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TREASURY DEPARTMENT

AC2587

UNITED STATES SAVINGS BONDS ISSUED AND REDEEMED THROUGH August 31, 1967

(Dollar amounts in millions – rounded and will not necessarily add to totals)

DESCRIPTION	AMOUNT ISSUED 1/	AMOUNT REDEEMED 1/	AMOUNT OUTSTANDING 2/	% OUTSTANDING OF AMOUNT ISSUED
TURED				
Series A-1935 thru D-1941	5,003	4,995	8	.16
Series F and G-1941 thru 1952	29,521	29,467	53	.18
Series J and K-1952 thru 1954	2,236	2,213	23	1.03
IMATURED				
Series E 3/:				
1941	1,866	1,629	237	12.70
1942	8,237	7,211	1,025	12.44
1943	13,253	11,638	1,616	12.19
1944	15,462	13,469	1,993	12.89
1945	12,137	10,383	1,754	14.45
1946	5,489	4,501	987	17.98
1947	5,195	4,087	1,108	21.33
1948	5,361	4,120	1,241	23.15
1949	5,286	3,989	1,297	24.54
1950	4,620	3,429	1,192	25.80
1951	3,999	2,968	1,031	25.78
1952	4,191	3,079	1,112	26.53
1953	4,779	3,413	1,367	28.60
1954	4,867	3,389	1,478	30.37
1955	5,068	3,448	1,620	31.97
1956	4,886	3,263	1,624	33.24
1957	4,590	2,955	1,635	35.62
1958	4,463	2,713	1,750	39.21
1959	4,173	2,489	1,684	40.35
1960	4,170	2,370	1,800	43.17
1961	4,200	2,257	1,944	46.29
1962	4,046	2,110	1,936	47.85
1963	4,498	2,152	2,345	52.13
1964	4,389	2,049	2,339	53.29
1965	4,294	1,900	2,394	55.75
1966	4,605	1,627	2,978	64.67
1967	2,022	331	1,691	83.63
Unclassified	660	681	-21	-
Total Series E	150,807	107,651	43,156	28.62
Series H (1952 thru May, 1959) 3/	5,485	2,853	2,631	47.97
H (June, 1959 thru 1967)	6,298	1,064	5,234	83.11
Total Series H	11,783	3,917	7,866	66.76
Total Series E and H	162,589	111,568	51,022	31.38
Series J and K (1955 thru 1957)	1,514	1,160	354 4/	23.38
All Series – Total matured	36,760	36,675	84	.23
All Series – Total unmatured	164,103	112,727	51,376	31.31
All Series – Grand Total	200,863	149,403	51,460	25.62

ludes accrued discount.
rent redemption value.
option of owner bonds may be held and will earn interest for additional periods after original maturity dates.
ludes matured bonds which have not been presented for redemption.

Form PD 3812 – TREASURY DEPARTMENT – Bureau of the Public Debt

TREASURY DEPARTMENT

WASHINGTON, D.C.

September 1, 1967

FOR IMMEDIATE RELEASE

MINT TO RESUME THE MANUFACTURE AND SALE OF PROOF COIN SETS

Miss Eva Adams, Director of the Mint, announced today that the manufacture and sale of proof coin sets will be resumed in January, 1968. Proof coins have not been made since 1964 when it became necessary to suspend their manufacture because of the coin shortage.

The sets will consist of one each of the five denominations - the half dollar, quarter, dime, nickel and cent. On the face of each coin will appear the mintmark "S" to designate its production at the United States Assay Office at San Francisco. The coins will have a mirror-like finish, as a result of special techniques and equipment which will be used in their manufacture. The sets will be sold at $5 each.

Orders for the 1968 proof coin sets will not be accepted before November 1, 1967. All purchasers of 1967 Special Mint Sets from the San Francisco Assay Office will receive a pre-punched order card for 1968 proofs prior to November 1, 1967. Additional information and ordering instructions will be released at a later date.

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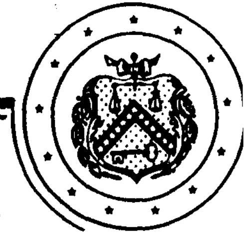
TREASURY DEPARTMENT



WASHINGTON, D.C.

R RELEASE 6:30 P.M.,
iday, September 1, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury .lls, one series to be an additional issue of the bills dated June 8, 1967, and the her series to be dated September 7, 1967, which were offered on August 28, 1967, were ened at the Federal Reserve Banks today. Tenders were invited for $1,400,000,000, thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day .lls. The details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	91-day Treasury bills maturing December 7, 1967		:	182-day Treasury bills maturing March 7, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.912	4.304%	:	97.604	4.739%
Low	98.904	4.336%	:	97.572	4.803%
Average	98.907	4.324% 1/	:	97.591	4.765% 1/

5% of the amount of 91-day bills bid for at the low price was accepted
26% of the amount of 182-day bills bid for at the low price was accepted

TAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 29,835,000	$ 8,795,000	:	$ 6,266,000	$ 6,266,000
New York	1,895,864,000	977,587,000	:	1,218,082,000	666,342,000
Philadelphia	24,757,000	9,170,000	:	12,364,000	5,664,000
Cleveland	27,610,000	18,665,000	:	19,670,000	19,522,000
Richmond	15,756,000	13,356,000	:	9,634,000	9,634,000
Atlanta	43,415,000	17,488,000	:	31,260,000	23,260,000
Chicago	212,269,000	122,191,000	:	142,565,000	98,085,000
St. Louis	65,945,000	42,946,000	:	25,582,000	23,082,000
Minneapolis	17,777,000	8,677,000	:	15,057,000	15,057,000
Kansas City	33,424,000	29,006,000	:	9,691,000	9,691,000
Dallas	22,398,000	10,398,000	:	18,021,000	13,021,000
San Francisco	289,245,000	142,020,000	:	124,105,000	110,405,000
TOTALS	$2,678,295,000	$1,400,299,000 a/		$1,632,297,000	$1,000,029,000 b/

/ Includes $201,022,000 noncompetitive tenders accepted at the average price of 98.907
/ Includes $107,506,000 noncompetitive tenders accepted at the average price of 97.591
/ These rates are on a bank discount basis. The equivalent coupon issue yields are 4.44% for the 91-day bills, and 4.96% for the 182-day bills.

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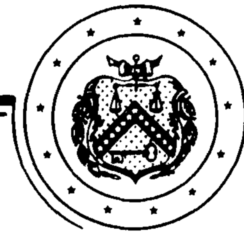
TREASURY DEPARTMENT



WASHINGTON, D.C.

September 5, 1967

FOR USE IN MORNING NEWSPAPERS OF
WEDNESDAY, SEPTEMBER 6, 1967

FRANCIS BATOR APPOINTED SPECIAL CONSULTANT
TO THE SECRETARY OF THE TREASURY

Secretary Henry H. Fowler today announced the appointment of Francis M. Bator as Special Consultant to the Secretary of the Treasury. Mr. Bator will counsel with him and other senior Treasury officials on a broad range of economic matters.

Mr. Bator will also become a member of the Advisory Committee on International Monetary Arrangements, chaired by former Secretary Douglas Dillon. This will permit him to continue the close association he has maintained with the work of the Dillon Committee while serving, prior to his departure from full-time government service, on the senior interdepartmental Steering Group which has been responsible for planning U.S. strategy on international monetary questions.

Mr. Bator is Professor of Political Economy, John F. Kenned School of Government, Harvard University, and Director of Studie in the School's Institute of Politics. From 1965 until September 1 of this year he served as Deputy Special Assistant to the President for National Security Affairs. His responsibilities at the White House covered European political affairs and the full range of foreign economic policy. In this last capacity, he was the White House member of the Cabinet Committee on the Balance of Payments and equivalent committees concerned with trade policy and the Kennedy Round and other international economic matters.

Mr. Bator was previously a member of the Senior Staff, National Security Council (1964-65) and Senior Economic Advisor, Agency for International Development, Department of State (1963-64).

F-1018

Before entering government service, Mr. Bator was on the faculty of economics at the Massachusetts Institute of Technology, and a member of the research staff of the Institute's Center for International Studies. He had been associated with M.I.T. since 1951.

While at M.I.T., Mr. Bator served at various times as consultant to the Office of the Secretary of the Treasury (1961-63); the Under Secretary of State for Economic Affairs; the Office of the Chief of Naval Operations; and the Congressional Panel on the Impact of the Peaceful Uses of Atomic Energy. He also lectured at various of the War Colleges and the Foreign Service Institute.

In 1962, Mr. Bator was the United States member of the United Nations Consultative Group on Economic Projections. In 1961 he served on the U.S. delegation to the Development Assistance Group, Organization for European Economic Cooperation. He has also been a consultant to private organizations and businesses, including The Rand Corporation, the Institute for Defense Analyses, and A.D. Little, Inc., Cambridge, Massachusetts.

Now 42, Mr. Bator holds B.S. and Ph.D. degrees in economics from the Massachusetts Institute of Technology. During 1944-46, he served in the United States Army in the U.S. and Pacific theaters, completing his service as a 1st Lieutenant, Infantry.

Mr. Bator's research and writing have been concerned mainly with the economic role of government. His technical publications have been in the fields of allocation theory and "welfare economics," macro-economic theory, and public finance. His book, The Question of Government Spending, was published by Harper & Brothers in 1960. In 1959 Mr. Bator was awarded a Guggenheim Fellowship.

Mr. Bator is married to the former Micheline C. Martin of New York and New Orleans. The Bators and their children, Nina, 16, and Christopher, 13, live in Cambridge, Massachusetts.

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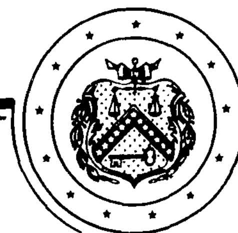
TREASURY DEPARTMENT



WASHINGTON, D.C.
September 5, 1967

FOR IMMEDIATE RELEASE

UNITED STATES AND FINLAND TO DISCUSS REVISION OF INCOME TAX TREATY

Representatives of the United States and Finland will meet in late September to discuss revision of the income tax convention between the two countries, the Treasury announced today.

The existing tax treaty with Finland was negotiated in 1952. The negotiations are expected to deal with a number of specific problems which have evolved out of the tax law changes which have taken place since 1952.

It is expected that among the items to be discussed will be new rules for the taxation of income derived by residents of one country who maintain permanent business connections in the other country, or who earn professional fees or salaries therein, or who receive royalty income. In addition, it is expected that the "Draft Double Taxation Convention" published in 1963 by the Fiscal Committee of the Organization for Economic Cooperation and Development (OECD), will be considered in the course of the negotiations.

Persons having comments or suggestions to make concerning the income tax treaty between the United States and Finland should submit their views by September 15 to Assistant Secretary of the Treasury Stanley S. Surrey, United States Treasury Department, Washington, D. C. 20220.

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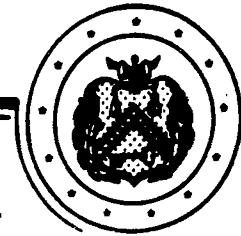
TREASURY DEPARTMENT



WASHINGTON, D.C.

September 6, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $2,400,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing September 14, 1967,in the amount of $2,301,559,000, as follows:

91-day bills (to maturity date) to be issued September 14, 1967, in the amount of $1,400,000,000, or thereabouts, representing an additional amount of bills dated June 15, 1967, and to mature December 14,1967,originally issued in the amount of $1,000,134,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated September 14,1967, and to mature March 14, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Monday, September 11, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on September 14,1967, i cash or other immediately available funds or in a like face amount of Treasury bills maturing September 14,1967.Cash and exchange tender will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained fr any Federal Reserve Bank or Branch.

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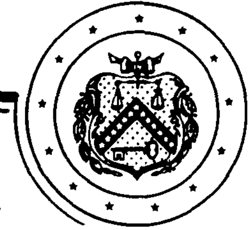
TREASURY DEPARTMENT



WASHINGTON, D.C.

September 7, 1967

FOR IMMEDIATE RELEASE

DR. SEYMOUR E. HARRIS RECEIVES
THE ALEXANDER HAMILTON AWARD

Secretary of the Treasury Henry H. Fowler today presented the Treasury's highest honor, the Alexander Hamilton Award, to Dr. Seymour E. Harris, Senior Consultant to the Secretary.

The award is given for outstanding and unusual leadership in the work of the Department.

The award to Dr. Harris cited his services as chief economic adviser to the Secretary of the Treasury since 1961, including his work as organizer and chairman of a group of leading economists who advise the Department on economic and fiscal policies.

In presenting the award, Secretary Fowler said that Dr. Harris' advisory group "has become a strong and vital link between the Treasury and many of the leading economists of the Nation.

"It is not by coincidence or chance," he continued, "that the period during which your group has functioned has also seen our country blessed by 77 months of economic expansion. You have contributed substantially to an expansion that in November will become the longest sustained economic upturn in our history."

Dr. Harris, who will be 70 tomorrow, is professor of economics and chairman of the economics department, University of California, San Diego.

In addition to an outstanding academic career and extensive service as a Government adviser and official, he is a noted writer in the field of economics.

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A native of New York City, Dr. Harris holds A.B. and Ph.D. degrees from Harvard University. He began his academic career as an instructor at Princeton University in 1920, returning to Harvard to teach in 1922. Except for one year on leave as an official of the Office of Price Administration during World War II, Dr. Harris remained at Harvard until 1964, when he assumed his present post with the University of California. He was Lucius N. Littauer Professor of Political Economy during his last seven years at Harvard. He also has been a visiting professor at Stanford University.

Dr. Harris was a consultant to the President's Council of Economic Advisers in 1950-51. During World War II, Dr. Harris also was a board member of the Economic Warfare Policy Committee, a member of the Secretary of State's committee on postwar commercial policy, and an economic adviser to the War Production Board. He later was an adviser to the Commodity Credit Corporation (1949-53) and a member of the Agricultural Mobilization Policy Board (1951-53).

From 1955 through 1960, he was chairman of the New England Governors' Textile Committee.

Dr. Harris was editor of The Review of Economics and Statistics, published by Harvard, for over 20 years. He is also the author of many books on economics, including The Economics of the Political Parties (1962), Economics of the Kennedy Years (1964), and Economic Aspects of Higher Education (1964).

Dr. Harris is a member of the American Economics Association, the American Academy of Arts and Sciences and the Harvard Club of New York, and is a trustee of the John F. Kennedy Library at Harvard.

The citation accompanying Dr. Harris' award is attached.

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CITATION

Alexander Hamilton Award

Seymour E. Harris

As Senior Consultant to the Secretary of the Treasury since 1961, you have contributed significantly to economic and fiscal policies that have brought unparalleled prosperity to the American people. On behalf of the Treasury, you organized and are chairman of a consultative group of leading economists who have advised the Department on major policy matters during the past six years. Your accomplishments for the Treasury are, however, only the most recent step in long and distinguished service as Government adviser and official. In addition to your achievements in Government, you have earned world recognition as teacher and author in the field of economics. Furthermore, your development and application of a close relationship between economics and public policy have resulted in economic advancement for the United States and other nations. Dedication to the public interest, major contributions to our economic well-being, academic and literary accomplishments -- these have been the hallmarks of your career. In ideals and in deeds, you have exemplified the highest traditions of Alexander Hamilton.

TREASURY DEPARTMENT

WASHINGTON, D.C.

September 8, 1967

FOR IMMEDIATE RELEASE

TREASURY HONORS 118 AT
ANNUAL AWARDS CEREMONY

Honors were awarded to 118 Treasury Department employees today for outstanding service and significant operational contributions at the Department's Fourth Annual Awards Ceremony.

In the fiscal year ended last June 30, Treasury employees received more than $950,000 in awards for adopted suggestions for improved Treasury operations and other outstanding service. Estimated first year benefits to the Treasury, in the form of cost reductions and increased efficiency, exceeded $3 million.

Among those recognized at the awards ceremony, held at the Departmental Auditorium, Washington, D. C., were:

-- 2 employees who received the Alexander Hamilton Award for demonstrating outstanding leadership while working closely with the Secretary.

-- 36 persons, who during the year had received either of the Treasury's two top awards, for Exceptional Service or for Meritorious Service.

