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Contents

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The Business Situation

The domestic economy was apparently continuing on a strong uptrend as the first quarter came to a close, with activity for the quarter as a whole probably about in line with the buoyant expectations for the period expressed by most analysts at the year's start. Industrial production, unfilled orders for durable goods, nonfarm payroll employment, and retail sales each moved up again in February. Indicators of residential construction activity, however, continue to be mixed. Preliminary data for March suggest that retail sales were off a bit, while unit assemblies of new automobiles advanced to a new record rate and steel ingot production showed a more-than-seasonal increase as mills continued to strain finishing capacity in the attempt to work down their huge order backlogs. The unemployment rate in March, moreover, dropped to 4.7 per cent, the lowest reading since late 1957. The updrift in industrial wholesale prices that began last fall seems to have continued. As in February, such prices apparently failed in March to register their expected seasonal decline. The mild but steady advance in the over-all level of consumer prices was interrupted in February when the price index showed no change, although Labor Department analysts noted that the advance was probably resumed in March.

The high level of over-all economic activity in recent months is, of course, partly attributable to the direct and indirect effects of the bulges in automobile and steel output. To some extent, these reflect temporary factors—although high output in both industries is also being supported by the strong general advance of the economy. The demand for further additions to steel stockpiles will presumably continue only so long as the threat of a strike remains, although the filling of previously placed noncancelable orders could lead to some further rise in actual inventories even if the strike threat were removed. In this connection, it is gratifying that the union, despite the continued uncertainty over the outcome of its election, was able to reach a settlement with the can producers, and that intensive steel labor talks are under way. The hope has been expressed that these talks will result either in a contract settlement by the May 1 deadline or at least in a postponement of the deadline to permit the making up of bargaining time lost during the union election.

Despite the possibility of some future cutback from the present extremely high rates of auto and steel output, prospects for further over-all economic advance in the months ahead remain good and have, in fact, become more firmly based. Thus, the results of the Government's latest capital spending survey, taken in February, confirmed the widespread belief that businessmen's spending plans for 1965 have been substantially upgraded since first reported last fall—which is not unusual—and that such outlays may well continue to grow at a good rate during the year. Another recent survey points to strength during the first half of the year in manufacturers' demand for additional inventories. Along with this indicated strength in the private business sector, of course, there is the prospective stimulus to be provided by the Government's fiscal activities during the second half of the year.

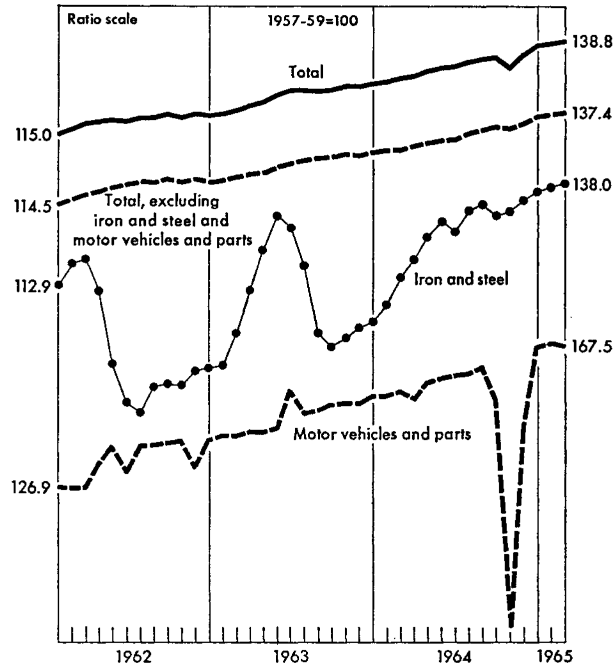
INDICATORS OF RECENT ACTIVITY

Industrial production continued upward in February. The Federal Reserve Board's seasonally adjusted index was up for the fourth month in a row, rising by 0.7 percentage point to 138.8 per cent of the 1957-59 average (see Chart I). Over-all output was thus 8.3 per cent above its year-earlier level. The recent advance was sparked by higher output of furniture, television sets, and commercial and industrial machinery, while materials production also moved ahead. Iron and steel producers succeeded in pushing output a little further above the very high level of the month before, but motor vehicle assemblies edged off a bit from the surging January pace, owing to a severe snow storm that forced many plants in the Midwest to close temporarily. In March, early indications are that automobile assemblies hit a new record and that output of finished steel

Chart I

RECENT DEVELOPMENTS IN INDUSTRIAL PRODUCTION

Seasonally adjusted monthly data



Source: Board of Governors of the Federal Reserve System.

edged up in response to heavier demand for products for which there was some unused finishing capacity. Steel ingot production also was up in March (seasonally adjusted), with unadjusted weekly output averaging more than 86 per cent of estimated capacity.

New orders received by durable goods producers in February were a shade under the record volume of the month before. Orders for electrical machinery and equipment showed a noticeable decline, reportedly attributable in part to the aftermath of a January bunching of defense orders for electronic equipment. Nevertheless, the average volume of durables orders received during the first two months of the year was above the average for any quarter of 1964. Moreover, the total backlog of unfilled orders, which has grown without interruption for more than a year, increased further in February and reached a level nearly 16 per cent above that of a year earlier.

The strength in industrial production in February contributed to the addition of 232,000 persons to the payrolls of nonfarm establishments. Gains were recorded in all major sectors, but manufacturing employment showed an especially strong increase and reached the highest level since the Korean war. The growth in factory employment was concentrated in the durable goods industries, reflecting in part the high operating rates of steel users. There was also a substantial amount of overtime in the durables sector, and as a result the average workweek clocked by all manufacturing production workers was maintained at the postwar record of 41.4 hours for the second month in a row. The return of longshoremen to their jobs buoyed the employment figures in the transportation industry. In March, with total employment (seasonally adjusted) expanding further while the civilian labor force contracted a bit, the over-all unemployment rate dropped to a seven-and-a-half-year low of 4.7 per cent, from 5.0 per cent in February. The decline in over-all unemployment, moreover, extended to all major labor force groups.

The rise in employment pushed personal incomes up further in February, and consumers continued to be in a spending mood. Thus, sales volume at retail outlets rose for the fourth month in a row. Sales at stores featuring nondurables were especially strong in February, in contrast to their sluggishness in preceding months, while durables sales were also up. Partial data for March suggest that total retail volume slipped a bit from the record February level. The decrease apparently in part reflected a decline—after seasonal adjustment—in unit sales of new cars from the extraordinary January-February pace, though sales of domestically built cars in March still amounted to a seasonally adjusted annual rate of around 8.7 million units. The sustained high rate of new car sales appears to reflect stronger demand than can be attributed solely to the recovery of sales lost during the strikes last fall. Industry forecasts of sales of domestically built cars this year have ranged up to 8½ million units.

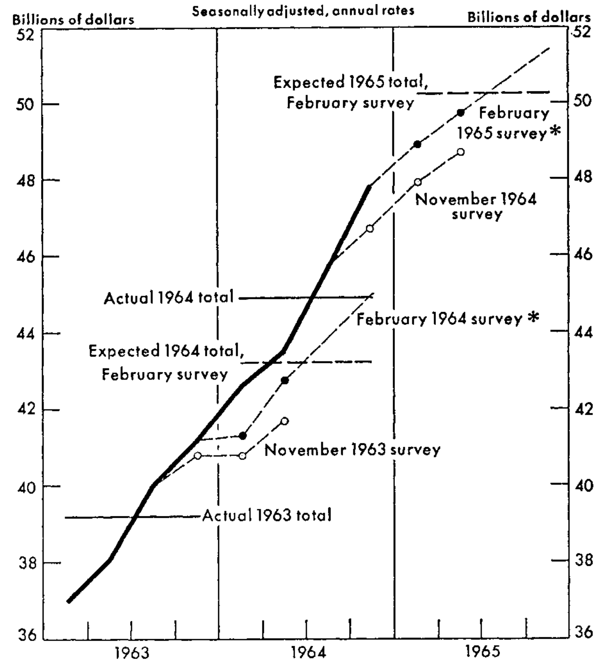
Developments in the residential construction sector continue to present a mixed picture. Both nonfarm housing starts and building permits issued—indicators that tend to foreshadow future activity—moved down in February. On the other hand, the F. W. Dodge Corporation reported that the value of residential building contracts awarded in February showed a slightly more-than-seasonal gain. Moreover, outlays for nonfarm residential construction in March were up for the fourth month in a row. For the first quarter as a whole, outlays were $26.9 billion (at an annual rate), or 4.5 per cent higher than in the final quarter of 1964. The mixed showing in residential construction thus far in 1965 seems to be about in line with the outlook for the year as a whole that many analysts deemed most likely. In general, no further decline in starts from late-1964 levels was foreseen, but a strong upward push was not expected either. This appraisal was held to be compatible with a moderate growth in outlays, attributable to the construction of a greater proportion of relatively costly units.

BUSINESS SPENDING PLANS

There is now a somewhat firmer indication than had been the case earlier that business capital spending is likely to continue to expand throughout 1965. A survey taken in February by the Commerce Department and the Securities and Exchange Commission indicates that businessmen plan to spend about $50.2 billion for plant and equipment in 1965 (see Chart II). If the February plans are realized, outlays this year will be almost 12 per cent larger than the amount actually spent in 1964—a sign of continuing business optimism and strong demand for capital goods as the economy moves into its fifth year of expansion. Larger expenditures are planned this year in all major industry groups. Spending plans by nondurables manufacturers show particular strength, especially in the textile and chemical industries, and the nondurables group as a whole projects a percentage rise in outlays for 1965 which is actually larger than that recorded in 1964. Durables manufacturers also expect to show another sizable spending increase. Outside manufacturing, it is noteworthy that the railroads have plans for a 15 per cent rise in capital investment this year, which, if achieved, would put their expenditures at a total almost twice as large as three years ago. Spending by commercial and communications firms is also expected to show strength.

The February survey shows that since late fall there has been a considerable upgrading of aggregate business capital spending plans for the first half of 1965 and for the year as a whole. Some upgrading between fall and spring is generally to be expected in years of over-all business expansion. Given the substantial 14½ per cent increase in 1964, however, many analysts had not been counting on the degree of optimism that in fact has apparently emerged. The only previous survey of plans for 1965 as a whole was that taken last fall by McGraw-Hill, which indicated that business at that time planned a year-to-year increase of only 5 per cent, compared with the February plans for a rise of nearly 12 per cent. For the first half of 1965, the Commerce-SEC survey taken last November indicated that expenditures in the six-month period, expressed at an annual rate, would be about 8 per cent above the 1964 total, but the upgrading shown in the latest survey was sufficient to push the rise to more than 9½ per cent. Furthermore, actual outlays in the fourth quarter of 1964 exceeded the amount indicated in the November survey by about $1 billion (at a seasonally adjusted annual rate).

Chart II
ACTUAL AND ANTICIPATED PLANT AND EQUIPMENT SPENDING



* February surveys report an average for the second half but no separate figures for the third and fourth quarters. Straight lines are drawn from the second-quarter figure through a point representing the second-half average.

Sources: United States Department of Commerce; Securities and Exchange Commission.

While it thus appears that the general pattern of repeated upward revisions which prevailed throughout 1964 may be continuing into 1965, there remains of course a margin of uncertainty. It is notable also that the February plans, if realized, imply a slower quarter-to-quarter growth in plant and equipment spending during 1965 than that which occurred during 1964. A further upgrading of spending plans would be necessary if the 1964 rate of growth were to be duplicated. The need for caution is underscored by the results of a National Industrial Conference Board survey, which show that new capital appropriations by leading manufacturers (net of cancellations) fell sharply in the fourth quarter of 1964. It should be noted, however, that the large size of the fourth-quarter decline was mainly attributable to a big drop in appropriations in one industry grouping, petroleum and coal products. Moreover, the backlog of manufacturers' unspent appropriations, which had been rising without interruption since the second quarter of 1963, was still expanding in the fourth quarter. Furthermore, the Treasury has meanwhile removed one possible drag on capital spending with its announcement, in February, that a planned review of corporate depreciation practices will be postponed. This review might have cost the affected corporations an estimated $700 million in additional taxes this year as a result of possible Treasury challenges of corporate practices since the 1962 liberalization of depreciation guidelines.

Prospects for inventory spending also show near-term strength, although further accumulation is planned at a more moderate pace than was recorded in the fourth quarter of 1964. According to a survey taken by the Commerce Department in February, manufacturers planned to add $900 million to inventories in the second quarter of the year following an expected addition of only $700 million in the first quarter. The actual accumulation in the fourth quarter of last year was $1.9 billion, but that figure was of course influenced by the initial widespread push to stockpile steel as a hedge against a possible strike. The plans for the first half of 1965 are more nearly in line with the moderate pace of accumulation that has prevailed throughout most of the current expansion. Moreover, manufacturers' inventory plans seem modest even if judged against a projected sales decline in the second quarter of this year, when auto and steel producers expect their shipments to move back to more normal levels from the exceptionally high first-quarter volume. Thus, the plans imply a further decline in the inventory-sales ratio, which has been generally trending downward since 1962 and is near its postwar low.

