meet its payments on its bonds? The pensioners are dependent entirely upon the solvency of that corporation, and in the Government's case the pen-

sioners are the social security people dependent entirely upon the solvency of the United States of America? The United States of America is not solvent as long as it thinks it can drain these pension funds without—

The CHAIRMAN. May I comment on the analogy. That corporation the Senator is talking about does not assume the liability to pay anything beyond what is in that fund, so when the fund is gone that is it. The corporation has no obligation to pay anything more, but in the Government's case where we have a social security fund and a big contingent liability, if that fund is exhausted the Government has the liability to pay those benefits anyway.

Mr. ZWICK. Yes, sir, but the difference between the private corporation and the Federal bookkeeping is that if you were looking as to whether or not you wanted to invest in that private corporation, you would look at the total assets of that corporation and not—

Senator WILLIAMS. And as a stockholder you would look at the total assets.

Mr. ZWICK. We do not have a budget for the United States that tries to get at the total assets of the U.S. Government. In other words, we do not try to capitalize the total value of all the resources the U.S. Government has. So the analogy breaks down. You want to look at the solvency of an individual company. You look at its total assets and total liabilities and also its current income statement. You do not have an equivalent situation in the Federal Government, and I think that is where your analogy is breaking down, Senator.

Senator WILLIAMS. Except this. You do not have registration of stock in the Federal Government, but you have got 200 million stockholders. The American taxpayers are the stockholders of America, and you do have this situation that domestically and internationally there is a lack of confidence in the stability of the U.S. Government; that is what is causing this run on our gold. The fact is that internationally many people feel that the Congress and the Executive have not faced up to the problem of balancing our budget.

This may be confusing, and I will be honest with you, I am one of those that do not understand a billion dollars, very few people do understand it. I think you will agree with me on that.

Mr. ZWICK. Yes, sir.

Senator WILLIAMS. You are one of the few that can do it, but a person can take the Federal budget and all of the expenditures and debt, put a piece of paper on the last six or seven zeroes, and have a family budget or a small business. The principle follows right through just the same. I just do not follow this logic that we can report a balanced budget to the American taxpayers and consistently spend over it.

Now, it is true the Federal Government will always make good on these obligations to the trust funds. I do not question that. It is just as easy to print a \$1,000 bill, perhaps cheaper, as it is a \$1,000 bond, but it is the value of that bill when you start printing it. That is what we are concerned about. It is the value of the dollar which is paid to the beneficiaries of these trust funds. That is what is affecting us, and that is where the cost comes. It is not that they will not be paid; they will be paid. I do not question a moment but the social security trust fund pensioners will always be paid their dollar receipts; but what is that dollar going to be worth? That is the question confronting us, and that

is the reason I am concerned that we have some fiscal restraints, which we do not have at the present time.

Mr. ZWICK. Yes, sir, I agree completely with your statement as you have now stated it. If you are interested in that question, I would commend the budget concept report which said do not look at the \$8 billion deficit for that number, nor look at your \$15.4 billion deficit, but look at the deficit in the expenditure account which gives you the best single indicator of the impact of the Federal budget on the economy and, therefore, the soundness of the of the dollar, and that deficit is \$4.7 billion, not \$8 billion or \$15.4 billion. So again, I come back to the issue—these are very complicated matters. If we are interested in the soundness of the dollar, we are interested in the impact of the Federal budget on the economy, inflation, employment, the balance of payments.

The Budget Concept Commission recommended, and I support it, that the most interesting indicator of that impact is the deficit on expenditure account which is \$4.7 billion, not \$15.4 billion.

Senator WILLIAMS. Well, figures do not lie, but politicians, you and I, we can manipulate those to prove pretty well any point; and if we both continue we will have a balanced budget here and perhaps a surplus; maybe you will be advocating a tax reduction.

I do not wish to delay this discussion. I do have some questions I want to direct specifically to the Secretary because I understand that he is the one that will have to make the decision as to what extent they will or will not support the amendment which I am proposing to introduce on this particular bill, a package which I—

Mr. ZWICK. It seems to me the President is going to have to make that decision.

Senator WILLIAMS. The President will make the decision, but the Secretary of the Treasury is the spokesman.

Mr. ZWICK. He is the senior fiscal representative of the Government.

Senator WILLIAMS. I do not think it would be fair to present the questions to you, recognizing your position. I want to emphasize here what has been said by others. My questions, even though they may be pointed at time, are in no way intended as a reflection on you personally. In the first place, you are new and you are not responsible for what has been done, and in the second place, I have great respect for you, and when I say that I mean it.

Mr. ZWICK. I appreciate those comments. I also want to be responsible for past decisions of this administration.

Senator WILLIAMS. I appreciate that. I fully recognize we do have this responsibility in Congress. I feel strongly that removal of this gold cover is only buying a little more time and that unless we attack the basic cause of the lack of confidence in the American dollar we will accomplish nothing. I think both you and I can agree that the cause of our present difficulties and the lack of confidence internationally in the American dollar is primarily the doubt that you and I as representatives of the Executive and Congress will be able to bring expenditures under control or that we will face up to it and raise taxes. Do you not agree with that?

Mr. ZWICK. Yes, sir; I agree completely with that.

Senator WILLIAMS. Do you not also agree that merely to remove the gold cover and take no further action in the direction of either of these—

Mr. ZWICK. That is not going to solve anything.

Senator WILLIAMS (continuing). Would be only borrowing time and postponing the crisis, which we must face sooner or later?

Mr. ZWICK. Yes, sir. The President has been asking since last August 3 that we take these additional steps.

Senator WILLIAMS. Yes. The President unfortunately has been placing more emphasis on the tax than on the reductions. What is past we cannot change. We are confronted here today, though, with a bill which the Secretary will report on tomorrow. I am hoping we can complete the hearing in time to go into executive session tomorrow and take final action. It will not take long.

I recognize that the bill must be acted on by April 1, and there is no need of waiting until the last minute. That is the reason I advanced my expenditure reduction and tax plan on January 31. I would like to leave this thought with you as we close. I know that you will be consulting with the Secretary, that if for any reason the Department decides that it cannot support the particular formula which I advanced for an \$8 billion reduction, if you have some other plan, suggest it. I am not wedded to the formula that I have advanced. As I made plain many times, I am not wedded to the figures. I think it is a reasonable package.

I am not fixed in a position on any one of these items, but I am firmly fixed in the position that there must be some language written into the same bill which will make mandatory a reduction in expenditures, a mandatory reduction which neither you in the Executive nor we in Congress, can violate.

Now, I realize Congress can always come back and repeal it. I am trying to establish priorities. I think Congress and the Executive together have a responsibility to establish these priorities, and in establishing them we are both going to have to face some unpleasant decisions. I personally feel that they have got to be faced, and I am willing to face them; but as I said before, just to pass a tax program that will pour more money into the spending stream without having placed any control over expenditures would in my own opinion only further fan the fires of inflation and create greater doubt both domestically and internationally on the question of whether or not we are going to meet this problem. As I see it we have no choice. The hour is very late, and I think you would agree with me that we do not have the time. I will leave just one further thought, and I apologize for the time.

I think that if the administration wants action in this connection it had better face up to this question and reach a solution now, because this bill will go through the Congress, no question about that, and be on the President's desk by April 1. If some solution is not worked out as a part of this bill, you are not apt to get action before June or July, and then I do not think this Congress will face up to a tax increase 3 months before the election. I think this is it.

I think that whether the proposal that I make or one similar is adopted, what you get from this Congress you are going to get in the

month of March. I cannot overemphasize the importance of working out a solution now, and to be frank with you, the hope that we can work out the solution is the reason that I did not press the Secretary yesterday or this morning for the final answer. I think that working together we can come up with a solution; I do not think we have any choice. We must come up with a solution we can agree on; I do not mean just you and I, but the majority of the Congress.

Mr. ZWICK. Thank you, Senator Williams. The only difference I think we have is that we did feel we had responded to congressional requests in the 1969 budget. I gather you feel we did not go quite far enough.

Senator WILLIAMS. I do not think it goes far enough and——

Mr. ZWICK. I understand.

Senator WILLIAMS. I am not trying to pick certain programs. I am not trying to make a political issue out of this. I think my record of endorsing the tax increase, which our mail is running 90 percent against, indicates my sincerity in this connection. It so happens that up to the present time, to the best of my knowledge, the bill which I introduced, which does propose to raise taxes 8 percent on corporations and six on individuals, is the only bill that has been introduced in either the House or Senate which proposes to face up to this question of raising taxes, and so I do not think that I have to apologize for my sincerity in this connection.

I am willing to stand up and face it. I do not think it is a question that we can sit back and see what is politically expedient. I do not think the administration can. I think this problem is not going away. I think it has got to be answered quickly. The answer we give to it I think in the next couple of weeks will determine to a large extent whether or not we survive this crisis of the American dollar.

Mr. ZWICK. As Secretary Fowler said both in his letter to you and yesterday, we deeply appreciate your support of our basic tax and the balance-of-payments objectives.

Senator WILLIAMS. But I want it understood that my support of the basic tax does not go alone. It is also contingent upon your support either for my plan of reductions or some plan of your own. Write your own plan. I am available all day and all night to try to work this out, but I want to make it clear that I will even vote against my own tax bill which I have introduced unless it has accompanying it the written-in expenditure reductions, and the tax liability is not taken alone.

The CHAIRMAN. I think that is amply clear now.

We have one additional witness and for Senator Hartke who has come in while we were interrogating the Director of the Budget, I would like to point out that the Secretary had to leave at 10 o'clock to attend a Ways and Means Committee meeting where he had been scheduled for some time. He will be back at 9 o'clock tomorrow. If you want to ask the Director of the Bureau of the Budget——

Senator HARTKE. I am the low man on the totem pole. I am always last, but I do not mind.

Senator WILLIAMS. I am going to leave. I do not want to be disrespectful. We are having hearings in the Foreign Relations Committee on foreign aid where they are asking for an extra \$900 million and I think it is equally important that I be over there and express an opinion on that.

Mr. Zwick. Thank you, Senator.

Senator HARRKE. Good morning.

Mr. Zwick. Good morning.

Senator HARRKE. Yesterday, I think we established pretty definitely that you said we would hit the ceiling on guns and butter.

Mr. Zwick. No, sir; I did not say that. I think you ended up the dialog with a statement that we could not afford both. I was sort of struck by that.

Senator HARRKE. You tell me where we can afford more.

Mr. Zwick. First, I am not quite sure, I listened to the analogy about the car going down the hill yesterday—

Senator HARRKE. I do not want to go into any analogies.

Mr. Zwick. Guns and butter—

Senator HARRKE. I am talking about domestic programs and international programs. If you do not like guns and butter, it is the same phrase.

Now, what I am asking you quite honestly and sincerely is this: Is it possible to substantially escalate the war without providing for additional tax requests other than those which are presently made by the administration?

Mr. Zwick. No, sir. As I stated—

Senator HARRKE. All right. In other words, what we have established is that we have a ceiling without additional revenue. In other others, without additional taxes, you have hit a ceiling of guns and butter under the present setup under—

Mr. Zwick. Or guns and butter; the only point I am trying to make is a fairly simple one. We were orbiting around a \$4 billion number yesterday. That happens to be one-half of 1 percent of the gross national product of this country.

Now, to say in some technical sense we cannot afford that is clearly wrong. If that is what we meant by guns and butter, I certainly object.

Senator HARRKE. You think we can afford to do a lot more than we are doing?

Mr. Zwick. That was the—

Senator HARRKE. I am trying to establish what is going to happen on your side because you are the people who made the request.

Mr. Zwick. That is correct.

Senator HARRKE. What I am trying to do is find out where our priorities are. Since no one will tell us, I am trying to get into the subject. What I am saying is that if there is an escalation of the war, under the present scheme of things, it would be the probable result that the administration will ask for an additional tax increase over and above that which they have already requested.

Mr. Zwick. I just cannot answer that question.

Senator HARRKE. Well, how do you plan—

Mr. Zwick. Let me make two comments. First, I think the President in both his state of the Union message and budget message as of a little over a month ago, did state priorities and did state his preferences, did say, of course, what he thinks we can do. It is a question of whether we want to do both. So, we have that to begin with. We now have pending before us a major review of the war and where it is going to lead. Until we have completed that review, and

that decision is reached, I certainly cannot sit here and tell you that if the President decided A, he would, therefore, do the following re taxes and expenditures, or if he decided B, the following would automatically result in terms of expenditures and tax policy. I just cannot answer that.

Senator HARTKE. I thought we settled that yesterday. Evidently we did not. My understanding is that Secretary Fowler said there would have to be compensatory action——

Mr. ZWICK. That is right.

Senator HARTKE. Is that a fair statement?

Mr. ZWICK. He said, overall, if you add to the budget and we assume the same forecast, some action would be needed.

Senator HARTKE. If we add to the budget by an escalation of war, that is what——

Mr. ZWICK. If we add to the budget by escalating the war, and our forecasts for the private sector remain the same, it is quite clear and quite correct—and that is what Secretary Fowler said yesterday—we would have to take compensatory fiscal action.

Senator HARTKE. Now, as Budget Director, are you constantly evaluating the position of the administration with regard not alone to the necessity for foreign expenditures but for domestic programs as well?

Mr. ZWICK. Yes, sir.

Senator HARTKE. Then, let me ask you pointblank, what is the present status in the administration concerning the report on the President's Commission on Civil Disorders?

Mr. ZWICK. It is being reviewed by all the relevant agencies for three points, as the President said in the press conference the other day—and I know this because he directed me to do it and I sent his instructions to the agency heads—(A) look at the report and see where it is consistent with both your authority and funding level and what you are doing about it, (B) note where you think it will be desirable but you neither have the authority or funding levels, and (C) note where you think it is not desirable. When you do not think it is desirable, document why you do not think so. Where you think it is desirable, but you cannot carry out, because you neither have the funds or authority, tell us what you would need to carry it out. So that is clearly underway within the administration now.

Senator HARTKE. So in this thing you had to make a determination as to whether or not you had enough money or are going to have enough money to carry out this program, is that right?

Mr. ZWICK. No; we want to make a determination first as to whether we think it is a good program.

Senator HARTKE. When you talk about funding what you are simply saying is how much money do you have?

Mr. ZWICK. No; I said the first determination we want to make is what part of the report we agree with and what part we disagree with, and then for those parts we agree with, what is the problem? Is it funding or authority?

Senator HARTKE. Are you making a determination what part you are agreeing with or disagreeing with?

Mr. ZWICK. We are reviewing within the administration——

Senator HARTKE. I think the report is an excellent report. I think it is a fine one. I personally would hope that practically everything in

it would be implemented. Let us be clear about that. Now, are you making the determination as to the desirability of following the recommendations of the report or is that being made by other agencies?

Mr. ZWICK. Each agency that has part of it is involved. The Secretary of HUD is reviewing those parts of the report that are relevant to his programs. The Attorney General is reviewing those parts of the report that are relevant to his programs. The HEW Secretary is making a similar review and they are in the process of that right now.

Senator HARTKE. That is one factor. On the other side of that coin which comes mostly in your purview is, Where are you going to get the money for those programs which you decide must be implemented?

Mr. ZWICK. We will aggregate the individual agency comments; yes, sir.

Senator HARTKE. Now, do you have a price tag on the total report?

Mr. ZWICK. No, sir; we do not have at this time, for several reasons. One, we cannot do it until we get the agency evaluations of it, and secondly, there are just big parts of that report which are not clear, so you can get major differences in cost, depending on what assumptions you want to make. Welfare and education are the two big items. If you make one assumption about welfare, you can get a very low number. An equally plausible opinion on what the report is saying about welfare could add \$12 billion or more, so when people say they look at the report and it implies \$2 billion or some other figure, I do not know how they do that without making very specific assumptions about the welfare level and the education levels that are implicit in the report. The direction and goals are quite clear in the report, I think, but it did not have specific welfare levels laid out. In order to price it out you have to make those assumptions.

Senator HARTKE. All right. But it is a fair assumption that if you are going to make any major accomplishment in line with the general overall recommendations of this Commission, it is going to require a substantial amount of money, is that not true? Federal money.

Mr. ZWICK. Well, you have all sorts of problems here.

Senator HARTKE. I know you have all sorts of problems.

Mr. ZWICK. One question is the housing area, to give you one example. We have proposed a 10-year housing program. We think that we pushed that 10-year housing program as far as it is feasible to go to increase, by 300,000 starts, the subsidized low- and moderate-income housing programs for this fiscal year. The report says that should be double. We question the technical feasibility of that. It is not a dollar issue but a question of whether you can, in fact, provide the labor, entrepreneurial space, mortgage financing, relevant to that recommendation. So you have to talk about cases where we would have disagreement, not with the objective, because clearly it has the same objective as our program, but where it is a question of technical feasibility and how fast can you go. You just cannot equate that. The simple answer is that there is enough money to do it, but we disagree in this case with what is feasible in terms of level of activity.

Senator HARTKE. What about plans to improve schools for every disadvantaged child in the country. If you implement that, that will require more money.

Mr. ZWICK. Oh, yes; certainly and depending on how you interpret that, it costs a little more to a great deal more money.

Senator HARTKE. Efforts to dramatically improve schools serving disadvantaged children through substantial Federal funding of year-round quality compensatory education programs, improve teaching and expanded experimentation and research.

Mr. ZWICK. That would require—

Senator HARTKE. In other words, two words, dramatically and substantial Federal funding, would that not be also a severe increase in the amount of money to be required?

Mr. ZWICK. That, it seems to me, is a reasonable interpretation. Of course, the point that the President has made is that over his 4 years that he has indeed tripled the money going into education programs.

Senator HARTKE. Here is one in which I have a very special interest because I authored an adult education bill and it passed the Senate and I was very proud of it, for elimination of illiteracy. Unfortunately, we did not give it enough money. Greater Federal support for adult basic education; that would be an addition, if you are going to do that.

The CHAIRMAN. Let me ask if we cannot get an answer from the witness to this because it seems to me, one answer would solve this whole problem here. The Senator has some recommendations here he is asking you about. He wants to know if those recommendations are carried out would that not mean an additional increase in cost? It seems to me the answer is clearly "Yes," and it would mean quite a bit of additional cost, perhaps running into billions. How much you do not know.

Mr. ZWICK. I thought I said "Yes," and I was saying quite a bit more.

Senator HARTKE. That is all I am really trying to prove. We have already established that if you are going to have a substantial escalation of the war this means a big amount of money. If you have any implementation of a major nature whatsoever to implement the Commission on Civil Disorders' report, then this means an awful lot of money and in this case, too, this would mean you would have to come to us and ask for additional taxes beyond what has already been requested, is that not true?

Mr. ZWICK. That is true.

Senator HARTKE. All right. Now, if that is true in this economy at the present time, will you please tell me how the surtax is going to really provide more revenue? I mean, I want the theory. I have listened to a lot of people explain this to me and I have listened to the theory that it will cut back sharply on demands and will slow down the economy, is that right?

Mr. ZWICK. Cut back on demand is another way of saying slow down the economy.

Senator HARTKE. Now then, very simply, will you tell me how you are going to substantially increase revenue by cutting back on demand when you already have a sluggish demand in the marketplace, overcrowded showrooms?

Mr. ZWICK. Well, sir, you have got several issues here. First, let us say that one way to increase revenues is to have a dramatic inflation. That is a way of increasing revenues which we rejected as—

Senator HARTKE. No question about that.

Mr. ZWICK (continuing). As a reasonable and prudent Government policy. So if we set aside that as a way to increase revenues and just talk about the economic impact of this, then I think it is quite clear that if you hold our discussion in terms of constant prices and you are operating at full capacity in the economy, that you will indeed increase the revenues to the Federal Government—if you have constant prices and you put a surcharge on. That is what we are saying and I think that follows.

Senator HARTKE. Let us come right back to excise taxes. Let us come right back and put this where it belongs. Is it your intention that the excise tax extension should be imposed? That is Government policy, is it not?

Mr. ZWICK. That is correct.

Senator HARTKE. Is it also not Government policy that both of these will have a dampening effect upon the economy?

Mr. ZWICK. Correct.

Senator HARTKE. Is it not also true that if it is going to have a dampening effect, there will not be an acceleration in the marketplace of sales?

Mr. ZWICK. Basically, the argument is that most of the dampening effect will come out of the pricing. The difference between real growth in the economy with the tax increase and the real growth in the economy without the tax increase is very small.

Senator HARTKE. Now, I understand what you are saying but you will not answer the question.

Mr. ZWICK. Yes, sir. I will answer the question.

Senator HARTKE. No, you will not. I am going to ask you again. When you are cutting back on demands you are cutting back on sales?

Mr. ZWICK. First, you can cut back on excessive demands and not cut back at all on sales.

Senator HARTKE. You can call it excessive demands or call it not excessive.

Mr. ZWICK. But, we are clearly trying to restrain—

Senator HARTKE. Let me ask the question so that you do not try to give me an answer which I do not want. By putting on the excise taxes and the surtaxes the intention is to cut back on demands?