-- 25 employees who, through outstanding suggestions or service, contributed to significant monetary savings, increased efficiency, or distinct improvements in government service.

-- 4 employees received special awards for providing exceptional staff leadership to the Cost Reduction and Management Improvement Program.

-- 15 supervisors, for notable achievements in encouraging employee contributions to efficiency and economy.

-- 12 employees who received special awards for outstanding contributions in improving communications and services to the public.

In addition, the awards ceremony, making the 178th anniversary of the Treasury Department, honored 24 long-time career employees -- 18 of whom have served more than 40 years, 4 more than 45 years, and 2 more than 50 years.

The awards were presented by Secretary of the Treasury Henry H. Fowler. Everett Hutchinson, Under Secretary of Transportation, was an honored guest as the Coast Guard participated in a Treasury award ceremony for the last time.

Five bureaus were honored by the Treasury. The U. S. Savings Bonds Division was cited for outstanding participation in the performance phase of Treasury Department's Incentive Awards Program. The U. S. Coast Guard was recognized for outstanding achievement in its suggestions program. The Internal Revenue Service was commended for a positive aggressive program in improving communications and services to the public.

The Office of the Comptroller of the Currency was recognized for its safety record among bureaus with 1,000 or more employees. As a third time winner the Office of the Secretary earned the privilege of permanently retaining the plaque for safety for its record among bureaus with less than 1,000 employees.

Attached is a list of those recognized, and their citations.

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EMPLOYEE SUGGESTIONS AND SERVICES

Recognition by the Secretary of outstanding suggestions or exemplary services which served to effect significant monetary savings, increased efficiency, or improvements in Government operations.

LCDR Don S. Bellis, 8th Coast Guard District, New Orleans, La.

For successfully developing the "Work Card" system for inspections of Coast Guard HU-16 aircraft with the results of better maintenance, improved flight safety and substantial saving. Estimated savings—$91,398. Suggestion Award—$500.

Michael Bienes, Internal Revenue Conferee, Audit Division, Brooklyn District Office, Internal Revenue Service

For suggesting a change in processing procedures which smoothed the flow of work and eliminated a time consuming processing task while assigned to the Manhattan District Office. Estimated savings—$10,458. Suggestion Award—$515.

Robert A. Bridges, Assistant to the Director, Tax Court Division, Office of the Chief Counsel, Internal Revenue Service

For the highly exemplary manner in which he has managed and directed the technical function of the Tax Court Division. Superior Work Performance Award—$500.

Bernard Chernoff, Plate Printer, Plate Printing Division, Bureau of Engraving and Printing

For suggesting a method of salvaging the expensive phosphor ink used in printing postage stamps. Estimated savings—$18,500. Suggestion Award—$715.

James A. Daniels, Criminal Investigator, Bureau of Narcotics, Lima, Peru

For exceptionally productive efforts with international law enforcement officials in several South American countries, involving the initiation of cases against important violators, the seizure of illicit laboratories and a very significant amount of narcotic drugs while working under the most hazardous of conditions. Superior Work Performance Award—$500.

RICCARDO R. DIONISIO, Master Chief Yeoman, 3rd Coast Guard District, New York, N.Y.

For developing a recruit processing check off listing which resulted in increased efficiency in recruit processing through the elimination of errors and omissions. Estimated savings—$23,010. Suggestion Award—$500.

ROBERT N. DYAS, Technical Advisor, Office of the Regional Counsel, Midwest Region, Internal Revenue Service

For the highly exemplary manner in which he has discharged his responsibilities in connection with the prosecution of numerous income tax evasion cases. Superior Work Performance Award—$500.

MICHAEL R. FINN, Internal Revenue Agent-Program Analyst, Audit Division, Internal Revenue Service

For the development of a check sheet which facilitates the more efficient analysis of deferred compensation plans and the preparation and review of the analysis memoranda. Estimated savings—$40,000. Suggestion Award—$860.

NAN HANCOCK, Tax Technician, Internal Revenue Service, Detroit, Mich.

For her diligence and perception in uncovering a fraudulent refund operation in the Detroit area. Special Service Award—$500.

JOHN J. HANEY, III, Chief, Special Procedures Section, Delinquent Accounts and Returns Branch, Collection Division, Philadelphia District, Internal Revenue Service

For a suggested improvement in a daily report form which resulted in substantial saving on a national basis and greatly reduced the frequency of incomplete reporting. Estimated savings—$20,196. Suggestion Award—$755.

RAYMOND A. HART, Criminal Investigator (Liaison Office), Office of Investigations, Bureau of Customs

For his efforts in effecting considerable savings to the government by the acquisition and maintenance of radio communications equipment. Special Service Award—$500.

Dudley E. Parker, Administrative Aide, 8th Coast Guard District, New Orleans, La.

For suggesting the elimination of a marine accident report form without loss of information and resulting in a cost reduction. Estimated savings—$18,200. Suggestion Award—$705.

Roger R. Reed (Deceased), Formerly Contract Specialist, Office of the Director, Bureau of the Mint

For developing improved handling procedures which resulted in significant savings in transactions with private copper refineries. Estimated savings—$65,428. Special Service Award—$975.

Thomas B. Robbins, Yeoman First Class, U.S. Coast Guard Headquarters

For developing an improved method of obtaining details and disposition of any offenses committed by applicant for a Merchant Mariner's document. Estimated savings—$10,000. Suggestion Award—$500.

Donald W. Sherman, Special Procedures Officer, Collection Division, Reno District, Internal Revenue Service

For initiative, tact and effectiveness displayed which led directly to changes in state tax laws. The changes enacted have resulted in substantial savings in administrative costs to the Federal Government. Estimated savings—$12,000. Special Service Award—$500.

Nicholas J. Tryforos, Internal Revenue Agent, Audit Division, Manhattan District Office, Internal Revenue Service

For suggesting and developing a bank location system which greatly facilitates agent investigative work. First year savings—$41,394. Suggestion Award—$860.

Roger C. Warner, Special Agent, Vice Presidential Protective Division, U.S. Secret Service

For excellent performance and outstanding courage in several situations involving grave personal danger. Special Service Award—$500.

MARVIN J. BERMAN, Criminal Investigator

NICHOLAS J. NATALE, Criminal Investigator

DONALD ZIMMERMAN, Criminal Investigator

JOSEPH P. BLAISE, Criminal Investigator

MICHAEL J. LA PERCH, Criminal Investigator

EDWARD A. BERTELE, Formerly Criminal Investigator
Alcohol and Tobacco Tax Division, North Atlantic Region, Internal Revenue Service

For outstanding services performed under conditions of grave personal danger during a long term undercover assignment. The employees successfully infiltrated a notorious interstate "moonshine" syndicate and, while posing as gangsters, collected valuable information which led to the successful prosecution of the case. Group Special Service Award—$2,800.

NICHOLAS R. DEVINE, Operations Officer, Bureau of Customs, Chicago, Ill.

EDWARD W. VOIGT, Customs Examiner, Bureau of Customs, Detroit, Mich.

For jointly suggesting that individual invoices be eliminated on repetitive shipments and grouped on one weekly customs entry. First year savings—$63,780. Group Suggestion Award—$970.

AWARDS TO SUPERVISORS

Recognition by the Secretary of notable achievements by supervisors in encouraging employee contributions to efficiency and economy. These supervisors were selected from Bureau nominees after consideration of such factors as the size of groups supervised, the value of contributions, and the nature of action by the supervisor.

DENNIS C. BEAMAN, Group Supervisor, Intelligence Division, San Francisco District, Internal Revenue Service

For his continuing and effective leadership and promotion of employee participation in the Cost Reduction Program. Through his personal example and positive leadership, the employees of his group developed and maintained an unusually active and productive role in the District's Cost Reduction Program.

RICHARD F. BUSCHMAN, Supervisor, Investment and Funds Section, Investments Branch, Division of Deposits and Investments, Bureau of Accounts

For the stimulus he has provided those under his supervision to reduce costs through in-depth appraisal of operations and for instilling in them a high sense of the Bureau's goals.

ROBERT A. COLE, District Director, Bureau of Customs, Port Arthur, Texas

For the untiring efforts, interest, alertness and initiative demonstrated in encouraging his employees to participate wholeheartedly in the improvement of Government operations.

SEYMOUR I. FRIEDMAN, Assistant District Director, Manhattan District, Internal Revenue Service

For his outstanding contribution to the Cost Reduction Program in the Manhattan District. His effective leadership fostered an awareness of good management and need for economy and efficiency at all levels of the District's operation.

273-912—67——2

Mary Ellen Gaskin, Supervisor, Stenographic Pool, Correspondence and Ruling Unit, Claims and Ruling Section, Division of Loans and Currency, Bureau of the Public Debt, Chicago, Ill.

For achievements in developing inexperienced employees while accomplishing an abnormally heavy workload through the exercise of exceptional supervisory skills and abilities.

Virginia B. Harter, Assistant Chief, Diversified Payments Branch, Washington Disbursing Center, Division of Disbursement, Bureau of Accounts

For her enthusiasm and support of the Incentive Awards Program which effectively promoted genuine interest in improving operations throughout the organization.

Ralph J. Hayes, Chief, Buildings Operations Division, Office of Administrative Services, Office of the Secretary

For stimulating his employees to constantly improve operations by means of the suggestion program resulting in improved morale and lower costs.

RADM Douglas B. Henderson, Comptroller, U.S. Coast Guard

For distinctive leadership in motivating his employees to improve operations through the Incentive Awards Program.

William H. Heygster, Foreman of Plate Printers, Plate Printing Division, Bureau of Engraving and Printing

For outstanding leadership in promoting the use of the Incentive Awards Program to reduce operating costs as manifested by the many significant contributions made by his employees.

Mary F. Keating, Chief, Document Branch, Check Accounting Division, Office of the Treasurer of the United States

For achieving outstanding effectiveness in encouraging the employees of her Branch to process a substantially greater workload without additional personnel or equipment.

Martin Lemesh, Chief, Special Payments and Claims Branch, San Francisco Disbursing Center, Division of Disbursement, Bureau of Accounts

For his significant contribution to the Incentive Awards Program by motivating employees to actively participate in the suggestion program and by encouraging subordinate supervisory personnel to recognize superior employees.

Frank G. Pappas, District Supervisor, Bureau of Narcotics, Dallas, Texas

For initiative, resourcefulness and unusual leadership in promoting the Incentive Awards Program among personnel under his jurisdiction.

Everett J. Prescott, Superintendent, Examining Division, Bureau of Engraving and Printing

For exceptional leadership and motivation of employees to work at peak efficiency and for recognizing such efficiency through the Incentive Awards Program, thereby contributing to the smoothness of operations during a major program change.

Jesse Swain, Ink Production Foreman, Ink Manufacturing and Testing Division, Bureau of Engraving and Printing

For exceptional leadership in motivating his employees to perform their duties with increased efficiency resulting in reduced costs and the elimination of safety hazards.

Marshall R. Weeks, Chief, Pension Trust Section, Los Angeles District Office, Internal Revenue Service

For his special success in substantially reducing an excessive inventory of requests for qualifications determinations. Using effective management techniques, his group was able to reduce its inventory by over 30% in spite of an overall increase in the volume of work received.

COST REDUCTION AND MANAGEMENT IMPROVEMENT

Special awards by the Secretary for their exceptional staff leadership within their respective organizations in furthering the Treasury Department's Cost Reduction and Management Improvement Program.

DALE AYLESWORTH, Management Analyst, Management Analysis Office, Bureau of the Public Debt

WILLIAM E. EDEN, Chief, Management Services Branch, Administrative Management Division, U.S. Coast Guard

J. ELTON GREENLEE, Director, Office of Management and Organization, Office of the Secretary

GEORGE R. NEIL, Management Analyst, Program Staff, Assistant Commissioner (Administration), Internal Revenue Service

ECONOMY CHAMPIONS

The U.S. Civil Service Commission formally recognized those Federal employees who were credited with the saving of $10,000 or more during the current year. Treasury employees so honored are listed below.

LCDR Don S. Bellis	U.S. Coast Guard
Michael Bienes	Internal Revenue Service
Bernard Chernoff	Bureau of Engraving and Printing
Marilyn M. Curtin	Internal Revenue Service
Nicholas R. Devine	Bureau of Customs
Christine Druffner	Internal Revenue Service
John J. Haney, III	Internal Revenue Service
John E. Hurley	Internal Revenue Service
Gerald P. King	Internal Revenue Service
Mary P. Langford	Internal Revenue Service
Dudley E. Parker	U.S. Coast Guard
Erma D. Pilgreen	Internal Revenue Service
Roger R. Reed (Deceased)	Bureau of the Mint
Thomas B. Robbins, YN1	U.S. Coast Guard
CHMACH W-3 Floyd L. Stormer	U.S. Coast Guard
Nicholas J. Tryforos	Internal Revenue Service
Edward W. Voigt	Bureau of Customs
Edward P. Weathersbee	Internal Revenue Service

SPECIAL AWARDS FOR EXCELLENCE IN IMPROVING COMMUNICATIONS AND SERVICES TO THE PUBLIC

Recognition by the Secretary for outstanding contributions during fiscal year 1967 which improved communications and services to the public.

MAY CHALOUPKA, Information Receptionist, New York Regional Disbursing Office, Division of Disbursement, Bureau of Accounts

For the quality of the relationship she has maintained with the public through her exceptional efforts to assist those she serves.

CHARLOTTE C. CHARLES, Securities Examiner, Correspondence and Ruling Unit, Bureau of the Public Debt, Chicago, Ill.

For excellence in preparing tactful, effective and diplomatic replies to inquiries received from the public.

LEO P. FERNANDEZ, Internal Revenue Officer, Internal Revenue Service, Blythe, Calif.

For his energetic and enthusiastic efforts to improve communications with the public in a sparsely settled area by making personal appearances before local groups and constantly working with local radio stations to adapt press releases for local use.

ROBERT O. GOFF, Legal Counsel, U.S. Secret Service

For noteworthy contributions in improving communications and services to the public in the interpretation of laws relating to the use of reproductions of U.S. coins, currency and securities in advertising and manufacturing.

MELVIN LERNER, Physical Science Administrator, Bureau of Customs Laboratory, Baltimore, Md.

For excellence in improving service to the public as reflected in substantive articles published in authoritative outside publications.

ANNA E. SAUL, Secretary-Office Manager, U.S. Savings Bonds Division, Providence, R.I.

For outstanding performance in providing information and service to the public throughout the State with the positive result of increased support of the program.

LT. DAVID S. SMITH, U.S. Coast Guard, Charlevoix, Mich.

For exemplary performance as the Charlevoix Group Commander in conveying information of public interest through a weekly radio program, publications, speeches and press relations.

GRETCHEN B. SCOTT, Correspondence Specialist (Research), Operating Facilities Division, Bureau of Engraving and Printing

For outstanding performance of correspondence duties and in recognition of the unusually current and valuable reference system she has established.

ROBERT E. WALTZ, Criminal Investigator, Bureau of Narcotics, Chicago, Ill.

For exceptional performance in improving the Government's communications and relations with the public through participation in Police Academies and by lecturing in colleges and before social and fraternal agencies.

JOHN ALFRED WHEELER, Jr., Chief, Trust Branch, Securities Division, Office of the Treasurer of the United States

For exemplary performance in serving the public and stimulating effective public relations in the processing of government securities transactions.

PEARL MAE WILLIAMS, Administrative Assistant, Office of the Director, Bureau of the Mint

For outstanding achievements in management of the extensive public contact work of the Office of the Director, resulting in a substantial enhancement of the organization's public image.

ROBERT J. WOJTAL, Attorney-Advisor, Office of the General Counsel, Office of the Secretary

For unusual technical competence in assisting the Department to implement the Freedom of Information Act in a manner aimed at insuring quick and easy access by the public to all Treasury information to which it is entitled.

SECRETARY'S AWARDS FOR SAFETY

Comptroller of the Currency

For showing the greatest reduction in the frequency of disabling injuries over the preceding four year average among bureaus with more than 1,000 employees. The Office reduced its rate to 1.4 injuries per million man-hours worked, a reduction of 52%.