The Money and Bond Markets in March

The money market displayed a steadily firm tone during March, readily accommodating the substantial flows of funds which occurred early in the month in connection with the quarterly corporate dividend and tax payments and again in late March in anticipation of the April 1 Cook County, Illinois, personal property tax date. The heavy demands placed upon the money market were reflected in higher rates on some short-term money market instruments, including certificates of deposit. In the Treasury bill market, however, yields edged lower through most of the month in response to good demand—apparently reflecting to some degree a reflow of short-term funds from foreign countries—which persisted even over the midmonth corporate dividend and tax payment period.

In the market for Treasury notes and bonds, the uncertainty about the potential repercussions of international financial developments which had clouded the atmosphere in February carried over into the early part of March, but a much more confident tone soon developed following favorable reports regarding the initial results of the President's balance-of-payments program. Activity expanded and prices of coupon issues moved progressively higher. Later in the month, a cautious tone reemerged and prices receded for a time before steadying at the close. Elsewhere in the capital markets, prices of corporate and tax-exempt bonds continued to decline at the beginning of March but rebounded subsequently, partly in response to the same factors that affected the Government bond market.

THE MONEY MARKET AND BANK RESERVES

The money market in March retained the firmer tone that had emerged during the previous month. Nationwide reserve availability continued to fluctuate around the lower levels that had begun to prevail in February. Federal funds traded mainly in a 4 to 4⅛ per cent range, and rates posted by the major New York City banks on call loans to Government securities dealers were generally quoted in a 4¼ to 4⅝ per cent range in the first half of the month, and in a 4⅜ to 4¾ per cent range thereafter. Offering rates for new time certificates of deposit issued by leading New York City banks increased early in the month, as banks sought to minimize the net decline in outstanding certificates over the dividend and tax period. At the same time, rates on such certificates also edged higher in secondary market trading. Rates on new and outstanding certificates stayed at the higher levels over much of the remainder of the month and then receded slightly late in the period. Toward the close of the month most dealers in bankers' acceptances increased their rates by 1/8 of a percentage point on all maturities of unendorsed paper, following a substantial rise in dealer holdings of acceptances.

As the month opened, reserve availability contracted somewhat when reserves absorbed through market factors were only partially offset by System open market operations. However, the money market banks, particularly those in New York City, were able to satisfy the major portion of their enlarged reserve needs in the Federal funds market where excess reserves previously accumulated by the "country" banks were redistributed. As a result, member banks reduced their borrowings from the Federal Reserve Banks despite the contraction in average nationwide reserve availability in the statement week ended March 3.

Over the following two statement periods, the money market once again demonstrated impressive flexibility in accommodating smoothly the increased credit demands and the massive transfers of funds and securities during the corporate dividend and tax period. System open market operations offset a substantial volume of reserves drained by market factors, and nationwide reserve availability was slightly greater than the levels prevailing in early March. Nevertheless, the reserve positions of banks in the leading money centers came under heightened pressure as these banks experienced a runoff of time certificates of deposit, reinforced by an expanding loan demand from corporations, finance companies, and securities dealers. The money market banks continued to fill a large part of their needs in the Federal funds market—where trading generally took place in a 4 to 4⅛ per cent range—and expanded their borrowings at the "discount" window moderately.

The money market remained quite firm during the last two statement weeks of the month. Reserve positions of money center banks continued under heavy pressure. First, tax checks cleared—wiping away the temporary accumulations of tax deposits over the midmonth corporate tax date. Then, the approach of both the March 31 quarterly bank statement date and the April 1 Cook County, Illinois, personal property tax date generated reserve needs. Federal funds were in strong demand throughout this period, and trading remained primarily within a 4 to 4⅛ per cent range. At the same time, the margin of unsatisfied demand for Federal funds increased and member bank borrowings from the Reserve Banks expanded—particularly during the statement week ended March 24, when available reserves were lodged with country banks at the start of their biweekly statement period.

Over the month as a whole, market factors drained $794 million of reserves, primarily as a result of an increase in required reserves and a decline in float, as well as changes in gold and foreign accounts; on the other hand, System open market operations provided $699 million of reserves. The weekly average of System outright holdings of Government securities rose by $683 million from the final statement week in February through the last week in March, while average System holdings of Government securities under repurchase agreements de-

Table I

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, MARCH 1965

In millions of dollars; (+) denotes increase, (−) decrease in excess reserves

Factor	Daily averages—week ended March 3	March 10	March 17	March 24	March 31	Net changes
"Market" factors						
Member bank required reserves*	− 274	+ 227	− 144	− 219	+ 60	− 350
Operating transactions (subtotal)	+ 80	− 622	+ 68	+ 337	− 307	− 444
Federal Reserve float	+ 194	− 300	− 27	+ 408	− 629	− 354
Treasury operations†	− 30	+ 109	− 105	− 66	+ 48	− 44
Gold and foreign account	− 56	− 80	− 54	− 186	− 7	− 383
Currency outside banks*	+ 16	− 382	+ 96	+ 93	+ 173	− 4
Other Federal Reserve accounts (net)‡	− 42	+ 30	+ 159	+ 86	+ 110	+ 343
Total "market" factors	− 194	− 395	− 76	+ 118	− 247	− 794
Direct Federal Reserve credit transactions						
Open market instruments						
Outright holdings:						
Government securities	+ 117	+ 376	+ 97	− 3	+ 96	+ 683
Bankers' acceptances	− 1	+ 1	− 1	—	—	− 1
Repurchase agreements:						
Government securities	− 18	+ 32	− 45	− 63	+ 18	− 76
Bankers' acceptances	+ 22	+ 29	+ 23	− 20	+ 39	+ 93
Member bank borrowings	− 250	+ 115	− 15	+ 93	+ 24	− 33
Other loans, discounts, and advances	—	− 4	− 23	+ 1	− 4	− 30
Total	− 130	+ 549	+ 36	+ 8	+ 173	+ 636
Excess reserves*	− 324	+ 154	− 40	+ 126	− 74	− 158
Daily average levels of member bank:						
Total reserves, including vault cash*	21,136	21,063	21,167	21,512	21,378	21,251§
Required reserves*	20,924	20,697	20,841	21,060	21,000	20,904§
Excess reserves*	212	366	326	452	378	347§
Borrowings	270	385	370	463	487	395§
Free reserves*	− 58	− 19	− 44	− 11	− 109	− 48§
Nonborrowed reserves*	20,866	20,678	20,797	21,049	20,891	20,856§

Note: Because of rounding, figures do not necessarily add to totals.
* These figures are estimated.
† Includes changes in Treasury currency and cash.
‡ Includes assets denominated in foreign currencies.
§ Average for five weeks ended March 31, 1965.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS MARCH 1965

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended					Average of five weeks ended March 31*
	March 3	March 10	March 17	March 24	March 31*	
Eight banks in New York City						
Reserve excess or deficiency(—)†	16	10	— 1	23	65	23
Less borrowings from Reserve Banks	115	76	73	180	96	108
Less net interbank Federal funds purchases or sales(—)	510	546	539	614	440	530
Gross purchases	*1,063*	*950*	*1,005*	*1,070*	*957*	*1,009*
Gross sales	*553*	*404*	*467*	*456*	*517*	*479*
Equals net basic reserve surplus or deficit(—)	— 609	— 612	— 612	— 770	— 471	— 615
Net loans to Government securities dealers	546	331	418	460	434	438
Thirty-eight banks outside New York City						
Reserve excess or deficiency(—)†	4	19	5	18	46	18
Less borrowings from Reserve Banks	40	129	104	88	193	111
Less net interbank Federal funds purchases or sales(—)	201	69	322	257	85	187
Gross purchases	*1,057*	*884*	*1,016*	*944*	*922*	*965*
Gross sales	*856*	*815*	*694*	*687*	*837*	*778*
Equals net basic reserve surplus or deficit(—)	— 237	— 179	— 421	— 326	— 232	— 279
Net loans to Government securities dealers	365	190	333	421	276	317

* Estimated reserve figures have not been adjusted for so-called "as of" debits and credits. These items are taken into account in final data.
† Reserves held after all adjustments applicable to the reporting period less required reserves and carry-over reserve deficiencies.

clined by $76 million. Average net System holdings of bankers' acceptances, both outright and under repurchase agreements, rose by $92 million during the period. From Wednesday, February 24, through Wednesday, March 31, System holdings of Government securities maturing in less than one year increased by $818 million, while holdings of issues maturing in more than one year expanded by $92 million.

THE GOVERNMENT SECURITIES MARKET

In the market for Treasury notes and bonds, a cautious tone persisted at the beginning of the month as participants continued to evaluate the implications of the balance-of-payments problem. Moderate offerings of selected issues by commercial banks and dealers outweighed a steady demand from public funds and other investors, and prices of most coupon issues tended slightly lower in the opening days of the period. At the lower price levels, however, offerings were readily absorbed and a steadier tone began to emerge. The market reacted favorably to reports of a February rise in Britain's official international reserves, but news of a further United States gold loss exerted some restraint upon the coupon sector. Against this background, prices fluctuated narrowly from March 3 through March 10 in light trading.

As the month progressed, a growing conviction emerged among market participants that the Administration's balance-of-payments program was yielding promising initial results, and this feeling produced a considerable improvement in market atmosphere. Offerings of securities tapered off while a steady investment demand appeared, including commercial bank interest in the 2½ per cent wartime issues and moderate institutional purchases of higher coupon issues. Investment demand in turn prompted increased dealer interest, and prices of most Treasury notes and bonds moved steadily higher from March 11 through March 17. Some profit taking then developed, and the price advance halted for a few days. Subsequent price movements were mainly irregular, although the generally favorable market atmosphere and steady investment demand continued to prevail. Toward the end of the month, a hesitant tone reappeared and modest price declines were registered, partly as a result of renewed concern over the pound sterling, but prices steadied at the close.

Treasury bill rates generally moved lower during most of the month in response to a broadly based demand, which focused on the increasingly scarce shorter maturities. In the early part of the month, a sizable demand for bills from public funds and commercial banks was augmented by corporate purchases, despite the approach of the quarterly corporate tax and dividend payment period. One factor contributing to the demand for bills appeared to be a reflux from abroad of corporate short-term funds under the recently initiated voluntary restraint program to curb capital outflows. Both March 10, a popular dividend payment date, and the midmonth corporate tax payment date passed with little evidence of strain despite the return of securities to the market from maturing repurchase agreements with corporations. During this period as through much of the month, the strong contraseasonal demand, which also included sizable public fund buying, readily absorbed the modest offerings that appeared.

At the last regular weekly auction of the month, held on March 29, average issuing rates were 3.921 per cent for the new three-month issue and 3.993 per cent for the new six-month bill—7 and 5 basis points lower, respectively, than the average rates at the final weekly auction in February. The March 25 auction of $1 billion of new one-year bills produced an average issuing rate of 3.987 per cent, as against 4.062 per cent on the comparable issue sold a month earlier. The newest outstanding three- and six-month bills closed the month at bid rates of 3.93 per cent and 4.00 per cent, respectively.

OTHER SECURITIES MARKETS

After a hesitant opening, a better tone soon developed in the corporate and tax-exempt sectors, partly in response to the favorable reception accorded major new issues. Subsequently, prices of corporate and tax-exempt bonds edged upward as the relatively higher yields available on new offerings, coupled with the recent price concessions made by dealers on older issues, stimulated expanded investor interest. The corporate and tax-exempt sectors were also encouraged by the more optimistic view of balance-of-payments developments as reflected in the improved atmosphere of the Government securities market, and by the rapid distribution to investors of the General Aniline and Film Corporation common stock sold by the United States Government through an underwriting group. Trading activity became lighter toward the close of the month, however, as an increased volume of secondary stock offerings appeared to be diverting investor interest from the bond markets while continued strong business loan demand reduced commercial bank interest in the tax-exempt market. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds increased by 1 basis point to 4.42 per cent while the average yield on similarly rated tax-exempt bonds rose by 6 basis points to 3.09 per cent. (These indexes are based on only a limited number of issues and therefore do not necessarily reflect market movements fully.)

The volume of new corporate bonds publicly floated in March amounted to an estimated $570 million, compared with $185 million in February 1965 and $355 million in March 1964. The largest publicly offered new corporate bond issue of the month consisted of $100 million of Ba-rated 4 per cent subordinated convertible debentures maturing in 1990. The debentures, which were offered to yield 3.87 per cent, were quickly sold. New tax-exempt flotations in March totaled about $950 million, as against $850 million in February 1965 and $770 million in March 1964. The Blue List of tax-exempt securities advertised for sale closed the month at $750 million, compared with $827 million at the end of February. The largest new tax-exempt bond flotation during the month consisted of $115 million of Aaa-rated housing authority bonds. The bonds, which were reoffered to yield from 2.10 per cent in 1965 to 3.40 per cent in 2005, were very well received. Other new corporate and tax-exempt bonds publicly offered during the period were accorded mixed investor receptions.

Recent Economic Policy Measures in Industrial Countries Abroad

Economic policy abroad moved in mixed directions over the past six months.[1] A number of countries pursued monetary restraint to deal with balance-of-payments deficits and inflationary threats. In the United Kingdom, restrictive measures were adopted primarily as a means of correcting a serious balance-of-payments deficit. As this article went to press, the government in a stringent April budget announced new measures, including substantial tax increases designed to curb internal demand and restore external balance. This action underlined Prime Minister Wilson's strong reaffirmation of his government's commitment to preserve the sterling parity.