Mr. ZWICK. That is correct, but picking out personal—

Senator HARTKE. That is all I am asking you. If you cut back on demands, is it not true that you are cutting back on sales?

Mr. ZWICK. No. Not if you are operating at full capacity.

Senator HARTKE. Oh, yes; but we are not.

Mr. ZWICK. Well, now we come to the argument.

Senator HARTKE. That is right. And you will admit we are not, will you not?

Mr. ZWICK. We are saying—surely there may be some sectors of the economy that are not operating at capacity, but we are saying that as an aggregate we are at capacity.

Senator HARTKE. All right. I am just going to show how ridiculous this excise tax situation really is when you come down to the meat. What is the average wholesale price upon which the excise tax estimates is made in this recommendation at the present time?

Mr. ZWICK. I cannot right off the top of my head give you that.

Senator HARTKE. Surely—you have an estimate of \$1.5 billion. How did you arrive at that figure? You had to use something. What did you use?

Mr. ZWICK. You asked for the index and I do not know what the wholesale index was, but I do know—

Senator HARTKE. Wait a minute. You do not understand. What I am asking you—I will do it another way around. How did you arrive at \$1.5 billion estimated—you told us in the Treasury report that it is going to be \$1.5 billion. Tell me how you got it.

Mr. ZWICK. We took estimates of sales at a particular price and multiplied it—

Senator HARTKE. And this is on wholesale price?

Mr. ZWICK. Right.

Senator HARTKE. An excise tax on wholesale. I am really surprised I have to go through all of this. I thought part of it could be omitted.

Mr. ZWICK. I am not sure—

Senator HARTKE. What price average do you use? You come up with \$1.5 billion, right?

Mr. ZWICK. That is right.

Senator HARTKE. For the whole calendar year, next—

Mr. ZWICK. Fiscal year.

Senator HARTKE. Next fiscal year, 1969, is that not right?

Mr. ZWICK. That is correct.

Senator HARTKE. How did you arrive at \$1.5 billion?

Mr. ZWICK. We took, as I say, the total sales—

Senator HARTKE. What is the total sales?

Mr. ZWICK (continuing). Of automobiles.

Senator HARTKE. I understand—what did you take, what total sales?

Mr. ZWICK. I do not have that number with me.

Senator HARTKE. Oh, my, you come here on excise taxes and tell us—

Mr. ZWICK. Senator Hartke, I normally expect the Secretary of the Treasury—

Senator HARTKE. You used 10 million automobiles at an average sale price of \$1,500. I will tell you what you used. I do not understand why you come here completely unprepared on a basic item like that.

Now, how many automobiles were sold last year?

Mr. ZWICK. Are you talking about the sales in February?

Senator HARTKE. I am talking about how many automobiles were sold last year.

Mr. ZWICK. I do not have that statistic.

Senator HARTKE. The staff member here says that domestic sales last year were 7,070,000. Now, this means that on 7,070,000 this last year, that you are proposing here that we are going to have an increase in sales this year of 3 million automobiles.

Mr. ZWICK. Would you make the same forecast based on the January and February automobiles sales?

Senator HARTKE. Yes. I have all of these. You will be lucky to get 8 million even with the sales coming along as they are now. What I

am saying to you is that you are going to cut back on demand and, therefore, on sales, and yet you are going to tell me you are going to sell 3 million more automobiles which would be the most banner year this country ever had in automobiles, and the fact is in 1967 you sold almost a million less automobiles than you did in 1966 and 2 million less than you did in 1965.

Mr. ZWICK. Sir, we are predicting a good year in 1968 after the tax increase and that is what we are disagreeing on, I gather.

Senator HARTKE. I am saying to you, it does not make good common-sense to say you are going to cut back on demand with the surtax and an excise tax and still increase sales by 3 million automobiles more—that would require an increase, not a cutback in demand. This is the tremendous—

Mr. ZWICK. It is cut back from what it otherwise would have been, sir. That is the argument.

Senator HARTKE. There is not anybody in the automobile business that has estimated you are going to have 10 million automobile sales.

Mr. ZWICK. I am not prepared to discuss the automobile sales situation this morning. I did not think I should be prepared for that.

Senator HARTKE. This is on excise taxes on automobiles. I mean, after all, most of these other people are asking questions on everything else under the sun. I am asking on the very thing you came here to testify on.

Mr. ZWICK. No, sir.

Senator HARTKE. You came here and asked us to give you an extension of this which would raise \$1.5 billion and I am saying to you that there is no way under the sun that that figure can be anything except an exaggeration of estimated income.

Mr. ZWICK. Senator Hartke, Secretary Fowler and I were invited here to talk on the bill. We normally divide up the workload. Secretary Fowler would normally be the person who would handle the revenue estimates. Chairman Long said he would be back at 9 o'clock tomorrow morning.

Senator HARTKE. You mean he did not tell you?

Mr. ZWICK. He can give you the answers to these questions. There is a normal distribution of work between the Secretary of the Treasury and the Director of the Bureau of the Budget. I do not think it is reasonable to assume that he is prepared on all the details on expenditures or that I would be prepared on all the details of the revenue estimates. So, I do object to the implication that we came unprepared for this meeting.

Senator HARTKE. You object to it but the fact is that I do not know—what does a budget director do other than that? You are telling us we are going to raise a billion and a half dollars with this excise tax if we extend it.

Mr. ZWICK. And Secretary Fowler will be happy, I am sure, to develop that for you tomorrow morning.

Senator HARTKE. You just prepare figures and submit them?

Mr. ZWICK. No; our staffs work together but I prepare for one of these hearings on those items I expect to be questioned on.

Senator HARTKE. What items did you expect to be questioned on, quotas and surtax?

Mr. ZWICK. Yes. Senator Long—

Senator HARTKE. I am not complaining about what the rest of them asked, but my understanding was those questions were to be omitted.

Mr. VAIL. Senator Hartke, we invited the Secretary, and the Secretary asked if he could be accompanied by the Director of the Bureau of the Budget to help him answer questions with respect to the budget. So, we did invite Mr. Zwick up here to answer questions with respect to the budget.

Mr. ZWICK. We were told that Senator Williams would question us on his bill in addition to the excise tax.

Senator HARTKE. Well, I had better wait until tomorrow.

Are you familiar with questions on the social security? Let me just take that. Are you familiar with the fact that there are going to be about \$2½ billion more taken out of the economy than is being put back into our social security fund?

Mr. ZWICK. Yes, sir.

Senator HARTKE. That has already somewhat dampened the economy, right?

Mr. ZWICK. Yes, sir.

Senator HARTKE. Who bears the biggest burden of that? What income group?

Mr. ZWICK. I have not studied it in great detail, but clearly it is in the lower income levels.

Senator HARTKE. That is right. Now, you are an economist, are you not?

Mr. ZWICK. Yes, sir.

Senator HARTKE. Now, is it not generally accepted economic theory that excise taxes are regressive?

Mr. ZWICK. Yes, sir.

Senator HARTKE. And, who bears the greatest burden of that?

Mr. ZWICK. By definition, people of lower income.

Senator HARTKE. In other words, we are making the lower income group pay for this war.

Mr. ZWICK. No, sir. That is why we want a surcharge. We have had a policy of removing excise taxes. It has been administration policy. At this time we are talking about a temporary emergency problem of getting additional revenues. I think our surcharge proposal is one which makes the overall tax package obviously progressive, not regressive. I doubt that anybody would disagree with any calculation of the total administration tax package which would show it was a progressive tax package, not a regressive one.

Senator HARTKE. I think I will wait until tomorrow, then, Mr. Chairman.

The CHAIRMAN. That then, concludes the examination of the Director of the Budget. We have other witnesses here who have been waiting, I regret to say, since yesterday to testify. We have two additional witnesses.

Thank you Mr. Zwick.

We have the Honorable Richard C. White from the 16th Congressional District of Texas, El Paso. We are pleased to have you with us, Mr. White. I understand you have a statement on the tourist exemption feature in Senator Williams' bill. We are pleased to hear you.

**STATEMENT OF HON. RICHARD C. WHITE, U.S. REPRESENTATIVE
FROM THE 16TH DISTRICT OF THE STATE OF TEXAS**

Mr. WHITE. Mr. Chairman, members of the committee, it is my understanding that your committee will consider, along with H.R. 15414, S. 2902. I should like to address myself to section 8 of S. 2902. This section would reduce the exemption on tourist goods entering this country from the present \$100, retail value, to \$25, retail value in the country of acquisition.

The administration recommendation on reducing tourist exemptions, to help the balance-of-payments problem, included a recommendation that contiguous countries to the United States, and Caribbean countries be exempted from the proposed change. No such exemption for Western Hemisphere nations is contained in S. 2902.

As a Congressman representing the largest city on the Mexican border, which adjoins the largest Mexican city on the border, I respectfully point out to the committee that the prosperity of all of our border cities along the Mexican and Canadian borders depends to a great extent upon the prosperity of our neighbors just across the border. In the case of my district, it is estimated that 70 percent of tourist expenditures in Mexico are returned to this country in the form of purchases in the United States.

Because this is the case all along both borders, I have introduced a bill, H.R. 2025, which would restore the previous limitations of \$200 retail value in an area within 5 miles of the U.S. borders with Canada and Mexico, and restore the previous limitation of 1 wine-gallon of alcoholic beverages. This would apply only in the 5-mile area, the area where the prosperity of our own border communities is so vitally dependent upon the prosperity of our neighbors.

I respectfully request that this matter of mutual prosperity be taken into consideration by the committee in its deliberations, and particularly that the committee refrain from striking a severe economic blow at our border communities by the restrictions proposed in S. 2902. If the provisions of section 8, S. 2902, are passed, I would ask that the committee consider an amendment similar to my bill, H.R. 2025.

Mr. Chairman, I am grateful for the opportunity to call this matter, which affects my district so greatly, to the attention of your committee.

The CHAIRMAN. Thank you very much, Mr. White, for your statement here.

The remaining witness is Mr. J. W. Kendrick of the National Small Business Association.

**STATEMENT OF J. W. KENDRICK, NATIONAL SMALL BUSINESS ASSO-
CIATION; ACCOMPANIED BY JOHN A. GOSNELL, SECRETARY AND
GENERAL COUNSEL**

Mr. GOSNELL. Thank you, Mr. Chairman. We will try to make this very brief, Mr. Chairman.

My name is John A. Gosnell and I am here for the purpose of introducing Mr. Kendrick. I am the secretary and general counsel of the National Small Business Association.

Our witness today, Mr. Kendrick, is from Chicago. He is president of the Met-L-Wood Corp. He is also a member of the association's tax

and fiscal policy committee. His remarks, therefore, represent the official position of the association on the proposed acceleration of corporate tax payments.

Before I introduce Mr. Kendrick, I thought the committee might like to have a brief summary of some of the current comments recently received from members of the association, since they have a bearing on the health of the small business segment of the economy.

The impression has been left with the finance committee that the economy generally is a boom economy, the implication being that it is both sound and deep and stable. To the contrary, we hear, and this is common knowledge, that the agricultural segment of our economy is in distress. This deeply concerns us because thousands of small business operations are dependent upon prosperous agricultural development of the economy.

The reasons assigned are inadequate prices for farm products, high cost of labor, and high cost of machinery and supplies.

Now, with respect to high cost of machinery and supplies, it is perfectly clear that this is a cost push situation and not a demand pull situation. With respect to manufacturing, we are advised that there is apparently no end to the demand for higher and higher wages and this demand is in no way related to increased efficiency or increased production. The squeeze on profits is further intensified by increasing costs of raw materials and components and the general problem is further aggravated by high interest rates.

The same comments generally apply to distribution where these factors have drastically reduced profits even in high volume operations. There is also widespread and profound concern over the pace of Government spending and it is felt that uncontrolled spending rather than the cost of the conflict in Vietnam is a primary cause of our deficit problem. Under these circumstances, it is easy to see why impact of acceleration of tax payments causes considerable concern.

Add to this the discriminatory burden placed on small business by such regulatory laws as the recent packaging law which may not greatly concern big business but which can have catastrophic effects on small business.

Also we are frequently asked why with such a vital need for increased revenue there has been no mention of closing the tax loopholes which have been mentioned so frequently in the past. For instance, what possible justification can there be to grant tax concessions to a profit-making enterprise owned by cooperatives and by religious and charitable organizations?

This about sums up the membership comments which we have received during the past 2 months. I am now pleased to introduce Mr. John W. Kendrick.

Mr. KENDRICK. Mr. Chairman, and members of the committee, my name is John W. Kendrick. I am president of the Met-L-Wood Corp., a small business located at 6755 West 65th Street, Chicago, Ill. I appear here both individually and as a representative of the National Small Business Association of Washington, D.C.

I appreciate the opportunity to appear before your committee. I want to discuss particularly my opposition to section 3 of H.R. 15414, which proposes the elimination of the \$100,000 exemption for pay-as-you-go payments on corporation profits taxes.

The Government defines a small business in manufacturing, with some exceptions, as any firm employing less than 500 people. My business is considerably smaller than that. We have just over 100 employees, and, what is more important in your consideration of section 3, we pay almost exactly \$100,000 each year in profits tax. Thus, 100 percent of our tax liability will be subject to double taxation if section 3 is enacted. We would pay a 20-percent surtax for each of 5 years. As a practical matter, every corporation with earnings less than ours will suffer at the same 20-percent rate.

As to the impact of the proposed elimination on small business, my company, for example, would have an average tax rate on profits of 54 percent—up from 45 percent. Big business during the same period will have a 48-percent average rate. A 54-percent tax rate is intolerably high for small business. Aside from the importance of the plow-back of profits for business, health, and growth, the small businessman is very restricted in his sources for funds, and the alternates from which he must choose are very limited when he is strapped financially.

A study of cash flows to the Government and away from small business for the proposed 5-year period is most important in any objective examination of section 3. The Government estimates the added revenue from this proposal will amount to \$2 billion over the 5-year period, which is \$400 million per year. Thus, enactment of section 3 would mean an increase of the cash flow to the Government for fiscal 1968 of less than 0.3 percent. The small business cash flow—from the private sector to the public sector—is contrastingly increased 20 percent. It would be very difficult indeed to find a more inequitable tax measure than this provision which forces a 20-percent cash flow impact on small business to yield a 0.3-percent cash flow to the Government.

But the Treasury Department points out that small business is the beneficiary of discriminatory legislation in the past and this measure simply brings corporations back into alinement with all other kinds of taxpayers; namely, individuals, proprietorships, and partnerships, all of which are on a pay-as-you-go basis and have been for many years. However, when individuals, proprietorships, and partnerships were placed on a pay-as-you-go basis, Congress forgave taxes in order that collections could become current. This is the big difference. It is not the pay-as-you-go part that is discriminatory. It is how you get there.

If the Treasury has increased cash flow as its motive, then section 3 is all wrong. All taxpayers should share equally in increased spending by Government. If, however, the Treasury has pay-as-you-go as its motive, then there is no problem at all. The doubleup portion of the tax should be forgiven, and the mechanics to effectuate such a change would be simple.

Congress has created bits of legislation with small business as one of the beneficiaries.

There was the creation of this particular exemption that is the subject of my testimony. There was sound reason for its enactment and certainly that reason is as valid today.

There is the Small Business Administration designed to help small business in many ways: financial support through loans, business management advice; technical assistance through research and publications, assistance in finding and obtaining Government contracts.

There are the Sherman, the Clayton, the Robinson-Patman Acts and the Federal Trade Commission Act, all similarly designed to see that smaller business has a chance to compete fairly. Their existence proves legislative concern for small business.

All of this legislation has been good for the people of the United States. The public interest has been served by a vital, alert, healthy small business sector of the economy. Is small business now to be singled out to pay a 20-percent surtax, an action tantamount to a reversal of long-established Government policy to create a favorable economic climate wherein small business can succeed or fail based on its own ability?

There is a tendency to think of profit as something a corporation earns and once earned is available for disbursement immediately. This is not true for the corporation any more than it is for the individual. This individual has income and it is subject to tax. He watches—along with the Government—his cash flow so that at tax time he will have the funds available. It is well known to Congress that few individual taxpayers can withstand the burden of a drastic increase in the tax rate or an accelerated rate of payment. (I cannot imagine myself handling a 20-percent individual tax increase.)

Yet, 2 weeks ago, last, the House of Representatives, with a few exceptions, appeared unconcerned about the drastic tax rate increase and the accelerated rate of payment to be imposed on the smaller corporation by the enactment of section 3.

Small corporations will find enactment of section 3 a tremendous burden. Cash flow is so important to the small corporation. Activity of a business generates cash at a restricted rate. Any small businesses find it difficult to meet a payroll or a withholding payment to the Federal Reserve. The profit is not there at the moment earned for the Government's asking. And the most devastating aspect of the proposal for a double tax on small business is its impact on the most rapidly growing and successful concerns, the ones that are the most valuable to our country. They are always short of capital even without Uncle Sam slipping an even larger hand into the cash drawer.

A constant chant of justification for enactment of section 3 has been that the corporation should be placed on the same footing with the individuals, proprietorships, and partnerships. Peas and watermelons are not the same; neither are the capital requirements for corporations compared with most individuals, proprietorships, and partnerships.

By way of example, let us examine the Fair Packaging and Labeling Act enacted by Congress in 1966. Implementation of its provisions will have little, if any, effect upon the individual, partnership, or proprietorship, insofar as need of capital is concerned. However, it will have a direct impact on the smaller manufacturing corporation in the grocery field. The Bureau of Standards, in attempting to establish voluntary standards, is thinking of utilizing a seal that would designate that the product and package has been approved by the Federal Government. Major manufacturers with large advertising budgets will undoubtedly utilize the seal to promote their products. The small manufacturer, who is unable to convert his manufacturing facilities rapidly, would have his markets taken away because of his inability to convert immediately. The chairman of the National Small Business Association's Board of Trustees, Mr. Lloyd E. Skinner, testified before Con-

gress that it would cost his company about \$186,000 to change the weights in his packages. Most machine tools in the small plant are single-purpose machines. Small business, as everyone recognizes, has a problem of capital. They cannot buy half of a new machine; therefore, it is essential that if the smaller companies are to survive, they must have a means of building a reserve. Section 3 of this bill would take that reserve away.

Enactment of most Federal programs imposes a proportionately greater burden on small business. In the aggregate these programs can mean the difference between profit and loss, between a going concern or a failing business. Just this year the cost of doing business has been heavily increased by: Social security increases, postal rate increases, minimum wage increases, and accelerated statutory benefits payments.

Each weakens the cash position of the smaller corporation. Enactment of section 3 would compound the problems of the smaller corporation.

As the Federal Government enlarges its share of the financial resources of the total economy, it weakens the private sector by reducing its reserve for expansion and by retarding job creation. Over the long haul such action by Government (as typified by sec. 3 of H.R. 15414) will greatly reduce cash flow to the Government.

For these reasons, Mr. Chairman, I oppose enactment of section 3 of H.R. 15414. It is unfair that there be imposed on the small corporation a 20-percent surtax.

Since the preparation of my formal statement, I have been privileged on both yesterday and today to hear the testimony of Secretary of the Treasury Fowler and your interrogation of him. Every responsible American is concerned about our country's fiscal condition and its fiscal policy. However, it is my opinion that Secretary Fowler has failed to understand the unique impact upon small business in the event section 3 of H.R. 15414 is enacted. Secretary Fowler has said on page 20 of his testimony that, and I quote:

Failure to take adequate fiscal action and thereby leaving the burden of fighting inflation to monetary policy would be like enacting a special tax that would fall on home buyers, home builders and suppliers, the savings institutions, State and local governments, and small business.

He, of course, is referring to the high cost of money and yet section 3 throws small business in to this money market. Small business would have to compete with the U.S. Treasury, big business, home buyers, home builders, and suppliers, the savings institutions and State and local governments in borrowing to finance their capital means.

Perhaps the greatest service I can render in my testimony is to establish some comparisons or frames of reference from which you can evaluate the comments I have made. The catchup surtax in total as proposed in section 3, H.R. 15414, exceeds 10 percent of the net worth of my company. The \$100 million of added revenue for the Treasury as a result of enactment of section 3 would be 2 percent of the presently projected \$20 billion annual fiscal deficit. This revenue must be regarded as infinitesimally small in respect to the total annual deficit and, therefore, every attention should be directed to the impact of the proposed 20-percent surtax on small business. Requirements for enactment of section 3 far ignore the impact of the administration's em-

phasis on the importance of the 10-percent surtax on business and individuals. This 10 percent surtax plus the 20 percent catchup surtax amounts to 30 percent for small business. This would result in an effective tax rate on small corporations of 59 percent.

Thank you, Mr. Chairman and members of the committee.

The CHAIRMAN. Thank you very much, sir. That concludes this morning's session and we will meet again tomorrow at 9 o'clock to hear the Secretary of the Treasury.

(Whereupon, at 11:40 a.m., the hearing was recessed, to reconvene at 9 a.m., Thursday, March 14, 1968.)

TAX ADJUSTMENT ACT OF 1968

THURSDAY, MARCH 14, 1968

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 9:05 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Smathers, Anderson, Hartke, Harris, Metcalf, Williams, Bennett, and Curtis.