Office of the Secretary

For showing the greatest reduction in the frequency of disabling injuries over the preceding four year average among bureaus with 1,000 or fewer employees. The Office reduced its injury rate to 1.2, a reduction of 68%.

THE SECRETARY'S ANNUAL AWARDS

The Secretary of the Treasury presents honorary awards each year to recognize bureaus for outstanding performance in a number of areas.

SECRETARY'S AWARD FOR INCENTIVE AWARDS PROGRAM (PERFORMANCE)

U.S. Savings Bonds Division

For the best overall results in effectively recognizing employee performance which significantly exceeded normal job requirements. Approximately 12% of the Division's personnel received performance awards or high quality pay increases during fiscal year 1967.

SECRETARY'S AWARD FOR INCENTIVE AWARDS PROGRAM (SUGGESTIONS)

U.S. Coast Guard

For the best overall results in the suggestion program during fiscal year 1967. Adopted suggestions increased 26% over the previous year. Estimated savings per 100 employees were approximately $4302.

SECRETARY'S AWARD FOR EXCELLENCE IN IMPROVING COMMUNICATIONS AND SERVICES TO THE PUBLIC

Internal Revenue Service

For a positive, aggressive program evidenced by enthusiastic and constructive leadership and by imagination and ingenuity of employees throughout the Service which led to the innovation of a variety of improved services to taxpayers.

CAREER SERVICE RECOGNITION

Recognition by the Secretary of employees in the Washington, D.C., area who attained 50, 45, or 40 years of Federal service during fiscal year 1967.

50 Years of Federal Service

Henry J. Holtzclaw	Bureau of Engraving and Printing
Jesse Swain	Bureau of Engraving and Printing

45 Years of Federal Service

Joseph R. Amato	Office of the Secretary
Robert W. Campbell	Bureau of Engraving and Printing
Rudy P. Hertzog	Internal Revenue Service
John E. Nead	Bureau of Customs

40 Years of Federal Service

Margaret L. Adams	Internal Revenue Service
Howard M. Annis	Office of the Treasurer of the U.S.
Ned W. Arick	Internal Revenue Service
E. Riley Campbell	Internal Revenue Service
Alwyn Cole	Office of the Treasurer of the U.S.
Bernard H. Fischgrund	Internal Revenue Service
Alvin R. Fox	Bureau of Engraving and Printing
Esther Friedman (Retired)	Internal Revenue Service
Esther M. Gornbein	Internal Revenue Service
Louise C. Guise	Internal Revenue Service
Jerome Matthews	Bureau of Engraving and Printing
Myrtice G. Pomeroy	Bureau of Customs
John Rendo	U.S. Secret Service
Levi R. Robinson	Bureau of Engraving and Printing
George Vlases, Jr.	Bureau of Customs
Floretta Vogel	Internal Revenue Service
Hazel A. Wasson	Internal Revenue Service
Hyman Weinstein	Bureau of Accounts

MERITORIOUS SERVICE AWARD

The Meritorious Service Award is next to the highest award which may be recommended for presentation by the Secretary. It is conferred on employees who render meritorious service within or beyond their required duties.

H. WALTON BLUME, Chief, Graphics Branch, Office of Administrative Services, Office of the Secretary

For his continuing excellence in the graphics work performed for the Office of the Secretary and the Treasury Department.

JOHN P. BOTTI, Superintendent, New York Assay Office, Bureau of the Mint

For exemplary leadership in guiding the New York Assay Office through a period of vastly increased responsibility and activity in all phases of its operations.

FRANKLIN W. CHAPIN, Director, Office of Industrial Relations, Bureau of Engraving and Printing

For his high level of professional skill and exceptional achievements in the labor management field.

GEORGE M. DELCHER, Statistical Assistant, Office of Tax Analysis, Office of the Secretary

For important contributions in providing accurate and timely statistical data on current revenues and other financial information required for successful fiscal policy formulation.

HENRY A. DOVE, Operating Facilities Officer, Division of Financial Management, Bureau of Accounts

For outstanding performance in managing the operating facilities of the Bureau of Accounts and a rare ability to uncover untapped potential human resources.

NORMAN R. DUNN, Regional Administrator of National Banks, Comptroller of the Currency, Dallas, Tex.

For his outstanding technical competence, resourcefulness and sustained superior performance in formulating and maintaining unusually high standards of National Bank supervision.

William J. Durkin, Assistant Commissioner (Permissive), Bureau of Narcotics

For a highly successful mission in the establishment of a Bureau of Narcotics enforcement program encompassing Mexico, Central and South America, and the development of a truly cooperative effort with officials of governments concerned.

Jay L. Esserman, Superintendent, Internal Audit Division, Bureau of Engraving and Printing

For his outstanding leadership and exceptional technical competence and resourcefulness in effectively planning, directing and coordinating the broad and complex audit activities required to attain internal control of the billions of dollars of securities and other assets under the Bureau's jurisdiction.

Homer C. Gant (Retired), Formerly Assistant Regional Commissioner (Administration), Internal Revenue Service, San Francisco, Calif.

For his outstanding performance as a resourceful administrator and leader and for his significant organizational ability and personal contribution to the Western Regional Office operations.

Edward J. Heid, Chief, Mobilization Planning Staff, Office of Management and Organization, Office of the Secretary

For his superior performance in the preparation of plans for the continuity of financial, economic, and operational aspects of the Department under emergency conditions.

J. Lucile Henderson, Chief, Directives Control and Distribution Branch, Office of Administrative Services, Office of the Secretary

For outstanding leadership of the Directives Control and Distribution Program.

Grace Hooten (Retired), Supervisory Salary and Wage Administration Specialist, Bureau of Engraving and Printing

For her outstanding leadership and exceptional technical competence in effectively planning, administering and coordinating the wage and classification program for the bureau.

SAMUEL LEVINE (Retired), Formerly District Supervisor, Bureau of Narcotics, Philadelphia, Pa.

For his outstanding performance in presenting to the medical and scientific professions the position of the Treasury Department regarding laws and regulations relating to narcotic drugs.

PHILIP M. LIGHT (Retired), Formerly Regional Director, U.S. Savings Bonds Division, New York City, N.Y.

For his unusual imagination and creativity in developing plans and promotions for the sale of Savings Bonds which served as prototypes for other states and regions.

RICHARD O. LOENGARD, Jr., Formerly Special Assistant for International Tax Affairs, Office of the Secretary

For his outstanding performance, skill and perceptive insight in areas of international tax affairs evidenced in his formulation of legislative proposals and participation in international income tax treaty negotiations.

THOMAS R. LUSK, Financial Economist, Tax Analysis Staff, Office of the Secretary

For outstanding contributions to the Treasury's tax analysis program, particularly in the area of revenue estimating.

PAUL McDONALD, Director, Office of Administrative Services, Office of the Secretary

For his loyal dedication over two decades in guiding the Department's administrative services program with emphasis on service with dignity and for effectively furthering the Safety and other programs of special importance to the Government.

MARY S. MAXFIELD, Secretary to the General Counsel, Office of the Secretary

For performance with intelligence, judgment, discretion and tact of confidential and highly important duties as Administrative Assistant and Secretary to five successive General Counsels.

THEODORE T. MERRILL, Assistant Director of Sales Operations, U.S. Savings Bonds Division

For his outstanding service and dedication which have inspired both his staff and volunteer workers to strive for and achieve goals that have exceeded expectations and have contributed immeasurably to the success of the Savings Bonds Program.

CHARLES M. MILLER, Assistant Superintendent, Denver Mint, Bureau of the Mint

For his superior performance during more than 33 years of Mint service. His administrative ability and his technical skill have been invaluable to the programs of the Denver Mint during a peak period of coin production unmatched in Mint history.

JACOB MOGELEVER, Special Assistant for Promotions, U.S. Savings Bonds Division

For his outstanding performance in securing and retaining the cooperation of the motion picture industry in support of the Savings Bonds Program.

HAROLD MOSS, Director, Foreign Tax Assistance Staff, Internal Revenue Service

For his outstanding leadership in implementing and administering an effective Foreign Tax Assistance Program and in particular for his work in establishing the Inter-American Center of Tax Administrators.

ROBERT J. NEWBRAND, Special Agent, U.S. Secret Service, San Francisco, Calif.

For outstanding service, unusual competence, and dedication at considerable personal risk in protecting the obligations of the United States from counterfeiting.

MICHAEL G. PICINI, District Supervisor, Bureau of Narcotics, Rome, Italy

For sustained contribution to international narcotic enforcement with particular emphasis on Europe, the Middle and Near East.

RUTH W. PICKNELL, Attorney-Advisor, Office of the General Counsel, Office of the Secretary

For invaluable services rendered and skill displayed in acting as Officer in Charge of the Office of Domestic Gold and Silver Operations, during a difficult and transitional period in which major changes in Treasury silver policy were made.

MYRTICE G. POMEROY, Public Information Specialist, Office of Public Information, Bureau of Customs

For continued exemplary performance in making information available to the public in succinct and attractive form regarding the privileges and responsibilities in clearing Customs on entering the United States.

ROBERT A. RIDDELL (Retired), Formerly District Director, Internal Revenue Service, Los Angeles, Calif.

For his exemplary performance as a District Director and for his entire record of excellent achievement.

ELMER L. RUSTAD, Assistant National Director, U.S. Savings Bonds Division

For dedication to the Savings Bonds Program, his warm and understanding leadership of staff and volunteers, and outstanding performance in creating systems and programs contributing to the achievement of record Savings Bonds sales.

MICHAEL H. SURA, Superintendent, Philadelphia Mint, Bureau of the Mint

For his forceful and imaginative leadership during a period of unprecedented transition in the Mint.

NORBERT G. STRUB (Retired), Formerly Assistant Commissioner, Bureau of Customs

For his consistent distinguished service during his 38 years in the United States Customs Service.

Bowman G. Taylor, District Supervisor, Bureau of Narcotics, Boston, Mass.

For pioneering our government's narcotic program in the Far East and development of numerous major narcotic investigations in cooperation with the law enforcement officials of the principal countries within that area.

Glenn L. Weaver, Special Agent in Charge, Vice Presidential Protective Division, U.S. Secret Service

For exemplary performance in meeting the unusual demand of his responsibility for supervision of the Vice Presidential Protective Division.

EXCEPTIONAL SERVICE AWARD

This is the highest award which may be recommended for presentation by the Secretary. The award is conferred on employees who distinguish themselves by exceptional service within or beyond their required duties.

LAWRENCE BANYAS (Retired), Formerly Deputy Assistant to the Secretary (Debt Management)

For outstanding contributions to the management of the public debt during his Treasury career of over 36 years.

ROSS A. HEFFELFINGER (Retired), Formerly Assistant Commissioner, Bureau of the Public Debt

For dedicated and efficient service to the Treasury Department over a period of many years, during which he made a major contribution to the effective performance of administrative functions and operations in support of the Department's debt management policies.

AMOS N. LATHAM, Jr., Director of Personnel, Office of the Secretary

For an outstanding record of leadership and guidance that has led to continuous growth in the application of sound personnel principles and practices in the management of Treasury's human resources.

JUSTIN T. WATSON, First Deputy Comptroller of the Currency

For unexcelled contributions to the stability and security of the banking industry during a period of unprecedented bank expansion.

ALEXANDER HAMILTON AWARD

This award is conferred by the Secretary to individuals personally designated by him to be so honored. It is generally restricted to the highest officials of the Department who have worked closely with the Secretary for a substantial period of time and who have demonstrated outstanding leadership during that period.

JOSEPH M. BOWMAN, Jr., Assistant to the Secretary (Congressional Relations)

For his significant leading role in the formulation and enactment of an exceptionally comprehensive Treasury legislative program.

FRANK LELAND HOWARD (Retired), Formerly Director, Office of Domestic Gold and Silver Operations, Office of the Secretary

For his distinguished contributions to the formulation and execution of Treasury policies concerning the domestic control of monetary metals.

U.S. GOVERNMENT PRINTING OFFICE: 1967

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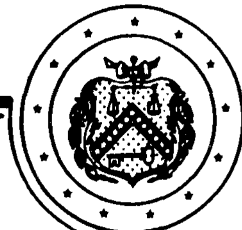
TREASURY DEPARTMENT



WASHINGTON, D.C.

ELEASE 6:30 P.M.,
y, September 11, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury , one series to be an additional issue of the bills dated June 15, 1967, and the series to be dated September 14, 1967, which were offered on September 6, 1967, opened at the Federal Reserve Banks today. Tenders were invited for $1,400,000,000, ereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day bills. etails of the two series are as follows:

OF ACCEPTED TITIVE BIDS:	91-day Treasury bills maturing December 14, 1967		:	182-day Treasury bills maturing March 14, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.906 a/	4.328%	:	97.510	4.925%
Low	98.891	4.387%	:	97.490	4.965%
Average	98.898	4.360% 1/	:	97.497	4.951% 1/

a/ Excepting one tender of $500,000
31% of the amount of 91-day bills bid for at the low price was accepted
39% of the amount of 182-day bills bid for at the low price was accepted

TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

trict	Applied For	Accepted	:	Applied For	Accepted
ton	$ 20,355,000	$ 10,355,000	:	$ 29,394,000	$ 23,394,000
York	1,542,503,000	917,562,000	:	1,214,527,000	626,092,000
Ladelphia	28,415,000	16,415,000	:	13,786,000	5,786,000
veland	30,616,000	30,616,000	:	39,709,000	25,709,000
mond	15,191,000	12,191,000	:	8,723,000	5,723,000
anta	53,465,000	42,780,000	:	33,590,000	22,290,000
cago	206,861,000	144,612,000	:	213,584,000	140,144,000
Louis	48,838,000	40,731,000	:	29,653,000	21,717,000
neapolis	27,296,000	21,856,000	:	20,338,000	14,838,000
sas City	36,259,000	36,259,000	:	21,355,000	20,294,000
Las	27,795,000	21,295,000	:	20,062,000	11,062,000
Francisco	124,039,000	105,349,000	:	148,274,000	83,024,000
TOTALS	$2,161,633,000	$1,400,021,000 b/		$1,792,995,000	$1,000,073,000 c/

ncludes $253,197,000 noncompetitive tenders accepted at the average price of 98.898
ncludes $144,040,000 noncompetitive tenders accepted at the average price of 97.497
nese rates are on a bank discount basis. The equivalent coupon issue yields are 48% for the 91-day bills, and 5.16% for the 182-day bills.

F-1022

STATEMENT FOR UNDER SECRETARY BARR
BEFORE HOUSE COMMITTEE ON BANKING AND CURRENCY

Tuesday, September 12, 1967

Mr. Chairman, Members of the Committee:

We are here today not because this Committee or the Congress as a whole has found any difficulty with the proposed five year extension of the life of the Export-Import Bank and the necessary expansion of its lending authority. Widespread support for these basic proposals in the bill shows that the Congress is well aware of the significant role played by the Export-Import Bank in support of United States industry and trade and in support of the United States balance of payments.

We are here because the bill reported out by this Committee and the parallel bill in the Senate have focused attention on certain very broad issues of U.S. trade and commercial policy.

One of these policy issues is the extent to which the United States should support trade in peaceful goods---on normal commercial terms---with the countries of Eastern Europe. A second is the extent to which and the manner in which the United States should sell military equipment to friendly nations. A third is embodied in the Byrd Amendment to the Senate bill---to what extent should the United States withhold commercial type credit from friendly countries on the basis of minimal commercial contacts those countries may have or may have had with North Viet Nam.

Today I wish to address myself only to this third issue. In countless appearances before this Committee the Secretary and I have stated that a priority objective of this nation is to correct the balance-of-payments deficit in our international accounts. To do so we must maintain constant pressure on two fronts. First, we must expand our balance-of-payments receipts. Export sales are the major item on this side. Secondly, we must maintain constant pressure to reduce unnecessary foreign exchange expenditures.

On the receipts side we believe that we must achieve an expansion of total exports which will bring our trade surplus up to a persistent level of around $7 billion per year. It was $6.7 billion in 1964, a record peacetime high; it dropped back to $3.7 billion last year; and it ran at an annual rate of $4.25 billion in the first half of this year. Obviously, we have a great deal of ground to cover to attain the size of trade surplus that we need.