In Germany, Austria, and Sweden, new restraints were primarily a response to domestic price and cost pressures. Meanwhile, Switzerland and the Netherlands held firm to the anti-inflationary policies adopted early in 1964. On the other hand, there were also several countries that moved toward relaxation of previous restraints. Italy and Japan cautiously began to ease their stabilization measures, and France was apparently beginning to lean in that direction as well. In Canada, monetary policy continued to be engaged in the exacting task of stimulating domestic activity while maintaining an improved external position.

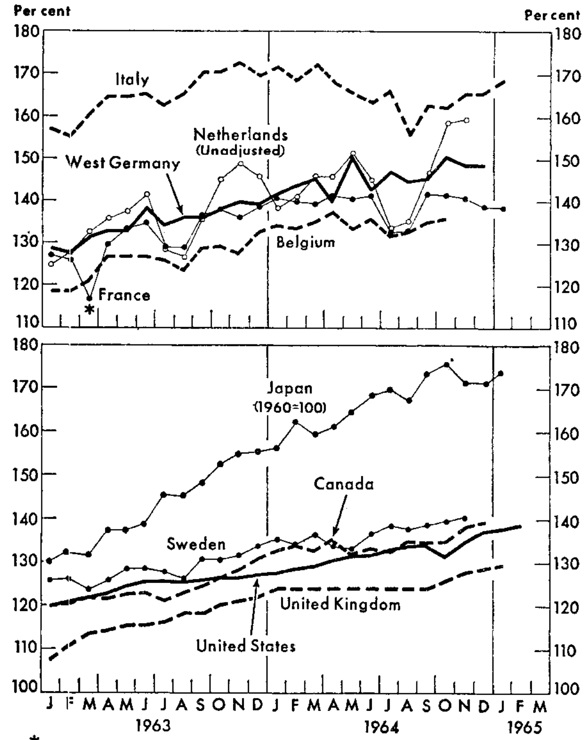
A comparison with a year earlier shows that in many countries the rapid rate of growth which had contributed to inflationary pressures tended to decline as production reached capacity limits (see Chart I). In several cases, however, price increases were also to some extent moderated (see Chart II), partly because enlarged imports helped to absorb excess demand and partly because the restrictive policies themselves have shown signs of achieving their goals. In a few countries—Italy, France, and Japan, in particular—these policies were a force tending to check the growth of production and income, although the ultimate aim of the stabilization efforts of course remained in all cases that of assuring a high and sustainable rate of growth over the long run.

In recognition of the increased interdependence of national economies, efforts continued to be made by authorities of major industrial countries toward ensuring the stability of the world economy. The most dramatic example of this cooperation was the $4 billion of credits provided by eleven countries, the Bank for International

Chart I

INDUSTRIAL PRODUCTION IN MAJOR COUNTRIES

Seasonally adjusted; 1957-59=100



* Affected by widespread strike in the public sector.

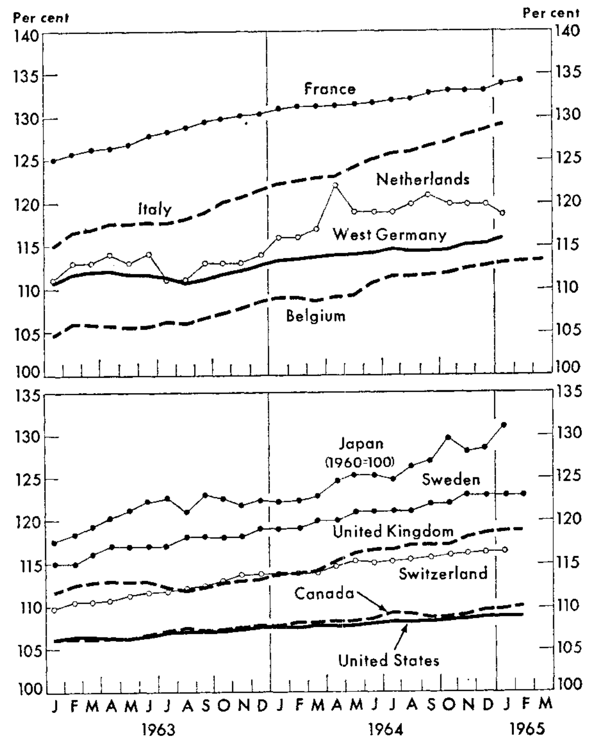
Sources: Organization for Economic Cooperation and Development, monthly statistical bulletins; national statistics.

[1] For a discussion of foreign economic policy measures in 1963 and early 1964, see "Recent Economic Policy Measures Abroad", this *Review*, April 1964, pp. 74-78, and "International and Monetary and Financial Developments", *ibid.*, October 1964, pp. 196-201.

Chart II

CONSUMER PRICES IN MAJOR COUNTRIES

1957-59=100



Sources: Organization for Economic Cooperation and Development, monthly statistical bulletins; national statistics.

Settlements, and the International Monetary Fund (IMF) to the United Kingdom at the height of the sterling crisis late in 1964.[2] In another development of great long-run significance, the executive directors of the IMF proposed a general 25 per cent increase in Fund member quotas and additional selective quota increases for sixteen member countries.[3] These proposed quota increases—which appear to be almost certain of approval by the necessary majority of the Fund's members—are designed to increase the IMF's gold and foreign exchange resources by about $5 billion, and member borrowing potential by about $6 billion.[4] These concrete manifestations of mutual support and cooperation will further strengthen the present international payments system.

UNITED KINGDOM, GERMANY, AUSTRIA, AND SWEDEN

Soon after taking office in October, the Labor government in Britain was faced with an acute confidence problem in the sterling exchange market. This problem was superimposed on a serious balance-of-payments deficit which had developed over previous months—a deficit about equally divided between the capital and the current accounts. Since the ensuing sterling crisis has been described in last month's *Review,* the focus here is on the measures taken by the British authorities to restore external balance and to bring about improvement in the country's competitive position. Late in October, the government announced a surcharge of 15 per cent on almost all manufactured and semimanufactured imports, coupled with rebates of indirect taxes—averaging about 2 per cent—on the value of exports. Furthermore, a special budget in November increased customs and excise taxes on certain fuels and oils and outlined additional measures for inclusion in the April 1965 budget. The latter measures included an increase in the income tax and a broadening of the coverage of the capital gains tax. Substantial increases in social benefit payments were also presented, mostly effective from the end of March, but the greater part of these expenditures will be financed from higher payroll contributions.

On November 23 the Bank of England raised its discount rate by 2 percentage points to 7 per cent (see table) in an effort to stem the speculative tide against sterling. This hike in the discount rate (the second in 1964, giving Britain the highest such rate among major central banks) demonstrated Britain's firm resolution to achieve external balance even at the cost of considerable monetary stringency at home. In addition, the Bank of England asked the banks and other financial institutions to give priority, within a more slowly increasing total of credit, to credits for exports and productive investments at the expense of consumer and real estate loans. Also, to assist the ex-

[2] For a detailed discussion, see Charles A. Coombs, "Treasury and Federal Reserve Foreign Exchange Operations", this *Review,* March 1965, pp. 43-45.

[3] For details, see "Increases in Quotas of Fund Members: Fourth Quinquennial Review" (Report of Executive Directors to Board of Governors), Supplement to *International Financial News Survey,* March 5, 1965.

[4] In general, IMF members can borrow up to 125 per cent of their quota. Thus, the proposed increase of about $5 billion in Fund quotas means that members' total potential claims on Fund resources would rise by 125 per cent of the increase, or by about $6 billion. However, it must be remembered that, to obtain these rights, members in the aggregate will have to pay to the Fund some $1.2 billion, or 25 per cent of their quota increase, in gold.

CHANGES IN CENTRAL BANK DISCOUNT RATES IN MAJOR INDUSTRIAL COUNTRIES ABROAD SINCE OCTOBER 1, 1964

In per cent

Country	Date	New rate	Change
Canada	November 24	4¼	+¼
Germany	January 22	3½	+½
Japan	January 9 April 3	6.205 5.84	−0.365 −0.365
Sweden	November 6	5	+½
United Kingdom	November 23	7	+2

port effort, the Board of Trade in January announced a wide range of new measures involving marketing assistance and government credit guarantees for exports; at the same time, the Bank of England improved refinancing facilities for commercial bank export credits. In the three months of December through February, there was considerable improvement in the British trade position. In particular, the seasonally adjusted trade deficit was well below that of the previous three months. On February 22 the government announced that, effective April 27, the import surcharge would be lowered to 10 per cent.

Meanwhile the government pressed forward with steps to insure long-term growth without inflation. On December 16 a Declaration of Intent was signed by the government and representatives of labor and management. The government asked the cooperation of labor and management in an attempt to keep price and wage increases within the range deemed to be in the national interest. It also made clear its intention to use sterner enforcement measures if voluntary compliance fails. Under this program, wage and price increases will be kept under surveillance by a National Board for Prices and Incomes. Representatives of important labor groups have reportedly already given tentative approval to the Board's 3 to 3½ per cent norm for wage increases. The government has also continued efforts to reduce the effect on domestic prices of restrictive practices in industry. Taken together, the various measures adopted by Britain during the past six months demonstrated the government's determination to deal effectively with the country's international payments problems.

Germany's restraining measures were more of a precautionary than of a corrective nature. Part of the recent expansionary thrust to the German economy had stemmed from a renewal of large current-account surpluses since early 1963. This surplus declined in the second half of 1964, as policy measures taken by Germany's European Economic Community partners slowed the growth of German exports and as Germany's own import demand increased markedly. A further increase in disposable income is anticipated in 1965—partly as a result of a long-anticipated income tax cut in January and partly as a reflection of higher wages and salaries that have resulted from recent labor negotiations. To counteract the inflationary potential of these developments, the German Federal Bank raised its discount rate to 3½ per cent on January 22 from the 3 per cent rate that had been in effect since May 1961. At the same time, the bank raised by a similar amount the rate at which it stands ready to sell money market paper to the banks. Also, the government enacted in February the 25 per cent withholding tax on interest earned by nonresidents on German securities. This tax had first been proposed in March of last year to stem the inflow of funds from abroad and thus curb the balance-of-payments surplus.

Austria adopted a restrictive monetary policy last fall when rapid growth of demand was placing increased strain on domestic resources. Effective October 31, minimum required reserves were raised from 10 per cent to 11.5 per cent on demand and time deposits and from 8 per cent to 9.5 per cent on saving deposits in large banks, with comparable adjustments for small banks. At the same time, the existing credit ceiling (the maximum ratio of credit to selected liabilities) was lowered from 70 per cent to 68 per cent of the banks' liabilities. In addition, the Austrian government early in 1965 authorized the use of 3 billion schillings ($115 million) of its debt held by the Austrian National Bank for initiating open market operations. Since a sizable balance-of-payments surplus was considered an important source of inflationary pressures, Austrian import restrictions were eased somewhat and the quota for foreign workers' entry to that country was raised. Also, the large banks early last September agreed not to repatriate 1.7 billion schillings ($65 million) of their foreign assets for a period of six months. This agreement was extended by another three months on March 1. It appears that some of these measures may have contributed to the emergence of a balance-of-payments deficit in the fourth quarter.

In Sweden, strong domestic demand during 1964 put considerable pressure on productive capacity. Excess demand was evident in the labor market, and price pressures were expected to become stronger unless counteracted. The task of curbing price increases and a larger trade deficit has mainly been borne by monetary policy. Along with other efforts to hold the line on credit expansion—including a hike from 9 per cent to 10 per cent in the penalty interest rate for commercial banks not maintaining the required liquidity level—the Bank of Sweden raised its discount rate in November to 5 per cent from the 4½ per cent level posted the previous January.

SWITZERLAND AND THE NETHERLANDS

The Swiss stabilization program introduced last year was keyed largely to reducing demand and liquidity pressures from both internal and external sources, lest such pressures become too strong for an economy already operating in high gear. The program was approved by the Swiss electorate in a February 1965 national referendum and extended for a year; it can be prolonged for yet another year without another popular vote. One effect of this program was a sharp rise during 1964 in domestic interest rate levels for all maturities. In November, the large banks in Zurich increased by an average of ¼ percentage point the interest they pay on medium-term bank bonds (Kassenobligationen), and in December these banks increased their market discount rate on trade bills by ½ percentage point to 3 per cent. This marked the second rise of the latter rate in eight months, following a five-year period of stability preceding April 1964. The extensive controls on imports of foreign capital have been retained. Early in 1965, Swiss capital and money market rates declined from their 1964 peaks but continued above the levels prevailing a year earlier when the stabilization program was just initiated. While the rate of price increases was reduced, the labor shortage remained pressing. Further restrictions on hiring of foreign workers have nevertheless been imposed because of mounting concern about the social problems created by massive immigration of temporary laborers. Decrees effective last November and this March are designed to bring about a limitation in the number of foreigners in the labor force and a gradual reduction, about 10 per cent, by mid-1966.