Also present: Thomas Vail, chief counsel.

The CHAIRMAN. The hearing will come to order.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY HON. CHARLES J. ZWICK, DI- RECTOR, BUREAU OF THE BUDGET; AND STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY (Resumed)

The CHAIRMAN. Mr. Secretary, if you want this bill reported, and this is your third day on this thing, I would urge you try to abbreviate your answers to the questions. I would urge Senators to try to abbreviate their questions and statements that precede the questions.

It seems to me the record amply reflects the views of the Senators and anybody whose views are not reflected can always indicate that by his vote. The record pretty well demonstrates what everybody thinks about this matter even though we may not agree on all of it. That being the case, perhaps we can get down to voting on the bill.

Senator Williams?

Senator WILLIAMS. Mr. Chairman, I agree completely with that, and I will make my questions very brief. I just want to establish the record.

Mr. Secretary, you are familiar with the two bills which I introduced, S. 2902 and S. 2903. I refer first to the so-called package bill which embraced mandatory reductions of \$8 billion and provided for increase in income taxes of 8 percent on corporations and 6 percent on individuals, with the corporate rate effective January 1, the individual effective April 1.

Now, with the extension of the excise taxes, the package together will provide about \$9.2 billion additional revenue and an \$8 billion reduction, which would reduce your deficit next year by \$17.2 billion.

If you eliminate the trust funds it would reduce the deficit to about \$11 billion, and if you use the method of reporting the Treasury is using now it would reduce next year's deficit prospective to around \$4 billion.

My question is, will the Treasury Department endorse that bill? That package as an amendment to this bill?

Secretary FOWLER. Senator Williams, I will answer that question in two parts. Number 1, with reference to section 6 of your bill where you recommend a temporary 8-percent surcharge on corporations and 6-percent surcharge on individuals, I would feel that the situation we face today in our overall financial problem calls for a minimum of a 10-percent surcharge which is the level recommended in the budget. Since a surcharge at that level would add over a half billion dollars in revenue in 1968 and over \$3 billion in fiscal 1969 to the revenues that would be obtained under the rates suggested in your section 6, I feel that this additional revenue at a minimum is needed to achieve the reduction in the budget deficits that are desired and to provide the margin of additional safety that we need in the light of the prospects ahead, that defense expenditures in the coming year will, if anything, be somewhat in excess of those set forth in the budget.

As to the other section of your bill having to do with the fixing of an expenditure level at \$178 billion as compared to the budget's \$186 billion, that is, section 5 of your bill, I believe that for the reasons set forth in the Bureau of the Budget analysis of this section that this particular method of approach to the problem of reducing expenditures is cumbersome and difficult and is the wrong procedural approach to the problem.

I do believe, Senator Williams, however, that you and I are in agreement in feeling that the present fiscal situation taking into account the prospect that, if anything, the level of expenditures forecast in the January budget, in the light of intervening events, particularly in the Far East, that there is likely to be a need for both tax increase and expenditure reduction before this session of Congress is out.

I am not prepared at this moment to make any evaluation of what the outlook for defense outlays will be. That is a matter which, as we have indicated, is under intense study at this time by the President, Secretary of State and Secretary of Defense. Therefore, I cannot put any final figure on what would seem to me to be the appropriate level of expenditure reduction.

I do believe, however, that before the session is out, there will be a need and I would hope that all of the Appropriation Committees and subcommittees that are currently engaged in acting on these matters instead of adding to the President's budget requests, would either hold at the present level of his request or where they can find good and valid reasons for reducing those expenditures, would entertain and search for additional economies in expenditure in the next fiscal year—expenditures that could be postponed without too serious damage to the programs involved.

Senator WILLIAMS. Mr. Secretary—

Secretary FOWLER. And I would also urge, Senator Williams, again as I indicated earlier, that the program reductions and reforms that are on pages 20 and 22 of the budget document be observed and effected by the necessary action of the Congress and, if anything, added to.

Senator WILLIAMS. Mr. Secretary, I do not have to tell you that I would support trying to hold the line when the budget appropriations

are before the Congress. I note your comments on section 5 in the bill, and I can understand your desire on the 10 percent.

Now, the reason that I thought maybe the 6 and 8 percent would be sufficient was due to the fact that with this reduction in expenditures it would still give us a great achievement.

Secretary FOWLER. Yes.

Senator WILLIAMS. But as I said at the time I made the statement I am not wedded to the formula. I am not wedded to the figures. I am going to ask you the same question as I asked you before, with the understanding that section 5 is amended to include your straight 10 percent across-the-board increase as you have recommended and include your tax bill and I will say in the beginning that with this understanding will you support the other part of the bill which will carry with it this reduction in expenditures? I do not have to remind you as to what is happening in Europe in connection with the run on gold, and I do not think that there is any step that could be taken by our country that would lend more confidence to the stability of the American dollar than to let the report go out from this room the fact that this committee and the administration working together are both going to work toward a tax increase and a real bonafide reduction in expenditures. The combination of these two would reduce and project the deficit for 1969 down to \$2 billion as you calculate it or \$9 billion if you eliminate the trust funds.

Now, if you would support the package, I in turn pledge that I would take your tax increase bill. All I am asking you to do is put into affirmative action the speech you just made in connection with the reduction in expenditures. I think you will agree with me that speeches by the administration for economy in Government and speeches on the floor of the Senate for economy in Government are not worth the paper they are written on unless they are backed up by action. I think you would support me in that.

Secretary FOWLER. I would support the general principle and statement that you have made, Senator Williams, that both of these approaches to the problem of fiscal restraint are desirable for the reasons I have already stated. I cannot support the incorporation of the expenditure reduction proposals as they are expressed in section 5 of your bill.

Senator WILLIAMS. Then do I understand for the record that the administration will support the tax increase but you would oppose the reduction in expenditures?

Secretary FOWLER. We would not oppose a reduction in expenditures. We would oppose the section 5 of your bill as the means, method, and measure of achieving that objective at this time.

Senator WILLIAMS. I think we are getting together now, because all I am after is the ultimate goal. I am not wedded to the amount. Now, what method do you have of spelling out this reduction comparable to \$8 billion; what is your alternate method?

Secretary FOWLER. I will have to defer to the Director of the Budget on any matter involving a reestimate of the budget. This is not a prerogative of the Treasury Department. I have told you that since 1939 when the Bureau of the Budget was transferred from the Treasury Department to the Executive Office of the President, my special area of concern and competence is to deal with the revenue side

of the budget. Therefore, your questions on other methods, alternative approaches that might be used to the expenditure limitation method are within the purview of the Director of the Budget. I, therefore, will defer to him on any question dealing with the selection of a particular method of achieving a particular budget expenditure reduction.

I would say, however, that as Secretary of the Treasury and concerned with the overall fiscal problem, I am terribly concerned and share your view that a sharp, decisive action in the direction of reducing this deficit in a very meaningful way is terribly important at this time. I naturally will use every bit of influence that I have and put forward my point of view which in principle is very close to yours, that it is necessary that before we allow this fiscal situation to move along further, that the Congress and the administration acting together work toward a decisive reduction in the outlook for the budget in 1969.

Senator WILLIAMS. Well, I will direct the question to the Director of the Budget. Do you have any formula or plan whereby we could propose it as a part of this package a mandatory reduction, one which would be acceptable to Congress and the administration but one which could not be exceeded? Of course, we could always repeal it. I realize that. But do you have a formula whereby we could incorporate some of that?

Mr. ZWICK. Senator Williams, let me make this reply fairly brief. We have a detailed response to your bill attached to the Secretary's testimony, so I will not go through that. (See p. 43.)

Senator WILLIAMS. That is correct.

Mr. ZWICK. We are, of course, in complete agreement with your effort to provide tight control over Federal expenditures, so the issue is technique, approach, procedure. We think that your technique, approach, procedure is not the correct way to achieve the objective. We think the correct way, the prudent way, the traditional way is through the appropriations process. We sent up a budget in January which we thought was a correct budget. Since then, we have taken the following steps which recognize the heightened world tensions that we are facing.

First, we are in the process of cutting back overseas personnel.

Second, we have put out an order to pull back on overseas travel.

Third, when we sent up the urgent supplemental, we covered only specific items for which there was a mandatory requirement for payment on which the money was urgently needed.

Fourth, before we sent up the supplemental, Monday of this week, we went through the items in that supplemental and cut in the controllable part—most of that supplemental was for mandatory items, such as pay and fighting natural disasters such as fires—but in what was the controllable part of that supplemental, we cut roughly 30 percent below what was in the January 29 budget.

So that we think the appropriate way for the administration and for the Congress to act in this situation is not to put a mandatory across-the-board ceiling, but to face up on a line-item-by-line-item basis to the individual program issues.

For example, your ceiling on personnel suggested, if we do the calculations, a 30-percent reduction in personnel in agencies outside of DOD and Post Office from the estimated June 30, 1969, level—after the Congress and the Executive have recommended and approved

about a 35-percent increase in their budgets since 1966. We do not think that is good government, orderly government, or efficient government—to require a mandatory 30-percent reduction in personnel while agencies will be spending 35 percent more money for expanded workloads or programs. So we think, to end this very briefly, that the appropriate process, the one that we are engaged in today, we were engaged in yesterday, will be engaged in day in and day out, is an orderly review of individual appropriation items and working with the Appropriation Committees to limit these expenditures.

Secretary FOWLER. Senator Williams—

Senator WILLIAMS. Then, I gather that your answer is, "No."

Mr. ZWICK. Our answer—

Senator WILLIAMS. That you do not have any alternative plan; is that right?

Mr. ZWICK. No, sir. I think our plan—

Senator WILLIAMS. I mean for writing into the law a mandatory—as I understand it, you do not support the bill that is before us and you have no alternative; is that correct?

Secretary FOWLER. Senator Williams, I have an alternative to suggest.

Senator WILLIAMS. Well, I would like to hear it.

Mr. ZWICK. Our alternative is a process, a traditional, accepted process, whereby—

Senator WILLIAMS. Which has not worked heretofore and which, when we got a tie vote in the Senate, was broken on the up side by the Vice President, a representative of the administration. My question is—I do not want to push it, but I want—we want to close these hearings out if we can this morning, but I want to make it clear. As I understand it, your position is that you would not support the plan of reduction in expenditures which I have advanced and you have no alternative that you could offer at this time from a legislative standpoint; is that correct?

Mr. ZWICK. No, sir. We have an alternative. What we are in agreement on is that we do not support a specific mandatory expenditure ceiling. Our alternative is to use the accepted, time-honored, traditional appropriations processes.

Senator WILLIAMS. Which over the years has not worked and which has got us into this hole now with the \$28 billion.

Mr. ZWICK. You may read the appropriations history different than I do.

Secretary FOWLER. Senator Williams, I have an alternative, not to suggest, because it is not my prerogative, but to call to the committee's attention.

The Congress has been faced with this type of problem before and after an extensive study of the organization and functioning of the Congress in dealing with budget and the appropriations process in the Legislative Reorganization Act of 1946 which was the signal milestone, you might say, in the legislative reform process, there was an attempt to improve budgeting efficiency and section 138 of that act which is on the books and the law of the land today, although not observed in recent years, provides as follows:

The Committee on Ways and Means and the Committee on Appropriations of the House of Representatives and the Committee on Finance and Committee on

Appropriations of the Senate, or duly authorized subcommittees thereof, are authorized and directed to meet jointly at the beginning of each regular session of Congress and after study and consultation, giving due consideration to the budget recommendations of the President, report to their respective Houses a legislative budget for the ensuing fiscal year, including the estimated overall Federal receipts and expenditures for such year.

Such report shall contain a recommendation for the maximum amount to be appropriated for expenditure in such year and which shall include such an amount to be reserved for deficiencies as may be deemed necessary such committee.

If the estimated receipts exceed the estimated expenditures, such report shall contain a recommendation for the reduction of public debt.

So here there is a procedure existing in the Congress to achieve, I think, the fundamental result you are trying to achieve and which I would be happy to see achieved, which is free from many of the defects in the approach and procedure which is incorporated in the section of your package bill.

I recognize that over the past 10 or 15 to 18 years this procedure has not been used. It does seem to me to be an alternative approach to this problem whereby an overall guideline could be fixed for the various appropriation acts to refer to, and through that fashion the Congress can effect through a series of appropriation acts the overall reduction and expenditure limitation that you are seeking to impose by section 5, and do so, as Mr. Zwick has indicated, in the context of the orderly assessment and reduction and specific reduction of particular appropriations, and thereby preserve in good measure the normal processes of dealing with the expenditure of funds which, after all, go back to the authorization and appropriation action by the Congress.

Senator WILLIAMS. That still would not solve the immediate problem because appropriations feed into the line and expenditure reductions have to be controlled, but I do think that—

Secretary FOWLER. But this does—

Senator WILLIAMS. Just a moment.

Secretary FOWLER. This does provide, Senator Williams, that "such report shall contain a recommendation for the maximum amount to be appropriated for expenditure in such year."

Senator WILLIAMS. I appreciate your calling that to my attention. I will make it a personal duty to contact the chairman of the Ways and Means Committee as well as our chairman. We will try to get the two committees together, and I will tell those committees that this is a method whereby we can put a ceiling on appropriations. I am going to convey to them your recommendation that we do so and your willingness to abide by whatever decision we come out with. Maybe we can come out with better than a \$8 billion reduction. Who knows? We may even save a lot more money than that. So, I want to convey to them your encouragement that we do take that action. I certainly will support it.

But in the meantime, I do not think we can sit idly by and pass the buck to tomorrow. We are going to have to answer it today. The run on the gold is today. But I have your position, and I appreciate it. I would like to ask on just two of the sections.

What is wrong with writing into law the Executive order of the President's putting a ceiling on the number of Government employees that are on the payroll as of July 1966? Now, President Johnson, when he issued that Executive order, and this only carries out the

provisions thereof, indicated to the whole world that he could live with that number of employees. We are now told that to roll it back would reduce the services by 30 percent.

You are not trying to tell this committee you added 30 percent to the payroll; are you? You did add that 180,000 to the two and a quarter million. I do not understand why you could not support that. Do I understand that you would object to that section of the bill?

Mr. ZWICK. Yes, sir, Senator Williams.

Senator WILLIAMS. All right. Now, the second question—the next section proposes to put a moratorium on all public works and new construction projects until the Vietnam war is over or until the budget is brought under control, with the exception that the Office of Emergency Planning would have the authority to certify that X project was essential to the national security or to our economy.

Now, this is comparable to the Executive order which was placed into effect by President Truman within 6 months of the outbreak of the Korean war. It was placed in effect immediately at the outbreak of World War II, but for some reason the President has not seen fit to implement that during the Vietnam war. What is wrong with writing that section into law?

Mr. ZWICK. Sir, let me first quickly get the numbers on the personnel ceiling correctly. As your section treats personnel ceiling, all other agencies would have to absorb the increases in DOD and Post Office, which will be up 207,000.

So, if you add the 207,000 to the 108,000 that the other agencies would be up, you would be talking about roughly a 30-percent reduction in personnel in other agencies when at the same time their budgets are up around 35 percent.

Some of this is simply because workloads are rising. For example, small business loans will be up 21 percent next year. Air traffic control, landings and takeoffs at airports with FAA towers, will be up 15 percent. I just do not see how you can run an orderly Government in which you expect bigger workloads to be handled by agencies, and bigger budgets, to be operated with 30 percent fewer people. That is not the way a prudent businessman would run his business and I do not think this is the way we ought to.

Senator WILLIAMS. No prudent businessman would be spending when he has a deficit 36 years, but now when we speak of excess personnel, after all, maybe we can put some of those to work who are around in isolated areas such as I found recently, where two men for nearly 2 years had not had a single duty to perform and nobody found it out. There must have been a lot of idle people around.

Are you not trying to tell me that it would be impossible to conduct this Government with a reduction of 2 to 3 percent in the personnel?

Mr. ZWICK. As that section is written, you would have to reduce the personnel of the other agencies roughly 30 percent.

Senator WILLIAMS. As that section is written you would have to reduce the personnel that is correct, and that is the reason that I said we must have it mandatory. You know and I know that the so-called 2-percent reduction which was put in at the end of the last Congress was a farce. The departments could get around that 2 percent by postponing the purchase of a typewriter and use it for em-

ployees. You know it was so interpreted and that it has not been effective; that is the reason I am speaking.

If we are going to do this let us not kid the American people. Let us really reduce. Do you have any alternative plan that you can come up with?

Mr. ZWICK. Senator Williams, there was no plan last fall to reduce personnel 2 percent. There was a formula which was applied in order to provide an obligation reduction by agency. This formula was based on 2 percent of payroll and 10 percent of all other objects for relatively controllable Federal programs. That gave an agency total from which the agency had to reserve that amount of funds. There was no statement ever made by the administration, and certainly it is not in the law, that you would have a 2-percent reduction in personnel.

Senator WILLIAMS. That is correct, except it is not in the law and the agencies were very careful, but it went through the Congress with a lot of Members of Congress thinking they had enacted a law which would achieve a 2-percent reduction. Anyway, I appreciate your position even though I disagree with it.

I have one further question on S. 2903, Mr. Secretary. It is the bill which I discussed with you when you first took over as the Secretary of the Treasury, and you were going to conduct a study and come back with a report. You have been back several times.

Now, could we endorse this bill which would bring us, then, about \$300 million additional revenue this year and a little more later—that is, the depletion amendment, from 27½ percent to 25 the first year, to 22½ the second year, and to 20 percent the third year.

Surely you and I both can agree this is a non-controversial proposal, and I am sure the President would support our feeling.

Secretary FOWLER. Senator Williams, as I stated in my letter replying to you, this depletion allowance is a part of our overall energy policy. It is true that in his message last year on protecting our national heritage the President directed his science adviser and the Office of Science and Technology to sponsor a study of our energy resources and to coordinate our energy policy on a Government-wide basis. This study is underway, will include an examination of the tax rules regarding natural resources, all of those that are related to energy policy, including those covered by your S. 2903. It would, I believe, be premature for me to comment on S. 2903 until the results of that study are completed and its recommendations have been considered.

With reference to the reduction in depletion rates over 20 percent to the 20 percent level during a 3-year period, the revenue effect is estimated to be for fiscal year 1968, \$100 million; fiscal year 1969, \$205 million; fiscal year 1970, \$320 million. These estimates have been made without taking into account likely changes in prices, production, and so forth.

I think that is all I have to say on S. 2903.

Senator WILLIAMS. Mr. Secretary, I note you say that there still is a study. Could you give us the names of the members of that study committee?

Secretary FOWLER. It is the Office of Science and Technology headed by Dr. Donald Hornig, the President's science adviser.

Senator WILLIAMS. He is not doing it alone, is he?

Secretary FOWLER. It is being done in and through his office.

Senator WILLIAMS. Well—

Secretary FOWLER. I am not familiar with the rest of the personnel involved in it.

Senator WILLIAMS. Is he a Government employee?

Secretary FOWLER. Yes, he is.

Senator WILLIAMS. All right.

Secretary FOWLER. He is on the staff of the President.

Senator WILLIAMS. That is what I thought. Now, will you furnish us a list of his co-workers who are working on this, or is he the only man working? Would you furnish that information at this point in the record? I would like to have the names of those who are working on this study and when they were appointed to this assignment.

The reason I ask that is this, if this is a new study group I would like to have the names of the previous people studying it. I wonder if we are not trying to study this proposal to death. Maybe we ought to have an examination or graduation.

Secretary FOWLER. Well, there are frequent refresher courses on that subject up on Capitol Hill. I hope this report will be a useful contribution to reexamination of national policy in this area, and I will supply for the record some accounting of the work that is being done and has been done on this study.

Senator WILLIAMS. And the names of those who are participating in this study. Will you give us that?

Secretary FOWLER. Well, I do not know whether that includes the names. I am not familiar with how the study is being conducted, Senator Williams, so I do not know to what extent—

Senator WILLIAMS. That is all the more reason maybe you and I both should be familiar with it.

Secretary FOWLER. We will both get educated.

Senator WILLIAMS. Will you give us those names of people in the study? I do not question that there is a study, but I would like to know who is doing it, and you can furnish it for the record, not this morning.

Secretary FOWLER. Yes, we will provide something that is fully responsive to what you—you want a progress report on the study?

Senator WILLIAMS. And who is making the study.

Secretary FOWLER. And who is involved in it, yes, sir.

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

Dr. Donald F. Hornig, the President's science adviser and Director of the Office of Science and Technology has been assigned responsibility for sponsoring a study of energy resources and coordinating energy policy on a government-wide basis.

In his message to Congress on "protecting our natural heritage" on January 30, 1967, the President said:

"The number and complexity of Federal decisions on energy issues have been increasing, as demand grows and competitive situations change. Often decisions in one agency and under one set of laws—whether they be regulatory standards, tax rules or other provisions—have implications for other agencies and other laws, and for the total energy industry. We must better understand our future energy needs and resources. We must make certain our policies are directed toward achieving these needs and developing those resources.