One of the most important factors in expanding our foreign sales is the competitiveness of our exports---and this depends to a considerable extent on the availability of credit. The availability of credit--both from the commercial banks and from the Export-Import Bank---is often a decisive factor in determining whether a sale is made by the United States or by some other country.

In our efforts to expand exports the Export-Import Bank has played a prominent role through its loans, through its guarantees of credit extended by commercial banks and through its support of the operations of the Foreign Credit Insurance Association. I firmly believe that restrictions on the activities of the Export-Import Bank of the type proposed by the Byrd Amendment would run the risk of introducing a serious block to our export expansion program and delay progress toward elimination of our balance-of-payments deficit.

Mr. Chairman and Members of the Committee, my colleagues and I are prepared to help in any way we can in your further consideration of this important legislation.

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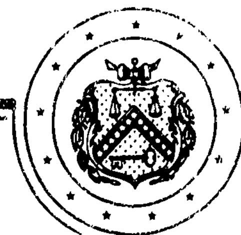
TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR IMMEDIATE RELEASE September 13, 1967

UNITED STATES FOREIGN GOLD TRANSACTIONS IN 1967

The Treasury announced today that net purchases of monetary gold by the United States from foreign holders during the second quarter of 1967 amounted to $17 million.

The major transactions during the quarter, as shown in Table I, were the purchase of $50 million from Canada by the United States and the sale by the United States of $34 million to the United Kingdom. In addition, the table includes gold sales and purchases for Fiscal Year 1967 which show net sales to foreign holders amounting to $232.2 million compared to sales of $378.4 million in Fiscal Year 1966.

The net drain on United States monetary gold stocks in the second quarter due to industrial and artistic demand (net of inflow from new production and scrap) came to $32.5 million. This brought the total net outflow of gold from the gold stock of the United States in the second quarter of 1967 to $15.5 million

Table II, attached, shows sales of gold by the United States during the second quarter of 1967 to other countries to enable them to pay the gold portion of their quota increases in the International Monetary Fund. Deposits of like amounts of gold were made by the IMF with the United States to mitigate the effects upon the United States gold stock of the quota increases. Transactions of this nature amounted to $5.3 million in the second quarter. During Fiscal Year 1967 these transactions amounted to $50.1 million.

Attachm~~ents~~

F-1023

TABLE 1

UNITED STATES NET MONETARY GOLD TRANSACTIONS WITH FOREIGN COUNTRIES AND INTERNATIONAL INSTITUTIONS
January 1 - June 30, 1967

(In millions of dollars at $35 per fine troy ounce)

Area and Country	First Quarter	Second Quarter	Fiscal year 1967 July 1, 1966-June 30, 1967
Western Europe			
France	-	-	-277.3
Greece	-	-	-0.6
Ireland	-0.3	-0.6	-1.3
Italy	-	-	-60.0
Switzerland	-	-30.0	-50.0
Turkey	-16.9	+21.2	-5.8
United Kingdom	+3.3	-34.0	+75.2
Yugoslavia	-0.7	-0.9	-2.8
Total	-14.5	-44.3	-322.7
Canada	-	+50.0	+100.0
Latin America			
Argentina	-0.4	-0.3	-22.2
Brazil	-0.4	-0.3	-1.7
Chile	-1.5	-1.5	-7.5
Colombia	*	*	-0.4
Costa Rica	-0.1	-0.1	-0.5
Dominican Republic	-0.1	-0.1	-0.4
Ecuador	-	-0.2	-0.2
Mexico	-10.0	-	-
Nicaragua	-0.1	*	-0.2
Peru	+10.0	+15.0	+25.0
Surinam	+2.6	-	+0.1
Uruguay	*	*	-0.2
Total	-0.1	+12.4	-8.6
Asia			
Afghanistan	-1.2	-0.1	-1.9
Indonesia	-1.8	-	-1.8
Iran	-1.3	-	-1.3
Iraq	-0.1	-0.1	-0.2
Pakistan	-0.2	-0.2	-0.8
Philippines	-	-	+7.5
Syria	-0.2	-0.2	-0.6
Total	-4.7	-0.6	+0.8
Africa			
Liberia	-0.1	-0.1	-0.3
Somalia	-0.1	-0.1	-0.2
Sudan	-0.1	-0.2	-0.5
Tunisia	-0.1	-0.1	-0.4
Total	-0.4	-0.5	-1.5
All Other	-0.1	-0.1	-0.5
Total	-19.8	+17.0	-232.2
Domestic Transactions	-29.9	-32.5	-128.0
Total Gold Outflow	-49.7	-15.5	-360.2

*Under $50,000.
Figures may not add to totals because of rounding.

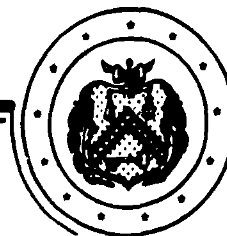
TABLE 2

UNITED STATES MONETARY GOLD TRANSACTIONS
WITH FOREIGN COUNTRIES
MITIGATED THROUGH SPECIAL DEPOSITS BY THE IMF
(Millions of U.S.$)

January 1 - June 30, 1967

Area and Country	First Quarter	Second Quarter	Total
Latin America			
Dominican Republic	-0.4	-	-0.4
Total	-0.4	-	-0.4
Asia			
Iran	-13.7	-	-13.7
Lebanon	-0.6	-	-0.6
Vietnam	-1.3	-	-1.3
Total	-15.6	-	-15.6
Africa			
Algeria	-	-0.8	-0.8
Cameroon	-	-0.2	-0.2
Central African Rep.	-	-0.1	-0.1
Chad	-	-0.1	-0.1
Congo (Brazzaville)	-	-0.1	-0.1
Congo (Kinshasa)	-	-2.4	-2.4
Dahomey	-	-0.1	-0.1
Gabon	-	-0.1	-0.1
Ivory Coast	-0.2	-	-0.2
Mauritania	-	-0.1	-0.1
Morocco	-	-0.9	-0.9
Rwanda	-	-0.2	-0.2
Upper Volta		-0.1	-0.1
Total	-0.2	-5.3	-5.5
Total	-16.2	-5.3	-21.5
IMF Deposit	+16.2	+5.3	+21.5

TREASURY DEPARTMENT



WASHINGTON, D.C.

September 13, 1967

)R IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders r two series of Treasury bills to the aggregate amount of ,400,000,000, or thereabouts, for cash and in exchange for easury bills maturing September 21,1967, in the amount of ,300,149,000, as follows:

91-day bills (to maturity date) to be issued September 21, 1967, the amount of $1,400,000,000, or thereabouts, representing an iitional amount of bills dated June 22, 1967, and to ture December 21,1967,originally issued in the amount of ,000,050,000, the additional and original bills to be freely terchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated ptember 21,1967,and to mature March 21, 1968.

The bills of both series will be issued on a discount basis under mpetitive and noncompetitive bidding as hereinafter provided, and at turity their face amount will be payable without interest. They ll be issued in bearer form only, and in denominations of $1,000, ,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 aturity value).

Tenders will be received at Federal Reserve Banks and Branches to the closing hour, one-thirty p.m., Eastern Daylight Saving me, Monday, September 18, 1967. Tenders will not be ceived at the Treasury Department, Washington. Each tender must for an even multiple of $1,000, and in the case of competitive nders the price offered must be expressed on the basis of 100, th not more than three decimals, e. g., 99.925. Fractions may not used. It is urged that tenders be made on the printed forms and rwarded in the special envelopes which will be supplied by Federal serve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of stomers provided the names of the customers are set forth in such nders. Others than banking institutions will not be permitted to bmit tenders except for their own account. Tenders will be received thout deposit from incorporated banks and trust companies and from sponsible and recognized dealers in investment securities. Tenders om others must be accompanied by payment of 2 percent of the face ount of Treasury bills applied for, unless the tenders are companied by an express guaranty of payment by an incorporated bank trust company.

F-1024

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on September 21, 1967, i cash or other immediately available funds or in a like face amount of Treasury bills maturing September 21,1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained fr any Federal Reserve Bank or Branch.

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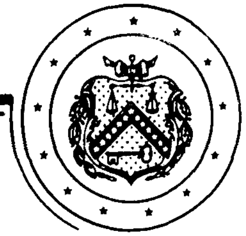
TREASURY DEPARTMENT



WASHINGTON, D.C.

September 14, 1967

FOR IMMEDIATE RELEASE

TREASURY MARKET TRANSACTIONS IN AUGUST

During August 1967, market transactions in direct and guaranteed securities of the government for Government investment accounts resulted in net purchases by the Treasury Department of $56,885,500.00.

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F-1025

STATEMENT OF THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL EXCHANGE
AND
PAYMENTS
OF THE
JOINT ECONOMIC COMMITTEE
SEPTEMBER 14, 1967, 10:00 A.M. EDT

Mr. Chairman and Members of the Subcommittee:

I

A little over two years ago -- on August 27, 1965 -- the members of this Subcommittee urged major improvements in the international monetary system, and particularly prompt action by the United States and other leading financial nations to insure an adequate and orderly expansion of the world's monetary reserves.

In a report to the Joint Economic Committee, your Subcommittee warned that failure to provide increased international liquidity would inevitably result in a scarcity of reserves, a decline in international trade and commerce, and a slowing of world economic progress.

The Subcommittee's report at that time was not its first expression of concern about the need for a mechanism to create additional reserve assets. In previous reports, both the Subcommittee and the Joint Economic Committee had called for free world action toward this end.

Last spring, the Joint Economic Committee included in its report on the January 1967 Economic Report of the President a "statement of agreement by Majority and Minority members of the Joint Economic Committee." Two of the points made in paragraph 6 of that statement reiterated the urgency of this problem in the following words:

> "6. In the field of international trade and finance, there is also general accord on the following conclusions:
>
> > "Agreement on international monetary reform is a matter of increasing urgency.
> >
> > "We cannot rely on supplies of new monetary gold being sufficient to assure the growth of international reserves, in keeping with the rising liquidity requirements of trade."

Moreover, the Subcommittee's 1965 report performed the invaluable services of directing attention to the growing urgency of the problem -- "the need for action is pressing," the Subcommittee stated -- and of suggesting guidelines for monetary improvements, including possible ways in which new reserves could be created.

The Subcommittee also gave its strong support to the decision by President Johnson, which I was privileged to announce in a speech at Hot Springs, Virginia, on July 10, 1965,

that the United States was prepared to participate in an international conference to seek substantial improvements in monetary arrangements.

I am pleased to be able to report to you today that the first and perhaps most critical step toward the goal which you urged, and which the United States has pursued through two years of difficult and intense negotiations, has now been achieved.

The Executive Directors of the International Monetary Fund and the Finance Ministers and Central Bank Governors of the Group of Ten major financial countries have agreed on an Outline Plan that "is intended to meet the need, as and when it arises, for a supplement to existing reserve assets."

This Outline Plan has now been made public by the International Monetary Fund, prior to consideration of the plan by the Board of Governors of the Fund at the Annual Meeting to be held in Rio de Janeiro during the last week of September (Attachment A).

At the Annual Meeting the Governors will have before them a Resolution requesting the Executive Directors to translate the Outline Plan into the legal text of the

necessary amendment or amendments of the Articles of Agreement of the Fund which, after acceptance, would bring the plan into effect. The United States will support this Resolution, and we hope that the Governors of the other 105 member nations of the Fund will also give it their support.

After the Executive Directors have completed the draft amendment of the Articles of Agreement of the Fund, and it is approved by the Board of Governors, the amendment will go to the member countries for their final acceptance. In the case of the United States, legislation will be proposed to the Congress to permit the United States to give its acceptance. Section 5 of the Bretton Woods Agreements Act requires that, before the United States accepts an amendment to the Articles, the approval of the Congress must be obtained.

We must leave to history the final judgment of the contingency plan. Time alone can measure its value and the worth of our efforts during the two years of study and two years of negotiation that preceded the agreement.

I am confident, however, that the agreement represents one of the great forward steps in international financial

cooperation -- the greatest since Bretton Woods -- and that our action ultimately will advance the well-being of countless millions of people throughout the world.

As your Subcommittee urged in its report, the Outline Plan is based on the constructive suggestions and views of many nations. It does not favor the interests of any one country or any group of countries. Instead, it will promote the interests and welfare of all members of the International Monetary Fund, who together make up a very large part of the world community.

The proposals in the plan also parallel, in other important respects, the suggestions contained in your report, as I shall discuss later in my testimony.

There has been considerable public discussion, and generally favorable reception for the Outline Plan and for the role of the United States in developing it and obtaining agreement on it.

Federal Reserve Chairman William McChesney Martin and I have been privileged to represent the United States in the discussions and negotiations of the Finance Ministers and Central Bank Governors of the Group of Ten.

However, if praise is due the United States' contribution to the Outline Plan, it is praise that rightfully belongs to the Members of Congress and the Executive Branch who have participated in, and contributed to, our years of study and negotiations. Just as the plan itself represents the collective efforts of people from many nations, the formulation and presentation of the United States' position, and our success in achieving a consensus, are the result of the work of numerous individuals and groups.

Officials of the Treasury, the Federal Reserve Board, the Office of the President, the Council of Economic Advisers, the Department of State, the Advisory Committee on International Monetary Arrangements, and members of the Congress, have all contributed to the success of our efforts.

We are particularly indebted and grateful for the support and guidance we have received from your distinguished Chairman, Congressman Henry S. Reuss, the members of your Subcommittee, the Joint Economic Committee, and individual members of the Congress. Many thoughtful addresses have been devoted to this subject by leading Senators and Congressmen, not serving on your Committee such as Senators Hartke and Clark.

Because an expansion of international liquidity is essential to the economic progress of our country, and to world economic growth generally, our efforts to resolve the problem have received strong bi-partisan support from the Congress. Republicans no less than Democrats have encouraged, assisted and guided us. In a letter to me of July 14, 1965, and in subsequent actions, Congressman Gerald R. Ford of Michigan and other Republican Congressional leaders have supported and contributed to United States' leadership in monetary reform.

I should also mention and express appreciation for the valuable contributions to our thinking, and to the development of the United States' position, made by former members of the Joint Economic Committee, Robert F. Ellsworth of Kansas, and Senator Paul Douglas of Illinois.

The members of Congress of both parties have helped immeasurably with our long and difficult task. We hope and expect to receive your continued guidance and support in the future.

II

In evaluating the agreement that has now been reached, it is useful to look back briefly along the road we have now traveled. It was in October 1963 that the Ministers and

Central Bank Governors of the Group of Ten countries asked their Deputies to "undertake a thorough examination of the outlook for the functioning of the international monetary system and of its future needs for liquidity." Following this directive, the Deputies of the Group of Ten held a number of meetings in 1963-64, which resulted in the publication of a Ministerial Statement and Report by the Deputies in August 1964. In this statement the Ministers and Governors set in motion a study group to "examine various proposals regarding the creation of reserve assets either through the International Monetary Fund or otherwise."

During 1964-65, this study group, under the Chairmanship of Rinaldo Ossola of Italy, prepared a comprehensive technical report on the creation of reserve assets, which was made public in August 1965. This report provided an inventory of the techniques by which reserves could be created and an analysis of the arguments for and against the use of each of these techniques.

While this work was in progress, President Johnson said in his Balance of Payments Message of February 10, 1965, that "We must press forward with our studies and beyond, to action -- evolving arrangements

which will continue to meet the needs of a fast-growing world economy. Unless we make timely progress, international monetary difficulties will exercise a stubborn and increasingly frustrating drag on our policy for prosperity and progress at home and throughout the world."

During most of the work in 1963-65, there was an underlying assumption that the matter was primarily a problem of creating reserves under the aegis of a limited group of major countries.

As I have mentioned, it was in July 1965 that President Johnson authorized me to announce, in a speech at Hot Springs, Virginia, that the United States was ready to participate in negotiations of a political nature on reserve creation, thereby launching the initiative that culminated in the present agreement. Shortly after this, in August 1965, this Subcommittee under the Chairmanship of Congressman Reuss issued its Report on the Guidelines for Improving the International Monetary System, which concluded that the need for action was pressing.

I, accordingly, undertook personal and individual consultations in Europe with the European Ministers and Governors of the Group of Ten, having previously consulted with the Japanese and Canadian Ministers in Washington.