In the Netherlands, anti-inflationary measures brought to a virtual halt last July the previous rise in consumer prices. In good part, this inflationary pressure had stemmed from the 1963 wage agreement which led to a 17 per cent rise in wages and salaries in 1964. Dutch wage negotiations for 1965—a major concern for the government—were settled in December, with wages and fringe benefits scheduled to rise by 8 to 9 per cent this year. To secure the labor unions' cooperation in restraining wage increases, the government advanced half of a scheduled income tax cut from January 1966 to July 1965. Output continued to expand through 1964, and the large trade deficit of early 1964 became smaller in the second half of the year. In the financial sphere, credit restraint resulted in substantial increases of short-term and long-term interest rates over 1963 levels. Commercial banks continued to exceed their permitted credit ceilings, and accepted the penalty of making interest-free deposits with the Netherlands Bank, meeting this penalty by repatriating foreign assets. Long-term capital has been attracted from abroad in large quantities, particularly since last summer when yields on new issues reached a peak of 6 per cent. Given the inflationary potential of such capital inflows, there has been increased discussion of the feasibility of reopening the Dutch capital market to new issues of foreign securities.

ITALY, JAPAN, FRANCE, BELGIUM, AND CANADA

In Italy, the stabilization program, introduced in the fall of 1963 and stiffened in early 1964, achieved its major objective of curbing the country's large balance-of-payments deficit. The payments balance swung into surplus in the spring of 1964 as the result of a considerable decline in imports, accompanied by export expansion and a net inflow (including reflows) of capital. The measures required to restore external balance apparently contributed to a falloff of production in 1964 in many sectors of the Italian economy and to an increase in unemployment. Consumer prices nevertheless continued to rise rapidly—by about 6 per cent last year. Since a broad range of wages is contractually linked to the cost of living, the interaction of rising wages and prices has not yet ceased.

The authorities have therefore been cautious and selective in choosing measures to stimulate the economy. In October, the Italian authorities made arrangements with savings banks to purchase about 200 billion lire ($320 million) of Treasury paper held by these banks as part of their compulsory reserves. According to the agreement, the savings banks would use the proceeds to acquire bonds of public enterprises engaged in rail and highway modernization and other public investments. In November, in view of the depressed state of the automobile industry, the government repealed the special tax of 7 to 15 per cent on automobiles imposed in February 1964 as part of the stabilization program. In March 1965, the government moved more strongly to revive production. The Credit Consortium for Public Works (a semiofficial agency designed to supply funds to local authorities) was authorized to borrow $400 million equivalent, and the Post Office Savings Fund will contribute $600 million equivalent, for the financing of an extensive public works program. Also included in this group of measures were a one-year reduction in employer contributions to pension funds and a cut in taxes on real estate transactions.

Japan's industrial output grew less rapidly in 1964 than in 1963 and became virtually stationary in the last few months of the year. There were an increased number of business failures, and prices in the Tokyo stock market continued the decline begun in July 1963. To bolster confidence, the Bank of Japan provided substantial support to the stock market by extending loans to two government-sponsored intermediaries, with the proceeds to be used for purchases of securities. Monetary policy, which had been increasingly restrictive in 1963-64, was relaxed in December and January. In December the reserve requirement against demand deposits and against time deposits subject to call on two-week notice was lowered from 3.0 per cent to 1.5 per cent, and the Bank of Japan's discount rate was reduced by 0.365 percentage point each in January and in April. After the two adjustments, it stood at 5.84 per cent. As Euro-dollar rates moved generally upward in February and March, the Japanese authorities on several occasions raised the maximum rates that Japanese banks are permitted to pay on dollar deposits.

The French stabilization effort, in effect since September 1963, slowed the inflationary trend, and after mid-1964 may also have exerted a depressing effect upon production. Nevertheless, wages continued to advance, and in the fall of last year the upward drift of consumer prices again gathered momentum. Thus, new restraining measures were introduced in November; controls were placed on certain food and restaurant prices, and the scheduled increases in controlled rents were postponed from January to July 1965. Because of the price pressures, the authorities have proceeded very cautiously in relaxing the stabilization program, and positive measures to stimulate growth have been minor. In January, the National Credit Council reduced slightly some key commercial bank lending rates (without, however, any change in the Bank of France's discount rate). At the same time, in a move to improve housing finance, commercial banks were permitted to sell mortgage loans to insurance companies and retirement funds, a privilege already possessed by financial institutions specializing in mortgage loans.

Belgian monetary policy remained on the side of restraint as wage and price increases continued. In addition to the July 1964 boost in the National Bank's discount rate from 4¼ per cent to 4¾ per cent, a 1 per cent compulsory reserve ratio against commercial bank deposit liabilities was put into effect in August and renewed in November and again in February. With Belgium's industrial production virtually level since mid-1964, the Belgian authorities have recently suggested that selective easing action might be taken if warranted.

Canada has experienced prolonged economic expansion and has made progress in reducing unemployment. Monetary policy has generally been stimulative, but has been adjusted to maintain Canada's external position without at the same time aggravating the United States payments difficulties. When the British discount rate was raised by 2 percentage points on November 23 and the Federal Reserve Banks followed immediately with a ½ per cent rise, the Bank of Canada raised its rate by only ¼ per cent to 4¼ per cent. Canada's moderate reaction in this instance was consistent with both the needs of the domestic economy and the desire to limit short-term capital inflows from the United States. Similar considerations influenced the Bank of Canada's open market operations. The Canadian money market remained fairly liquid, even after President Johnson's balance-of-payments message in February and the subsequent measures to curb the flow of funds from the United States. Canadian Treasury bill yields—which over long periods have tended to be higher than United States yields—often moved below those on United States Treasury bills.

Economic policy abroad in the near future may face substantial adjustments, particularly in the monetary area, as the United States program to reduce capital outflows takes effect. (Several key documents relating to this program are reprinted in last month's and in this *Review.*) Recent developments, such as the sharp rise in Euro-dollar rates, suggest that the outflow of funds from this country has been reduced. In the absence of counteracting policies, there might be a tendency for credit conditions to tighten in several countries abroad. The authorities are of course aware of this problem, and there are already indications that policies are being adapted to the new conditions.

A Primer on Federal Budgets

By JOSEPH SCHERER*

The Federal budget is a multipurpose document. Its original purpose had been, and its main purpose continues to be, to provide a system of planning and control over Government activities by the executive and legislative branches. In this respect, it serves the same functions that a budget plan performs for an individual or a business. But, unlike the budget of any other single economic unit, the Federal budget because of its sheer size—some $90-120 billion per year, depending upon the particular budget concept used—exerts a potent influence on the nation's economy. This influence, moreover, is being increasingly directed, as a matter of deliberate policy, toward assisting the economy to attain, and sustain, high levels of employment and economic activity. Not only have these growth and stability goals been incorporated in legislation, as in the Employment Act of 1946, but there appears to be a growing consensus among the citizenry that it is appropriate and desirable for the Federal Government to pursue such goals.

In order to evaluate how the Federal Government carries out these housekeeping and policy purposes, it is necessary to examine budget data, totals as well as components. This is not easy, since the needs of analysts have led to the development of a number of concepts that at times appear to provide conflicting data. For example, different dollar magnitudes can be found for categories designated by the same general name. Thus, the data for fiscal 1964 (the year ended June 30, 1964) show the Federal deficit as $8.2 billion in the administrative budget, or $4.8 billion in the consolidated cash budget, or $3.9 billion in the national income account budget. Likewise, for the current year, fiscal 1965, the Bureau of the Budget estimates the deficit will be $6.3 billion in the administrative budget, $4.0 billion in the cash budget, and $5.0 billion in the national income account budget. These three different deficit amounts are, of course, neither arbitrary nor unnecessary. Instead, they reflect an attempt to provide appropriate data for unraveling some exceedingly complicated economic and accounting relationships.

As a very abbreviated summary, each of the three widely used measures of the Federal budget has its own appropriate use. Yet each measure, singly, as well as all measures together, still leaves something to be desired in terms of providing a complete picture of the role of the Federal Government in the economy. For example, none of the budgets integrate complete information, on a current basis, about Government lending activities and guarantees of loans, although this information may be assembled from other sources.

The administrative budget provides data which are most useful to the Government itself for housekeeping and control purposes. Because of the detail given for individual agencies and the availability of detailed monthly data, the administrative budget may prove helpful to an analyst focusing on some narrow aspect of the Federal impact on the economy.

The consolidated cash budget provides the most comprehensive view of Federal expenditures and receipts. Changes in these flows have a direct impact on the Government's cash balances and constitute a major determinant of Treasury debt operations with the non-Federal sector.

Finally, the Federal sector in the national income accounts is often used for formulating and analyzing problems primarily in the framework of the national income and product accounts data.

It is the purpose of this article to delineate in broad terms the uses and limitations of the alternative budget series and also to indicate the typical sources where these data can be found. First, the budget process is briefly described. Then an explanation is given of the basic characteristics of each budget concept, of some of the interlocking relationships among the budgets, and of the way in which each budget serves different analytical or administrative purposes.

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THE BUDGET PROCESS

The President's budget message, and its accompanying documents, usually delivered to Congress in the third week of January, present a comprehensive view of Federal spending and receipts for the current and the next fiscal year. (The Federal Government's fiscal year runs from July 1 of one year to June 30 of the following year and is identified by the year in which it ends.) Implementation of the tax and spending programs described in the budget is dependent upon legislation already in effect, as well as on new legislation still to be enacted. The new legislation does not come in a single package, but is introduced and considered by Congress in separately proposed and separately enacted bills. It will be useful to consider for a moment the general process by which a bill is enacted, and then to focus more specifically on what further steps are necessary before a particular agency can actually spend funds for a program.

Each new activity of the Federal Government (or extension of an old activity) must be authorized by a bill which has passed both houses of Congress and has been signed by the President.[1] Such bills are considered first by the appropriate legislative committee responsible for the subject area (true of both the House of Representatives and the Senate), which in turn typically refers the bills to subcommittees specializing in particular segments of the over-all area covered by the full committee. After the relevant legislative subcommittee and committee have approved the bill—including, if necessary, authorization to appropriate up to a given amount of money for the program—the bill is brought to a vote before the full membership of each branch of Congress.

For major legislation in the House of Representatives, the Rules Committee ordinarily acts as an intermediary to determine when legislation can reach the floor for consideration. Failure of the Rules Committee to bring out a bill produces complications since the bill cannot be voted on by the full chamber, except by a cumbersome procedure which is not often tried. If the bills for a particular program passed by the two houses differ in any respect, these differences must be resolved by a conference committee composed of members of the two houses, so that identical bills can be resubmitted for passage in each house and then transmitted to the President for signature.

The above procedure only authorizes the program in a general way. Actual authority to spend funds typically involves a further step—the passage of an appropriations bill again by both houses of Congress, which is then signed by the President. An appropriations bill follows the same general procedure as any substantive legislation, that is, it must pass a subcommittee, then a full committee, and then the full chamber. But for an appropriations bill, no matter what Government agency or subject area is involved, the bill starts its trip in the Appropriations Committee of the House of Representatives before it can be voted upon by the full House and similarly must be passed by the Senate Appropriations Committee before it can be voted on by the full Senate.

In effect, then, legislation requiring the spending of money typically goes through two complete rounds of legislative approval—first, the act authorizing the program (with a bill considered first by the subject area committees) and, secondly, the act providing the funds for the program (with a bill originating in the appropriations committees). And it is important to note that the amount of the appropriations bill need not be the whole amount authorized in the legislation setting up the new program (first round). Since control over the scope of any program is ultimately determined by the amount of money made available, it is obvious that the appropriations committees in the two houses occupy a strategic position. Appropriations bills, however, are not the only avenue by which a Government agency can obtain the right to spend, although it is the most important one.

A Government agency acquires the authority to spend money from legislation providing new obligational authority (NOA). The NOA may be given in any of three forms—appropriations, contract authorizations, and authorizations to expend from debt receipts. Only the first two are directly under the control of the appropriations committees of the two houses.

1. APPROPRIATIONS. These permit an agency to order goods and services and draw funds from the Treasury to pay for these goods and services up to some stated amount. Most spending takes this form. Although appropriations are usually limited to one year, some may cover several years or be "no year" (i.e., available until expended) because of the long-term nature of the project. The Defense Department holds the bulk of these multiyear appropriations. There are also "permanent appropriations", such as for interest on the debt, which do not require new action by Congress when additional funds are needed.

[1] Some bills, of course, are passed over a Presidential veto, and a few bills have become law without Presidential signature under the Constitutional provision that, if the President does not sign or veto a bill, it becomes law after ten days provided that Congress is in session.

2. CONTRACT AUTHORIZATIONS. These allow an agency to contract for goods and services, but payments cannot be made until Congress passes an appropriation to provide funds for the obligations incurred.

3. AUTHORIZATIONS TO EXPEND FROM DEBT RECEIPTS. These allow agencies to borrow money, generally through the United States Treasury, to contract for the purchase of goods and services, and to pay for them with the borrowed funds. This procedure has been called "back door" financing and has been subjected to criticism by some members of Congress because the appropriations committees have no say in establishing the actual amount of spending by the agency under this system. Instead, the authority to borrow from the Treasury—and the amount —are given in the legislation authorizing the program. Under this arrangement, an agency may carry on its activities indefinitely without recourse to any annual appropriations, unless otherwise specified in the law. Many of the Government loan programs have been set up in this fashion since it is usually expected that such programs will sooner or later be self-supporting.