"I am directing the President's science adviser and his Office of Science and Technology to sponsor a thorough study of energy resources and to engage the necessary staff to coordinate energy policy on a Government-wide basis."

A small energy policy staff is being established in the Office of Science and Technology and one of its responsibilities will be to assure the effective conduct

of the energy resources and policy study. The President on November 25, 1967, announced the appointment of Mr. S. David Freeman to head this staff. Additional professional staff members are being recruited to assist Mr. Freeman.

The President requested an appropriation of \$500,000 in the OST budget for fiscal 1969 to finance the first year of the 2-year energy policy and resources study. The study will be supervised and controlled by OST, but the detailed work is expected to be done under contract. The appropriation request is pending before the Congress and the contractor for the study has not as yet been selected.

The study has been designed in collaboration with the interested Federal agencies and with the assistance of Resources for the Future, a nonprofit research organization with expertise in the energy field. The study is expected to include consideration of energy supply and demand, availability of various forms of energy at particular prices; tax policies; institutional arrangements, competition and price regulation; efficiency of energy supply and use; national security, safety and reliability; environmental and other associated effects; energy R. & D. for the future; international implications and cooperation; and present Federal and State energy policies and policy alternatives.

There have been numerous studies of particular forms of energy and individual problems in the energy field in recent years, but the last comprehensive resources study was the Paley Commission Report completed in 1952 (the President's Materials Policy Commission Report).

Prior to assuming his current position on December 1, 1967, Mr. Freeman was engaged in private practice of law in Washington as a partner in the firm of Swidler and Freeman. Prior to entering private practice, he was assistant to the Chairman of the Federal Power Commission from 1961 to 1965. During that time, Mr. Freeman played a leading role in the conduct of the FPC's National Power Survey and as a key aide in the planning and execution of the FPC's electric power and natural gas regulatory programs.

Senator WILLIAMS. That is correct. Who is making the study. Now, I understand your answer is in the negative, that you would not support the bill.

Secretary FOWLER. Not at this time.

Senator WILLIAMS. Well, Mr. Secretary, I can only add that I am disappointed, very greatly disappointed that the administration will not cooperate in a bona fide reduction in expenditures. I think that you are making a mistake and that the Congress is making a mistake if we do not likewise proceed even without your support. I would say this, and I am not excusing Congress of its responsibility. The Director of the Budget is correct, these estimates have been increased many times, but far too often they have been increased with the support of the administration. I most respectfully suggest—

Secretary FOWLER. Let me say—

Senator WILLIAMS. If I may finish. These programs are enacted by Congress at times increasing them beyond the amount that the Budget and the President think is advisable, but it still does not cost any more to sign a veto message than it does to sign an approval. If the President would only back us with veto messages I will assure you that some of us would back him down here. Let us really try voting in the manner in which we are speaking, because without it I think we are headed to a catastrophe. I do not want to see it reach the point where, as one fellow suggested the other day, if there is a devaluation of the American dollar he was going to suggest that President Johnson's picture be put on the devalued dollar bill so that there is a constant reminder to the American people as to who is responsible for debasing our currencies. Let us not let that happen.

Secretary FOWLER. We will not let that happen and there will not be a devaluation of the dollar and I just have two comments.

No. 1, I would hope that the Congress would not add any additional items to the President's budget expenditure or budget outlay estimates.

No. 2, I would hope that the Congress would effect the program reductions, the specific program reductions in some 50-odd programs that are listed on pages 20 to 22 of the President's budget message, and speaking as Secretary of the Treasury, I would welcome further reductions in those programs and other parts of the President's budget in an effort to reduce this deficit.

Senator WILLIAMS. I have no further questions.

The CHAIRMAN. Mr. Secretary, I just want to make a brief statement, then I will be through. You may comment on it if you want to.

Let me say that I have heard the testimony here and virtually all the questions and answers that have been asked. I personally am not going to support any effort to put this big tax increase, this 10 percent or any part of it, on this extension of these excise taxes, for a number of reasons.

In the first place, the Williams amendment would tell the Appropriations Committee how much that committee should appropriate. Now, this Senator just got through making a fight out there on the floor against putting a tax amendment on an appropriations bill. I do not like the Appropriations Committee doing our work for us and I do not propose to be so inconsistent as to do their job for them. We ought to give them an opportunity if they are interested to do their job and recommend to us what they think about it, so we would know their thoughts on it.

Now, in the second place, with regard to the tax increase itself, under the Constitution the House should originate tax measures. Now, we have the right to amend House bills and we have done so in the past. But, I think that this would be a very inappropriate case for us to exercise our power to amend because the House has labored on this matter over a period of almost a year and has given it a lot of study.

The fact that they have not yet sent us a tax bill has the overwhelming support of the majority of the American people. I would say about 80 to 90 percent of the American people have no enthusiasm at all for that tax increase and the House in taking its time about it, certainly has the support of the public. If they feel their duty and conscience and responsibility required them to send us a bill, I think they will send it to us. What little efforts I have made to detect the sense of the House would indicate that the chairman of the Ways and Means Committee would probably have no particular feeling about it one way or the other if we wanted to act in that fashion but that there would be a substantial number of that Ways and Means Committee who would resent us trying to take charge of this matter on short notice. We've only given it a couple of days' consideration while the House has been studying that matter with the Secretary and the Treasury and others advising and consulting them over a period of a year. It looks as though the House is thinking about doing something in this area. If they want to do it, I would think that they ought to do it.

Now, I do not know of anything that could further confuse matters than to take this \$3 billion tax extension bill and tie it up in an endless conference where the House would not yield and the Senate would not back down. It could sort of parallel that situation where the senior Appropriations Committee members on the House side could not agree with the senior members of the Senate Appropriations Committee some years ago on what room they were going to meet in.

The result was that the Government practically came to an end trying to decide if the House members were going to walk to the Senate side or the Senate members were going to walk to the House side.

I am fully convinced you are not going to get that big tax bill the administration is advocating until the House Ways and Means is willing to let that bill go. We do not have the power to make them submit our recommendations to the House for a vote. If they said they are not ready to act on that matter, because they want to give it further consideration, I think the House would back the chairman and the Ways and Means Committee overwhelmingly.

All we would do then is just impede the passage of this bill to get the Government \$3 billion which, in my judgment, should pass on its merits. I am pleased that the Secretary said he was not going to try to do anything about the depletion allowance on this bill. The administration has tried to do something about depletion allowances. They tried when President Kennedy was in and Henry Fowler was the Undersecretary of the Treasury at that time and they did not succeed. It did not get through the House and it got nowhere in the Senate.

I will be glad to know who these people are making this depletion study, Mr. Secretary, because I have got some information prepared on the depletion I would like for them to consider when they are considering Mr. Williams' point of view on depletion, so they will have both sides of the argument.

Now, if you want to kill this bill, that surtax is just one more thing that could impede passage. I am happy to see that there is no indication that you are going to implement a "no new starts" program. Some of these new starts are more essential than the continuation of some of the existing construction. Some construction could better be postponed than do without some new starts on some vital projects and it would seem to me the whole thing ought to be considered.

If you want to comment that is all right, but I am not going to prolong the record by insisting you answer in detail what I think about the matter, because I think if you have to respond in detail to what 17 members of this committee think about the subject and we all have fiercely independent views on it, we would never get the bill reported.

Secretary FOWLER. Well, I have only one comment I would like to make, Senator Long, and that is that I want to be abundantly clear with the Congress of the United States, not just members of this committee or members of the House Ways and Means Committee, but speaking to the Congress, and this is the only forum I have to speak to the Congress, that there are factors which give great urgency to prompt action by the Congress of the United States to decisively reduce the budget deficit which we are confronted by in this fiscal year and the coming fiscal year.

I will cite just five factors which I think you all ought to be aware of here.

First, the highly volatile situation in the international exchange, gold and financial markets, now threatens the very preservation of the international monetary system as we have known it.

Second, the clear indication that the Federal Reserve System is on the move to increasing monetary restraints, to arrest mounting inflation which they are doing reluctantly only because of the lack of

action on this tax bill. They believe that a combination of fiscal and monetary restraint rather than a sole reliance on monetary restraints is the preferable course and I agree with them.

Third, it is now clear to everyone as a result of developments in the Far East that if there is any likelihood of expenditure estimates being revised, they would be revised on the up side rather than on the down side as we face the situation in the future.

Fourth, the increasing pace of the economy with the outlook for increasing expenditures stretching through the second half of the year in conjunction with a rapidly expanding private sector calls for prompt action in the nature of fiscal restraint.

Fifth, our trade surplus since the first of the year is running at a sharply reduced level from the 1967 pattern and is comparable to the disturbingly low level reached in December. This cannot be permitted to continue because it would tend to cancel out some of the gains that we hope to achieve in our balance of payments as a result of the direct measures announced in the President's New Year's Day message.

In the light of all these factors, it seems to me that all reasonable men who want to preserve their country's economic and financial viability ought to come together and put a tax bill on the books and do that promptly, and I hope the Congress will manage to do that within the next 30 days.

The CHAIRMAN. Well, I think I have made my position clear, Mr. Secretary. Frankly, insofar as those international problems and the run of gold are concerned, I do not think it is a domestic deficit that is creating that problem. The problem there has to do with your international deficit and I must note that while the administration on the one hand is pressing for such things as a rollback of the gold cover—which is just a temporary palliative—it is resisting some of the things that would very greatly reduce our deficit, such as withdrawal of troops from Western Europe or a major portion of them, some limitation on imports that are giving us difficulty with our balance of trade such as steel, textiles—

Secretary FOWLER. I would only cite, Senator Long, that just today there is reported an editorial commenting on the gold situation in the highly respected financial Times of London, an editorial yesterday saying that:

U.S. Congressional approval of a tax increase would do more than any number of statements to save the situation.

I think that expression of editorial opinion expresses my point of view, the point of view of Chairman Martin, the point of view of most of the economic and financial officials, both public and private, that are concerned with this problem here and in other countries.

The CHAIRMAN. Well, I am not too much concerned about those people in other countries, Mr. Secretary, insofar as our domestic economy is concerned. Now, they have a right to advise us where we have a deficit—

Secretary FOWLER. It is our dollars.

The CHAIRMAN (continuing). In our international balance of dollars with them. But as far as the American people and the American Government, it seems to me that is not too much of their business.

Secretary FOWLER. Senator Long, in the system in which we operate, they have our dollars and they are asking for our gold, I might say

this is not a one-way street. These countries are themselves trying to follow policies to expand their economies so that we will be able to market more exports and build up our trade surplus and they do not want to expand their economies and take special efforts to do so with some risks to their own inflationary situation and then have us cancel that out by allowing our economy to run at an excessive rate of speed. So, it is a two-way, cooperative action we are trying to achieve.

The CHAIRMAN. Well, I am not going to burden the record by debating all that with you, Mr. Secretary. We can do that at some other date. All I say is if you want this \$3 billion you better take this trick while you can take it rather than wait and have the whole thing wind up at an impasse between the Senate and House. In my judgment, insofar as the surtax is concerned, it will not help, it will hurt to try it in the Senate at this time when the House for its own reasons—

Secretary FOWLER. Senator Long, I am allocating my time 7 hours a day on the House side and 1 hour a day on the Senate, so I am trying to go through the normal processes.

The CHAIRMAN. All I am saying, Mr. Secretary, is that I see no indications from the House that they would like for us to act on that surtax first. That being the case, my guess is, it would not do anything but prejudice your case for a surtax to ask the Senate to act on it first.

Now, it is all right with me—that is one good thing about the Senate rules—anybody can offer his amendment and have it voted on. There is no limitation on what somebody can offer. It does not even have to be relevant, and it does not have to make sense. I have learned it does not even have to be a complete sentence. He can just offer anything he wants to out there on that Senate floor and get a vote on it by demanding yeas and nays and insisting he will not settle for anything less. I respect those Senate rules, although I do not approve of them as much as I did when I was a junior Member, but it has a lot of logic to it and I would certainly respect everybody's right to offer it.

Thank you very much.

Senator SMATHERS. Mr. Chairman, just let me burden the record just a little bit on that same subject.

Mr. Secretary, I just will say this: First, I very much agree with the general tenor of your statement. My own feeling is that we have never been in a more serious financial and fiscal situation in our country than we are today. I have never, in the 22 years I have been here, seen a time when it was so urgent for the Congress to act as it is today with respect to our fiscal problems. I cannot believe that it was the intention of the founders of this Government that the great mass of the Members of the Congress should be left helpless to act. Or to put it another way, left in a position where they could not act merely because one or two men, no matter how much admired or how much respected, take a rather adamant position in terms of saying they did not believe the time has come to act. Even in the case of civil rights legislation, you can get cloture on filibusters. Nobody has ever contested the right of the Senate to amend and the Senate does have the right to amend tax measures passed by the House of Representatives.

I do not believe anybody has a higher regard for Wilbur Mills than do I, but on the other hand I represent Florida. They did not send me up here to ask Wilbur Mills what I ought to do.

Now, if Wilbur, whom I respect and greatly love, is going to take a position, I have a right to take a position different than his and sometime during the course of 6 months or 10 months or a year I should be permitted to have an opportunity to vote on that position. Particularly where I think it is so serious that we have to have some expression from the majority of the Members of the Congress as to what they think. So, therefore, I disagree with my beloved and respected chairman of this committee that we should do nothing but await some action from the House.

I would hope that the House would originate this. I would hope that the House would act and if they would act, I would much prefer it, but I do not believe that we must stay here hamstrung. We do have the right to amend. Both the House and the Senate have rights, and I think the time has come for us to insist on ours.

Now, with respect to the bill before us, how much revenue, Mr. Secretary, does this bill bring in? I would like to get it for the record once again. Briefly.

Secretary FOWLER. In my opening statement to the committee I included a table indicating that for the fiscal year 1968, the revenue from this bill would be \$1.1 billion. For fiscal year 1969, \$3.1 billion. I am giving rounded figures. (See p. 52.)

Senator SMATHERS. Let me ask you this question: If we shifted or if you should shift or if the House should shift or the Senate should shift emphasis from the surtax, 10 percent surtax, to a reinstatement of the rates on individuals and corporations which we had prior to 1964 and at that same time reinstated the excise taxes which we took off, how much revenue would that produce, approximately?

Secretary FOWLER. On the excise taxes, if you restore the excises repealed in the 1965 act, the full year revenue effect; that is, for a full year from the date of reinstatement, would be \$2.4 billion. If you included in that restoration the movement backup of the auto tax to the 10-percent level, that would add \$700 million more. The total would be three billion one for the full year effect.

Now, assuming the effective date of the full restoration of the law to what it was prior to that period, we would get as of April 1, \$600 million in fiscal 1968 and three billion one in fiscal 1969.

Now, as to your other question, the part of your question which I believe contemplated the return to the tax rates that existed in 1963—

Senator SMATHERS. Yes.

Secretary FOWLER (continuing). I think between \$22 and \$23 billion of revenue would be a consequence of a restoration of the— at least that is the amount—

Senator SMATHERS. I think it is in the area—

Secretary FOWLER (continuing). That has been frequently quoted that the taxpayers would be paying in addition today if they were paying under the tax laws as they existed prior to the passage of the Revenue Act.

Senator SMATHERS. Right. I recall many times stating that this administration has reduced taxes by over \$22 billion. That is, the

Kennedy and Johnson administrations between them. If we had not done that and kept the tax rate what it had been in 1962, today we would not be experiencing this substantial deficit which we are now having. In 1962 and 1963 people got along, it seemed to me, rather well. Certainly, in the face of the challenges we have in Vietnam, and here at home, I think that the time has come to rather seriously consider not only the 10-percent surtax increase but possibly in lieu of that a movement to the reinstatement of the rates and type and character of tax which we had in 1962. Would the Secretary care to comment as to whether or not he would have any objection to that particular approach?

Secretary FOWLER. You are speaking now particularly of the excise taxes?

Senator SMATHERS. The excise taxes and the reinstatement of the rates which we had, individual rates.

Senator CURTIS. All taxes.

Senator SMATHERS. All taxes.

Secretary FOWLER. Well, I would think that the restoration of the rate levels that preexisted the passage of the Revenue Act of 1964 would provide, on a temporary basis, revenues that would reduce this deficit to a very low level and as far as I am concerned would be quite a welcome measure which would be quite acceptable from the point of view of the Secretary of the Treasury. It would be resuming the status quo ante as far as the rate picture is concerned to the 1963 levels. It would be borrowing back in effect the tax reduction which the economy and the American people have had over the last 4 years and temporarily borrowing it back for the time period in which the war in Southeast Asia creates this unusual and hopefully temporary drain on our financial picture.

Senator SMATHERS. And in addition, was that not the basic concept of the so-called new economic theory of taxes to stimulate our economy. We did reduce taxes for the purposes of taking the burden off the people to stimulate the economy. That is one side of the coin in the total concept of the new economic theory. We should have enough gumption, when needed to turn the coin over and put the taxes back on. Is that not the theory?

Secretary FOWLER. Absolutely, Senator. This must be a two-way street, and it implies certainly in the application of those who believe in that theory of fiscal policy, that when the economy is slack and the private sector is not advancing in a dynamic manner, that you provide increased incentives and stimulus through tax reduction, but it follows from that logically that when the economy is running at an excessive rate of speed or threatens to be overheated and bring on an inflation which is always followed by a sharp decline, that the appropriate policy is to apply fiscal restraint and a tax increase is an accepted element in all the economics that are practiced throughout the free world as a means of fiscal restraint.

Senator SMATHERS. Thank you.

Now, Mr. Secretary, let me address myself to the gold problem just briefly.

Secretary FOWLER. May I say that as far as choosing between using the surcharge approach and the restoration of income tax rates as they preexisted 1964 or some modification of those rates or restoring the

excise taxes repealed in 1965, I would think the excise tax would be a far less preferable and secondary approach to our financial problems. I will not go into details in my answer, but that is my position.

Senator SMATHERS. I want to burden the record with this brief statement. Last fall I had the happy privilege of traveling into six countries of Europe. As the Secretary knows, when I got back I called him and said that I was very much concerned about our general economic position, because in every country in which I visited, I had the opportunity of talking either with the head of that country or, you might say, the central bank president. As I told you at that time, they were concerned about what we were going to do, whether we were going to take care of our growing fiscal problem, whether we were going to demonstrate any self-discipline. They seemed to be more concerned about that than they did anything else.

Secretary FOWLER. That continues to be the case up to this moment.

Senator SMATHERS. They were very specific and very clear that what happened to us would hurt them. It was sort of like the old expression, when we get a cold here, they get pneumonia, and it was very evident that if we did not take stern measures to bring our house in order, it would not only be catastrophic here but it would be doubly catastrophic there. I have just now returned from a trip through the major countries of South America where they are accustomed to a great deal of inflation. The responsible people do not like it. They know what danger it does. I had the privilege of talking to the head of the Government and in each instance every one of the gentlemen were greatly concerned about what we in the United States were going to do. Did we have enough self-discipline to put a tax on ourselves or were we going to follow that unfortunate sad rôle which so many of their governments had followed? They said that it was imperative that we, the Congress, take some action which would show that we do have enough self-discipline to put our house in order.

So, while I would agree with the chairman that the problem of the run on our gold does not specifically hurt the American people as such, nevertheless in the long range it will have the effect of destroying the dollar as the free world's reserve currency. It will have the effect finally of bringing about a devaluation possibly of our own dollar which at that point cannot help but do great and serious damage to our own economy. I am one of those who is very strong in the belief that we have to act and I, therefore, do not propose to forever sit back and wait for a committee on the other side, respected as it is, just because a couple of members have deemed in their judgment that this is not the time to act. Others have a right to exercise their judgment, too.

Senator Curtis and then Senator Anderson.

Senator CURTIS. To the Director of the Budget, my question concerns that part of the William's proposal which would put a limitation on expenditures. My question is not do you approve of it. My question is not will it operate smoothly. My question is not whether or not you or anybody else thinks it would create chaos in the Government. The people are rather used to that anyway.

My question is this. If the William's proposal for rolling back and reducing expenditures is passed, will it reduce expenditures in your opinion?

Mr. ZWICK. You are saying if it became the law of the land?

Senator CURTIS. Yes.

Mr. ZWICK. That expenditures of the fiscal 1969 be limited to 178—

Senator CURTIS. No, no. My question is quite simple. If it becomes law, will it reduce expenditures?

Mr. ZWICK. In contrast to the 1969 budget as published, yes, sir.

Senator CURTIS. Do you know of any way in which it can be violated by the departments if it is passed?

Mr. ZWICK. You may have to change some other laws or else violate those laws. There are mandatory payments, for example, public assistance, veterans compensation and pensions, interest on the public debt, and so forth, which could build up to a level that would exceed that expenditure limit. So, you could find a department caught with two laws that are inconsistent.

Senator CURTIS. And the last law counts; does it not?

Mr. ZWICK. I am sorry. I did not hear you.

Senator CURTIS. The last act of the legislature is ruling in case there are two inconsistent acts.

Mr. ZWICK. In this case I am not sure, Senator. I would have to get a legal opinion on that. Certainly, we have obligations to States and others. I am not sure what happens, but I would be alarmed if it meant that we couldn't promptly meet our obligations for interest on the debt, or had to stop payments to veterans, or required other steps of that kind.