These individual consultations revealed a basis for further negotiations. During the year 1965-66 the Deputies of the Group of Ten countries made a searching examination of the various proposals for reserve creation to ascertain whether or not there was a basis for agreement on major points. During this year, the Executive Directors and Staff of the International Monetary Fund also carried on constructive studies of the problem.

In July 1966, the Ministers and Governors of the Group of Ten reviewed a second Report from their Deputies, that set forth a number of essential elements of agreement for a contingency plan of reserve creation, and narrowed down the many possible approaches to this problem to five alternative schemes providing for ways and means for reserve creation. During this year there was a growing realization that the subject of creating/supplementary reserve asset was of vital interest to all of the members of the IMF. The Ministers therefore instructed their Deputies to undertake a further stage of negotiations, in which the views of the whole world would be represented, through a series of Joint Meetings between the Deputies of the Ten and the Executive Directors of the Fund, representing the 106 nations who are members of the International Monetary Fund.

Four such Joint Meetings of the Deputies and the Executive Directors were held in 1966-67. There emerged from the fourth and final Joint Meeting a draft Outline Plan which has now been refined and agreed. A number of important issues were resolved in July and August of this year, largely through two meetings of the Ministers and Governors of the Group of Ten on July 17-18 and August 26.

Throughout the course of these negotiations, the support and interest evidenced by this Subcommittee has given additional strength to the negotiators of the Executive Branch, and has helped them to put the U.S. positions effectively before the Delegations of other countries.

I would also like to acknowledge the effective work that has been done by an interdepartmental group which has met frequently to plan U.S. positions and estimate those held by other nations. This group, under the Chairmanship of Under Secretary of the Treasury Frederick L. Deming, consists of Federal Reserve Board Governor J. Dewey Daane, Francis Bator, Deputy Special Assistant to the President for National Security Affairs, Arthur Okun, member of the Council of Economic Advisers, Anthony Solomon, Assistant Secretary of State for Economic Affairs, William B. Dale, U.S. Executive Director of the I.M.F.,

Winthrop Knowlton, Assistant Secretary of the Treasury for International Affairs, and George H. Willis, Deputy to the Assistant Secretary of the Treasury for International Affairs, who serves as Secretary of the group.

Vigorous and effective assistance in this endeavor was provided by former Secretary of the Treasury Douglas Dillon, and I have deeply appreciated it. Secretary Dillon, in an address in June 1965, had also called attention to the "urgent need to strengthen the international Monetary system so as to ensure that the needed increases in reserves will be forthcoming."

Shortly after this, the President announced that I was naming an Advisory Committee on International Monetary Arrangements under the Chairmanship of former Secretary Dillon. This Committee, consisting of distinguished economists and financial leaders, has met a number of times with me and with the principal U.S. Government officials concerned, and has kept its finger closely on the pulse of these negotiations, giving me invaluable advice from their judgment and depth of experience. The members of this Committee at the time of the London meeting were:

Edward M. Bernstein, EMB Ltd.

Kermit Gordon, President, Brookings Institution, former Director of the Bureau of the Budget

Walter W. Heller, Professor of Economics, University of Minnesota

Andre Meyer, Partner, Lazard Freres & Co.

David Rockefeller, President, Chase Manhattan Bank

Robert V. Roosa, Partner, Brown Brothers Harriman and Co.

Frazar B. Wilde, Chairman of the Board, Connecticut General Life Insurance Co., and Chairman, Board of Trustees, Committee for Economic Development

Professor Charles P. Kindleberger served as a member of the Committee until September 20, 1966.

III

The main underlying facts which led to the conclusion -- reflected in the initiative launched two years ago -- that the international monetary system needs a major new supplement to existing reserve assets are now fairly well known. But these facts are so fundamental to an understanding of why the effort to establish a supplement to existing reserve assets was launched that a brief summary of them is necessary at this point.

The Special Drawing Rights are distinguished from gold and foreign exchange, the two major components of reserves in the past, by the fact that these two types of reserves have not been created by a conscious and deliberate international decision. The historical development of reserves -- the two major components, gold and foreign exchange, as well as reserve claims on the Fund -- is shown in a chart which appears as Attachment B to this statement.

So far as gold is concerned, the amount available for monetary reserves is a residual that remains available for monetary purposes after new gold production has met the demands for private industrial, artistic, and professional use. In addition, there is some absorption of gold in countries in which traditionally there is hoarding of gold, and there is a speculative demand for gold that fluctuates in intensity from time to time. Projections of new gold supplies for monetary purposes indicate that the amount available, which averaged $655 million a year in 1955-59 and $565 million in 1960-64, is likely to be much smaller in the future, unless there is a reflow of gold from speculative hoards. During 1965-66, the combined gold reserves of individual countries and international financial institutions rose only $170 million.

The other main component in the recent growth in reserves has been the accumulation of liquid dollar claims on the United States by other countries. While this method of reserve creation has much flexibility, it depends on the decisions of a number of individual countries, and the growing volume of dollar liabilities places an increasingly heavy potential strain on the gold reserves of the United States. Moreover, it provides reserves only to other countries, and does not provide any addition to the reserves of the United States. There is a general realization that it would be unwise to depend in the future on additional supplies of dollar liabilities for the secular growth of world reserves. In 1965, the Subcommittee concluded that "the United States should seek neither to expand nor reduce the international role of the dollar." They felt that the dollar will continue to have an important or even a growing international role, as a private transactions currency, and through the voluntary holding of the dollar by foreign central banks. But they did not believe that the dollar can or should contribute as much to international liquidity in the future as it has in the past. This latter opinion was generally shared by the countries with which we have been negotiating in the Group of Ten and in the Fund.

From these considerations it became evident that, as sources for reserve growth, gold and foreign exchange were likely to dwindle in the future; at best, they are highly uncertain. What can be said about the future demand for reserves?

During the past 16 years world imports have grown about three times as fast as global reserves. To a large extent, this was made possible by the willingness of the United States to permit a decline in its reserves while its import trade (along with its exports) was advancing at a relatively rapid rate. If we disregard the United States, and make a comparison between the trend lines of the growth of reserves and the growth of imports for the rest of the world, there is a closer relationship. During these 16 years the import trade of the rest of the world increased at the very satisfactory rate of nearly 8 percent per annum, while reserves rose at the rate of about 5-1/2 percent per annum.

Even though the reserves of the rest of the world outside the United States have been growing at what appears to be a relatively high rate of 5-1/2 percent per annum, the more rapid growth of imports has meant that reserves on the average now cover only about four months' imports for the rest of the world.

In the last decade, total reserves of all members of the Fund have slipped from about 56 percent to 36 percent of world imports.

There was a substantial slowdown in the growth of reserves in 1965-66, largely because the United States provided much smaller amounts of dollars to add to the official reserves of the rest of the world. In fact, about two-thirds of the additions to reserves outside the United States in 1965-66 came from other and non-traditional sources, largely related to the balance of payments of the United Kingdom. The United Kingdom made substantial drawings on the IMF which created for the time being reserve claims on the Fund for Continental European countries and some other nations, and the British also converted some $800 million of marketable securities into liquid reserve assets.

One cannot now anticipate the relationship that will be considered desirable in the future between the growth of reserves and rising levels of world trade. If, however, there were to be a continuation of the relationship of the past ten years to world trade, this would call for something like $2-1/2 to $3 billion a year in annual increments of reserves of all types when world trade reaches $250 billion a year.

IV

I shall refer in more detail later in this statement to the Subcommittee's report on Guidelines for Improving the International Monetary System. I am happy to say at this point, however, that the Outline Plan has incorporated a very large portion of the suggestions made by the Subcommittee. The first guideline pointed out that world liquidity needs cannot be adequately met by existing sources of reserves (gold, dollars and pounds sterling) or even by the addition of new reserve currencies. The Subcommittee concluded that "new ways of creating international reserves must be sought." The draft Outline Plan does provide, in my judgment, a satisfactory constitutional framework for achieving this objective. It will provide, once it is embodied in an amendment and the amendment has been ratified in accordance with regular Fund procedures, a way to create reserves that will supplement existing reserves in the form of Special Drawing Rights (SDR) in the International Monetary Fund.

Agreement on this Outline Plan therefore represents a major breakthrough in international monetary arrangements.

49

It is more than a mere evolutionary step in the development of the Bretton Woods system. It is a breakthrough that has been achieved by two years of thorough study of the problem by the major financial powers, followed by two years of intensive negotiations. It is proposed to give effect to the Outline Plan through the first formal amendment to the Articles of Agreement of the International Monetary Fund that has ever been adopted. All previous evolution within the Fund has taken place during the past 22 years without the necessity of an amendment.

The new Outline Plan is in my judgment a major new substantive departure in the international monetary sphere. This is not to deny that many of the actions taken in that sphere in the postwar period have been important and highly constructive. The quotas of the International Monetary Fund were increased by international decisions in 1959 by 50 percent and again in 1966 by 25 percent. In 1961 an agreement was negotiated, known as the General Arrangements to Borrow (GAB), under which a Group of Ten leading financial countries provided additional credit lines to the Fund up to $6 billion, for use by the Fund to forestall or cope with an impairment

of the international monetary system. All three of these international actions committed substantial additional resources to support and maintain the international monetary system.

In addition to these multilateral decisions, a network of bilateral credit facilities of a short-term character has been developed by the United States and other countries through swap arrangements of the Federal Reserve System with foreign monetary authorities.

All of these arrangements have helped greatly to strengthen the monetary system which has facilitated a sustained growth of world trade, international investment, and general economic prosperity that has been unrivaled in past history. There is, however, an important difference between these improvements that have taken place and what is now being provided in the Outline Plan.

The essential difference is that these earlier improvements did not consciously deal with the problem of supplementing international reserves. The resources of the Fund are used to provide medium-term financial support in the form of credits to be extended to individual countries that are faced with temporary balance of payments or reserve problems.

Apart from an amount corresponding to the gold paid into the Fund, the resources provided through these enlargements of the scope of the Fund have been essentially conditional credit facilities that have been available to individual countries only in conjunction with a review and appraisal of a country's economic policies, by the staff and Executive Board of the Fund.

As a by-product of the use of the medium-term credit facilities in the Fund, reserves have been created from time to time while these credit facilities were outstanding, but only for the countries which were in fact lending their resources to borrowing countries through the Fund. A return of the borrowing country to equilibrium and a repayment of these medium-term credits would have the effect of cancelling these temporary additions to international reserves. The use of the bilateral facilities under the swap network provides only short-term credit to the borrowing country, and also results in the creation of reserves for the lending country. These reserves are even more short-term in character than those which have, for a time, been outstanding as a result of the lending operations of the Fund.

51

The new Special Drawing Rights (SDR) are consciously aimed at a different and more fundamental problem. Their objective is to provide a means by which global reserves can be expanded on a permanent basis by international decisions.

V

What has now been achieved through arduous negotiations is to bring the monetary authorities of the whole Free World together in agreement on a single specific plan to provide supplementary reserves in the future by a conscious international decision. This brings us to a new phase in international monetary cooperation.

Reaching agreement on this Outline Plan has not been easy. Negotiating problems have resulted from differing assessments among the nations as to the future needs for reserve assets. Some countries tended to judge the world's needs for reserves perhaps too much in the light of their own current experience and their current reserve position -- and not enough in terms of past experience or future trends. This tendency has had a pervasive effect on their attitudes toward a whole range of specific problems.

Another problem -- which, like the one just cited, was less of a negotiating difficulty in itself than the cause of differences in view on various specific negotiating points -- had to do with fears that the establishment of a supplement to existing reserves would cause or intensify domestic inflationary pressures in some countries. Monetary authorities are of course

very conscious that the creation of money in any form is a very useful but dangerous tool. In the right quantities, the growth of the domestic money supply is necessary to facilitate the continued growth of business activity. If too much is created, inflationary pressures are enhanced. If too little is created, deflationary pressures result.

The experience with domestic monetary systems has influenced the approach taken by most countries to the creation of international reserves. On the one hand, there has been recognition that while international reserves and domestic money are not fully analogous, an evolution of international reserves broadly similar in some basic respects to that of domestic money, toward more reliance on conscious and planned decisions as to reserve growth, is a logical and necessary development. On the other hand, widespread awareness that money can be managed has as a corollary a widespread recognition that it can also be mismanaged. Fears of mismanagement of deliberately created international reserves -- in particular, fears of excessive creation of such reserves, with the possibility that this might cause or greatly intensify domestic inflationary pressures in some countries -- have been one of the underlying issues throughout the negotiations.

While the mere creation and allocation of new reserves to various countries need not, in themselves, have any inflationary consequences, it may not always be easy for monetary authorities in a particular country to neutralize or sterilize all inflows of reserve assets from abroad, or to offset in their money markets all outflows of reserves to other countries. But, on the whole, the evidence of the past six years seems to indicate that the rate of growth in the domestic money supply has substantially exceeded the trend of international reserves in most important countries. This suggests that international reserve growth has not been the real governing causal factor in monetary expansion even in those countries that have gained reserves.

Nevertheless it is important that this initial breakthrough be carried out in such a way that the first experience with the Special Drawing Rights does not give rise to misgivings regarding misuse of the ability to create reserves. I am convinced that the procedures adopted in the Outline Plan are fully adequate to provide assurance against any possibility of excessive use of this new authority to create reserves.

VI

In appraising the agreement we have reached, it is also useful to review the extent to which we have been able to attain international agreement along the lines set forth two years ago by this Subcommittee.

Clearly we have accomplished the first point in the Guidelines, that a new way of creating international reserves must be sought. We have sought and we have found and agreed upon a plan that will make it possible to add supplementary reserves to the existing sources of reserves.

Secondly, the Subcommittee cautioned that the Plan should not encourage or require countries to convert existing balances or new acquisitions of reserve currencies into gold or the new reserve medium. They wished to maintain the role of the dollar both as a transactions currency and as an official reserve medium, without basically expanding or reducing itspresent role. In this connection, the Committee concurred with the view that we have continually expressed in the Executive Branch, "that the nation's objective in international monetary reform is not to find a device for enabling the U.S. to finance balance of payments deficits painlessly." The agreement that we have reached has, in my judgment, avoided impairing the role of the

dollar in the future and leaves the position of the dollar in the status desired by the Committee.

Third, the Committee found that gold should continue its present role but that nothing should be done to enhance its value in relation to other forms of reserve assets. The Outline Plan should confirm the permanence of the price of gold, and it is our hope that it will also increasingly operate to remove any special enhancement of the position of gold that may have developed as a result of uncertainty regarding the future growth of the world's reserves.

The Subcommittee's fourth point called for a new method of reserve creation combining minimum annual increases with supplements determined by annual decision. At a relatively early stage in the negotiations, it became clear that there was a strong feeling that it would not be feasible to reach international decisions, on the difficult matter of the amount of Special Drawing Rights to be created, at periods so short as one year. Decisions on the amounts of Special Drawing Rights to be established will normally cover five-year periods, with actual allocations made at intervals within those five years -- which intervals could be annual. It is, however, possible to review a five-year plan at any time if there are important changes in the world situation.

As the fifth point, the <u>Guidelines</u> called for the arrangements to be carried out under the International Monetary Fund, and there has now clearly been a full acceptance of this point. It was also suggested that the new reserves should be distributed to all Fund members who qualify under criteria applicable equally to all countries. After extensive negotiation, the principle of participation of all IMF members, with distribution across the board to all participating Fund members in proportion to their quotas, has been fully agreed.

The Committee found that the new reserves could not be used as a primary foreign aid device, and this view was strongly evidenced by other Group of Ten countries. There is no direct connection between the new Special Drawing Rights and the financing of economic development. The developing countries will, however, obtain benefits like other countries, in the form of additions to their reserves, and will also benefit more generally, insofar as adequate growth in reserves serves as a protection against a cumulative tendency to excessive restrictions on capital flows, aid expenditures, and trade expansion that could be the result of a global shortage of reserves.

On the eighth point, the Guidelines suggested that the distinction between owned and borrowed reserves should not be critical, and that reserve units or drawing rights could be used by the Fund to create reserves. While there was considerable feeling that there are important differences between owned reserves and borrowed reserves, there was agreement that reserve assets can be created in the form of drawing rights or of units.