NOA is generally considered the avenue whereby Congress can control the size of the budget. An increase in NOA for a fiscal year above the amount for previous years suggests that Government spending will grow. The failure of NOA to rise, however, may not be significant since Congress may merely have legislated NOA at levels below the amounts needed to pay for commitments under already existing programs. For example, some veterans' programs specify benefit payments to veterans eligible under specified conditions. If NOA for a program of this type is cut without changing the eligibility requirements and claims under the program are greater than projected, then supplementary appropriations must be voted before the end of the fiscal year in order to prevent default on a commitment made by the Government.

NOA, including carry-overs from prior years, represents the potential level of spending for a particular program. By contrast, obligations are commitments already made which will require spending of funds—funds available to the agency from obligational authority previously granted.[2] Expenditures are the end of the line which runs from NOA to obligations to expenditures.

Spending in any single fiscal year is always made up of a combination of spending from appropriations carried over from previous years as well as from appropriations newly legislated. In fiscal 1966, for example, the Administration's recent budget document estimates that $27.6 billion will be spent from the pool of previously authorized NOA—to pay for those parts of long-range programs now under way which will be completed during fiscal 1966. An additional $72 billion will be spent in fiscal 1966 from part of the NOA that the President is asking for in his budget message. Thus, total spending (in the administrative budget) is expected to amount to $99.7 billion—part out of existing multiyear appropriations and part out of new appropriations to be voted this year, which will include some new multiyear appropriations to be spent over several successive fiscal years, roughly at the pace that the programs are carried out.

Expenditures usually take the form of the issuance of a check which, when cashed, will reduce the Treasury's balance at a Federal Reserve Bank. But there are exceptions. Sometimes an expenditure takes the form of the issuance of a security, as in the case of payments of subscriptions to the International Monetary Fund (IMF), which raises the debt but does not reduce the Treasury's cash or bank balances. Since payment by issuance of a security does not affect the Treasury's cash balance, it is therefore not a cash budget expenditure; it is, however, listed as an expenditure in the administrative budget and raises the debt. It does not become a cash expenditure until the security is redeemed (by the IMF in the illustration cited). At that time, the cash balance will be reduced and the transaction will also reduce the amount of outstanding Government debt. Ordinarily, retirement of Federal debt is not counted as an expenditure but as a debt transaction, which is similar to private accounting practice in distinguishing between "current" transactions and balance-sheet transactions.[3]

ADMINISTRATIVE BUDGET

When reference is made to "*the* budget" in the press or in the halls of Congress, it almost invariably means the administrative budget. The President is required by the

[2] Obligations, particularly of the Department of Defense, have sometimes been interpreted as a good approximation of a "new orders" series. Such an interpretation is incorrect, because obligations also include commitments for expected disbursements for the wages and salaries of Government employees.

[3] Of course, debt operations—selling or retirement of securities—will change the level of the Treasury's cash balance but will not be recorded as a receipt or expenditure. In other words, transactions in United States Government debt instruments are usually classified as debt operations and are not included in budget transactions.

Table I

FEDERAL BUDGETS AND THEIR DATA SOURCES
Fiscal 1964 and fiscal 1965

In billions of dollars

Item	Administrative budget		Cash budget (DTS basis)*		Consolidated cash budget — receipts from and payments to public		National income account budget	
	Fiscal 1964 (actual)	Fiscal 1965 (estimate)	Fiscal 1964 (actual)	Fiscal 1965 (estimate)	Fiscal 1964 (actual)	Fiscal 1965 (estimate)	Fiscal 1964 (actual)	Fiscal 1965 (estimate)
Receipts	89.5	91.2	121.6	‡	115.5	117.4	114.7	116.0
Expenditures	97.7	97.5	125.6†	‡	120.3	121.4	118.5	121.0
Surplus (+) or deficit(−)	− 8.2	− 6.3	− 4.0	‡	− 4.8	− 4.0	− 3.9	− 5.0
Type of data	Monthly seasonally unadjusted, available with a three-week lag. The Budget projects annual data for the current fiscal year and the next fiscal year based on the Administration's economic assumptions and proposed programs.		Daily and monthly seasonally unadjusted, available with a three- to four- day lag.		Monthly and quarterly unadjusted, quarterly seasonally adjusted, available with a one-month lag. The Budget projects annual data for the current fiscal year and the next fiscal year based on the Administration's economic assumptions and proposed programs.		Quarterly seasonally adjusted, available with a two-month lag (complete expenditure data and all receipts data except corporate profits tax accruals available with a one-month lag). Quarterly unadjusted, available in February and July. The Budget projects annual data for the current fiscal year and the next fiscal year based on the Administration's economic assumptions and proposed programs.	
Sources of data	Treasury Department: Monthly Statement, Treasury Bulletin; Survey of Current Business; Federal Reserve Bulletin; Economic Indicators; The Budget		Treasury Department: Daily Statement*, Treasury Bulletin		Treasury Department: Monthly Statement, Treasury Bulletin; Survey of Current Business; Federal Reserve Bulletin; Economic Indicators; The Budget		Survey of Current Business; Economic Indicators; The Budget	

Note: Because of rounding, figures do not necessarily add to totals.
* Daily Statement of the United States Treasury (DTS).
† Includes clearing account.
‡ Full reconciliation to DTS basis for estimates is not available.
Source: *The Budget of the United States Government,* Fiscal 1966.

Budget and Accounting Act of 1921 to submit this budget to Congress every January in order to initiate a new round in the legislative process authorizing funds to support the activities of the regular Government agencies. These agencies are "controlled" by Congress through the power of the purse, i.e., Congress determines how much each agency shall have to spend by specifically approving dollar amounts for various purposes in an appropriations bill (which may lump together a number of agencies).

The administrative budget covers only those agencies for which Congress makes regular appropriations. Prior to the 1930's, this budget was a good measure of total Government activities. However, with the establishment and growth of self-financing agencies—whose operations are not included in the administrative budget—this budget has become an increasingly less adequate measure of the Federal Government sector. Government activities excluded from the administrative budget are the trust funds (of which the best known are the various social insurance funds) and quasi-public agencies, such as the Federal Home Loan Banks. These additional activities in recent years have added some $25 billion to $30 billion a year to Federal receipts and expenditures, as recorded in the cash budget.[4]

In addition to the direct exclusion of certain activities from the administrative budget, there are some accounting conventions in this budget which must be recast in constructing the cash budget and the Federal budget in the national income and product accounts. An example of these conventions can be seen in the treatment of interest payments. Interest payments for fiscal 1964 totaled $10.8 billion in the administrative budget, while actual cash outlays for interest payments totaled only $8.0 bil-

[4] Many of these activities (trust accounts) are financed by special earmarked taxes, while others (lending agencies) are financed, at least in part, by borrowing from the Treasury or in the market.

lion.[5] The bulk of some $3 billion of *noncash* interest is accounted for by "bookkeeping" payments by the Government to itself (intragovernmental transactions) for securities held by the trust funds and by the accrual of interest on outstanding Government securities, most notably savings bonds and Treasury discount bills, which becomes a cash expenditure when the savings bonds or Treasury bills are turned in for payment. Other intragovernmental transactions are included in the administrative budget figures, both for receipts and expenditures, in order to allocate these expenses and receipts more properly to the individual agencies concerned. This procedure raises the total of Government receipts and expenditures above the amount shown for the same agencies in the cash budget (described in the next section), because the cash budget eliminates intragovernmental transactions. However, the difference between the cash and the administrative figures for a particular agency in any given year is likely to be relatively small, compared with the total, except for interest payments as just discussed and for those agencies whose operations include trust fund functions, most notably the Department of Health, Education, and Welfare.

Despite its incomplete coverage of the Federal sector, the administrative budget is a source of valuable data to persons interested in knowing how much is spent by a "regular" Government agency and its major divisions. Data for this budget are published in the Treasury's *Monthly Statement of Receipts and Expenditures of the United States Government,* approximately three weeks after the end of each month (see Table I). To the extent that a Government agency, or activity, can be closely identified with a specific activity or segment of the economy (for example, the National Park Service, Rivers and Harbors and Flood Control, or Military Construction), these outlays as summarized in the *Monthly Statement* indicate the current scope of Government activities in the area concerned. Perhaps the most widely used data in the *Monthly Statement,* other than the summary budget totals, are those which give the breakdown of Defense Department spending by functional category—such as research and development, military construction, etc. (More detailed spending and order data are released directly by the Defense Department but are typically available with a much longer time lag than the administrative budget data.) Annual data classified by broad functional categories are given in the budget itself and usually in the budget review, generally issued after each Congressional session; current data appear in the *Monthly Statement* and in the *Treasury Bulletin.*

[5] Net interest paid in the Federal sector of the national income accounts for fiscal 1964 was $8.1 billion, compared with $8.0 billion in the cash budget. Usually the difference in levels for interest payments in the cash and national income budgets has been larger than that shown for fiscal 1964. The reason for differences in levels is discussed in the section devoted to the national income version of the budget.

CASH BUDGET

The cash budget is the most comprehensive budget statement issued by the United States Government and is designed to show the cash flows between the Federal Government and other sectors of the economy. Unlike the administrative budget, it covers not only the activities of the regular Government agencies found in the administrative budget but also the cash flows associated with the activities of the trust funds (such as social security) and Government-sponsored enterprises (such as the Federal Home Loan Bank Board). Like the administrative budget, it also covers the purchase and sale of assets (both "real", such as buildings, and "financial", such as mortgages and other loans). However, as noted earlier, certain items, e.g., interest payments, treated as accrual items in the administrative budget are placed on a cash basis. For many years a substantial number of economists have regarded the cash budget as the best measure of the total impact of the Federal Government on the economy.

Total expenditures and receipts in the cash budget are larger than in the administrative budget, since the cash budget includes a wide range of Government activities omitted from the administrative budget. Nevertheless, because the cash budget eliminates many transactions of Government agencies with each other (intragovernmental transactions), it records certain Government activities at lower levels than the administrative budget (for example, interest payments, as noted previously). The total of cash budget expenditures, however, does understate the full magnitude of the cash flows between the Government and the private sector, as some agencies are listed only on a *net* basis on the expenditures side. The Post Office, for example, is recorded as having spent $600 million in fiscal 1964—but this amount represents only "net expenditures" obtained after deducting postal receipts (sale of stamps, etc.) from total postal expenditures. Government corporations are also typically recorded only on a net basis. The device of netting, incidentally, is not restricted to the cash budget; it also affects some of the data reported in the administrative budget, as mentioned earlier, and in the national income budget.

The cash budget in the form of "receipts from and payments to the public" is also called "the consolidated cash budget". Annual data giving a functional breakdown for receipts and expenditures are published in the budget and in the budget review (with some exceptions). Monthly data are also available (with functional breaks) for this cash budget in the *Federal Reserve Bulletin,* but seasonally adjusted data are available only on a quarterly basis and only for total cash income, total cash outgo, and the resultant cash surplus or deficit.

Detail for some ten categories of receipts and expenditures are available in a variant of the cash budget known as the *Daily Statement of the United States Treasury* (DTS) which excludes a few Government corporations whose accounts are not commingled with the Treasury's. These DTS data, *not* seasonally adjusted, are published for each working day, with a lag of about three or four days and are cumulated to a monthly total and for the fiscal year to date. The DTS data are used by analysts who are particularly interested in the level of, or changes in, the Treasury's cash balances and by those who need current data (daily and monthly totals) for major categories of Government receipts and expenditures and for debt operations.

A comparison of the consolidated cash budget and administrative budget expenditures on a functional basis is shown in Table II. Differences for the same function, if large, are likely to reflect differences in coverage and in the treatment of intragovernmental transactions in the two budgets. In addition, relatively small differences in amount arise for functions called by the same general name in the two budget accounts because of differences in the accounting techniques used in recording these expenditures for the different budget accounts.

The surplus or deficit of the cash budget (not the administrative budget) will determine how the balances held by the Treasury will change. When a surplus is generated, the balances rise and Government debt held by the public may be retired. On the other hand, cash deficits, depending upon the level of the cash balance, may require that the Government borrow from the public in order to pay its bills. Consequently, the net flows as recorded in the cash budget are one of the major determinants of Government debt operations.

But there is no one-to-one correspondence between cash deficits and Government debt operations. A deficit can be financed simply by running down the cash balance. Alternatively, the Government may borrow to build up its cash balance rather than to meet a deficit in the cash budget. Moreover, the average level of balances maintained by the Government varies from time to time by substantial amounts which are determined by operating and policy considerations not directly related to the cash surplus or deficit.