Senator SMATHERS (now presiding). The Secretary has agreed to meet with the House Ways and Means Committee at 10 o'clock. He is already running late. He has stated that he would be happy to stay here to answer any questions. Mr. Zwick will stay on so if there are any questions we have to direct to the Secretary, we can direct them to Mr. Zwick and let Mr. Fowler go and keep his appointment. Is that satisfactory?

Senator CURTIS. Yes. I have no questions of the Secretary.

Senator SMATHERS. All right. Anybody have any questions of the Secretary?

Senator BENNETT. I would like to take advantage of the good nature of the Secretary to just make a very short statement as the chairman did.

We meet here this morning in the shadow of the Senate debate on the removal of the gold cover and in the shadow of what is happening in the London gold market and I recognize that the comment I am about to make does not involve the Secretary's jurisdiction, but at the same time, there is going on in Washington a set of negotiations regarding a copper strike that has lasted for 8 months nearly—it will be 8 months on the 15th—that is costing us—it is increasing our foreign exchange deficit, foreign balance-of-payments deficit, at the rate of a billion dollars a year. I understand that the Government representatives have suggested a settlement in excess, representing an increase in excess of 9 percent in those wages and that cannot bring it to a head.

I think if we are concerned about this whole package of inflation and gold drain, I hope the Secretary will do what he can to persuade his colleagues in Government that this is another area which is very largely in the hands of the administration, and they should be acting to stifle that loss rather than to increase it, and I am greatly disturbed

about the immediate effects of this kind of an attitude represented by the Government's position, the administration's position in this negotiation.

I had a lot of questions that I was going to ask the Secretary about this copper situation, but I will abandon them in favor of this very brief statement, realizing that the Secretary himself can have only the power of suggestion and recommendation.

Senator SMATHERS. Senator Hartke and Senator Metcalf, a moment ago while you were out I stated that the Secretary had an agreement to meet with the House Ways and Means Committee at 10 o'clock. He stated, however, he would be happy to stay here longer, a while longer, if we had any questions to direct to him. Mr. Zwick will stay on with us and be here the balance of the morning. So, if anyone has any questions—Senator Anderson, we will go around this way. Do you have any questions of Secretary Fowler?

Senator ANDERSON. I can ask the Bureau of the Budget.

Senator SMATHERS. Senator Hartke?

Senator HARTKE. I would like to get something straightened out. I am always on the bottom here. I do not mind being on the bottom, but you people get to ask questions and then you dismiss the witness as soon as you come around to the bottom end of the table. It is all right with me, but yesterday I asked a question of the Secretary, I mean the Director of the Budget, concerning how he arrived at a figure and I would like to—

Senator SMATHERS. The Director of the Budget is going to stay here.

Senator HARTKE. He could not answer the question yesterday.

Secretary FOWLER. We are sorry.

Mr. SURREY. I can answer it.

Senator HARTKE. The question is on the matter before us at the moment, the excise taxes, and on the excise tax there is an estimate for fiscal year 1969 of an income of \$1.5 billion. I just want to know how this was arrived at.

Mr. SURREY. This related to the automobile excise tax, as I understand it, Senator Hartke.

Senator HARTKE. I am taking your testimony upon the matter before the Finance Committee. All this other material I do not mind talking about; I would like to ask a question about it, too, but the matter before us is the excise tax extension and it says in the report that it is going to provide for additional revenue of \$1.5 billion for the fiscal year 1969, and I just ask upon what basis this estimate was made.

Mr. SURREY. We used an estimate for fiscal 1969 of manufacturers' sales of automobiles of somewhat over 9 million.

Senator HARTKE. Somewhat. How much over?

Mr. SURREY. 9,250,000 for calendar 1968. You have to make an estimate of what the manufacturer's price per car is. We estimated approximately \$175 tax per car which means a manufacturer's price of \$2,500 per car.

Senator HARTKE. You have taken an average overall manufacturer's cost of \$2,500 per vehicle with an overall sales of 9,250,000 automobiles—

Mr. SURREY. Sales by the manufacturer plus imports. Not necessarily consumer sales. There are some cars that will be added to dealer's inventory in this period.

Senator HARTKE. I understand that.

Will you tell me what were the manufacturers' sales last year?

Mr. SURREY. The manufacturers' sales and imports, yes. The sales figures for 1964 were a little over 8 million; 1965, 9.6 million; 1966, 9.2 million; 1967, 8.1 million. These are calendar years. For calendar 1968, we are estimating 9,250,000.

Senator HARTKE. 9.8 million for 1965; right?

Mr. SURREY. 9.6 million.

Senator HARTKE. All right; 9,600,000 for 1965; 9,200,000 for 1966.

Mr. SURREY. Calendar year.

Senator HARTKE. And 8,100,000 for 1967; right?

Mr. SURREY. Right.

Senator HARTKE. What you are saying, then, is that you anticipate a 10-percent increase in sales of automobiles, sales of automobiles this year?

Mr. SURREY. The figure we gave would have that result. We are in touch with all the data one can get with respect to what the automotive market will do, and the figures generally that we were using were a composite of the estimates made in December that the various automobile companies and others were using. Roughly, all of the estimates clustered somewhere around 9 million—ranging from 9 million to 9.3 million. That was a composite estimate back in December of the various automobile manufacturers and also those of the various investment houses and others who make their estimates in this field, and we generally use those sources, and we come to some figure that is roughly a consensus of the various estimates in this area.

Senator HARTKE. I understand the consensus theory.

Mr. SURREY. It is not a consensus theory because—different companies have different estimates as to what the market will be.

Senator HARTKE. I understand that. You estimate an increase in manufacturers' sales of over 1,100,000 automobiles for this year.

Mr. SURREY. Yes. Now, of course, you have to understand that this includes also import sales, too.

Senator HARTKE. Well, the import sales, I understand—

Mr. SURREY. Import sales are running over a million units.

Senator HARTKE. Yes. The fact of the matter is 1,020,000 last year; right?

Mr. SURREY. I have the figure for fiscal 1967, somewhat under a million.

Senator HARTKE. All right. In 1966 you had less.

Mr. SURREY. Yes.

Senator HARTKE. About 900,000 in 1966 and for the record, you only had about half that many in 1965. In 2 years the imports have doubled; is that not true?

Mr. SURREY. Imports have gone up.

Senator HARTKE. Imports are doubled and they are still on the way up; right?

Mr. SURREY. Not as high. No. The rise is not as great, according to our estimates.

Senator HARTKE. In the first 2 months of this year? How much do you show for the first 2 months of this year?

Mr. SURREY. I do not have it on a monthly basis.

Senator HARTKE. I do have here someplace—

Mr. SURREY. In jumping from 1967 to 1968, Senator, your figures are going to be thrown off somewhat by strikes in 1967. In other words, if you just go to the manufacturers' sales in 1967 and compare it with 1968, your figures will be distorted to some extent by strikes and, therefore, you show a larger rise in 1968.

Senator HARTKE. Let me just put to you pointblank what I do not understand about your tax theory. I cannot understand how you are going to have this substantial increase in sales estimated for this year when you anticipate you are going to have a tax increase of 10 percent which is going to cut back on demand.

In other words, you are anticipating a revenue estimate here based upon an increase in sales of some 10 percent—

Mr. SURREY. I say the 10-percent factor is to some extent affected by the strike last year. So that consequently you have pushed into 1968 some sales that you would ordinarily have found in 1967. Now, that does give you a higher rate.

Senator HARTKE. Let me say your estimate is higher than the American Automobile Dealers Association's estimate is. You know that, do you not? Of sales?

Mr. SURREY. I am not personally aware of it. I might say without going into the particular companies involved that the estimates in December when we made up our estimates of all the companies were over 9 million.

Senator HARTKE. Yes. I understand that. Over 9 million. The fact of the matter is the total estimate from the automobile dealers is 9.1 million and the total estimate that you have given is 9.2. In other words, your estimate is higher than the highest estimate of the automobile dealers or the highest estimate from the manufacturers. Just shake your head and say "No" if you do not want to agree with me. I am telling you it is, because we just checked it again with Detroit and had the Commerce Department check this figure.

Mr. SURREY. As of today you are saying?

Senator HARTKE. As of today we checked the figures again to make sure what their estimates were. It is indicated they estimate 9.1 million from the Automobile Dealers Association and a little over 9 million as far as the manufacturers are concerned.

Mr. SURREY. But, what I want to indicate, I was giving you the basis of the estimates for our budget figures and now—

Senator HARTKE. I am not going to argue with you. Let us assume you are right for the moment. What I am saying is that you are indicating an even greater increase in sales even though you say that if you increase taxes you are going to dampen the economy.

(The comparison of automobile sales as estimated in the budget and as estimated by automobile dealers is referred to later in the testimony.)

Mr. SURREY. There is one other factor that you have to take into account and you are trying to get this precise, Senator. Remember, you are dealing with 100,000 cars here and there—

The CHAIRMAN. Let me just interrupt at this point. Secretary Fowler has committed himself to be at the Ways and Means Committee. Are there any more questions the Senators want to ask the Secretary?

Secretary FOWLER. I would just as soon stay here and—

Senator HARTKE. No, I do not approve of that, Mr. Chairman. He is the Secretary.

The CHAIRMAN. Might I ask, then, if Mr. Surrey can stay here after Secretary Fowler departs? Might I ask then, that whatever questions, Senator, you want to ask of Secretary Fowler, would you mind asking those now. He can then depart and you can continue to direct your questions to Mr. Surrey and Mr. Zwick. Is that all right with you, Senator?

Senator HARTKE. All I can say is I have gone through this every day—I just want my position very clearly known with the committee. I sit here every day and listen to anybody else ask all the questions he wants to and then a witness makes an appointment and they say everybody else give up on your questions.

Senator ANDERSON. I do not think that is quite right.

Senator HARTKE. It is right.

Senator ANDERSON. I skipped over for you.

The CHAIRMAN. All we are asking you to do is if you have got some more questions you want to ask Secretary Fowler, get your answers from him on the questions you want to ask him.

Senator HARTKE. I will be willing to do that.

Let me ask, then, on the tax increase, what is the theory of the tax increase in regard to its effect upon the economy? Is it not that it is to dampen the demand?

Secretary FOWLER. That is one of the hoped for effects.

Senator HARTKE. What other?

Secretary FOWLER. To dampen demand so that personal income with the tax increase, as the Council of Economic Advisers estimated, would increase only about 8 percent in the calendar year 1968. And the gross national product would increase only about \$60 billion. There would be increases beyond that level in both personal income and gross national product, if you did not dampen demand, and secondly, that if we can dampen demand by a mixture of fiscal restraint and monetary restraint rather than relying on monetary restraint alone, we will get a better balanced pushing down.

Senator HARTKE. I understand what you are saying. but I do not think that it can be demonstrated. In the first place, are not personal savings in relation to disposable income substantially up?

Secretary FOWLER. Yes.

Senator HARTKE. They are not buying now. They have money with which to buy but they are not using it now, is not that true?

Secretary FOWLER. But they are still at the very, very high savings rates which are abnormally high, still the overall volume of business is quite high and the economy is running in the last two quarters of 1967 and the first quarter of 1968 at rates of speed and rates of growth that if continued, are going to create both imbalance, in our trade picture, our export-import picture, and strains on the economy which will continue to encourage the rising wage-price spiral.

Senator HARTKE. I do not think what happened last year indicates that. If I am wrong on these figures, I wish you would correct me. My understanding is that the gross national product, excluding inventory change, increased at the annual rate of 8.4 percent in the first quarter of 1967, 8.1 the second quarter, 6.6 the third quarter and 5.7 the fourth quarter, is that correct?

Secretary FOWLER. No. I do not think those would be the figures that I have in mind.

Senator HARTKE. Well, now, will you tell me where they are wrong? I gave you a steadily declining increase in the gross national product from 8.4 percent in the first quarter, 8.1 percent in the second, 6.6 percent in the third, and 5.7 percent in the fourth. If that is wrong I would like to know it.

Secretary FOWLER. Senator, my recollection is that in the first quarter of calendar 1967, the gross national product increased at an annual rate of about \$4 billion. It went up in the second quarter to an annual rate of \$9 billion. It went up in the third quarter to an annual rate of about \$16 billion, and continued in the fourth quarter at an annual rate of \$16 billion.

Senator HARTKE. I would like for the record now to show these percentages. Final demand for goods and services.

Secretary FOWLER. Now, that is final demand.

Senator HARTKE. That is right. Is not that the thing?

Secretary FOWLER. No. I understood you to say gross national product, Senator, and I think on your final demand figures—

Senator HARTKE. I said that includes the gross national product, excluding inventory change. Now, inventory does not have anything to do with the economy basically, except in the final analysis that it may be hoped for.

Secretary FOWLER. Your figures on final demand are correct.

Senator HARTKE. That is right. This is what really affects the economy. Now, the second thing, on personal consumption expenditures. Did not they follow generally the same pattern? They do not show an expanding economy. They show a contracting economy. The first quarter was 5.4, second, 7.9, then it dropped substantially in the last half of last year to 4.6 and 4.9 in the last two quarters of last year.

Secretary FOWLER. Well, taking a given component in the gross national product picture, Senator, my comments would be that despite the fact that personal consumption expenditures in the last two quarters of 1967 were growing at a slightly diminished rate of increase from the previous quarters, the totality of demand growth from all the other sectors, government—Federal, State, local—plant and equipment, all the other elements of demand, were such that the gross national product in the last two quarters despite a declining rate in personal consumption expenditures, despite an increase in the savings rate, and despite some strikes, nonetheless increased at a rate of \$16 billion per quarter in the third and fourth quarters and it promises to—

Senator HARTKE. Is it not true also that capital expenditures flattened out last year for the first time in about 6 or 7 years?

Secretary FOWLER. In the early part of the year, but fixed investment came back in the third and fourth quarter. Capital expenditures are on the way up and the projections are that they will increase at a rate of 5 to 6 percent.

Senator HARTKE. What you are saying is the same thing you said a year ago when you first asked for the tax increase and your predictions did not come true. I am not going by predictions. I am going now by the current effect. Is the housing industry at the present state anywhere near what it was, say, 2 years ago when we had stable prices?

Secretary FOWLER. Two years ago would be——

Senator HARTKE. The new housing starts.

Secretary FOWLER. The recent figures are not up to the levels reached in 1966, in the early part of 1966. They are well above——

Senator HARTKE. That is what I am getting at.

Secretary FOWLER (continuing). The depths to which housing sank in the fall of 1966.

Senator HARTKE. Yes.

Secretary FOWLER. And early winter.

Senator HARTKE. I agree with you. What I am saying to you, and I think it is quite understandable is that we have had higher levels of economic growth, higher levels of economic activity in a period of stable prices 2 years ago. We have had an increase in population since that time and for all intents and purposes, only last year 2½ percent real growth in the country. Is that not true?

Secretary FOWLER. Right.

Senator HARTKE. Well, how are you going to correct a situation by cutting back on demand when you have available excessive plant capacity and excessive supply in the marketplace today? I can go downtown and buy any car you want, any color, any model, and have it delivered to you at bargain prices, absolutely bargain prices. I can buy any pair of shoes I want with or without shoe strings, loafers or otherwise, any amount of food, any kind of food I want.

Every show window is full and not like in Russia where they have the windows full and nothing in the stores. Nothing on the counter and you can go back in the back room and they have material they cannot even advertise. In the appliance industry, they are trying to hold the line even trying to keep their sales up.

Secretary FOWLER. I think the regrettable fact, however, is that while you might find those goods, you would not find them at the prices you were able to find them in the 1966.

Senator HARTKE. I agree with——

Secretary FOWLER. And, due to the totality of the demand in the economy during the last two quarters of 1967 and currently in the first quarter—in the second half of last year we had a gross national product increase of \$16 billion at an annual rate per quarter, and nearly one-half of that increase is represented by price increases—have got an inflationary situation.

Senator HARTKE. Mr. Secretary, you are trying to tell us that it is demand and you have not been able to find one place in the market, not one. You say totality but you have not been able to specify one place in the market in which there is not an available supply. Not one. And, there is no question prices have gone up. Material has gone up. Labor.

Secretary FOWLER. I would think——

Senator HARTKE. Just a minute. Senator Bennett indicated that labor costs are going up even more, and overhead has gone up. Local taxes have gone up, and now you are asking for an additional cost, and when you put on an additional cost, you are going to push prices still higher.

Secretary FOWLER. Well, by the same token, all of the economic wisdom, Senator, that can be summoned to this problem, indicates that you are not going to reverse a wage-price spiral in an atmosphere of excessively expanding demand.

Senator HARTKE. Now, I have asked you now, and I am going to ask you again, will you just specify one place where there is excessive demand—do not give me that totality.

Secretary FOWLER. Well, the totality is a fact.

Senator HARTKE. You cannot make totality up except with individuals. All I am asking for, and I think this is a simple request, is give me just one place in which there is a shortage in the marketplace of productive capacity or available supply. I do not care how many people want to argue this philosophy; you cannot argue on the basis of economics that when there is an excessive supply that there is an overdemand. That just cannot be so.

You have a situation where you sold a million less automobiles in 1967 than you did in 1966 and 2 million less than you did in 1965. And now you are coming here and saying that you are going to go ahead and fill that backlog, that backlog, and sell as many automobiles as you did in 1965 and complain that that is excessive demand when you have had an increase in the growth in the country and an increase in population. If you sold as many as you did in 1965 you would just be holding even. That is not growth. That is not excessive demand.

Just name me one place—I do not think that is too much to ask—one place where there is an excessive demand for one item in the marketplace. I do not think you can show it to me.

Secretary FOWLER. I would say medical costs are a typical example, where there is a—

Senator HARTKE. Medical costs. You mean to say that you are going to go ahead and cut down on money so people cannot pay their medical bills?

Secretary FOWLER. No, I was answering your question, are there areas in the economy. I think your question about whether there are particular areas where there are marked shortages, is not the compelling economic question here as it is viewed by most people who consider themselves expert in this problem.

Senator HARTKE. Now, you talked to some experts and I talked to some experts. If you wish, we can match experts. I would rather go ahead and talk facts, if you do not care.

Secretary FOWLER. Let me just read you from a statement of the Chairman of the Economic Policy Committee of the OECD, which is a 20-country body. These are objective outside observers. They are not participants in this debate which has been raging. And the Chairman of this OECD Policy Committee meeting on the 5th and 6th of March, and this is—

Senator HARTKE. Do you want to identify him for the record?

Secretary FOWLER. I do not have his name. I perhaps—

Senator HARTKE. This unknown expert, right?

Secretary FOWLER. This is a discussion which is not normally made on the public record and perhaps I will just paraphrase by saying it is the nearly unanimous view of objective observers and outside students of the American economy that in the period ahead, the appropriate economic policy is to try to keep our expansion at or below a 4-percent level of increase in real terms, and that in order to achieve that, a prompt enactment of the tax increase is necessary in order to prevent our expansion from becoming excessive and thereby giving a continued impetus to the inflationary trends, to the in-

flationary psychology, to the wage-price spiral, to all of the unbalancing elements that threatened the health and stability of the economy today.

Senator HARTKE. Mr. Secretary, that is beautiful rhetoric. Will you just tell me one item, just one item. If you do not have one, just tell me. I will accept that.

Secretary FOWLER. Well, I would say experienced skilled labor.

Senator HARTKE. Skilled labor. All right. What are you going to tell me then? Are you going to increase the taxes so that you do something to increase skilled labor? What are you going to do to the skilled labor market?

Secretary FOWLER. We are going to increase taxes to restrict, to moderate the growth in demand.

Senator HARTKE. For skilled labor?

Secretary FOWLER. To moderate the growth in demand in the economy so that shortages in skilled labor will not be such an element in the economic picture that wages will continue to bound up at excessive rates out of line with productivity and that prices will not continue to bound up as sellers try to compensate for increase in costs. With a tax increase we will create a situation in which a reversal of the current wage-price spiral which has characterized particularly the last 8 months will be achieved.

Senator HARTKE. All right.

I am just going to show you how unsound that is in economics and in human psychology. No. 1, most skilled labor is organized, right?

Secretary FOWLER. I would say a good deal of it is. I do not happen to have the components broken down that way.

Senator HARTKE. Do you mean to say you are going to bring down the wage scales of these people in organized industry?

Secretary FOWLER. I am saying that the increases in wage scales and in labor costs and in unit labor costs in manufacturing have been increasing in recent times at an excessive rate, out of line with increases in productivity, and the result of that and the result of the increases in prices which manufacturers and sellers carry out in an atmosphere of excessive expansion is a serious economic problem which should be arrested.

Senator HARTKE. All right. Let us come back to facts and avoid some of the rhetoric. The fact is that if you put through this tax increase, 10-percent surtax, it means less take-home pay for the man who is working for a living, right?

Secretary FOWLER. No, it depends upon what happens to the level of his wage income and other things at the same time. Another factor that must be considered is what that wage income that he takes home is going to be worth in terms of prices, the goods and services he buys.