The Committee went on to suggest an expansion in IMF quotas, both general and selective. They suggested that provisions should be made for periodic increases in the Fund's conditional borrowing facilities to maintain reasonable balance between them and owned reserves. There were general and selective increases in IMF quotas early in 1966, following a review that was made in 1964-65. While there is a general recognition that periodic quota increases are desirable, there is no present indication that the member countries wish to proceed at the present time with action along this line. The next quinquennial review of quotas would be due about 1969-70.

A recommendation was made that bilateral arrangements should be expanded as a second line of defense against short-term instability. The network of these arrangements has been enlarged from time to time.

As point 12, the Subcommittee suggested that substantial improvements are needed in the adjustment process. As mentioned elsewhere a basic study on this matter was prepared by Working Party 3 of the OECD in 1965-66. Efforts to improve national policies through cooperation and consultation are going forward as a continuing process.

This brief catalogue of the points covered in the 1965 Guidelines makes clear that the largest part of the Subcommittee's judgment as to the practical course to follow, made in 1965, has now become the collective international judgment of 1967. This is an impressive tribute to this earlier judgment.

VII

Under Secretary Deming has prepared a statement explaining the Outline Plan in some detail and will be glad to present it to the Committee and to answer technical questions. In this statement, however, I should like to call your attention to several major questions that have arisen in the negotiations and in public comment on the Outline Plan. These relate to (1) the effectiveness of the Special Drawing Right as a supplement to reserve assets equivalent to these other assets, (2) the relationship of the Outline Plan to the United States balance of payments, and (3) the provisions relating to voting and making decisions to activate the plan.

It is not surprising that an agreement which brings together 106 nations may not take the form that would be favored by every monetary expert in the field. In fact, many of the negotiators might have produced somewhat different plans in some respects if they had been able to achieve their own personal formulations of the plan. It was, however, essential to reach an agreement, and in the process of negotiation these individual views were hammered into the shape of an agreed Outline Plan to create a supplement to existing reserve assets.

The answer to the question as to whether we have a good reserve asset is, in my judgment, strongly affirmative. The practical test in the future will be the attitudes of monetary authorities toward the Special Drawing Right. It is important that they count it as a part of their official reserves and they be prepared to make effective use of it in their transactions with other monetary authorities. I believe it is the judgment of the group that these two tests will be met, on the part of most, if not all, members of the Fund. It is the intention of the United States to treat 100 percent of its holdings of Special Drawing Rights as part of its international reserves.

The second main point to which I would like to draw your attention is the relationship of the Outline Plan and the Special Drawing Right to the United States balance of payments.

In a few quarters it has been suggested that the plan is weak because it does not provide a solution to the balance of payments problem of the United States. Throughout the course of these negotiations I have done my best to make it very clear that the United States was fixing its eyes

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on the global needs for reserves and did not expect that the plan for reserve creation would solve the United States balance of payments problem. That is a matter which I associate with the general subject of the adjustment process. At an early date in the negotiations there was a complete and full understanding that negotiations with regard to a supplementary reserve were to deal with global needs and not with the problems of the balance of payments of individual countries.

The questions of improving and developing the processes of adjustment in international imbalances were examined in a separate study undertaken by Working Party No. 3 of the OECD in 1965-66. A continuous search for improvement in adjustment policies goes forward in Working Party No. 3 of the OECD at its frequent meetings, and is also carried on through the annual and special consultations held by the International Monetary Fund with its member countries. Accordingly, as a matter of design and logic, we should dissociate this Outline Plan from balance of payments considerations.

The third point of the Outline Plan on which I would like to comment is the decision-making provisions. These provisions call for an 85 percent majority vote to create

Special Drawing Rights. They represent a change from the practice of the International Monetary Fund where an 80 percent majority is required to take a decision to increase quotas. Under the provisions of the new scheme, both the United States with 21.9 percent of the votes, the European Economic Community with 16.5 percent of the votes, and any other group of countries with more than 15 percent of the total voting power could block a proposal to undertake the creation of reserves.

It was widely recognized in the Group of Ten and in the Fund that in the new venture we were undertaking involving the creation of reserves where confidence and the availability of resources to back the new asset are so important, it was necessary to have the widest participation. The possible abstention of a major country such as the United States, or a major group of countries such as the EEC, would in practice make any decision to create reserves meaningless. Therefore, the 85 percent majority is a recognition of the fact that, with this breakthrough into a major new area of international cooperation, this provision was considered a reasonable requirement for an effective plan.

Moreover, I firmly believe that this voting majority is consistent with a workable decision-making process. The IMF has operated in practice on a consensus basis. I am sure that this effective and successful cooperation will continue in the future. Our ability to reach agreement on this new Outline Plan is additional and convincing evidence of the willingness of all countries to take a constructive and responsible attitude toward the problems of the international monetary system.

VIII

I have noted how prophetic the Guidelines of the Subcommittee have proved to be in foreshadowing the agreement that is now before the Governors of the International Monetary Fund for their consideration and approval. If we now leave the structure and content of the agreement, and attempt to evaluate its significance for the future, what can be said? President Johnson on August 28, 1967 rightly pointed out:

> "Certainly no human being today can fully appraise the potential of this new development in the international monetary field."

But he ventured to state that it will stand out in the history of international monetary cooperation, and that it marks the greatest forward step in world financial cooperation in the 20 years since the creation of the International Monetary Fund itself. The President went on to point out three major consequences of the agreement.

First, the fact that agreement had been reached on this Outline Plan makes it unmistakably evident that all the major industrial nations of the free world have shown their clear and sincere intent to build strongly and securely on the base of our current international monetary system. If

the Plan achieves the approval of 106 nations, this intent will be solidified into a truly global determination.

Secondly, the President pointed out that a firm foundation has been developed for another reserve asset to join gold, dollars and other reserve currencies as a needed means of payment for a world of growing trade and commerce.

Third, the gold and exchange markets can now reflect a new sense of confidence in the adequacy of future reserve supplies. With the United States unquestionably committed to convert gold into dollars at $35 an ounce and with the availability of a new facility to draw on when needed, there can be no reasonable basis to fear a shortage of reserves.

In my view, the idea of international cooperation to insure orderly and adequate growth of monetary reserves in the years to come was basically an idea whose time had arrived. It became clear to all enlightened financial experts in the free world -- certainly to an overwhelming majority of these experts -- that there was a dilemma resulting from the uncertain and limited supply of new reserves to be expected of existing types of reserves, and the irrestible onrush of growing world trade and investment which in turn will make the need for more reserves uncontestable and compelling.

This agreement should, in my judgment, give reasonable insurance that there can be an orderly and adequate growth of monetary reserves in the future. The new facility should provide a dynamic element of growth in the world's reserves for the future -- a growth element of a deliberate character subject to joint, collective and responsible processes of international decision.

This will be its contribution to the growth and evolution of the monetary system. But the Special Drawing Right facility can also provide useful insurance against the impairment of the existing structure of the international monetary system. Thus, looked at either from the point of view of growth and expansion of the world's financial and economic system, or from the point of view of maintaining the essential element of confidence which is so vital to the whole structure of finance and banking, we may legitimately claim a real contribution from this landmark step in aligning the governments and monetary authorities of the world in support of a single specific plan for supplementing reserves.

I know that the international monetary system may seem to some to be a matter for experts and far removed from the daily concern of the average American family. Yet the average man may have an instinctive and well-founded feeling that the

world's financial structure is important to him. Some of us are old enough to remember that the financial problems of the early thirties in the United States were closely related to the breakdown of the international monetary system which took place in the early years of the great depression. We do not expect that we have to deal in the future with such dramatic demonstrations of the connection between the welfare of the average citizen and a smoothly functioning and adequate international monetary system. But American business interests have clearly become more and more farflung, and the prosperity of many towns, cities and farms is closely related to the earnings which they derive from international transactions. The most obvious and clear-cut practical impact of failure to provide for adequate reserve growth is the danger that world markets and world business will be handicapped and the world's economic growth slowed down if countries are driven by a shortage of reserves into competitive restraints on their dealings with other countries.

In sum, the Outline Plan represents the first stage in establishing an international constitutional structure under which a good, effective and sound supplement to other reserve assets can be created by a reasonable and responsible

process of international decision. This is the essence of what we in the Executive Branch sought, and it is my understanding of what the Subcommittee has envisaged.

Attachments

Attachment A

INTERNATIONAL MONETARY FUND

Outline of a Facility Based on Special Drawing Rights in the Fund

Introduction

The facility described in this Outline is intended to meet the need, as and when it arises, for a supplement to existing reserve assets. It is to be established within the framework of the Fund and, therefore, by an Amendment of the Fund's Articles. Provisions relating to some of the topics in this Outline could be included in By-laws adopted by the Board of Governors or Rules and Regulations adopted by the Executive Directors rather than in the Amendment.

I. Establishment of a Special Drawing Account in the Fund

(a) An Amendment to the Articles will establish a Special Drawing Account through which all the operations relating to special drawing rights will be carried out. The purposes of the facility will be set forth in the introductory section of the Amendment.

(b) The operations of and resources available under the Special Drawing Account will be separate from the operations of the present Fund which will be referred to as the General Account.

(c) Separate provisions will be included in the Amendment for withdrawal from or liquidation of the Special Drawing Account; Article XVI, Section 2 and Schedules D and E on withdrawal and liquidation will continue to apply as they do at present to the General Account of the Fund.

II. Participants and Other Holders

1. Participants. Participation in the Special Drawing Account will be open to any member of the Fund that undertakes the obligations of the Amendment. A member's quota in the Fund will be the same for the purposes of both the General and the Special Drawing Accounts of the Fund.

2. Holding by General Account. The General Account will be authorized to hold and use special drawing rights.

III. Allocation of Special Drawing Rights

1. Principles for decisions. The Special Drawing Account will allocate special drawing rights in accordance with the provisions of the Amendment. Special considerations applicable to the first decision to allocate special drawing rights, as well as the principles on which all decisions to allocate special drawing rights will be based, will be included in the introductory section of the Amendment and, to the extent necessary, in a Report explaining the Amendment.

2. Basic period and rate of allocation. The following provisions will apply to any decision to allocate special drawing rights:

(i) The decision will prescribe a basic period during which special drawing rights will be allocated at specified intervals. The period will normally be five years in length, but the Fund may decide that any basic period will be of different duration. The first basic period will begin on the effective date of the first decision to allocate special drawing rights.

(ii) The decision will also prescribe the rate or rates at which special drawing rights will be allocated during the basic period. Rates will be expressed as a percentage, uniform for all participants, of quotas on the date specified in the decision.

3. Procedure for decisions

(a) Any decision on the basic period for, timing of, or rate of allocation of special drawing rights will be taken by the Board of Governors on the basis of a proposal by the Managing Director concurred in by the Executive Directors.

(b) Before formulating any proposal, the Managing Director after having satisfied himself that the considerations referred to in III.1 have been met, will conduct such consultations as will enable him to ascertain that there is broad support among participants for the allocation of special drawing rights at the proposed rate and for the proposed basic period.

(c) The Managing Director will make proposals with respect to the allocation of special drawing rights: (i) within sufficient time before the end of a basic period; (ii) in the circumstances of III.4; (iii) within six months after the Board of Governors or the Executive Directors request that he make a proposal. The Managing Director will make a proposal for the first basic period when he is of the opinion that there is broad support among the participants to start the allocation of special drawing rights.

(d) The Executive Directors will review both the operations of the pecial Drawing Account and the adequacy of global reserves as part of their nnual report to the Board of Governors.

4. Change in rate of allocation or basic period. If there are nexpected major developments which make it desirable to change the rate at hich further special drawing rights are to be allocated for a basic period, i) the rate may be increased or decreased, or (ii) the basic period may be erminated and a different rate of allocation adopted for a new basic period. 'aragraph III.3 will apply to such changes.

5. Voting majority.

(a) For decisions on the basic period for, timing of, amount and rate f allocation of special drawing rights, an 85 per cent majority of the voting ower of participants shall be required.

(b) Notwithstanding (a) above, the decisions to decrease the rate of llocation of special drawing rights for the remainder of the basic period ill be taken by a simple majority of the voting power of participants.

6. Opting out.

The Amendment will include provisions that will prescribe to what extent participant will be required initially to receive special drawing rights, ut will stipulate that beyond any such amount a participant that does not ote in favor of a decision to allocate special drawing rights may elect not o receive them under that decision.

V. Cancellation of Special Drawing Rights

The principles set forth in III relating to the procedure and voting for he allocation of special drawing rights will be applicable, with appropriate odifications, to the cancellation of such rights.

. Use of Special Drawing Rights

1. Right to use special drawing rights.

(a) A participant will be entitled, in accordance with the provisions f V, to use special drawing rights to acquire an equivalent amount of a urrency convertible in fact. A participant which thus provides currency will eceive an equivalent amount of special drawing rights.

(b) Within the framework of such rules and regulations as the Fund may dopt, a participant may obtain the currencies referred to in (a) either irectly from another participant or through the Special Drawing Account.

(c) Except as indicated in V.3(c), a participant will be expected to use its special drawing rights only for balance of payments needs or in the light of developments in its total reserves and not for the sole purpose of changing the composition of its reserves.

(d) The use of special drawing rights will not be subject to prior challenge on the basis of this expectation, but the Fund may make representations to any participant which, in the Fund's judgment, has failed to observe the expectation, and may direct drawings to such participant to the extent of such failure.

2. Provision of currency.

A participant's obligation to provide currency will not extend beyond a point at which its holdings of special drawing rights in excess of the net cumulative amount of such rights allocated to it are equal to twice that amount. However, a participant may provide currency, or agree with the Fund to provide currency, in excess of this limit.

3. Selection of participants to be drawn upon.

The Fund's rules and instructions relating to the participants from which currencies should be acquired by users of special drawing rights will be based on the following main general principles, supplemented by such principles as the Fund may find desirable from time to time:

(a) Normally, currencies will be acquired from participants that have a sufficiently strong balance of payments and reserve position, but this will not preclude the possibility that currency will be acquired from participants with strong reserve positions even though they have moderate balance of payments deficits.

(b) The Fund's primary criterion will be to seek to approach over time equality, among the participants indicated from time to time by the criteria in (a) above, in the ratios of their holdings of special drawing rights, or such holdings in excess of net cumulative allocations thereof, to total reserves.

(c) In addition, the Fund will, in its rules and instructions, provide for such use of special drawing rights, either directly between participants or through the intermediary of the Special Drawing Account, as will promote voluntary reconstitution and reconstitution under V.4.

(d) Subject to the provisions of V.1(c), a participant may use its special drawing rights to purchase balances of its currency held by another participant, with the agreement of the latter.

4. Reconstitution.

(a) Members that use their special drawing rights will incur an obligation to reconstitute their position in accordance with principles which will take account of the amount and the duration of the use. These principles will be laid down in rules and regulations of the Fund.

(b) The rules for reconstitution of drawings made during the first basic period will be based on the following principles:

(i) The average net use, taking into account both use below and holdings above its net cumulative allocation, made by a participant of its special drawing rights calculated on the basis of the preceding five years, shall not exceed 70 per cent of its average net cumulative allocation during this period. Reconstitution under this subparagraph (i) will be brought about through the mechanism of transfers, by the Fund directing drawings correspondingly.

(ii) Participants will pay due regard to the desirability of pursuing over time a balanced relationship between their holdings of special drawing rights and other reserves.

(c) Reconstitution rules will be reviewed before the end of the first and of each subsequent period and new rules will be adopted, if necessary. If new rules are not adopted for a basic period, the rules for the preceding period shall apply unless it is decided to abrogate reconstitution rules. The same majority as is required for decisions on the basic period, timing of, or rate of allocation of special drawing rights will be required for decisions to adopt, amend, or abrogate reconstitution rules. Any amendment in the rules will govern the reconstitution of drawings made after the effective date of the amendment, unless otherwise decided.

VI. Interest and Maintenance of Gold Value

(a) Interest. A moderate rate of interest will be paid in special drawing rights on holdings of special drawing rights. The cost of this interest will be assessed against all participants in proportion to net cumulative allocations of special drawing rights to them.

