

Moderating Fiscal Actions

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EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

March 17, 1966

GARDNER ACKLEY, CHAIRMAN
JAMES S. DUESENBERY
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MEMORANDUM FOR THE PRESIDENT

Subject: Moderating Fiscal Actions

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See p 36!!

1. Through Joe Califano, you asked us for a rundown of the ways your January Budget program helps to moderate the pace of the economy.
2. To meet our commitments abroad, we had to shoulder continuing large increases in special Vietnam costs. These reach \$4.7 billion in fiscal 1966 and mount to \$10.5 billion in fiscal 1967. Apart from this substantial Vietnam increase of \$5.8 billion, the total of all other Budget expenditures rises only \$600 million in fiscal 1967, reaching \$102.3 billion from \$101.7 billion in fiscal 1966.
3. The net increase of \$600 million results from several substantial increases offset by a number of major decreases.
 - . The increases total \$5.3 billion, consisting of
 - \$3.2 billion for Great Society programs,
 - \$0.8 billion for higher interest costs on the public debt, and
 - \$1.3 billion for unavoidable commitments such as construction already in progress and the full year effect of last year's pay increases.
 - . The decreases total \$4.7 billion and consist of
 - \$1.6 billion in defense outlays not related to Vietnam,
 - \$1.5 billion in savings through pruning lower priority programs and improving management, and
 - \$1.6 billion in increased sales of mortgages, etc. and shifts away from direct Federal loans.

4. Expenditures for many programs are being substantially reduced in fiscal 1967. Following are 7 cases where Budget expenditures for fiscal 1967 are below those of the current fiscal year by at least \$50 million:

	<u>Reduction in fiscal 1967 expenditures (millions of dollars)</u>
Space research and technology	300
Small Business Administration	245
Food for Peace	162
Farm income stabilization	145
Postal service	123
Military family housing	105
Schools in impacted Federal areas	87

5. When Administrative Budget expenditures are taken as a proportion of GNP, it is clear how tightly the Budget has been held down.
- Excluding special Vietnam costs, this proportion falls from 14.9% in fiscal 1965 to 14.5% in the current fiscal year. It drops further to 13.7% in fiscal 1967, the lowest figure since fiscal 1948.
 - Even including Vietnam costs, the proportion rises only slightly from 14.9% in fiscal 1965 to 15.2% for both fiscal 1966 and fiscal 1967, remaining well below previous levels.
 - During the decade from fiscal 1955 to fiscal 1964, the Budget was at least 16% of GNP in nine years, and was 15.5% at its low point in fiscal 1960.

- . As a proportion of GNP, defense expenditures in fiscal 1966 and 1967 are lower than in any post-Korean year except fiscal 1965.
6. Measures on the tax side will have a significant moderating effect.
- . The increase in payroll taxes effective January 1 lifted revenues and reduced after-tax incomes by nearly \$6 billion on a full year basis. Moreover, a further rise will take effect next January at a rate of \$1-1/2 billion.
 - . The Tax Adjustment Act of 1966 will add \$6 billion to Federal revenues over the next 15 months. We estimate that it will make a substantial subtraction from total private spending
 - \$4 billion (annual rate) by the end of this calendar year, and
 - \$6 billion by the middle of calendar 1967.
7. The economic impact of this new legislation comes from several tax changes that draw off private purchasing power.
- . For the rest of this calendar year, the excise tax restoration will siphon off purchasing power at a rate of \$1 billion. Meanwhile, the graduated withholding plan will cut into consumer incomes at an annual rate of \$1-1/4 billion.
 - . In the first half of 1967, the graduated withholding plan will lose its punch, but the excise tax restoration will step up to a \$1-1/2 billion rate. And the quarterly payments of self-employment taxes will enter the picture.
 - . The speedup in corporate tax payments will add \$1.0 billion to revenues this spring and \$3.2 billion in the spring of 1967. To be sure, many corporations will not have to tighten their belts as a result of paying their taxes more promptly. But this measure will surely take some of the zip out of business investment demand.
8. Putting the expenditure and the tax side together, we can conclude that, despite the large increase in Vietnam costs, the fiscal 1967 Budget does not supply fresh new economic stimulus.

- It is the first time in 4 years that the economy is not getting new additional fuel from the Budget.
- You have demonstrated that fiscal policy can make an appropriate prompt adjustment to changing economic conditions, while meeting increased defense commitments. The Nation can have justified confidence that your fiscal actions will continue to fit the needs of the economy.



Arthur M. Okun
Acting Chairman