Senator HARTKE. All I am doing is going back to the worker who is out here in the marketplace. If you put on a 10-percent surtax, and that includes the Federal worker also, he is going to have less take-home pay.

Secretary FOWLER. Depending on what has happened to his wage increases and prices in that process. In the atmosphere that is created without the tax, increases in wages may be 7, 8, and 9 percent, but the

increase in his real take-home pay is obviously not going to be that much.

Senator HARTKE. Look at the settlement which is being negotiated at this moment or trying to be negotiated in the copper industry. If there is a 10-percent surtax they are going to say, "Look, as far as we are concerned we are going to have to have enough money to cover the difference. Our taxes are going up. As far as we are concerned we are going to have to have an increase in wages." Every single person who has to deal with this business will tell you that one of the things that the labor negotiators say is, "If you are going to have a tax increase, we are going to have to have the right to reopen our contracts."

Secretary FOWLER. Senator Hartke, I think by far the predominant element that would enter into these discussions and negotiations is not the fact that taxes may go up 1 percent as a result of the surtax, but that prices are going up 3½ and 4 percent and that is the principal element of concern on the part of the wage earner who is trying to maintain and if anything, increase the real wages and the real buying power as a result of his labor.

Senator HARTKE. All right. I am not going to pursue this any further, but I will say to you, it is my judgment that you have not been able to demonstrate one single factor, not one single factor, in which there is an excessive demand for available supply or productive capacity which destroys your argument completely. With respect to skilled labor, the only way that your increase would be effective is to cause massive unemployment, so this is a doctrine which is going to do two things. It is going to attempt to destroy a great economy which is already sluggish and produce mass unemployment and to cause a recession in the marketplace following the pattern which was laid down by Britain. It will add 10 percent to our cost in the international market which will mean our products will be less competitive than they are today, which will accelerate our balance-of-payments problem.

I want to ask you just one other question.

Secretary FOWLER. I just note my complete disagreement with that analysis.

Senator HARTKE. I know you disagree with it and I respect your right to disagree with me, but just respect mine to disagree with you.

One question on investments overseas. Why was Greece, a military dictatorship, given special treatment in investments overseas?

Secretary FOWLER. We followed the pattern of treating the countries in the categories that had been established under the interest equalization tax which separated the less developed countries from the developed countries according to criteria which were established at that time.

Senator HARTKE. You recognize that every Greek paper over there proclaimed this as an endorsement of the military junta, that they were given special treatment at the special request of certain individuals inside America—

Secretary FOWLER. I have no—

Senator HARTKE (continuing). On behalf of the Greek Government to give this military junta, which denies the rights of constitutional

government there, special treatment in the field of investments overseas.

Secretary FOWLER. I have no control over what the Greek press writes. The fact of the matter is that there was no special judgment made with reference to Greece in this matter and we followed the pattern that had been laid down in the categories of less developed countries under the interest equalization tax and maintained from that time regardless of the nature of the ruling power.

Senator HARTKE. I just want to make one other statement, that the greatest user of skilled labor today is the Department of Defense. That is all.

Mr. SURREY. Senator Hartke, could I just clear up one point in our colloquy, if you do not mind?

Senator HARTKE. Yes, sir.

Mr. SURREY. I did not catch the facts that you were using dealers' figures on dealers' sales, I think, and dealers' figures on dealers' sales will not come out the equivalent of the figures we are using because we use manufacturers' sales and depending on how inventories change, there will be a difference. Inventories were very low and there will be an inventory increase and that inventory increase will account for manufacturers' sales may be about 200,000 higher, so, therefore, the figures are not talking about the same thing and you can get a discrepancy between your figures and our figures.

Senator HARTKE. What I am saying is that you are anticipating an increase in sales——

Mr. SURREY. No.

Senator HARTKE (continuing). For this year.

Mr. SURREY. No. What I was saying is your figures will jibe with ours if you take into account the inventory adjustment. Our figures and yours.

Senator HARTKE. All right.

The CHAIRMAN. Senator Harris?

Senator HARRIS. No questions.

The CHAIRMAN. Senator Metcalf?

Senator METCALF. No questions.

The CHAIRMAN. Mr. Secretary, we will excuse you——

Secretary FOWLER. Thank you, Mr. Chairman. I seem to be in demand this morning.

The CHAIRMAN (continuing). For your long-delayed meeting at the Ways and Means Committee. Thank you very much.

Any further questions of Mr. Surrey?

Senator BENNETT. I have none.

The CHAIRMAN. Any further questions of the Director of the Budget?

Then, if there are no further questions——

Senator ANDERSON. I want to say one thing. In speaking about the House acting on the surtax bill, the Constitution says all bills for raising revenue originate in the House. This is for raising revenue. I think we could very properly deal with something else.

The CHAIRMAN. Thank you, Senator.

Well, then, that concludes the hearing and if the Senate grants permission, the committee will meet in executive session probably in the Office of the Secretary of the Senate or else some room over off the Senate floor at 2:00 o'clock and if the Senate does not grant permis-

sion, then we will meet at 9:30 tomorrow morning to take up the bill in executive session. I hope we can meet at 2.

Senator BENNETT. I cannot be there at 2. I can be there at 2:30. You can start without me.

The CHAIRMAN. We will not reach any conclusive decisions before 2:30. Thanks very much.

(Whereupon, at 10:55 a.m., the hearing was concluded.)

(By direction of the Chairman the following are made a part of the printed record:)

SALT LAKE CITY, UTAH, March 5, 1968.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
2227 New Senate Office Building,
Washington, D.C.:

On behalf of the mining industry in Utah we wish to register strong opposition to S. 2063, a bill that would reduce depletion rates on minerals extracted from the earth. An arbitrary reduction of depletion allowances which have been worked out over a period of many years would impose serious hardship on broad segments of the mining industry. Such action would sharply reduce incentives which are urgently necessary to the development of a continuing supply of domestically mined strategic materials.

Considering the importance to the mining industry and indeed the Nation of these issues, we strongly recommend that they be considered on their own merits and not included as add-on elements to other legislation.

PAUL S. RATTLE,
Manager, Utah Mining Association.

INVESTING BUILDERS & OWNERS ASSOCIATION, INC.,
New York, N.Y., March 7, 1968.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: This association represents major private investment builders in the New York area. About 90% of the construction sponsored by private investment capital in New York City is produced by member firms of this association. Many of our members are engaged in similar construction projects in other cities of the United States.

In behalf of its members, this association vigorously opposes H.R. 15414, presently before the Senate Finance Committee, which would eliminate the present exemption of \$100,000 from estimated tax liability, and increase the present requirement of paying at least 70% of estimated tax liability to a new 80% level.

Penalties applicable to general contractors and subcontractors who underestimate tax liability are severe; the speed-up of corporate estimated tax payments will actually result in a 20% tax increase over the next 5 years; and those firms whose tax liability amounts to \$100,000 or less will be particularly hard hit.

We ask your earnest consideration in disapproving this proposal.

Respectfully,

LEWIS WHITEMAN, Executive Director.

STATEMENT ON H. R. 15414, TAX ADJUSTMENT ACT OF 1968, IN BEHALF OF THE
CHAMBER OF COMMERCE OF THE UNITED STATES, BY ROBERT R. STATHAM,
TAXATION AND FINANCE MANAGER.

The National Chamber appreciates this opportunity to present its views on H. R. 15414, which provides for acceleration of corporate income tax payments, postponement of scheduled reductions of excise taxes on automobiles and telephone service, and for prompt refunds for overestimated taxes.

In November, 1967, the Chamber issued a statement setting forth its position with respect to the Nation's fiscal affairs. That statement, which was reaffirmed last month by the Chamber's Board of Directors, is attached hereto as part of

this statement. Briefly, it is the view of the National Chamber that in light of forecast deficits of \$22.8 billion in fiscal 1968 and \$21 billion in fiscal 1969, there must be a reduction in Federal spending. Following a commitment by the Administration to a program of expenditure reduction, the Chamber will support an across-the-board temporary tax increase in the form of a surtax imposed uniformly upon individuals and corporations.

ACCELERATION OF CORPORATE TAX PAYMENTS

In effect, the proposed acceleration is a further temporary increase in the taxes of corporations. The Chamber's position is that any tax increase should be borne in like manner by individuals and corporations. Consistent with this view, the National Chamber opposes the provisions in the bill pertaining to acceleration of corporate income tax payments. The proposed acceleration has the effect of reducing corporate working capital and forcing corporations to go to the money market.

This proposed speedup would be the fifth change in corporate income tax payment patterns since 1950. Prior to 1950, corporate income taxes were payable in four installments of 25% each in the year following the taxable year. By the *Revenue Act of 1950*, the Congress provided for the tax to be paid in two installments of 50% each, on March 15th and on the following June 15th—both of these payment dates being in the year immediately following the year in which the tax liability arose. Comparable dates were provided for fiscal year corporations.

The *Internal Revenue Code of 1954* adopted a new payment plan for corporations whose tax was in excess of \$100,000. The transition was over a five-year period. When fully effective, a corporation was required to pay 25% of its estimated tax in excess of \$100,000 in the third quarter of the year in which the tax liability arose. Another 25% of the estimated tax was paid in the fourth quarter of the year of liability. The remainder of the tax was paid in two equal installments the following year.

In 1964, a further acceleration took place. Under the *Revenue Act of 1964*, a system was adopted whereby a corporation's tax, in excess of \$100,000, was placed on a completely pay-as-you-go basis. The changeover was to take seven years, and was to be fully effective by 1970 so the tax would be paid in the year of liability in equal 25% payments.

However, by the *Tax Adjustment Act of 1966*, the seven-year transition period was reduced to four years, making the changeover complete by 1967. For taxable years beginning in 1966, a corporation was required to pay 74% of its estimated tax liability in excess of \$100,000 during the taxable year. For 1967, and thereafter, full current payment of estimated corporate taxes in excess of \$100,000 was required.

What is now being proposed is to eliminate the \$100,000 exclusion, which corporations have had relative to estimated taxes. This exclusion is proposed to be eliminated over a five-year period beginning in 1968. In addition, a corporation's estimated tax payments for a given taxable year would be increased from 70% to 80% of its final tax liability. These proposals amount to a tax increase for all corporations having income tax liabilities. They result in an increase in corporate tax payments of an estimated \$800 million in fiscal year 1968 and \$400 million in each of the fiscal years 1969 through 1972.

Increasing the base to 80% requires corporations presently using the 70% tax base to pay an additional 10% of one year's tax in 1968. This, plus the elimination of the \$100,000 exclusion constitute very real burdens upon corporations. Money which could otherwise be used for working capital will not be available, and these corporations will have to borrow funds to make up the difference.

ACCELERATION COMPARED WITH INDIVIDUALS' WITHHOLDING

It is argued by some that requiring the acceleration of corporate payments simply puts corporate taxpayers on the same basis as individuals. Without getting into the question of the propriety of the existing provisions of the Internal Revenue Code imposing a double tax on corporate earnings, the least that should be said is that in the area of estimated taxes there are problems unique to corporate taxpayers. Corporations have a more difficult time than individuals in estimating their income for a future year. Corporations generally are on the accrual method of accounting and report income before cash is received and can be used to pay taxes. Unlike the wage earner or the salaried worker, the corporation simply cannot estimate accurately its income for the immediate future.

It should be recalled that when individuals were placed on a pay-as-you-go basis by the *Current Tax Payment Act of 1943*, this Committee proposed that individuals should be taxed on 1942-income or 1943 income, whichever was the greater, but that taxes for the other year should be forgiven. In conference, the final decision was to tax individuals on the income of the higher year and forgive 75% of the tax on the income of the lower year. There has been no similar provision in the corporate area to reduce the added burden on corporations imposed by the acceleration provisions.

EXCISE TAXES

The National Chamber has not opposed the postponement of the reduction of the excise taxes on automobiles and telephone service. These so-called temporary taxes have been a burden on the taxpaying public and are discriminatory. They should be eliminated just as soon as revenue requirements permit. Fixed termination dates should be established, as has been done in H.R. 15414. Such termination dates must be adhered to. We would hope that the Congress would make this the last postponement of the elimination of these burdensome taxes.

REFUNDS

In its testimony before the House Committee on Ways and Means in August 1967, the National Chamber recommended that if the change were made from 70 percent to 80 percent in estimating corporate income taxes, provision should be made to permit a refund for overpayment of estimated tax prior to the filing of the final return. Provision to this effect is included in H.R. 15414. It is important that this provision be retained.

SUMMARY

The position of the National Chamber with regard to the provisions of H.R. 15414 may be summarized as follows:

First, the Chamber opposes the acceleration of corporate income tax payments both as to the elimination of the \$100,000 exclusion under present law and the increase in the base for estimating tax from 70 percent to 80 percent.

Second, the Chamber does not oppose the postponement of the excise tax reductions in the case of automobiles and telephone service, provided firm dates for the termination of these taxes are to be adhered to.

Third, the Chamber supports the provisions in H.R. 15414 relative to prompt refunds in the case of overestimated corporate taxes.

ADDENDUM

S. 2902.—In the announcement of hearings on H.R. 15414, the Chairman extended an invitation for those making statements to include comments on S. 2902, as there were indications the text of this bill might be offered as an amendment. We should like to address the remainder of this statement to provisions of S. 2902.

Section 5 would impose a ceiling of \$178 billion on Federal expenditures for 1969. The National Chamber favors such an action. It concides with our position that proposed 1969 expenditures should be reduced by at least \$8 billion. Fixing a ceiling on expenditures is not a substitute for exercising fiscal restraint on individual appropriation bills. However, it appears to be the only certain way Congress can bring total Federal expenditures under control in 1969.

A ceiling on the number of Federal employees in the Executive Branch of the Federal Government is provided by Section 3. The National Chamber shares the concern of many members of Congress over the sharp increase in the number of Federal employees during the past three years and the continued increase as proposed in the fiscal 1969 budget. In the four-year period from 1962 through 1965, the number of Federal employees increased by about 11,000. However, for the more recent four-year period, including 1969, the increase will total slightly over 300,000, with much of this growth in the civilian agencies. With staffs already swollen, there should be no particular hardship in the operation of this ceiling.

The Chamber is already on record opposing travel restraints because they infringe on individual liberties and because it is anticipated they will cause a reduction in our exports to countries feeling the loss of American tourist dollars. However, the provisions of Section 10, prohibiting nonessential foreign travel by government officers and employees, have great merit.

With respect to removal of the gold cover on United States currency, the Chamber believes that there should be a reduction, but not a complete removal. The National Chamber supports the proposal to remove the limit on the interest rates of Federal Government bonds.

We have already stated our views with regard to a tax surcharge on individuals and corporations and the postponement of the reduction of the excise taxes on automobiles and telephone service. The proposal in S. 2002 for an 8% surcharge on corporations retroactive to January 1, 1968, and a 6% surcharge on individuals effective April 1, 1968, does not agree with our view that any surcharge should be uniformly applied to individuals and corporations at the same rate, at the same effective date, and without retroactivity. It is the National Chamber's view that any surcharge should be computed on the tax liability of the taxpayer after the deduction of the investment and foreign tax credits.

POSITION ON FISCAL RESTRAINT

CHAMBER OF COMMERCE OF THE UNITED STATES, FEBRUARY 22, 1968

The present posture of the Nation's fiscal affairs threatens the economic security and opportunity of our citizens and the strength and vitality of our free society. The continuing precipitous increase in the high level of nondefense spending at a time of rapid expansion in our defense commitments has brought dangerous disorder to fiscal management and appears to reflect a dangerous misconception that in these times the Federal Government can spend without restraint on programs that do not meet a stern test of critical essentiality.

In the absence of corrective action, the prospect of a \$22.8 billion budgetary deficit in fiscal year 1968, and a \$21.2 billion budgetary deficit in fiscal year 1969, will almost certainly produce damaging inflation, resulting in cruel economic hardship for middle and low income families, a termination of the sustained economic growth we have experienced over the past several years, and an impairment of confidence in the soundness of the dollar at home and abroad. Under these conditions, our critical balance of payments problems will become even more severe and our ability to provide for our future will be impaired. Capital funds for business expansion and modernization will be inadequate and consequent dislocations and imbalances in our free enterprise system will ensue.

In January, 1967, the National Chamber declared, "For the period of the present military stringency all less essential or new spending programs should be decelerated or postponed." Since that time, the Chamber has reiterated its strong position in favor of substantial cutbacks in nonessential spending in all categories of governmental activity. On August 22, 1967, in testimony before the House Committee on Ways and Means on the Administration's proposal for a 10 percent surtax, the Chamber spokesmen again urged the immediate institution of steps toward fiscal restraint by urging, "No amount of Federal spending can solve all of our problems immediately. Some programs may have to wait until we are again at peace in Viet Nam. Priorities must be established. * * * The Chamber of Commerce believes that if the situation is as serious as the Administration contends, and we believe it is, real and immediate major cuts in nonmilitary spending should be effected." The Chamber also recommended to the Congress at that time that final action on a tax increase should await a clarification of the economic indicators that were then mixed and uncertain as to the course of the economy.

Unfortunately, developments subsequent to that testimony have evidenced no meaningful progress in the adoption of policies providing for restraint in spending. Inflationary pressures which cannot be controlled merely by reliance on a tax increase have gained strength. The Nation's capital markets have sustained further severe strain. In the light of these facts, the Chamber has adopted the following statement of principles as a program for the establishment of fiscal restraint in the affairs of the Federal Government for both the immediate and future periods.

First, as a minimum goal in expenditure reduction for fiscal years 1968 and 1969, there should be a bona fide reduction in Federal spending of at least one dollar for every dollar of tax increase.

Second, following a commitment by the Administration to a program of expenditure reduction, the Chamber will support an across-the-board temporary tax increase in the form of a uniformly applied surtax imposed upon individuals and corporations.

Third, an unrelenting and successful effort must be directed to the elimination of successive deficits in our national budgetary affairs if we are to avoid the economic erosion of an improvident government.

Fourth, there should be established a commission to review priorities in nondefense expenditures and to make recommendations for long-term methods of establishing effective controls over Federal expenditures.

In endorsing this fiscal program, the National Chamber stresses the fact that the success of these proposals in averting fiscal disorder will depend on the existence of a sustained commitment to expenditure reduction. The restoration of rigid spending discipline in this fiscal year and the years to follow is essential to the maintenance of public confidence in the integrity and responsibility of our fiscal system.

It must be clearly understood that a tax increase is not a substitute for expenditure reduction. It is urgent that a continuing program of spending reduction begin immediately and as a practical matter it is incumbent upon the Administration to provide principal leadership with the cooperation of the Congress in this regard. If there is no sustained program of expenditure control, then a tax increase alone is of questionable efficacy and doubtful wisdom.

HECLA MINING Co.,
Wallace, Idaho, March 5, 1968.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance, U. S. Senate, 2227 New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: We are very much opposed to S. 2903 which would cut back to 20% depletion rates in excess of 20% on uranium, sulphur and certain domestically mined strategic minerals. Such action would drastically curtail expenditures required in the search for these minerals which are a vital necessity to the domestic economy and in many instances to our national safety.

Exploration for minerals is much more costly today than it was even five years ago, and this seems a poor time for our Government to throw up road blocks with respect to much needed new ore deposits.

With best regards and best wishes, I am,
Yours sincerely,

I. J. RANDALL,
Chairman of the Board.

NEW YORK, N.Y., March 4, 1968.

Re H. R. 15414.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: As attorneys for the Building Trades Employers Association of the City of New York which Association has for its membership approximately 1,000 building construction contractors doing business in this city, we write to advise you that the Association we represent is opposed to the enactment of H. R. 15414 which is now under consideration by the Senate Finance Committee.

The phasing out of the \$100,000 exemption which is provided under present law will constitute a severe burden upon the construction industry in this city and for that matter throughout the country. Most corporations engaged in the construction industry do not have liability for annual Federal Income taxes in excess of \$100,000. The cost to those corporation of making advance payments of Federal Income taxes based upon unrealized profits will undoubtedly be another factor contributing to the increased cost of construction in this city and elsewhere.

We urge your Committee not to act favorably upon this Bill.

Respectfully,

FRENCH, FINK, MARKLE & McCALLION.

[Telegram]

NEW YORK, N.Y., March 7, 1968.

HON. RUSSELL B. LONG,
 Chairman, Senate Finance Committee,
 U.S. Senate, Washington, D.C.:

The Cement League of New York City supports the position of the Building Trades Employers Association in opposing of the Tax Adjustment Bill of 1968, H.R. 15414.

ALFRED G. GERUSA, *President.*

[Telegram]

NEW YORK, N.Y., March 7, 1968.

HON. RUSSELL B. LONG,
 Chairman, Senate Finance Committee,
 U.S. Senate, Washington, D.C.:

The Building Contractors and Mason Builders Association of New York City supports the position of the Building Trades Employers Association in opposing passage of the Tax Adjustment Bill of 1968, H.R. 15414.

FRED J. DRISCOLL, Jr., *President.*

[Telegram]

NEW YORK, N.Y., March 7, 1968.