(b) Maintenance of gold value. The unit of value for expressing special drawing rights will be equal to 0.888 671 grams of fine gold. The rights and obligations of participants and of the Special Drawing Account will be subject to an absolute maintenance of gold value or to provisions similar to Article IV, Section 8 of the Fund's Articles.

VII. Functions of Fund Organs and Voting

1. Exercise of powers. The decisions taken with respect to the Special Drawing Account, and the supervision of its operations, will be carried out by the Board of Governors, the Executive Directors, the Managing

Director, and the staff of the Fund. Certain powers, and in particular those relating to the adoption of decisions concerning the allocation, cancellation, and certain aspects of the use of special drawing rights, will be reserved to the Board of Governors. All other powers, except those specifically granted to other organs, will be vested in the Board of Governors which will be able to delegate them to the Executive Directors.

2. Voting. Except as otherwise provided in the Amendment, all decisions pertaining to the Special Drawing Account will be taken by a majority of votes cast. The precise formula for the voting power of participants, which will include basic and weighted votes, and possibly the adjustment of voting power in relation to the use of special drawing rights, will be the subject of later consideration.

VIII. General Provisions

1. Collaboration. Participants will undertake to collaborate with the Fund in order to facilitate the proper functioning and effective use of special drawing rights within the international monetary system.

2. Nonfulfillment of obligations.

(a) If the Fund finds that a participant has failed to fulfill its obligations to provide currency in accordance with the Amendment, the Fund may suspend the right of the participant to use its special drawing rights.

(b) If the Fund finds that a participant has failed to fulfill any other obligation under the Amendment, the Fund may suspend the participant's right to use any special drawing rights allocated to, or acquired by, it after the suspension.

(c) Suspension under (a) or (b) above will not affect a participant's obligation to provide currency in accordance with the Amendment.

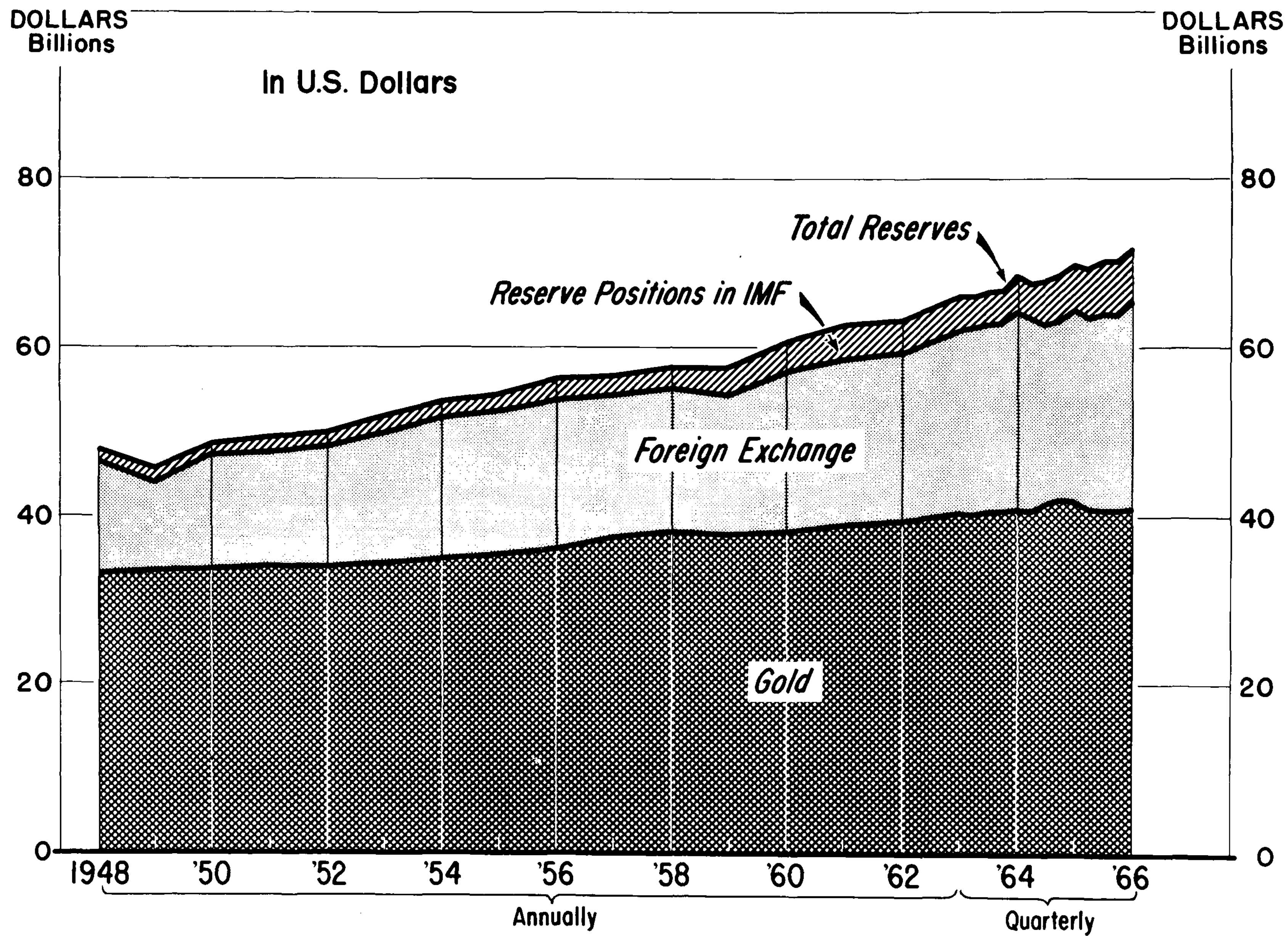
(d) The Fund may at any time terminate a suspension under (a) or (b) above.

3. Accounts. All changes in holdings of special drawing rights will take effect when recorded in the accounts of the Special Drawing Account.

IX. Entry into Force

The Amendment would enter into force in accordance with the terms of Article XVII of the Fund's Articles.

COMPOSITION OF WORLD RESERVES, 1948-'66



Office of the Secretary of the Treasury

C-113B

Attachment B

STATEMENT BY THE HONORABLE FREDERICK L. DEMING,
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS,
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS
OF THE
JOINT ECONOMIC COMMITTEE
SEPTEMBER 14, 1967

I would like to join Secretary Fowler in expressing appreciation for this opportunity to make a progress report on the international monetary negotiations and to explain in more detail the workings of the "Outline of a Facility Based on Special Drawing Rights in the Fund." I would particularly like to join him in thanking this Committee for the inspiration it has given to this endeavor as well as for the timely and thoughtful guidance it has provided throughout the negotiations.

The basic concept embodied in the Plan is quite simple. The Plan provides for a new international asset which will be an effective supplement to existing reserve assets -- gold, reserve currencies, and reserve claims on the Fund -- one that will be a permanent addition to world reserves. The problem of elaborating this simple concept was partly technical and partly political -- the new asset had to be endowed with qualities that would make it useable and acceptable. It not only had to be a high quality asset -- it had to be regarded as such.

The Plan is embodied in the Outline you have before you. As Secretary Fowler has explained, the Outline will be implemented through amendments to the Articles of Agreement of the International Monetary Fund. I can sum up the essential elements of the Outline Plan to create Special Drawing Rights (SDR) in four basic points:

1. <u>Quality as a reserve asset</u> - SDR are to be denominated in units of account equivalent to the gold value of one dollar; they will have the strong backing of the solemn obligations of Fund members to accept them and pay a convertible currency in return. It is planned that they will bear a moderate rate of interest.
2. <u>Mode of creation</u> - SDR are to be created under an IMF procedure which will assure wide support for their creation, with final responsibility for decisions resting on the Fund Board of Governors. Each decision to create will authorize a specific amount of SDR.
3. <u>Mode of allocation</u> - SDR are to be allocated to participants in proportion to their IMF quotas. All IMF members are eligible to participate. Allocations of SDR will take the form of book entries in a Special Drawing Account of the Fund.
4. <u>Mode of transfer</u> - SDR will be transferred by debiting the SDR account of the user and crediting the SDR account of the receiver, with the receiver paying convertible currency to the user. There will be rules on eligibility to use, on eligibility to receive, and on partial reconstitution of the amount used. The Fund will act as a kind of traffic director, guiding the flow of SDR as they are transferred from one country to another.

These are the main elements. I would now like to go into some of the more significant aspects of the main elements in more detail.

Perhaps, first I should emphasize an essential difference between existing reserves and SDR. This difference is that SDR will be created by deliberate international decisions. How are these decisions to be taken?

The Managing Director of the Fund will be generally responsible for initiating proposals to start the machinery working, although it will be possible for the Fund Executive Directors or Governors to request a proposal for SDR creation from the Managing Director. The principal criterion for making a proposal is that there must be a widely-recognized global need for reserve creation.

In arriving at a decision to propose creation of the new asset, the Managing Director will have to take into consideration a number of factors and developments -- both quantitative and qualitative. Some obvious ones that come to mind are: the general trend in reserve growth, the supply of gold and reserve currencies, the volume of international trade and its relationship to international reserves, the general climate in the international monetary system, the state of the international exchanges, the reserve policies of participants, the workings of the adjustment process, and so on. This list is not meant to be exclusive or to emphasize one factor as against another. In fact, I believe it would be a mistake to attempt to fix an elaborate or detailed listing of criteria and relative priorities, because conditions change and the relative importance of criteria change. Certainly it would not be useful to incorporate a fixed list in the agreement or the report. But, in coming months, some general principles may be noted.

I want to underline one point that Secretary Fowler noted in his statement. Early in the negotiations it became apparent that the present state of knowledge and prospective institutional arrangements did not lend themselves to attempts to make short-term and cyclical adjustments to the volume of international reserves. Central banks can do this in their domestic spheres, but it did not seem possible to attempt this on an international scale. This principle bears repeating because of its significance for understanding the nature of the decisions to be taken to create SDR. It was agreed that decisions would be taken from time to time to create a specific amount of reserves for a period as a whole. Such decisions would not be changed unless unexpected major developments required modification of the established trend. It was also agreed that a reasonable period for which decisions about the future could be made was five years forward. Therefore, proposals to create SDR will normally be for five years ahead. Allocations, however, will be made to participants at regular intervals during the period.

The nature of decisions taken after the first five-year period would depend on the five-year prospective need for reserves as conceived from that point in time. The Outline Plan provides that the Executive Directors must keep the adequacy of global reserves under review and the Managing Director is required to make a new proposal to allocate SDR within sufficient time before the end of a basic period. The essential point is that the Outline Plan envisions that the reserve creation machinery would continue to operate in the future and that any SDR created would remain a permanent addition to world reserves.

Once a proposal is made, it must be considered and approved by the Fund. To assure that decisions for reserve creation will have the widest

possible approval, the Outline Plan provides that the Managing Director shall undertake full consultations to ascertain there is broad support for his proposal. The proposal, once put forward, and concurred in by the IMF Executive Directors, would be submitted for the approval of the Fund Governors voting by 85% weighted majority. If there were unexpected major developments, a simple majority could reduce the trend amount and an 85% majority could increase it. The technical possibility of cancellation of SDR by an 85% majority will also be provided for, although we would not expect this provision to be used.

The proposal to create an amount of new assets will be for a specific amount. Obviously, we cannot tell now what that amount will be -- it will be the product of a wide consensus, with judgment based on various factors. But perhaps a little guidance may be obtained from the recent past.

Over the past 16 years -- since the end of 1950 -- global reserves have increased at an annual average of $1.4 billion, or 2.4 percent. As Secretary Fowler has noted, United States reserves have been declining during this period and reserves in the rest of the world have grown at an annual rate of about 5.4 percent.

If one projects world trade growth at about its present rate, world imports in 1970 will reach about $250 billion in contrast to 1966 volume of $192 billion. At that level, annual increments to reserves -- assuming that the same relationship of reserves to trade as now prevails -- should be $2.5 to $ 3 billion.

Thus, total reserve growth of some $2 billion a year or so would seem

reasonably consistent with the recent path. How much of the total growth would be in the form of the new asset naturally would depend on judgments as to growth in other forms of reserves. Given present and prospective conditions of new monetary gold supply and the intention of the United States to reach equilibrium in its international payments position when the situation in Vietnam makes this feasible, those other sources might be quite small.

For illustrative purposes, however, let us assume that the plan enters into effect in 1969 and a proposal to create $1 billion of SDR a year for five years is adopted. How would this affect the participants in the Plan? SDR will be allocated to members of the Fund in proportion to their Fund quotas. For example, the United States has 24.6% of the total Fund quotas and thus would receive $246 million of SDR created each year -- a total of $1,230,000,000 for the five-year period. Receiving an allocation of SDR means that in each of the five years the Fund will credit the United States on the books of the Special Drawing Account in the Fund with $246 million SDR.

Assuming the annual creation of $1 billion and assuming present IMF quotas are those applying when the first creation and allocation takes place, the annual amounts credited to the accounts of various countries or groups of countries would be about as follows:

Germany	-	$ 57.2 million
France	-	47.0
Italy	-	29.8
Netherlands	-	24.8
Belgium-Luxembourg	-	20.9
Total EEC	-	$ 179.7
United Kingdom	-	116.3
Canada	-	35.3
Japan	-	34.6
Sweden	-	10.7
United States	-	245.9
Total Group of Ten	-	$ 622.5
Other Europe	-	66.9
Middle East & North Africa	-	43.0
Other Asia	-	107.5
Other Africa	-	39.6
Latin America	-	89.0
Australia & New Zealand	-	31.3

Now, just what kind of asset will these countries have to supplement their other international reserves? What are the factors which give it high quality and acceptability?

Each SDR is to be denominated in terms of 0.888671 grains of fine gold. This is the gold value equivalent of one U.S. dollar. Thus, each SDR will be equal to the gold value equivalent of one dollar. Let me be clear that SDR will be gold value guaranteed, but they will not be redeemable in gold. Further, I also want it to be clear that it would be against the rules for a country to use its SDR merely to change the composition of its reserves. In other words, it would be inappropriate for any country observing the rules to use its SDR to obtain dollars and in turn use those dollars to buy gold from the United States.

Countries will earn net a modest rate of interest on holdings in excess of their cumulative allocations. The formal amendment probably will not set a specific interest rate, but rather a range which will allow the rate to be set in the light of the circumstances at the time of creation of SDR.

The backing of SDR will be unimpeachable. It will consist of a firm, unequivocal, and solemn obligation to accept the new asset when it is presented and to pay a convertible currency in return. That obligation is the fundamental backing of the asset, and is the principal factor which will give it value as an asset. The obligation is qualified, but the limits are broad enough so that there can be no doubt about the usability of SDR to obtain convertible currencies. Each participant will be obligated to accept SDR up to an amount equal to its cumulative allocations plus two times its

cumulative allocations. This obligation makes unnecessary and takes the place of the pool of currency used to back present IMF drawing rights. This concept of acceptance obligations is so important to understanding the working of the scheme that I would like to devote some time to explaining it.

Put in its simplest form, a country's acceptance obligation is always the difference between its actual holdings of SDR and three times its cumulative allocations. Thus, using the previous example of creation of $1 billion SDR a year for five years, the United States would receive $246 million SDR per year. In the first year, assuming we used none of our $246 million SDR, our potential acceptance obligation would be $492 million SDR -- that is, three times our cumulative allocations of $246 million ($738 million), minus our actual holdings of $246 million SDR. If we had transferred all of our $246 million SDR allocation to other countries, our potential acceptance obligation would be $738 million SDR. If we held our allocation of $246 million SDR and had received $246 million SDR in transfers from other countries, our potential obligation would be $246 million SDR.

By the fifth year, we would have cumulative allocations of $1,230 million SDR and, assuming that we held this amount and that we had already accepted $1 billion SDR from other countries, our potential additional acceptance obligation would be $1,460 million SDR.

For the EEC countries, the aggregate allocation would be $180 million SDR per year, or $900 million over a five-year period. The aggregate acceptance obligation is three times $900 million, or $1.8 billion more than the Community's allocation.