Table II

FEDERAL EXPENDITURES AND RECEIPTS
ADMINISTRATIVE BUDGET AND CONSOLIDATED CASH BUDGET
Fiscal 1964-66

In billions of dollars

Type of transaction	Administrative budget			Consolidated cash budget		
	Actual	Estimate		Actual	Estimate	
	1964	1965	1966	1964	1965	1966
Receipts						
Individual income taxes	48.7	47.0	48.2	48.7	47.0	48.2
Corporation income taxes	23.5	25.6	27.6	23.5	25.6	27.6
Excise taxes (net)	10.2	10.7	9.8	13.7	14.4	13.7
Employment taxes	—	—	—	16.8	16.7	18.7
Estate and gift taxes	2.4	2.8	3.2	2.4	2.8	3.2
Customs	1.3	1.4	1.5	1.3	1.4	1.5
Deposits by states, unemployment insurance	—	—	—	3.0	3.0	2.9
Veterans' life insurance premiums	—	—	—	0.5	0.5	0.5
Other budget and trust receipts	—	—	—	5.6	6.1	7.1
Miscellaneous budget receipts	4.1	4.5	4.7	—	—	—
Interfund transactions	− 0.7	− 0.8	− 0.6	—	—	—
Total	89.5	91.2	94.4	115.5	117.4	123.5
Expenditures by function						
National defense	54.2	52.2	51.6	54.5	52.8	52.5
International affairs and finance	3.7	4.0	4.0	3.5	3.6	4.2
Space research and technology	4.2	4.9	5.1	4.2	4.9	5.1
Agriculture and agricultural resources	5.6	4.5	3.9	5.8	4.6	4.1
Natural resources	2.5	2.7	2.7	2.6	2.8	2.9
Commerce and transportation	3.0	3.4	2.8	6.5	7.4	6.5
Housing and community development	− 0.1	− 0.3	*	1.7	− 0.2	0.7
Health, labor, and welfare	5.5	6.2	8.3	27.3	28.9	34.1
Education	1.3	1.5	2.7	1.3	1.5	2.6
Veterans' benefits and services	5.5	5.4	4.6	6.1	6.0	5.1
Interest	10.8	11.3	11.6	8.0	8.5	8.8
General government	2.3	2.4	2.5	2.2	2.4	2.4
Unallocated and interfund transactions	− 0.7	− 0.7	− 0.1	—	—	—
Deposit funds (net)	—	—	—	− 0.6	*	*
Undistributed adjustments	—	—	—	− 2.9	− 1.8	− 1.6
Total	97.7	97.5	99.7	120.3	121.4	127.4

Note: Because of rounding, figures do not necessarily add to totals.
* Less than $50 million.
Source: *The Budget of the United States Government,* Fiscal 1966.

THE NATIONAL INCOME ACCOUNT BUDGET

The Federal budget in the national income and product accounts (NIP) records the receipts and expenditures of the Government sector as an integrated part of the recorded activities of other sectors of the economy. The national income accounts, sometimes called "the GNP accounts", are a measure of current output (both goods and services) in the economy. The Federal sector data have gained wide currency in the last three years, since the President's Council of Economic Advisers has often used this version of the budget for its analyses of Federal fiscal impact.

Like the cash budget, the Federal sector account is a more comprehensive statement than the administrative budget. It differs from the cash budget, however, by restricting itself to receipts and expenditures which reflect the direct impact of Government spending and tax programs on the flow of current income and output, as measured by the national income accounts. A broader measure of the economic impact of the Government would include not only the direct impact but also influences on asset holdings and liquidity—which may indirectly affect income and output. Thus, such a measure would allow for the effect of all transactions involving existing assets, as well as any assets of a purely financial character (bonds, mortgages, loans, etc.).

On the expenditures side, the cash budget records spending at the time of payment, but in the NIP concept spending is typically recorded when delivery is made to the Government sector—which often does not coincide with the time of payment.[6] On the receipts side, the national income budget differs from the cash budget most importantly in recording corporate profits taxes when the tax liability is incurred rather than when the tax payment is made.

Expenditures in the Federal sector account are classified into five categories (see Table III) which identify the basic economic import of the expenditures. The largest single category, accounting for more than half of the total, is "purchases of goods and services". Such purchases are one of the major components of total GNP as viewed from the product side—the others being personal consumption expenditures, domestic investment, net exports, and state and local government purchases. The next largest category of Federal expenditures, approximately one fourth of the total, is "transfer payments", defined as payments for which no goods or services have been rendered in exchange. These are mainly made to individuals and include such items as old-age pensions and unemployment benefits. Although transfer payments are not directly included in GNP, they do affect GNP indirectly because they add to disposable personal income which in turn strongly affects personal expenditures on goods and services. The other three items, accounting for less than one fifth of total Federal expenditures, are (1) "grants-in-aid to state and local governments", which increase the receipts of these governmental units and, in turn, are spent by these units for goods and services or for transfer payments; (2) "net interest paid", which adds to personal income but is not counted as part of GNP;[7] and (3) "subsidies less current surplus of Government enterprises", a category

Table III

FEDERAL RECEIPTS AND EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS
Fiscal 1964-66

In billions of dollars

Type of transaction	Actual	Estimate	
	1964	1965	1966
Receipts			
Personal tax and nontax	51.4	50.3	52.2
Corporate profits tax accruals	23.5	23.9	24.7
Indirect business tax and nontax accruals	16.0	16.8	16.1
Contributions for social insurance	23.8	25.0	28.0
Total	114.7	116.0	121.0
Expenditures			
Purchases of goods and services	66.1	65.9	66.7
Transfer payments	30.4	31.8	35.2
Grants-in-aid to state and local governments	9.8	10.7	13.0
Net interest paid	8.1	8.5	8.6
Subsidies less current surplus of Government enterprises	4.1	4.1	3.5
Total	118.5	121.0	127.0
Surplus (+) or deficit (—)	— 3.9	— 5.0	— 6.0

Note: Because of rounding, figures do not necessarily add to totals.
Source: *The Budget of the United States Government*, Fiscal 1966.

[6] It should be noted that the "delivery" concept for recording purchases (or spending) is the standard national income accounts treatment for purchases made by all sectors of the economy (and not only the Government sector). Goods produced, but not yet delivered, show up in the inventory component of gross national product (GNP).

[7] Interest paid by the Federal Government is considered as part of personal income, though, unlike private interest payments, it is not included in total GNP because Federal Government interest payments are not viewed as income arising out of current production. Government interest in NIP excludes intragovernmental payments (similar to the cash budget) but treats certain items, such as interest on Treasury bills and savings bonds, on an accrual basis (similar to the administrative budget). Therefore, the interest total in NIP is likely to be different from that in the cash and the administrative budgets.

which records the net of subsidy payments to private business offset by any profits made by Government agencies.

This five-part classification is very useful in differentiating broadly, and in a way not available from any other source, between analytically distinct types of Government spending. Moreover, additional details for some of these categories, available on an annual basis only, further enrich our understanding of the composition of Government spending. However, the delivery basis for recording Government expenditures on goods and services sometimes fails to identify properly the time period when the Government is significantly influencing the level of private

Table IV

RECONCILIATION OF ADMINISTRATIVE BUDGET AND CASH BUDGET TO FEDERAL RECEIPTS AND EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS
Fiscal 1964

In billions of dollars

Type of transaction	Administrative budget total	Adjustments from administrative to cash budget	Consolidated cash budget total	Adjustments from cash to national income account budget	National income account budget total
Receipts					
Administrative budget receipts	89.5	—	—	—	—
Less: Intragovernmental transactions	—	4.2	—	—	—
Receipts from exercise of monetary authority	—	0.1	—	—	—
Plus: Trust fund receipts	—	30.3	—	—	—
Equals: Federal cash receipts from the public	—	—	115.5	—	—
Adjustments for agency coverage: Less: District of Columbia revenues	—	—	—	0.3	—
Adjustments for netting and consolidation: Less: Interest and other earnings	—	—	—	1.4	—
Plus: Contributions to Federal employees' retirement funds, etc.	—	—	—	2.0	—
Adjustments for timing: Plus: Excess of corporate tax accruals over collections, personal taxes, etc.	—	—	—	− 0.7	—
Adjustments for capital transactions: Less: Realization upon loans and investments, sale of Government property, etc.	—	—	—	0.6	—
Equals: Receipts—national income budget	—	—	—	—	114.7
Expenditures					
Administrative budget expenditures	97.7	—	—	—	—
Less: Intragovernmental transactions	—	4.2	—	—	—
Accrued interest and other noncash expenditures	—	2.0	—	—	—
Plus: Trust fund expenditures (including Government-sponsored enterprise expenditures net)	—	28.9	—	—	—
Equals: Federal cash payments to the public	—	—	120.3	—	—
Adjustments for agency coverage: Less: District of Columbia expenditures	—	—	—	0.3	—
Adjustments for netting and consolidation: Less: Interest received and proceeds of Government sales	—	—	—	1.4	—
Plus: Contributions to Federal employees' retirement funds, etc.	—	—	—	2.0	—
Adjustments for timing: Plus: Excess interest accruals over payments on savings bonds and Treasury bills	—	—	—	0.9	—
Excess of deliveries over expenditures and other items	—	—	—	1.5	—
Less: Commodity Credit Corporation foreign currency exchange	—	—	—	0.6	—
Adjustments for capital transactions: Less: Loans—Federal National Mortgage Association secondary market mortgage purchases, redemption of International Monetary Fund notes, foreign assistance, etc.	—	—	—	3.4	—
Purchases of land and existing assets	—	—	—	0.5	—
Equals: Expenditures—national income budget	—	—	—	—	118.5
Surplus (+) or deficit (−)	− 8.2	—	− 4.8	—	− 3.9

Note: Because of rounding, figures do not necessarily add to totals.
Sources: *Economic Report of the President,* January 1965; *The Budget of the United States Government,* Fiscal 1966.

employment and output. This is particularly troublesome when the level of Government orders is subject to wide variation, as was the case at the beginning and end of the Korean war. This timing problem is one illustration of the need for different budget concepts: it is not possible to construct a single series which is appropriate for all uses.

The Federal sector data are available quarterly on a seasonally adjusted annual rate basis. The figures are released about one month after the quarter is over, except for corporate profit tax accruals which lag by about two months.[8] The data are revised as more information is obtained for the period. While individual adjustments of components are generally small, in combination they sometimes shift the budget from an originally estimated deficit to a surplus.

A comprehensive view of how the administrative, cash, and national income budgets are related is shown in Table IV. In summary, moving from the administrative budget to the cash budget primarily entails adding to the administrative budget a total for the trust funds plus Government-sponsored enterprises while eliminating from the administrative budget a total for intragovernmental transactions. The transition from cash to NIP transactions (with some qualifications) primarily involves: (1) timing adjustments (mainly to an accrual basis on the receipts side and to a delivery basis on the expenditures side), (2) the elimination of assets transactions included in the cash figures, and (3) the elimination of lending activities included in the cash figures.

THE BUDGET AND THE ECONOMY

Because of its sheer size, the Federal Government inevitably exerts a potent influence on the functioning of the economy. Budget data provide the raw material for analyzing this influence, but each form of the budget statement is not equally useful for this purpose. Typically, the administrative budget is not used for assessing the Government's impact on the economy, because it does not cover the full range of Government activities. Instead, the Government sector in the economy is usually analyzed with the data from the cash budget or the NIP budget.

A lively controversy has been going on for a number of years over the relative merits of the cash versus the NIP budget as the best measure of the Government's impact on the economy. When annual data are used, disagreement over the relative merits of the two comprehensive budget statements is not great. Although there are some differences in the levels of receipts and expenditures and the size of the surplus or deficit, the general trends observed in using either of the two comprehensive budget measures by and large will be similar. When quarterly data are used, however, the problems of choosing between the two measures become more troublesome because there are often conflicts both as to the direction and the magnitude of changes. Much depends on the particular problem under investigation, and often data from both budgets are needed to obtain a rounded picture.

The popular view of budget impact is that a surplus is a contractionary influence, that a deficit is an expansionary influence, and that a balanced budget is neutral. This popular view is, at best, only a partial view of the role of fiscal policy in the economy; a fuller perspective of the role of Government impact is somewhat more complex. In its simplest form, this popular view may be called the "cross section" approach. Taking the economy for a fixed period, a balance sheet of each of the sectors is compiled to show how each is affecting the economy. In this view, a Government deficit of $2 billion for the period is expansionary, because the Government is adding to the demand side of the economy more than it is taking out in taxes. But this is far from the full story. Another dimension is added by the "time series" approach which looks at the change in budget position between two periods. For example, a deficit of $2 billion may be considered restrictive in the second period if it follows a deficit of $7 billion in the first period, whereas it may be held to be expansionary compared with a previous surplus. In other words, if the $2 billion deficit followed a period when the budget deficit has been larger, say $7 billion, then the budget is exerting an effect in a contractionary direction. Given the change in strength of the forces at work in other sectors of the economy, this reduction in the amount of stimulus from the Government sector may be just the right amount of restraint for the economy, if high levels of activity are to be maintained and if potential excesses are to be curbed before they develop.

Both of the approaches described above, however, by measuring the fiscal impact of the Government in terms of the over-all budget surplus and deficit ignore the fact that for any given budget structure (the combination of spending programs and tax programs), the budget outcome depends not only on the specific character of these programs but also on the level of operation of the economy itself. Thus, for any particular year, an economy operating at full employment may give a budget surplus, while the same economy operating at 6 per cent unemployment, with the same expenditure and tax programs, will probably show a

[8] Seasonally unadjusted figures are also available in the February and July issues of the *Survey of Current Business,* United States Department of Commerce.

sizable budget deficit. As a correction for the distortion introduced by the impact of the economy itself on the realized net budget position, the concept of the full-employment budget surplus has been developed.