HON. RUSSELL B. LONG,
 Chairman, Senate Finance Committee,
 U.S. Senate, Washington, D.C.:

The Master Carpenters Association of New York City supports the position of the Building Trades Employers Association in opposing passage of the Tax Adjustment Bill of 1968, H.R. 15414.

EDWARD J. FEE, *President.*

NATIONAL ELECTRICAL CONTRACTORS ASSOCIATION,
 Washington, D.C., March 5, 1968.

HON. RUSSELL B. LONG,
 Chairman, Senate Finance Committee,
 U.S. Senate, Washington, D.C.

MY DEAR SENATOR LONG: The National Electrical Contractors Association thanks you for permitting us to provide this statement to the Senate Finance Committee as part of the record on H.R. 15414, the Tax Adjustment Act of 1968.

By way of introduction, the National Electrical Contractors Association, which was organized in 1901, is the nationally recognized spokesman for the electrical contracting industry. This industry is composed of small business firms primarily engaged in making on-the-site electrical installations. These concerns individually employ about 16 workmen on the average, although a number have payrolls which average in the thousands of men. These companies can be found in every community of the United States and are engaged in construction projects which range from wiring of small homes to such highly technical and involved installations as atomic energy plants and missile complexes.

The typical electrical contractor provides the skilled service of procuring materials and fixtures and installing them in a safe, efficient and workmanlike manner whereby the electric power generated and brought to the owner's property line can be utilized to energize fixtures, appliances and equipment. In short, the contractor serves as the vital link between energy and its applicators.

We urge you to remove that portion of the Bill H.R. 15414 which provides for the acceleration of income tax payments by corporations. For those corporations which are presently "going concerns" the accelerated tax payments have the same effect as a tax increase. It is unfair discrimination to single out one segment of the economy for a tax increase. Electrical contractors and, in fact, all construction contractors and subcontractors who are small business corporations will have their working capital seriously impaired by the elimination of the \$100,000 exemption from the estimated tax as well as the 10% increase of payments on estimated tax liabilities.

The most reliable financial statistics in electrical construction reveal profits to be only about 3%. Final payments to construction contractors are slow and to subcontractors even slower. Moreover, the Federal Government as a purchaser of construction does not remit money with undue speed as you well know. In addition, there is great pressure for more construction—urban renewal, private construction, and governmental construction at all levels. It is likely that the taxing of working capital as provided in H.R. 15414 will precipitate the bankruptcy and failure of small business firms in industries where capital needs are already critical.

We thank you for considering our thoughts and feel sure that your due deliberations will result in the removal of the accelerated tax payment from the Tax Adjustment Act of 1968.

Cordially yours,

ROBERT L. HIGGINS,
Executive Vice President.

AMERICAN MINING CONGRESS,
March 5, 1968.

Senator RUSSELL B. LONG,
*Chairman, Committee on Finance,
United States Senate, Washington, D.C.*

DEAR SENATOR LONG: The announcement of the Committee on Finance setting the date for public hearings on H.R. 15414, a bill to extend excise tax rates and speed up corporation income tax payments, stated that statements on S. 2902 and S. 2903 would also be received.

S. 2903, introduced by Senator Williams on January 31, 1968, would reduce the percentage depletion rate on oil and gas wells, by stages, from 27½% to 20% and would reduce the percentage depletion rate for sulphur, uranium, and United States deposits of the minerals listed in section 613(b)(2)(B) of the Internal Revenue Code from 23% to 20%. This reduction would be made in two stages and would be fully effective beginning with the year 1970.

The Tax Committee of the American Mining Congress is opposed to S. 2903 and strongly urges that it not be adopted by the Committee on Finance or by the Senate. Although the American Mining Congress does not purport to represent the oil and gas producers, the entire bill is subject to the serious objection that it has not been given adequate consideration and Congress has not had an opportunity to assess its potential damaging effects upon the extractive industries. Furthermore, this cut in depletion rates has not been recommended by the Treasury Department.

The American Mining Congress represents producers of sulphur, uranium, and most of the minerals the domestic deposits of which are eligible for percentage depletion at the 23% rate. The Mining Congress has not had adequate time to assess the full impact of S. 2903 on the companies producing these minerals and on the available supply. Many of these minerals are currently in short supply. Most of the remainder have a potential for short supply situations as consumption in our economy continues to expand. They are virtually all of strategic importance to our military defense. In this critical period it would seem to be a serious mistake to discourage production.

In considering S. 2903, it should be understood that action to reduce the depletion rate on these mineral deposits from 23% to 20% would be taken by the entire extractive industry as a signal from Congress that industry could no longer depend upon a continuation of any of the existing depletion rates. Consequently, in making decisions on production expansion all companies in the industry would have to take into account the possibility of further cuts in depletion deductions. The effect would be to discourage new exploration, development, and production of needed mineral resources.

A further concern to the Committee in considering S. 2903 should be the question of the fairness of a cut in depletion rates for producers who have undertaken mineral extraction operations on the basis of the depletion rates presently stated in the law.

Respectfully submitted.

FRED W. PEEL,
Chairman, AMC Tax Committee.

AMERICAN AUTOMOBILE ASSOCIATION,
Washington, D.C., March 5, 1968.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: For more than forty years, the American Automobile Association has opposed Federal excise taxes on the purchase of private passenger cars.

While we can understand the necessity for the continuance of this tax at the present seven percent level, this still does not lessen our basic objection to such a tax. We hope this Committee, and the House Ways and Means Committee, will, if the situation in Vietnam permits, rescind this tax ahead of the schedule called for in H.R. 15414.

The AAA is opposed to such Federal excise taxes for three reasons:

1. The tax is not related to the ability to pay.
2. The automobile is a necessity, not a luxury. About seventy percent of employed persons travel to work by automobile.
3. The American motorist is the heaviest-taxed group in our nation. Total special taxes, fees and tolls paid by highway users are now over \$13.5 billion annually.

With the passage of this legislation, the American motorist will have seen the Congress change its mind on this subject four times in the last six years.

Three times the tax will not have been reduced as scheduled (1963, P.L. 88-52; 1964, P.L. 88-348 and 1968, H.R. 15414), and once the rate has actually been increased (1966, P.L. 89-368).

We are hopeful that this time the Congress will not change its mind, but will permit scheduled reductions to begin on January 1, 1970, regardless of other circumstances.

Sincerely,

GEORGE F. KACHLEIN, Jr.,
Executive Vice President.

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS ON H.R. 15414
"TAX ADJUSTMENT ACT OF 1968" AND SUGGESTED AMENDMENTS, SUBMITTED
BY EUGENE J. HARDY, VICE PRESIDENT, GOVERNMENT RELATIONS DIVISION

The National Association of Manufacturers is pleased to present its views on H.R. 15414 and suggested amendments contained in S. 2902. In this statement, we shall confine our remarks to opposition to the income tax provisions of the former and support for the expenditure limitation provision of the latter.

ACCELERATION OF CORPORATE INCOME TAX PAYMENTS

H.R. 15414 would raise from 70 percent to 80 percent the basis on which corporations make current payments on their estimated tax liabilities. It would also eliminate over a five-year period the exemption of the first \$100,000 of tax liability from current payment requirements.

In testimony before the House Ways and Means Committee last August, the NAM opposed such legislation. We are still opposed to it.

Acceleration of tax payments has the same practical effect during the transition period as an increase in tax rates or a surcharge on tax liability. In the case of a corporation which accurately gauged its tax liability for calendar 1967 and paid close to 70 percent thereof in that year, it now would be required to pay an extra 10 percent of a year's tax in calendar 1968. This would be a serious burden to be placed on top of any income tax surcharge that may later be imposed.

The burden becomes even more serious for many small corporations. A corporation whose tax liability remains consistently below the \$100,000 margin would, over the next five years, have to pay almost six years' taxes. Thus, in effect, they would be subjected to a surcharge of 16 percent in addition to any surcharge Congress may legislate.

The argument has been made that since proprietors of unincorporated enterprises already pay their taxes on a current basis, it is only fair to subject small corporations to the same treatment. But, the extra burden on the small corporations would be the result, not of their being on a pay-as-you-go basis, but of the transitional problem of getting on a pay-as-you-go basis. There was a similar transitional problem for small proprietors when individual taxpayers were first

placed on a pay-as-you-go basis in 1944. At the time Congress resolved the difficulty by a broad stroke—three-quarters of the 1943 tax liabilities of individuals were simply wiped off the books. No one has proposed a similar tax forgiveness for small corporations if their payments are made current.

From 1964 through 1967 the over-all speed-up of corporate tax payments under existing legislation has amounted to at least \$12 billion. As many authorities have noted, the resulting squeeze on corporate cash resources has contributed in no small measure to upward pressures on interest rates and tightness in the credit markets. An additional speed-up would aggravate these conditions.

If this legislation is to be enacted, however, there is one section of H.R. 15414 which the NAM strongly endorses—the provision for quick refunds of over-payments of estimated income taxes by corporations. This measure would offer some relief for corporations that, for one reason or another, overestimate tax liabilities for a given taxable year and it should be incorporated in the Internal Revenue Code regardless of the action taken on the other provisions.

EXPENDITURE LIMITATION

It has been indicated that the text of S. 2902 will be offered as an amendment to H.R. 15414. Several large issues are raised in S. 2902 but one is of overriding importance for the conduct of our fiscal affairs.

Section 5 of that bill would limit total Federal spending in fiscal 1969 to \$178 billion, except for any amounts above \$25 billion that the President deems necessary for Vietnam. The \$178 billion figure is the level the Administration has estimated for fiscal 1969 revenues, assuming passage of the 10 percent tax surcharge, but \$8 billion lower than the Administration's estimate of fiscal 1969 expenditures. Thus, the expenditures ceiling would ensure a balanced Federal budget in 1969 if the Administration's revenue estimates are reasonably accurate and if Vietnam costs do not rise significantly over budget projections.

Both of these conditions are open to question. However, the thrust of the amendment is clearly to control current spending and with this objective the NAM is in complete accord.

It would be preferable, we realize, to exercise fiscal restraint through a detailed review by the Administration and Congress of all spending programs—a review which would lead to assignment of priorities for spending in the context of a full-employment economy beset by inflationary pressures. This would be preferable to a rigid ceiling on expenditures set by law that conceivably might misapply to our economic circumstances a year from now.

Unfortunately, there is little evidence that such a review will be made in the near future. Despite the Administration's earlier emphasis on "expenditure restraint" when the 10 percent surcharge was suggested last summer, the 1969 budget proposes only minor cuts in various programs and an overall spending increase of \$10.5 billion over fiscal 1968, two-thirds of which would be for non-defense purposes.

Two weeks ago, the NAM Board of Directors overwhelmingly adopted a resolution, which reads in part:

"Our fiscal situation is critical and the exercise of rigid discipline is imperative for both domestic policy considerations and maintenance of international confidence in the dollar. Therefore, the Administration and the Congress should cut anticipated government outlays sufficiently to hold spending in fiscal 1969 to the level of fiscal 1968."

While the mechanics of Section 5 of S. 2902 are slightly different, the NAM feels that it is wholly consistent with the spirit of the above resolution. If, under the present circumstances, the only means to achieve fiscal discipline is through a legislative limit on expenditures, Section 5 deserve the support of the Committee on Finance.

STATEMENT OF GEORGE S. BULLEN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C. 20005

SUMMARY SHEET

The National Federation of Independent Business submits this statement dealing only with Section 6154 Installment Payments of Estimated Income Tax by Corporations, (a) Corporations Required to Pay Estimated Income Tax.

The National Federation of Independent Business asks that H.R. 15414 be amended by the Senate Committee on Finance as follows:

On page 5, line 7, of the printed version of the House bill, the figure \$40 be stricken and inserted in lieu thereof the figure \$10,000.

The attached statement sets forth our arguments in favor of the requested amendment.

STATEMENT

The National Federation of Independent Business appreciates the opportunity to submit this statement on H.R. 15414.

The National Federation of Independent Business is a nationwide business organization composed of more than 243,000 independents in all phases of commercial enterprise and professions throughout the fifty States.

Inasmuch as your Committee is considering the Administration's request for a speedup in corporate tax collections, I would like to make known to you the Federation's position on this matter regarding the smaller corporations throughout the country. We very strongly feel that, should the President's proposal to drop the \$100,000 exemption figure to \$40 be approved by your Committee, a great hardship will be wrought upon those smaller corporations who now only find it necessary to pay their corporate income taxes on an annual basis. The number of corporations involved here is truly great. The latest figures we have, taken from "Statistics of Income 1963" show that a total of 601,854 incorporated businesses actually paid taxes. Of this figure, 507,509 paid less than \$10,000 in corporate taxes. In other words, based on these figures, about 84% of the total of corporations having annual tax liability, actually pay \$10,000 or less annually in corporate taxes.

Should the Congress approve the \$40 figure suggested by the Administration, virtually every corporation in the United States having any tax liability will be forced to file and pay on a quarterly basis. Mr. Chairman, when we consider that the great majority of small businesses are operated on much tighter cash flow requirements than are larger corporations, we see that it is entirely possible that these quarterly payments could create considerable financial difficulties in their business operations. For instance, a small corporation which might have prepaid, let us say, \$5,000 of its estimated income taxes for 1968 in the first half of the year, the payment being based upon its actual tax liability for the preceding year, finds that it is running into financial reverses during the latter half of 1968. This small corporation might well find itself extremely short of working capital in a year in which it is going to incur an operating loss. Credit conditions being what they are today, small firms find it extremely difficult to obtain ready credit at reasonable rates. However, if a firm has at its disposal the \$5,000 already paid to the Government as a prepayment, during the latter half of 1968, when it most needs the money to continue operations, it could possibly make the difference between success and failure. Additionally, since the firm will be incurring an operating loss for 1968, it would be entitled to a refund of the prior year's taxes due to loss carry-back provisions. Should the Administration's proposal be enacted as requested, the firm would have no hope whatsoever of utilizing that portion of its estimated taxes already prepaid, as it would have to wait until the end of the year before it could expect a refund from the Federal Government.

I only cite the above example as the type of problem which would be faced by smaller corporations throughout the country.

The National Federation of Independent Business requests that the \$100,000 exemption figure, if lowered, not be dropped below \$10,000.

We realize full well that this does not eliminate an existing disparity between corporation taxes and those paid on an individual basis as a result of business partnerships or proprietorships. However, this disparity already exists and, therefore, they would suffer no additional hardship. At the same time, corporations with tax liabilities of \$10,000 or less would be greatly aided by such an exemption.

The Administration has based its request for the \$100,000 exemption exclusion on two basic facts. The first being that the speeded up revenue collection is necessary in order that the Government will be able to meet its financial commitments in a timely manner. The second factor upon which the request has been made is that such action would remove the existing inequity regarding corporate tax payments as opposed to tax payments required by unincorporated businesses.

The Federation cannot argue over the fact that the Government must find a better method of meeting its financial obligation. However, we do feel that the smaller corporations who will be affected could be placed in an extremely precarious financial position. This is particularly true in cases where the quarterly payments may already have been made, and the business finds itself suddenly in need of additional operating capital. With an ever-increasingly tight money market, this

business must attempt to borrow the required capital. If the money is available at all, the business finds that with an existing prime interest rate of 6 or 7 percent, it will be required to pay a rate of 8 to 10 percent. Borrowing money at such high rates would certainly add to inflationary pressures already prevalent in the economy. On the other hand, if the business is not required to make its quarterly payments, and if the Government finds it necessary to borrow an amount which it would have been receiving, it can go into the money market to borrow at interest rates of 4 or 4½ percent. Such borrowing, when necessary, would prove far less inflationary than business borrowing at much higher rates.

Regarding the contention that lowering the \$100,000 figure to \$40 would create equality, we agree, *with the exception* that base corporate tax rates are higher than base individual rates. However, we do not feel that such equality would be the best answer for all concerned. In order to equalize the two, it will be necessary to cause financial hardship and difficulty for one sector while doing nothing to alleviate the burden already being borne by the other sector. The exemption removal would not prove at all helpful to those individuals already subject to the \$40 provision, but it would definitely harm all smaller corporations.

Allegorically speaking, what the exemption removal would do might be compared to John Smith, who has a broken leg and finds it necessary to hobble about on crutches. His friend Joe Doe is physically sound and able to get around very well on his two good legs. There is an obvious inequality between their physical conditions and capabilities. Would it be sensible, merely to erase this existing inequality, for Joe Doe to break his leg as well?

While it is true that the greatest number of corporations who pay taxes fall in a category of less than \$100,000 in annual tax liability, these corporations are, at the same time, even in aggregate numbers, not the corporations contributing the greatest amount of annual Federal tax outlays. For example, examination of the Security and Exchange Commission—Federal Trade Commission "Quarterly Financial Report for Manufacturing Corporations" for the third quarter of fiscal year 1967, indicates that 64% of all manufacturing corporations have assets of \$5 million or less. Yet these corporations accounted for only 16.2% of all corporate Federal tax outlays!

Within the business structure of our country, small business has always been considered a unique and special group, deserving of special considerations in order that they might successfully compete with their big business rivals. Throughout our recent history, this fact has been demonstrated time and time again. The Congress itself has established ample precedent for special consideration where small business is concerned. For example:

1. Revenue Act of 1950, action was taken by Congress on a Korean War excess profits tax. The Congress exempted from the excess profits tax the first \$25,000 of corporate income. In this legislation, the Congress raised the corporate income tax rate from 45% to 47% but only on all profits over \$25,000 (PL 81-809).

2. In 1951, Treasury Secretary Snyder called for an increase in the corporate normal tax from 25% to 33%. The Congress cut this increase to 30%, on the first \$25,000 of corporate income, and provided that this should drop to 25% on March 31, 1954 (PL 82-183).

3. In enacting the original Investment Credit (1962), Congress continued its acknowledgement of the needs of small business by providing that the full credit would apply only to the first \$25,000 of income, and at reduced rates above that figure, and by taking the initiative and enabling it to apply investments in used property to a maximum of \$50,000 in any one year (PL 87-834).

4. In 1964, Congress moved again to assist small business by reducing the tax rate on the first \$25,000 of corporate income from 30% to 22%, and by increasing the tax rate on such incomes over \$25,000 from 22% to 26%. This effected a reversal of the steps in tax rates—at the \$25,000 income level—specifically intended for the benefit of small business (PL 88-272).

It is evident from the above that the Congress has considered the needs of small business in the past. We request that these needs continue to be considered by not reducing the \$100,000 exemption figure below a level of \$10,000. As presented earlier in this statement, this \$10,000 figure would exempt a majority of smaller corporations who find themselves in the greatest need of the continued practice of being allowed to file and pay their income taxes on an annual, rather than on a quarterly basis.

Therefore, the National Federation of Independent Business recommends that on page 5, line 7, of H.R. 15414 the figure \$40 be stricken, and the figure \$10,000 be substituted.

PROGRESSIVE ELECTRIC CONTRACTING CORP.,
Long Island City, N.Y., March 11, 1968.

HON. SENATOR LONG,
Senate Finance Committee
Senate Office Building, Washington, D.C.

Dear SENATOR LONG: We strenuously object to the Senate Bill to speed up corporate income tax payments which jeopardizes small corporations since an extra 20% in income taxes will have to be paid in each of the following five years.

Small businesses have severely limited working capital and it is very hard to borrow money at the present time due to the tight money market. This extra tax burden could severely limit our operations.

We suggest that the present \$25,000 exemption be lowered to \$20,000.

Very truly yours,

KURT C. WALTER, *President.*

EASTERN STATES ELECTRICAL CONTRACTORS, INC.,
New York, N.Y., March 11, 1968.

Re Counterpart Bill H.R. 15414 To Speed Up Corporate Income Tax Payments.

Hon. RUSSELL B. LONG,
U.S. Senate,
Senate Office Building, Washington, D.C.

DEAR SENATOR: In accordance with this Bill, small store owners, repair shops, service stations, builders and contractors will be required to pay an additional 20% in income taxes in each of the next five years.

This would severely limit the working capital and sources of borrowing, especially during tight money periods. This additional load on small business could very easily result in bankruptcy, stop or delay expansion, and discourage new enterprises.

A suggested alternate to the proposal would be a lowering of present exemption to \$20,000.00 estimated tax liability.

The penalties involved in this bill are especially harsh for now or growing small corporations where net income is erratic or indeterminable in advance.

Very truly yours,

MORTON D. HOFFMAN, *President.*

SCHONSTEDT INSTRUMENT Co.,
Silver Spring, Md., March 7, 1968.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
United States Senate, Washington, D.C.

DEAR SENATOR LONG: I am writing you concerning an urgent matter because of your known reputation of being a friend to small businesses. My concern pertains to the Tax Adjustment Bill pending in Congress which would eliminate the \$100,000 exemption and put all corporations on a pay-as-you-go tax basis by 1972.

The enactment of this legislation will impose a very severe handicap on small business for a few of the following reasons:

1. Severely limit its cash flow, forcing some to:
 - a. go out of business;
 - b. merge with a large company;
 - c. fall into the hands of loan sharks.

2. Increase accounting expenses. Many small firms ascertain their profits only at the end of their fiscal year and not on a quarterly or monthly basis as would be required. Small firms can afford only costly primitive accounting methods versus the computer techniques used by large firms.

3. Company-sponsored research and development would be curtailed leading to the eventual death of many small companies. Our greatest recent innovations have been made by small companies, e.g., Xerography and polaroid cameras to mention a few.

To me it does not make sense to spend large sums of money to promote small business via the Small Business Administration and small business set asides for Government contracts and then choke small business to death by unwise tax

legislation. We all know that the Government needs more money but this seems to me to be a cruel and short-sighted way to get it.

I am confident that you will give this matter your most thoughtful consideration.

Sincerely yours,

E. O. SCHONSTEDT, *President.*

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
Los Angeles, Calif., March 7, 1968.

Hon. RUSSELL B. LONG,
*Chairman, Senate Finance Committee,
Old Senate Office Building, Washington, D.C.*

DEAR MR. LONG: The committee on federal taxation of the American Institute of Certified Public Accountants offers the following comment regarding Section 4 of H.R. 15414, a bill to continue certain existing excise tax rates and to revise the current method for payment of estimated tax by corporations.

Section 4 (proposed Section 7502(e) of the Internal Revenue Code) concerns the timely mailing of deposits of tax. While we support the principle stated in proposed Section 7502(e), that a timely mailed deposit of tax will be considered as timely filed, we recommend the deletion of proposed Section 7502(e)(2)(A), which especially requires that for a timely mailed deposit of tax to be considered timely filed, the deposit must be mailed two days before the due date for making the deposit. A conforming deletion should also be made of the phrase ". . . on or before such second day . . ." appearing in proposed Section 7502(e)(2)(B).

Public Law 89-713 amended Section 7502 of the Internal Revenue Code. Section 7502 as amended now specifically provides that, "If any return, claim, statement, or other document required to be filed, or any payment required to be made, within a prescribed period or on or before a prescribed date under the authority of any provision of the internal revenue laws is, after such period or such date, delivered by United States mail . . . the date of the United States postmark stamped on the cover in which such return, claim, statement, or other document, or payment is mailed shall be deemed to be the date of delivery or the date of payment, as the case may be." [Emphasis supplied.]

The clear intent of Section 7502 is that a timely mailed payment of tax would be considered timely notwithstanding any other section of the Internal Revenue Code. It is regrettable that the Internal Revenue Service in administering Section 6302 (which provides general rules for the mode or time of collection of taxes) chose to ignore the existence of Section 7502 (which provides specifically that timely mailing is to be treated as timely filing and paying). Section 7502 was disregarded through a strained interpretation to the effect that a "payment of tax" does not include a "deposit of tax".

The Service-adopted regulations provide that the timeliness of a deposit of tax would be determined by the date of receipt by the authorized depository rather than the postmark date. The hundreds of thousands of taxpayers already burdened with the periodic filing (in some cases semi-monthly) of returns and deposits of withholding, social security, excise and corporate estimated and income tax were now saddled with the additional burden of sending such tax payments to authorized depositories sufficiently far in advance to allow for mail delivery delays and processing time at the depository. This seems harsh and unnecessary.

Proposed Section 7502(e) presently being considered by your Committee, would continue to distinguish between a "payment" of tax and a "deposit" of tax by providing that a "deposit" of tax must be mailed two days prior to the due date in order to be considered timely while a "payment" of tax may be mailed on the due date to be timely.

We strongly urge an end to this Treasury Department imposed artificial distinction. H.R. 15414 should be amended to provide that "deposits" of tax and "payments" of tax may be mailed on the due date to be considered timely. The consistency of treatment of "deposits" and "payments" will ease taxpayer compliance burdens without loss of efficiency or revenue to the Treasury.

If you require further elaboration on this matter we would be pleased to furnish it.

Sincerely,

DONALD T. BURNS,
General Chairman, Committee on Federal Taxation.

U.S. INDEPENDENT TELEPHONE ASSOCIATION,
Washington, D.C., March 12, 1968.

Honorable RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Under consideration by your Committee is H.R. 15414, the Tax Adjustment Act of 1968. Of particular concern to this Association is the continuation of the telephone excise tax as provided by this proposed legislation.

The United States Independent Telephone Association (USITA) represents the Independent (non-Bell) segment of the telephone industry. Involved are 2,200 telephone companies serving principally the rural and suburban areas of this nation. Although our companies are but one-fifth in numbers of telephones compared with the Bell System, they serve over half the geographical area of this country—the entire states of Hawaii and Alaska, and some portion of all states except Delaware and Rhode Island.

Our members appreciate the fact that this country is currently faced with a multitude of fiscal problems. They do not propose to add to these difficulties. However, on behalf of the telephone users it is believed the following points should be made:

(1) The telephone excise tax on residential service is a regressive tax. In 1966 when our Executive Vice President testified before your Committee on this subject, he pointed out that over half of the households with telephones in this country had incomes of less than \$6,000 and one-fifth had less than \$3,000 a year. The individual hardest hit by the excise tax is the poor man who has need of telephone service.

(2) Our industry likes to think in terms of *universality* of telephone service. Communications by telephone are just as much a public service, just as much a necessity, as communications by mail. Yet it is a fact, and it can be documented, that cost of telephone service is a limiting factor to universal residential and farm telephone development. Because of the definite relationship between telephone development and earnings many in the low income groups just can not afford telephone service.

The national average excluding Hawaii and Alaska (January 1, 1967) of households with telephone service is 87 percent. Below this national average are these states represented on your Committee:

	Percent			Percent
Louisiana.....	78		Arkansas.....	66
Florida.....	81		Montana.....	82
New Mexico.....	72		Oklahoma.....	82
Tennessee.....	77		Kentucky.....	73
Georgia.....	75			

Only Minnesota (95%) and Connecticut (96%) are well above the national average.

The national average (October 1967) of farms with telephones is 80 percent. Below the national average are these states represented on your Committee:

	Percent			Percent
Louisiana.....	74		Georgia.....	75
Florida.....	74		Arkansas.....	65
New Mexico.....	65		Oklahoma.....	78
Tennessee.....	70		Kentucky.....	68

That universality in farm telephones can be approached is proved by the fact that Connecticut has 98 percent farms with telephones. And there is virtual universality in government-subsidized mail service and in nonexcise taxed electric service. So why should the poor and near poor be penalized because of an excise which has no other attribute except ease of collection.

(3) The year 1968 will see inflationary pressures causing numerous increases in local telephone rates. Wage scales and local taxes are increasing. These increased costs can not come out of our revenues from toll messages, the rates for which are set by the Bell System and regulated by the Federal Communications Commission. We foresee these needed increases in local service rates with the additional 10 percent of excise on top.

(4) Increased taxes of all kinds including utility income taxes are ultimately reflected in the rates paid by the user. Any increase in taxes paid by telephone companies must in the end be paid by the telephone user. The telephone user will therefore be doubly affected by any Viet Nam war taxes imposed on corporate incomes as presently proposed by the Administration.

(5) Utilities in general and the telephone in particular are subject to sales or equivalent taxes at the local level. Well over half the states now have a sales tax on local service. Many hundreds of communities in addition have their own utility taxes. You doubtless are aware that the City Manager of Arlington County (adjoining Washington, D.C.) proposes to put a 15 percent tax on utilities in order to pay for the County's share of Washington Metropolitan Transit Authority costs. The user's telephone dollar now consists of more than one-third direct taxes and may even be approaching one-half. Contrast this with the government's management of the postal system where rural service is subsidized along with other "public service" items and all without taxes.

(6) It looks as if the excise tax on telephone service could be "temporary" for nearly three decades. This will be the twelfth time that the tax has been continued in the interest of expediency. Certainly over thirty years there should arrive a time when expediency could be replaced by practicality.

(7) The Senate voted in March 1966 to eliminate the excise tax from residential service. At that time its desires did not prevail in conference. However, the arguments apply, now as then, on the inequity of the telephone excise tax on residential service. In fact all reason opposes the continuance of the utility tax solely on telephone service and argues instead that if there is to be an excise, sales or value added tax, the treatment of the telephone user should be in the lowest priority.

(8) The President's original request was for the telephone excise tax to be at the current rate until July 1, 1969 when it was to fall to 1 percent. Elimination was scheduled for January 1, 1970. The House Committee in its recommendation changed this for a step-by-step reduction "coordinated with the reductions in the tax on passenger automobiles." The *Congressional Record* indicates this schedule of reductions "was determined after consultation with representatives of the auto industry" (p. H-1511). Our members ask why should the telephone excise tax be coordinated with the auto excise and why was the telephone industry not consulted? Further, when the excise on passenger cars was reduced from 10 to 7 percent, the telephone excise was not so treated. Why should it be coordinated at this late date.

May I respectfully request that the Committee consider the possibility of:

(A) Exempting residential telephone exchange service from the continued imposition of the telephone excise tax particularly in the event the proposed Act is coupled with an increase in corporate income taxes; and

(B) Retaining the Administration's original request for reduction of the telephone excise tax from 10 to 1 percent on July 1, 1969 and elimination on January 1, 1970, rather than coupling the telephone scheduled reduction with the passenger auto excise tax reductions.

Sincerely yours,

HERBERT H. BUTLER, *Secretary.*

THE TAX COUNCIL,
Washington, D.C., March 14, 1968.

Hon. RUSSELL B. LONG,
*Chairman, Committee on Finance,
New Senate Office Building, Washington, D.C.*

DEAR MR. CHAIRMAN: The enclosed statement deals especially with the problems which small and growing corporations would encounter in moving quickly to a current payment basis under the provisions of H.R. 15414.

We submit a specific program of moderation should the Committee decide that some acceleration should be applied to tax liabilities under \$100,000.

We will be most grateful for the consideration given to our thoughts and suggestions.

Sincerely yours,

JOHN C. DAVIDSON, *President.*

THE TIMING OF CORPORATE TAX PAYMENTS

STATEMENT OF THE TAX COUNCIL ON H.R. 15414

The Tax Council, a non-profit business membership organization, appreciates the opportunity to submit its views to the Committee on Finance with respect to the provisions of H.R. 15414 dealing with the timing of corporate tax payments.

Because there is no reason to apply the brakes to business investment spending at this time, and because corporate profits are not a present or prospective inflationary factor, there is no economic case for increasing the current burden of corporate taxes apart from a uniform temporary increase in tax applying to all taxpayers. Nevertheless, under the provisions of H.R. 15414, there would be an increase from 70% to 80% in the requirement for current payment on corporate tax liabilities in excess of \$100,000, and a five year program for putting tax liabilities under \$100,000 on a current basis would be inaugurated. In the first instance, the result would be equivalent to a 10% surcharge in the current year. In the second, the result would be equivalent to a 16% surcharge in the current year and in each of the four succeeding years, for companies whose liabilities do not exceed \$100,000.

The Council urges that these provisions be deleted from the pending bill. If the Committee decides to give its support to some further acceleration of corporate tax payments at this time, however, we urge that consideration be given to a much more moderate program with respect to liabilities below \$100,000.

Prior to 1950, corporations paid their taxes in four installments spread over the year following the close of the tax year. The Revenue Act of 1950 required payment in two installments in the first two quarters of the year following the tax year. This transition was accomplished in stages over a five year period. Current payment began with the Revenue Act of 1954, which required corporations to pay half of their estimated liabilities in excess of \$100,000 in the last half of the tax year, and the remainder in the first half of the succeeding year. Again, this transition was accomplished in a five year period. The 1964 and 1966 Revenue Acts combined to bring current payment up to the present level. As stated in the Report of the Ways and Means Committee on H.R. 15414:

"The development has been gradual because of a desire to ease possible transitional problems for the corporations involved . . ."

Nevertheless, the bill as now written would accomplish in five years for liabilities under \$100,000 what required 14 years for liabilities in excess of that figure.

A 16% additional tax payment each year over five years would severely repress the growth and job creating potential of small corporations. It is well known that these corporations often have great difficulty in raising money from banks and other outside sources. The inflow of new business for growth firms, especially in manufacturing and in research and technology, often is not steady. To handle new business as it comes along, such firms must attempt to hold together their forces of skilled and technological workers even though this means recurring red ink in slow periods. Even with a quick refund of overpayment of estimated tax as provided in the pending bill, the burden of additional tax inevitably will take its toll in the small business community.

It does not seem appropriate, moreover, to justify speedup with respect to small corporations by reference to current payment of tax by unincorporated businesses. The large forgiveness of tax when the latter was effected minimized the doubling up of tax and hence the transitional problem.

If acceleration is to be applied to tax liabilities under \$100,000, therefore, The Council believes the program should be much more moderate than is provided in H.R. 15414. Specifically, we suggest:

First, that further speed-up be limited to tax liabilities in excess of \$50,000, and
Second, that the transition with respect to tax liabilities under \$100,000 be stretched out over a much longer period than provided in the House bill or at least 10 years.

We hope these thoughts and suggestions prove helpful to the Committee in its deliberations.

Respectfully submitted.

JOHN C. DAVIDSON, *President.*

NATIONAL ASSOCIATION OF
PLUMBING-HEATING-COOLING CONTRACTORS,
St. Paul, Minn., March 14, 1968.

Re H.R. 15414.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The National Association of Plumbing-Heating-Cooling Contractors appreciates the opportunity to provide the members of the Senate Committee on Finance with this statement in opposition to certain provisions of

H.R. 15414, which would both eliminate the present corporate exemption on payment of estimated taxes by corporations on tax liability below \$100,000 and increase from 70% to 80% the necessary payments of estimated tax liability to avoid additional assessments for underpayment.

This Association is one of the oldest in existence, having been formed in 1883. It consists of some 8,500 contractors in the plumbing, heating and cooling business, located in all 50 states. Our membership is composed of small businessmen who have considerable variety in types of operation, the fields served and number of employees.

Despite such differences, all corporate members will be seriously affected by the proposed acceleration of estimated income tax payments even though the proposed reduction in the current exemption of \$100,000 is accomplished over a five-year period. Furthermore, the new 80% test for corporate taxpayers would increase the economic impact felt by small business corporations and may critically impair working capital requirements of many of our members.

Experience has disclosed that final payments to construction contractors and subcontractors are indeed slow. Consequently, the availability of working capital, is an ever present problem for most small contractors who participate in the construction of needed schools, factories, power houses, water treatment plants, sewage treatment plants, urban renewal projects and other government-sponsored or public-oriented projects.

Even though the proposed changes concerning the payment of estimated taxes by small corporations may appear both equitable and economically expedient, the accelerated tax payments will have the same practical effect as an additional tax increase imposed only on small business corporations. Accordingly, we strongly urge that these provisions of H.R. 15414, providing for the acceleration of income tax payments by small corporations, be deleted.

Respectfully yours,

WILLIAM C. RASCHER, *President.*

[Telegram]

LOUISVILLE, Ky., March 16, 1968.

Re Internal Revenue Service administrative action concerning industrial development bonds.

Senator RUSSELL LONG,
Senate Office Building, Washington, D.C.:

We deplore the arrogant and unwarranted action of the IRS in seeking to deny by administrative action tax exemption on industrial development bonds issued by States and municipalities.

In Kentucky the issuance of these bonds is authorized by law to fill a stated public purpose for the relief of unemployment. Like all other public purpose bonds they are issued on a comparable tax exempt basis and are certified to be properly tax exempt by every legal counsel within our knowledge. The exemption of municipal bonds from Federal taxation is both statutory and constitutional. The constitutional doctrine of reciprocal immunity from taxation of Federal and municipal bonds, one by the other, has always been upheld by the Supreme Court.

Should the Federal Government assume the authority by statute, without a specific constitutional amendment clearly confirming that authority, to tax State and municipal bonds the very sovereignty of the States and the direction of their financial affairs would be destroyed.

From whence derives the authority or precedent for an agency of the Federal Government to prohibit tax exemption on a properly and legally issued State or municipal bond? Does this mean that it is within the purview of a Federal agency to decide what is or is not a public purpose of a State in contravention of the laws of a State and the expressed wishes of its people through its elected representatives? Does this mean that the relief of unemployment is not a proper public purpose of a State municipality? Does this mean that the IRS can subsequently decide to prohibit tax exemption on any other type of public purpose bond—water, sewer, electric, streets, schools—by its sole administrative action and for whatever reasons it may then deem appropriate?

Since 1950, 27,170 persons have been employed in Kentucky by plants built out of industrial bond proceeds. We estimate annual payroll at \$135 million and Federal taxes paid at close to \$5 million by these jobs. Of 1,073 plants located in Kentucky since 1950, 137 were built from bond proceeds. Almost all plants are

in small towns. Without the vehicle of industrial aid, small communities are without sources of capital to attract industry, create jobs and relieve unemployment, cannot compete with metropolitan areas, and will lose population and workers by migration to urban areas. Kentucky has benefited enormously from this efficient pooling of public and private effort. Please support legislation to strike down the IRS action and support the tax exemption of industrial as well as all other municipal public purpose bonds.

W. L. LYONS & Co.
J. J. B. HILLIARD,
By GEORGE L. PARTLOW.

[Telegram]

LONG ISLAND CITY, N.Y., March 14, 1968.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.:

The Chamber of Commerce of the Borough of Queens is strongly opposed to the adoption of H.R. 15414 because it would seriously endanger the already precarious financial condition of hundreds of the small businesses in Queens.

NED R. ARNOLD,
Chairman, Congressional Affairs Committee,
Chamber of Commerce, Borough of Queens.

(The following letter was submitted to the committee by Hon. Ernest Gruening, a U.S. Senator from the State of Alaska:)

ALASKA AGGREGATE CORP.,
ANCHORAGE, ALASKA, March 6, 1968.

HON. ERNEST GRUENING,
New Senate Office Building, Washington, D.C.

DEAR SENATOR GRUENING: The proposed speed-up of corporate estimated tax payments, now before the Ways and Means Committee, will cost a corporation over a five-year period a full year's taxes that would not otherwise be paid, as explained in the attached report.

Alaskan corporations, the majority being seasonal in nature, will be paying taxes on profits not yet made. For example, our business profits are made entirely in the third quarter. On an estimated tax of \$100,000, we will pay two quarters of \$25,000 each before any profits are made.

This would appear to me to be the Administration's answer to the rejected surtax and everyone should be aware of it.

Very truly yours,

RICHARD L. ERICKSON, Secretary.

[Telegram]

WASHINGTON, D.C., March 13, 1968.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.:

The Painting & Decorating Contractors of America urge your committee remove that portion of H.R. 15414 which provides for acceleration of income tax payments by corporations. Our 7,000 members are all small business firms and this elimination of the \$100,000 exemption from the estimated tax plus the 10-percent increase in payments would be a distinct hardship. Your consideration of our position in this vital matter is appreciated.

PAINTING & DECORATING CONTRACTORS OF AMERICA,
ED. S. ORRENCE.

[Telegram]

WASHINGTON, D.C., March 13, 1968.

Senator RUSSELL LONG,
 Chairman, Senate Finance Committee,
 Old Senate Office Building, Washington, D.C.:

The Sheet Metal and Air Conditioning Contractors National Association wishes to go on record as opposed to H.R. 15414, Tax Adjustment Act of 1968. We particularly oppose that portion of the bill which calls for acceleration of income tax payments from 70 percent to 80 percent. It would greatly harm small business construction corporations as the effect would be to eliminate their working capital. We further urge that the \$100,000 exemption be retained.

CLIFFORD J. REUSCHLEIN, *President.*

MEXICO CITY, March 15, 1968.

Hon. RUSSELL B. LONG,
 Chairman, Finance Committee,
 U.S. Senate, Washington, D.C.:

The American Chamber of Commerce of Mexico views with alarm proposed legislation S. 2902 sponsored by Senator John Williams of Delaware which proposes to further reduce duty free goods to twenty five dollars without exempting any country. Mexico-United States border transactions in 1966 were five hundred and twenty one million by Mexico and three hundred and thirty two million by the United States leaving Mexico one hundred and eighty nine million in its favor. This balance and others from tourism allowed Mexico to buy from the United States one billion twenty four million or sixty four percent of its total imports and exported to the United States six hundred and forty eight million or fifty four percent of its total exports leaving the United States three hundred and seventy six million in its favor. 1967 figures will show that Mexico continues to be one of the few billion dollar customers that the United States has. We felt pertinent that you should be advised of this view of the American Chamber of Commerce of Mexico and that it be made known at your current hearing which allowed Senator Williams to present his proposal on this matter.

The American Chamber of Commerce of Mexico proposes no further reduction on duty free goods as relates to Mexico since border transactions although favorable to Mexico return to the United States to purchase capital goods and maintain employment. We also feel that any action to disrupt the sound economies now developing along the Mexico-United States border would be harmful on both sides and might cause retaliatory measures by Mexico in an attempt to reduce trade gap which it is now experiencing if the views in section eight of S. 2902 continue to prevail. The national interest of the United States and the relationship now existing between Mexico and the United States as well as the Alliance for Progress are not best served by reducing duty free imports from Mexico to the United States.

AMERICAN CHAMBER OF COMMERCE OF MEXICO,
 WILLIAM R. SCHIELE, *President.*

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