The full-employment budget surplus is an estimate of the budget outcome for any given budget structure, assuming that the economy is at full employment. (In theory, there could of course be a full-employment deficit.) By estimating the net surplus or deficit of different budget structures for the assumed full-employment level of activity for any year, it is possible to measure the relative restrictiveness of these different structures, i.e., the budget structure with higher full-employment surplus is taken to be more restrictive than budgets with smaller surpluses (or deficits). While the full-employment surplus concept is a highly suggestive addition to the other techniques of analysis, estimates of the precise magnitude of "full employment" and of the budget outcome at that level of activity are not particularly easy, and there are also some problems in the analytical interpretation of the estimates. The development of this concept, however, is indicative of the imaginative way new analytical tools are being forged to advance the art of fiscal analysis.

The full Government impact, of course, depends not only on the absolute levels of its receipts and expenditures, or how they change, but also on the further changes in spending by the private sector induced by the impulses emanating from the Government. Furthermore, different kinds of Government spending may affect the economy differently—for example, increases in Government purchases of goods may not have the same impact on the economy as an equal dollar increase in old-age payments. Similarly, an increase or decrease in income taxes will affect the economy differently from an equal dollar change in excise taxes. But what is not yet known with much certainty is the quantitative extent of these differences and how they may themselves vary under different economic conditions. Thus, a less aggregative approach also will have to be developed eventually to provide greater information.

The Government sector influences the economy in many different ways—by its spending programs, by its tax programs, by its credit programs, by its debt management actions, by its monetary policy, and by other actions which do not fit neatly into any of the foregoing classifications. Only part, although a very important part, of all this economically significant behavior is encompassed by the data typically found in the various budget documents. Much, however, is still to be learned. In part, improved insights will come from advances in the analytical tools applied to the public finance field. In part, advances also will depend on improvements of the kinds and quality of data available, for data provide the raw materials for the application of the analytical tools.

The President's Balance-of-Payments Program

Last month's Review *contained several official statements and documents relating to the initial measures taken to implement the President's program for quickly achieving a substantial improvement in our balance-of-payments position. One of these documents was a letter by Chairman Martin to nonbank financial institutions, giving guidelines for their foreign lending and investing. Two additional sets of such guidelines have since been issued and are reprinted below. One consists of the Federal Reserve System's guidelines for commercial banks. The other constitutes the Commerce Department's program for nonfinancial business concerns.*

CIRCULAR NO. 5628—MARCH 5, 1965
GUIDELINES FOR FOREIGN LENDING ACTIVITIES OF COMMERCIAL BANKS UNDER THE PRESIDENT'S BALANCE-OF-PAYMENTS PROGRAM

To All Banks in the Second Federal Reserve District:

The following statement was issued by the Board of Governors of the Federal Reserve System and released for publication in morning newspapers, Monday, March 8:

The Board of Governors of the Federal Reserve System today issued a set of fourteen guidelines for commercial banks to follow in complying with the President's program to improve the nation's balance-of-payments position, in part through voluntary efforts to restrain foreign lending and investment. It was recognized that, in restraining the growth of loans to foreigners, banks will be foregoing some of the gains that would otherwise have accrued to them. Nevertheless, the Board stated, if a voluntary program is to be effective, the national interest must come first in decisions on future specific loan transactions.

The guidelines for foreign lending operations specify that absolute priority should be given to all bona fide export credits. With respect to nonexport credits, banks are expected to give the highest priority to loans to less developed countries and to avoid restrictive policies that would place an undue burden on Canada, Japan, and the United Kingdom. To meet these priorities, the guidelines contemplate that nonexport credits to other advanced countries will be cut back to the extent needed to achieve the goal of the President's program.

The objective of the program is that outstanding bank credit to nonresidents of the United States not rise above the amount outstanding at the end of 1964 by more than 5 per cent. Banks which find themselves in excess of the target are expected to reduce their foreign loans as quickly as possible and, in the most extreme case, to bring their lending back to the target level within the next twelve months.

The guidelines cover the method of calculating the base for an individual bank against which the rise of 5 per cent in outstanding loans can be measured. They also clarify how those banks already in excess of the target as a result of year-to-date operations will be expected to bring their operations within the policy objectives. The guidelines spell out, among other topics, the relationship of trust departments to the program, the handling of financial transactions for customers, the position of Edge Act corporations, the operations of foreign branches of United States banks and of United States branches of foreign banks.

In considering problem areas involved in the development of the guidelines, the Board had the benefit of technical advice from the following specialists in commercial bank foreign operations:

Mr. Roger Anderson, Continental Illinois National Bank, Chicago, Illinois; Mr. Harry P. Barrand, Jr., Manufacturers Hanover Trust Company, New York, New York; Mr. Alfred W. Barth, The Chase Manhattan Bank, New York, New York; Mr. W. A. Hurst, Bank of America National Trust and Savings Association, San Francisco, California; Mr. John M. Meyer, Jr., Morgan Guaranty Trust Company of New York, New York; and Mr. J. J. Wieckowski, Girard Trust Bank, Philadelphia, Pennsylvania.

The Board pointed out that the role of these individuals was advisory only. They were not asked to approve or disapprove the guidelines nor to assume any responsibility in connection with their formulation.

The Board indicated that the guidelines, effective immediately, will be reviewed from time to time in the light of experience gained from operation of the program. The interpretations are designed to help individual banks make the decisions regarding their own operations that are required to ensure an effective program.

Copies of the new guidelines are being made available through the Federal Reserve Banks to all commercial banks in the country. Banks having questions concerning their application are urged to consult with the Federal Reserve Bank of their District.

Following is the text of the guidelines:

PREFACE TO GUIDELINES. The following guidelines have been designed by the Board of Governors of the Federal Reserve System for use in implementing President Johnson's program for the voluntary curtailment of foreign credit by banks. They will be in effect until modified or supplemented. However, they may be changed from time to time in the light of new circumstances and in the light of the experience gained as the program goes forward. The guidelines should be helpful to individual banks as they play their own particular part in the achievement of the President's over-all balance-of-payments program, and each bank should feel free at any time to discuss its problems with the Federal Reserve Bank of its District.

It is clear that banks, in undertaking a voluntary role in the program, are being called upon to make sacrifices. In restraining the growth of their loans to foreigners they will be foregoing some of the gains that would otherwise have accrued to them. But, if a voluntary program is to be effective, decisions on future specific loan transactions must be made primarily with an eye to the national interest rather than profits. The achievement of the President's goal will be in the long-term interest not only of the nation, but also of the individual institutions which are now being called upon to forego immediate advantage or gain.

1. ESTABLISHING A TARGET BASE FOR AN INDIVIDUAL BANK. The objective of the program is that outstanding bank credit to nonresidents of the United States not rise above the amount outstanding at the end of 1964 by more than 5 per cent, subject to the conditions set forth in Guideline No. 3.

The following steps are involved in calculating the base, and the amount of credit outstanding on any particular date, for an individual bank:

(1) Take outstanding claims of United States banking offices on foreigners as of December 31, 1964, as required to be reported on Treasury Department Foreign Exchange Forms B-2 and B-3. Contingent accounts, such as unused balances of letters of credit and commitments to lend, are excluded from the base. (For further information, reference is made to the instructions printed on Forms B-2 and B-3.)

(2) Subtract from this amount any claims for account of customers included on the forms, as well as any participations in individual loans arranged or insured by the Export-Import Bank or made with Export-Import Bank guarantees.*

(3) Add any claims not reportable on Forms B-2 and B-3, such as long-term foreign securities and permanent capital invested in foreign branches and subsidiaries.

(4) Compensating balances, or any other claim on the lending bank of the debtor or of any other person by arrangement or understanding with the debtor, should not be deducted from loans or other claims on foreigners for purposes of determining the base.

(5) It is expected that a simplified form for making the above calculation, and for making monthly reports on foreign credits, will be furnished to the banks within a short time.

Banks which are exempted from reporting on the Treasury forms because their foreign credits are below the minimum reporting requirement are nevertheless included in the program.

2. PARTICIPATIONS IN EXPORT-IMPORT BANK LOANS AND LOANS GUARANTEED BY THE EXPORT-IMPORT BANK. Participa-

* This is an amended paragraph. Amendment was published in Circular No. 5630 of March 11, which also noted that, "for the purposes of Guidelines Nos. 1 and 2, loans with Foreign Credit Insurance Association guarantees or insurance are to be treated as loans with Export-Import Bank guarantees or insurance and therefore are excluded from the program".

tions in individual export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees or insurance, and holdings of "Export-Import portfolio fund" participations are excluded from the 5 per cent target.

The role of the Export-Import Bank within the framework of the President's program will be coordinated by the National Advisory Council for International Monetary and Financial Problems.

3. BANKS IN EXCESS OF 5 PER CENT TARGET. It is clearly recognized that some banks may currently be above the 5 per cent target because of loans made prior to February 11, 1965, or may subsequently be brought above the target as a result of (a) binding commitments entered into before February 11, or (b) the extension of bona fide export credits, or (c) the extension of credits at the specific request of an agency of the United States Government. A bank in such circumstances would not be considered to be acting in a manner inconsistent with the program; however, it should reduce its claims on foreigners to 105 per cent of the base as quickly as possible. Even in the most extreme case, this reduction should be accomplished within the next twelve months.

Such a bank will be invited periodically to discuss with the Federal Reserve Bank of its District the steps it has taken and proposes to take to bring about the reduction of its claims on foreigners consistent with these guidelines.

Banks with bona fide commitments are clearly not being asked to refuse to honor such commitments, even if honoring them involves a temporary excess of lending above the target. However, banks would be expected to seize every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature, and to ensure that drawings under credit lines are kept to normal levels and usage. At time of renewal, all credit lines should be reviewed in light of their consistency with the voluntary foreign credit restraint program. Proposed extensions or renewals of existing bona fide commitments should be reviewed in the same manner.

4. LOAN PRIORITIES. Within the 5 per cent guideline, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of nonbank or foreign funds are not entitled to priority.

With respect to nonexport credits, banks should give the highest priority to loans to less developed countries and should avoid restrictive policies that would place an undue burden on countries such as Canada and Japan, which are heavily dependent on United States financing, and on the United Kingdom, which is suffering from balance-of-payments difficulties.

Given the probability of some expansion of the end-of-1964 volume of loans for financing exports and the priorities established for the less developed countries, as well as the need to avoid restrictive practices with regard to Canada, Japan, and Britain, it is expected that nonexport credit to the other advanced countries will be cut back to the extent needed to achieve the goal of the President's program.

Without attempting to specify all types of loans that will need to be restricted, it is obvious that credits to developed countries that can be cut back with benefit to our balance of payments and with the least adverse side-effects include: credits to finance third-country trade; credits to finance local-currency expenditures outside the United States; credits to finance fixed or working capital needs; and all other nonexport credits to developed countries that do not suffer from balance-of-payments difficulties.

5. BANK SALES OF FOREIGN ASSETS TO UNITED STATES RESIDENTS. In general, banks should not expand their lending abroad by selling to United States residents (including United States banks) claims on foreigners existing as of the base date and replacing such assets with other loans to foreigners. Sales to United States residents of foreign securities owned on the base date, which would be free of the interest equalization tax, or of loan participations, could assist an individual bank to stay within the 5 per cent target, but would clearly not benefit the United States payments position. Therefore, in the event of any such sales, the bank's base should be reduced by an amount equivalent thereto.

6. BANKS WITH NO FOREIGN LOANS OUTSTANDING ON DECEMBER 31, 1964. In general, banks with no previous foreign lending experience would be expected not to make foreign loans during 1965. However, bona fide export loans to foreigners may be made in reasonable amounts, provided this financing does not represent a shift from previous United States or foreign sources of financing. Banks making foreign loans for the first time should take precautions to ensure that their activities do not become a means through which credit is extended to foreign borrowers who have been denied credit by established lenders cooperating in the voluntary program.

7. BANKS WHOSE PREVIOUS FOREIGN BUSINESS HAS CONSISTED ALMOST ENTIRELY OF EXPORT FINANCING. The few banks falling in this category would ordinarily be expected to keep within the 5 per cent ceiling. Since they would have no maturing nonexport loans to provide funds for additional export credits and would therefore need to rely upon nonrenewal of maturing export loans, reasonable amounts in excess of the target from time to time would not be considered in conflict with the program. But every effort should be made by such banks to keep their lending within the ceiling. They should take care to ensure that export loans do not represent a shift from previous United States or foreign sources of financing.

8. TRUST DEPARTMENTS. Managing officers of trust departments should be made familiar with the voluntary restraint effort. They should bear the purpose of that program in mind in making any acquisitions of foreign obligations for trust accounts. For example, they should not exercise their authority under any trust account to acquire foreign obligations which, in the absence of the restraint program, would have been acquired by the bank for its own account. Pension funds, including those administered by banks, have been furnished separate guidelines, as part of the program to restrain foreign credits of nonbank financial institutions.

9. FINANCIAL TRANSACTIONS FOR CUSTOMERS. While banks must, of course, follow instructions given to them by their customers, it is expected that, in buying foreign investments for customers, they will be guided by the principles inherent in the President's balance-of-payments program. They should not encourage customers to place liquid funds outside the United States. Banks should not place with customers foreign obligations which, in the absence of the restraint program, they would have acquired or held for their own account.

10. FOREIGN BRANCHES. It is assumed, of course, that United States banks having branches, as well as subsidiaries and affiliates, in foreign countries will not utilize them to avoid the foreign credit restraint program for United States banks.

Foreign branches have independent sources of funds in the countries in which they are located and from third countries, in many cases through the attraction of Euro-dollar deposits. The balance-of-payments program is not designed to hamper the lending activities of the foreign branches insofar as the funds utilized are derived from foreign sources and do not add to the dollar outflow. Concern arises only in those cases where the resources are derived (directly or indirectly) from the United States.

Total claims of the head office on overseas branches, including permanent capital invested in, as well as balances due from, branches, represent bank credit to nonresidents for purposes of the program.

11. PROBLEMS OF EDGE ACT CORPORATIONS. Edge Act and agreement corporations are included in the voluntary credit restraint effort. The foreign loans and investments of such a corporation may be combined with those of the parent bank for the purposes of the program, or separate targets may be set for the parent bank and the subsidiary.

An Edge Act corporation that has not yet undertaken any significant volume of loans and investments may take as a base, alone and not in combination with its parent, its paid-in capital and surplus, up to $2.5 million, even though an equivalent amount of foreign loans and investments had not yet been made as of December 31, 1964.

12. UNITED STATES BRANCHES AND AGENCIES OF FOREIGN BANKS. Branches and agencies of foreign banks located in the United States are requested to comply with the principles of the program of credit restraint applicable to domestic banks.

13. SUBSTITUTION OF EXPORT CREDIT FOR CREDIT FOR OTHER PURPOSES. Banks should be on the alert to avoid granting credit to domestic customers if the result would be to aid the latter in making foreign loans or investments inconsistent with the program. Even export credit to foreigners, if it supplants credit previously obtained from foreign sources and thus frees the foreign funds for other uses, may be detrimental to the United States payments position.

This is obviously a difficult area and one in which there is considerable room for possibly damaging substitution of domestic for foreign financing, and for substitution of export credits to foreigners for other credits to foreigners. In general, success will depend on the ability of banks to identify loans that are inconsistent with the program and on the application of the Department of Commerce program with respect to foreign credit and investment by nonfinancial firms.

14. MANAGEMENT OF A BANK'S LIQUID FUNDS. Banks that have placed their own funds abroad for short-term investment purposes, including United States dollar deposits outside the United States or the acquisition of non-United States money market paper, should refrain from increasing such deposits and investments and should, in a reasonable and orderly manner, seek to reduce them. Since such funds are ordinarily placed outside the United States solely to provide a slightly higher rate of return, they are strong candidates for reduction under the program.

This guideline applies equally to deposits and investments payable in foreign currencies and to those payable in United States dollars.

This guideline does not call for a reduction in necessary working balances held with foreign correspondents, although such balances are also considered claims on nonresidents for the purposes of the program.

Our Foreign Department will be pleased to confer with you on any problems that may arise under the guidelines.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

CIRCULAR NO. 5633—MARCH 18, 1965
PROGRAM OF DEPARTMENT OF COMMERCE FOR BUSINESS CONCERNS UNDER THE PRESIDENT'S BALANCE-OF-PAYMENTS PROGRAM

To All Banks and Other Financial Institutions in the Second Federal Reserve District:

The President's program to improve the Nation's balance-of-payments position, in part through voluntary efforts by American industrial concerns to effectuate reductions in their capital outflow, has been implemented with respect to such concerns by the Department of Commerce. In a letter to the chief executive officers of over 600 industrial concerns, which was released on March 17, Secretary of Commerce John T. Connor set forth the program proposed by the Department of Commerce.

For your information, the following documents are printed on the following pages:

Press release of the Department of Commerce, dated March 17, 1965;
Letter of the Secretary of Commerce;
Press release of the Department of Commerce, dated February 24, 1965;* and
Summary Worksheet for nonfinancial industrial concerns.*

You will note from the letter that the Secretary of Commerce expects corporations planning substantial investments abroad to take care to minimize the balance-of-payments effects of such investments. He states that the Department of Commerce or the appropriate Federal Reserve officials, when the System's program for banks is involved, would be glad to discuss such situations with the concerns. The Secretary also points out that repatriation of short-term financial funds invested abroad should be done with caution in the case of balances in countries subject to balance-of-payments problems, and suggests that it would be desirable for companies with large balances to consider consulting with the appropriate Federal Reserve Bank on this problem.

If you have any questions or comments regarding the program to improve our international balance-of-payments position, please contact our Foreign Department (Telephone Extension 1000), which is in charge of its administration at this Bank. Questions regarding statistical information should be directed to our Balance of Payments Division (Telephone Extension 2000).

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

* Not reprinted here. May be obtained from this Bank by requesting a copy of Circular No. 5633.

PRESS RELEASE OF THE DEPARTMENT OF COMMERCE DATED MARCH 17, 1965

Secretary of Commerce John T. Connor today called upon American business executives engaged in international operations to "make an extraordinary effort" to help improve the Nation's balance-of-payments position.

The Secretary issued his call in a letter to 600 corporate executives, enlisting their personal support in a voluntary program to produce "significant reductions" in the balance-of-payments deficit.

The Secretary said the list of 600 companies did not necessarily encompass all firms engaged in international business, and he extended an open invitation to other firms with sizable international activities to participate. Such firms should write him if they feel they can make a substantial contribution to the voluntary program.

In his letter, the text of which he made public today, the Secretary asked each company to set up a balance-of-payments "ledger" for 1964, showing selected debits and credits, to consider how their 1964 results could be improved for 1965 and 1966, and to give him their personal estimates of the dollar amount of prospective improvement for 1965.

"We have been thinking in terms of an average improvement in balance-of-payment terms, in 1965 of 15 to 20 per cent over the 1964 results", Secretary Connor said. "We realize, however, that any such target will be inappropriate for many corporations—either on the low or high side—but the important thing is to make an extraordinary effort. . . . only you are in a position to set up a reasonable but meaningful objective for your own company, in the light of your operating facts and problems."

The Secretary also asked for 1963 and 1964 figures for short-term assets held abroad "because of the unique opportunity" to shift such assets and register an early improvement in the balance of payments.

He requested that first reports be submitted by April 15th, and quarterly reports through 1965 and 1966.

He said he had decided against a formalized system of prior notification of new investments and expansions abroad, including financing, expressing the belief that the estimates and reports being requested would prove to be adequate.

"We, of course, expect that care will be taken to minimize the balance-of-payments effects of large investments", the Secretary said, "and either we, or the appropriate Federal Reserve officials when their program is involved, would be glad to discuss such situations should you so desire."

In his letter, the Secretary stated that individual reports and estimates would be kept confidential and periodic summaries of the data collected would be compiled for use by the government and for release to the public.

In the category of "special problems", the Secretary mentioned the national objective of increasing private investment in less developed countries, and said he did not wish the program to inhibit the flow of such investment.

A second "special problem" dealt with the repatriation of short-term financial funds, the Secretary requesting the exercise of caution in countries having balance-of-payments problems.

On a third "special problem" involving Canada, the Secretary said he did not anticipate cutbacks in direct investments. He asked, however, that firms "take particular care to assure that short-term funds put at the disposal of subsidiaries in Canada serve only to meet operating needs".

Secretary Connor closed his letter to the corporate executives stating, "President Johnson is confident, as am I, that you will cooperate with us in this extremely important program of serious concern to you and to our country. We urgently need your help."

The text of Secretary Connor's letter, together with a suggested summary worksheet [see footnote on page 93], a listing of "developed countries,"[1] and instructions for the worksheet [see footnote on page 93] are attached.

LETTER OF THE SECRETARY OF COMMERCE

The President has asked me to handle the voluntary cooperation program with American industry which is a key part of our over-all effort to improve our Nation's balance-of-payments situation. Since the success of this program depends entirely on full cooperation and help from the heads of the United States corporations doing a significant amount of business internationally, I am writing to you to enlist your personal support.

As you can see from the enclosed press release [see footnote on page 93], the Advisory Committee for this industry program, chaired by Mr. Albert L. Nickerson, Chairman of the Board of Socony Mobil Oil Company, is composed of outstanding leaders from the business community who have been active in direct overseas investments and international trade. That Advisory Committee met with me on February 26, and strongly urged that our program be set up on as informal and personal a basis as possible, with a minimum of formal reporting requirements and other "red tape". All members of the Advisory Committee have given me their judgment that the leaders of American industry will respond quickly and favorably to that kind of approach and that, as a result of such leaders taking personal responsibility for this effort, our voluntary program will produce significant reductions in the balance-of-payments deficit. The Advisory Committee is particularly in favor of a flexible approach that enables each company head to work out his own program, based on the operating facts of his own business, rather than limit the means of meeting each company's objective by having the government prescribe some formula of general application.

That advice makes sense to me, and the form of the program that we had been planning has been modified along the lines suggested.

Consequently, I ask for your help specifically as follows:

1. Please set up for your company a balance-of-payments "ledger" for the year 1964 which shows the selected debits and credits. I enclose a summary work sheet [see footnote on page 93] to indicate the needed figures, and some instructions to help your technical people in preparing it for you.

2. After looking at your 1964 results—and we realize in most cases a significant favorable balance will be shown —please consider how that 1964 result can be improved for the years 1965 and 1966. We have been thinking in terms of an average improvement in balance-of-payments terms, in 1965 of 15-20 per cent over the 1964 results. We realize, however, that any such target will be inappropriate for many corporations—either on the low or high side—but the important thing is to make an extraordinary effort. Therefore, we have concluded that only you are in a position to set up a reasonable but meaningful objective for your own company, in light of your operat-

[1] The "developed countries" are: Australia, Austria, Belgium, Canada, Denmark, France, Germany (Federal Republic), Hong Kong, Italy, Japan, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Republic of South Africa, San Marino, Spain, Sweden, Switzerland, United Kingdom. This list is subject to some modification at a later date.

ing facts and problems. The nine suggestions listed on the enclosed press release do not exhaust the list of possibilities that you and your associates can put together in devising an approach meeting the national purpose, yet tailored to your particular circumstances. In short, I am asking you to establish, *and then let me know,* your best *personal* estimate of how much of an improvement in terms of net dollars you think your company can make over all in 1965, compared with 1964, by taking all feasible steps to help the Nation deal with this serious problem.

3. It would also be helpful for us to have a few of your summary figures for the year 1964 showing credit and debit items separately. The work sheet referred to in paragraph 1 would be appropriate for your 1964 report and should be returned to us. It may also be helpful in calculating your 1965 target. We understand that for many firms or industries, such as petroleum operations or contract construction, there may be a need to include in their "ledger" other information on foreign transactions in order to show a realistic balance-of-payments performance. In such situations, we would welcome any supplementary figures you wish to supply, and will take them into consideration in reviewing your results.

4. Because of the unique opportunity to shift short-term assets and make an early improvement in the balance of payments, I would also like to have your figures at the end of 1963 and 1964 for short-term assets held abroad either directly or through United States banking or other financial institutions. In addition, we would like to have figures on such assets held in developed countries by your subsidiaries and branches.

5. I would like to receive your first set of figures by April 15, if this is possible, and I hope it is.

6. Thereafter, I am asking you to send me quarterly reports through the years 1965 and 1966 showing the data in paragraphs 2, 3, and 4 above and revisions, if any, in your over-all goal for the year. You should also give your personal evaluation of points or problems you consider to be of particular significance.

7. While prior notification regarding substantial new investments or expansions abroad, including information indicating how they would be financed, would be helpful, we have decided against a formalized program asking for such information. It is our hope that the over-all estimates and reports that I am requesting will prove to be adequate, and that the results will be clear enough to obviate the need for prior notification of new investments. We, of course, expect that care will be taken to minimize the balance-of-payments effects of large investments and either we, or the appropriate Federal Reserve officials when their program is involved, would be glad to discuss such situations should you so desire.

8. We shall be very glad to talk on the telephone or meet with you to discuss this or any other aspect of this voluntary program of interest or concern to you as it moves along.

Your company's report and estimates will be treated by us as strictly "Confidential" and shown only to those few government officials who are working with us directly in this program. We do plan to put together a periodic summary of the reports in aggregate terms for consideration with the Advisory Committee and for reports to the President, the Cabinet, and the public.

There are a few special problems which I would like to call to your particular attention.

First, we regard the national objective of increasing the contribution by private enterprise to growth in less developed countries of such importance that we do not wish this program to inhibit the flow of these investments.

Second, while relatively rapid progress in repatriating short-term financial funds invested abroad, wherever appropriate, would be helpful, we request that this be done with caution in the case of balances in countries subject to balance-of-payments problems. We are naturally concerned not to cause difficulties on the exchanges and it would be desirable for companies with large balances to consider consulting with the appropriate Federal Reserve Bank on this problem.

Third, we do not anticipate cutbacks in Canadian direct investments, but firms should take particular care to assure that short-term funds put at the disposal of your subsidiaries in Canada serve only to meet operating needs in Canada. Opportunities should be explored for obtaining at least a portion of working capital requirements from the Canadian market. In this process, we hope that short-term investments in Canada by parents or subsidiaries clearly in excess of working requirements will not be increased. No doubt opportunities will arise to reduce these balances, particularly those denominated in United States dollars, but this should be done only in a gradual and orderly way.

I am sure you are aware of the vital importance of improving the United States balance-of-payments position. Such improvement is essential to international monetary stability, to this Nation's economy, and to continued business progress. The capability of this Nation to manage its international fiscal affairs is being carefully watched around the world.

President Johnson is confident, as am I, that you will cooperate with us in this extremely important program of serious concern to you and to our country. We urgently need your help.