These examples indicate that the potential acceptance obligations of the U. S. will be large enough to accommodate a transfer of all EEC holdings and the EEC acceptance obligations will be large enough to take a transfer of all U. S. holdings. Obviously, these are extreme examples, and the system simply would not work that way. But they demonstrate that the acceptance obligations are quite ample. The margin between the amounts created and the acceptance obligations normally should insure ample coverage for SDR transfers.

The obligation to accept SDR is the foundation of the Outline Plan. Yet one might ask what would happen if a country should fail to honor its obligations to accept or if there were a major calamity and the Plan were liquidated or if a member were to withdraw. We have given careful thought to these remote contingencies, which we do not expect will occur but which a prudent man must guard against. There are three points that are relevant:

1. Because the obligation to accept SDR against the payment of convertible currency is the essence of the Plan, the Outline provides its most severe sanctions -- suspension of the right to use any SDR held by a country -- for failure to honor this commitment.

2. Most of the transfer of SDR will be directed by the Fund to countries in strong balance of payments and reserve positions, and it is quite a remote possibility that such countries would default on their obligations. Moreover, even in the unlikely event a default were to occur, the acceptance obligations of the major industrial countries are large enough so that transfers could be directed toward these countries. It is worth recalling, at this point, that the allocations of the Group of Ten countries are 62 percent of the total and that these countries have potential acceptance obligations more than three times the total amount allocated to the rest of the world. In addition, a growing number of countries are demonstrating the financial capacity which will qualify them as receivers of SDR.
3. To cover the unlikely event of liquidation of the Plan or a withdrawal, detailed provisions will be made for redemption in acceptable means of payment of countries' holdings of SDR in excess of their cumulative allocations. The specific provisions will be worked out in the coming months and incorporated into the amendment implementing the Outline. We expect that, should there be any losses in the event of a withdrawal or liquidation, such losses would be shared among all members in proportion to their allocations. Thus, countries would not be exposing themselves to special risks by holding a large amount of SDR relative to other countries' holdings of SDR.

In concluding my comments on acceptance obligations, I want to make one point very clear. I have called these acceptance obligations "obligations," and they are exactly that from two points of view. That is, (a) they are obligations to provide backing for the SDR, and (b) they are limited so that each country knows what its maximum constitutional obligation is. But I want to stress still a third viewpoint.

These new assets, as I have indicated, are high quality assets designed to supplement existing reserve assets. Countries that get SDR from other countries -- over and above their regular allocations -- normally will be surplus countries and, thus, countries gaining reserves. Some of their reserve gains will be in the form of the new asset -- which will be useable, as are its other reserves, when it needs to use them. Thus, accepting the new asset is no more of a burden than accepting gold or foreign exchange or reserve claims on the Fund. In this sense, the acceptance obligation is misnamed and, because of this fact, the acceptance limit of three times allocations is not a fixed limit. Countries, if they wish, can accept and hold more than their acceptance limits -- the limits merely state their obligations to accept.

Why, then, are any limits set for acceptance? There are none for holdings of gold and dollars. The answer is a simple one. In the initial periods, while the world gets used to these new assets, it was judged to be the conservative course to say that no country need take more than a proportion of the new assets. Their quality is good, but they are new and people

proceed with more caution with a new asset. I suspect that, in time, the concept of acceptance limits will be dropped.

I have already made the point that SDR are useable to obtain convertible currencies, mainly dollars. This is essentially how countries use gold. They use gold to buy convertible currencies, mainly dollars. Because SDR are new and do not have a tradition of use as a monetary asset, as do gold and dollars, a few basic principles to guide their transfer have been provided. They are:

1. Countries will be expected to use SDR only for balance of payments needs or to protect their reserve position. A country's judgment as to its eligibility to use may not be challenged, but the Fund may make representations and direct drawings to a country which the Fund believes has failed to observe this expectation.

   This expectation simply expresses existing practice, under which present reserve assets are used almost exclusively for balance of payments needs or to protect reserve positions. It will help to assure an orderly flow of SDR and avoid instability resulting from shifts in the composition of reserves which might come about if, at a particular time, one of the three principal reserve assets -- gold, dollars, and SDR -- happened to look more attractive than the others. When a country -- say the United States -- is eligible to use SDR, and wants to do so, it would request the Fund to debit, say, $100 million of its SDR account and credit a country, or countries, eligible to receive SDR with $100 million SDR. The receiving country, or countries, will then credit the U. S. account with the equivalent in convertible currencies of $100 million SDR. This brings us to the second major principle of use -- how is eligibility to receive determined?

2. I have already mentioned that normally countries in strong balance of payments and reserve positions will be eligible to receive SDR. It is only natural that countries in this situation should receive SDR, since they would be the ones which would be gaining reserves because of their balance of payments positions. Transfers of SDR could also go to countries in a strong reserve position even though they have moderate balance of payments deficits. Among the countries eligible to receive SDR, the Fund will try to maintain equality, over time, in the ratios of their holdings of SDR to their total reserves or in the corresponding ratios to total reserves of their holdings in excess of their allocations. The purpose of this rule is to achieve a generally fair distribution of the SDR among the countries that meet the standards entitling them to receive SDR.

3. The third principle of use concerns what is known as reconstitution. I would expect that a very considerable amount of use of SDR will be reconstituted through the normal processes of balance of payments adjustment. Countries that are in deficit and that use the asset will switch to a surplus position and will become eligible to receive transfers of SDR. It is, of course, natural for countries that lose reserves when in deficit to try to regain them when in surplus. However, some countries were concerned that a few countries might use SDR to the exclusion of other reserves and that these countries might not become eligible to

receive a reflow of SDR, because they would remain in balance of payments deficit. While all countries agreed that some reconstitution provisions were necessary, it was important to avoid a compromise of the quality of the asset as a supplement to gold and dollars. The rules on reconstitution that were adopted assure that the asset will not be abused, yet do not interfere with its reserve asset status.

First, a general obligation to reconstitute, related to time and amount of use, is set down. The specifics are to be elaborated in rules subsidiary to the agreement. The purpose of this was to make it possible to change the reconstitution rules without formally amending the agreement. It was widely agreed that it was not possible to lay down reconstitution rules for all time, as they would have to be adjusted as experience is gained with the use of SDR and, perhaps, in time dispensed with, as concern about exclusive use of this one asset is dissipated by actual experience.

Rules were made for the first five years of creation of SDR. The reconstitution rules will be reviewed before the end of this and each subsequent basic period and new rules adopted, if necessary and if approved by an 85 percent majority. During this initial period, a country's average net use of allocations of SDR, calculated on the basis of the preceding five years, "shall not exceed 70 percent of its average net cumulative allocation during this

period." If any country exceeds this rate of use, the Fund would direct part of the natural flow of SDR to it, in order to maintain this standard. Thus, reconstitution will take place through a restoration of holdings of SDR in the account of the user with the Fund, with payment of convertible currency by the user to other users. The term reconstitution aptly describes the substantive intention. A country "reconstitutes" its reserve position in SDR by purchasing SDR from other countries. It should be clearly understood that there is no bar to the use of 100 percent of allocations of SDR; a reconstitution obligation is incurred only with respect to average use above 70 percent.

In addition to the net average use rule, it is also provided that "Participants will pay due regard to the desirability of pursuing, over time, a balanced relationship between their holdings of Special Drawing Rights and other reserves." A rigid application of such a relationship is not called for; this provision is intended, rather, to draw attention to the idea of a balanced use of all three assets over time and, thus, maintain stability, in a general way, over time in relative holdings of the new asset and existing reserve assets.

In implementing the basic principles of use, the Fund will act as a kind of traffic director, making known to eligible users which countries

are the eligible receivers of transfers and assuring that the flow to receivers is distributed in an equitable manner. It may provide that using and receiving countries may deal directly with each other in arranging transfers, but the Fund must be informed of the transaction so that the proper entries may be made on its books, and it may act as an intermediary to bring eligible users and receivers together. The Fund will also have the obligation to direct the flow of SDR to countries that have become eligible receivers because they have incurred a reconstitution obligation and to promote voluntary reconstitution transactions between countries having an obligation to reconstitute and countries whose holdings are in excess of their cumulative allocations of SDR.

There is an area to which the Fund role as traffic director does not extend. This is the provision in section V(3)(d) of the Outline, which allows an eligible user to select the country to which it wishes to transfer its SDR for the purpose of purchasing balances of its own currency held by the other country, provided the latter agrees to accept SDR. This provision is of particular interest to the United States, although it applies generally to any participant. It will remove a disability that would otherwise impair the effective use of SDR by a reserve center. It gives the U. S. the option to acquire dollars held by a given foreign country by using SDR, but only if the dollar-holding country agrees. Normally, we use our reserve assets to buy balances of our own currency, and this provision would allow us to use the new asset in much the same way as we do existing assets, provided both parties agree to the transaction. Of course, it does not modify, in any way, our firm commitment to buy and sell gold at $35 an ounce.

In closing, I would like to emphasize that the Outline is a constitutional document that must be implemented by specific legal provisions. This applies particularly to the provisions on holding and use, liquidation and withdrawal. With this caveat, I welcome any questions you may have on the details of the operation of this new supplement to existing international reserves.

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Statement of the Honorable Robert A. Wallace
Assistant Secretary of the Treasury
Before the
House Committee on Banking and Currency
Thursday, September 14, 1967

The Treasury Department strongly urges that prompt, favorable action be taken on H.R. 10908 which would extend for two more years the flexible authority under which the appropriate financial agencies can regulate maximum rates of interest or dividends payable on savings accounts. H.R. 10908 would also extend the authority of the Federal Reserve to: (a) vary reserve requirements on time and savings deposits between 3 and 10 percent, and (b) conduct open market operations in securities issued or guaranteed by any agency of the United States. Both are valuable potential tools to promote financial stability and the efficient functioning of our financial markets.

This same legislation was originally enacted last September 21 for a period of one year. There is no need to review in any detail the circumstances which made this legislation essential a year ago. Within an environment of heavy demands for credit, and limited supplies, a very aggressive competition for funds among financial institutions contributed last year to an upward

escalation of interest rates and a diversion of funds from thrift institutions. The flow of savings into mortgage markets was disrupted and the housing industry suffered a severe dislocation. Not all of these difficulties were due to uninhibited interest rate competition, but it was an important factor in the total picture.

During the past year, the regulatory authorities have made prudent use of the flexible ceilings on interest rates payable on savings accounts. Some of the highest rates that were being paid in the spring and summer of 1966, and that were threatening to become even more general and further escalated, were brought down to more moderate levels. At the same time, the regulatory authorities avoided pressing the ceiling rates down abruptly to levels which, if they had been too low in relation to prevailing market rates of interest, might have choked off the reflow of savings to the thrift institutions.

With the help of these ceilings, and of other policies during the past year that have been designed to alleviate strains and upward rate pressures in the financial markets, savings flows to thrift institutions and commercial banks rose to record levels in the first seven months of 1967. The increase in savings at savings and loan associations, mutual savings banks, and commercial

banks was $25.8 billion in the January-July period of 1967, compared with $12.8 billion in the same months of 1966, and amounts ranging from $15.7 billion to $18.2 billion in the comparable periods of 1963 to 1965.

The heavy savings inflow in 1967 has occurred without an upward move in the rates payable on savings, although money market rates of interest have risen in recent months after declining from late 1966 through the early months of the year. Because home mortgage financing has been more readily available from savings institutions and other investors, housing is making a strong recovery. Total private housing starts in July reached a seasonally adjusted annual rate of 1.36 million units, 61% above the low of last October.

But, we must not be lulled into a sense of false security. Some of this year's large savings inflow at financial institutions is the reflection of outflows or absences of normal inflows last year. Already there are some signs of a slackening in the rate of gain, and indeed it would have been unrealistic to anticipate continued inflows at the rate experienced earlier this year. Against the background of market interest rates that have risen significantly in recent months -- despite an expansionary monetary policy -- it would be foolish indeed to ignore the possibility of a return bout of interest rate competition of the type

experienced last year among financial institutions. Such a competition could have severely detrimental consequences again for savings flows, mortgage money, and homebuilding activity. Since the legislation under consideration has amply demonstrated its effectiveness, the only prudent course is to extend it -- and promptly, since it would otherwise expire in a few days.

The need for prompt action on a simple extension of legislation which has already demonstrated its value is the reason why the Treasury Department strongly favors H.R. 10908, which has already been passed by the Senate. The alternative bill, H.R. 12754, also includes provision for a regular audit of the Federal Reserve System by the Comptroller General. The merits of such a provision are debatable, but whatever merit there might be, the audit proposal is not related to the purpose of the existing authority which expires in just a few days. Since consideration of the audit proposal could not help delaying prompt action on the vitally needed extension of existing authority, the Treasury Department opposes the alternate bill H.R. 12754.

As your Committee is well aware, the legislative authority for ceiling interest rates is far from a panacea. There is even a question whether interest rate ceilings are a desirable permanent or long-term feature of our financial landscape.

But, in the present setting, with some key interest rates already above last year's peaks and all interest rates higher than we like to see them, the temporary extension of the authority to prescribe ceiling interest rates for savings is a necessary step.

There is still the danger that rising market rates of interest could begin to pull funds away from savings institutions and imperil the continued recovery in housing. The present legislation cannot remove that risk, although prudent use of the administered rate ceilings on savings accounts can help to keep rate competition among the financial institutions from further aggravating a stringent credit situation.

The best insurance against a repetition of last year's very tight money markets and imbalance in the distribution of credit would be the swift adoption of the President's tax proposals, and accompanying expenditure restraints. Without such tax action, there is a grave danger that the combination of government and private credit demands would so far exceed supplies that market interest rates would shoot well above their present high levels, with major disruptive effects on the financial markets and on segments of the economy that depend on those markets. Under such conditions, it would be better to have the authority in H.R. 10908

than not to have it, but there would be a question then as to how much good could be done by administered ceilings on interest rates payable by financial institutions.

The greatest value of H.R. 10908 is in the circumstances that would be expected to prevail given the President's tax increase and expenditure restraint proposals -- an environment of healthy rising economic activity and strong but not excessive, or overwhelming, credit demands. Under those circumstances, the extension of authority provided in H.R. 10908 will provide the financial regulatory authorities with needed tools that have demonstrated their value and effectiveness in the past year. Therefore, your prompt and favorable action on this simple two-year extension is earnestly requested.

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STATEMENT BY THE HONORABLE JOSEPH W. BARR
UNDER SECRETARY OF THE TREASURY
BEFORE THE SENATE FINANCE COMMITTEE
ON S. 2100
THURSDAY, SEPTEMBER 14, 1967

Dear Mr. Chairman:

I am pleased to have this opportunity to testify on the bill S. 2100, which provides certain encouragements to the construction or rehabilitation of low-income housing.

We recognize that this hearing will serve to call attention to various approaches to the goal of increasing the supply of adequate housing in poverty areas. Both the goal and the desire to explore all approaches are most laudable. As is always the case with Government policies, we must be ready to evaluate alternative means of achieving our objective and consider that objective in the light of other calls upon our resources. The bill introduces new ideas in the approach to the problem of low-income housing, such as the increased reliance on equity investment, which justify a careful study.

I shall address myself to the tax and loan provisions of S. 2100. Briefly, the bill allows generous investment credits, generous depreciation provisions, generous capital gain treatment after ten years, a partial relief from local property taxes, and a generous low interest loan.

All of these tax and loan benefits are conditioned on the housing project meeting certain standards as to acceptability as low-income or moderate-income housing. These standards are administered by the Secretary of HUD. I shall not add anything to the evaluation of these provisions as respects a desirable housing policy since Secretary Weaver has already commented on this. I shall have a few remarks to make later on about the problem of linking tax treatment to findings as to compliance with conditions established by Government Departments other than Treasury.

I shall not undertake to repeat the details of the bill's tax provisions, but I shall draw your attention to certain broad aspects of the way these tax provisions are set forth in the bill.

(1) The investment credit and the depreciation provision are structured to provide more tax benefits the larger the proportion of equity that is put into the project, though as I shall point out later the structure of the bill as a whole does not always provide a better rate of return for higher equity.

(2) The investment credit and the depreciation provisions are structured to yield tax benefits even if the housing project itself is unprofitable. Actually, the depreciation is so generous that the normal expectation would be for the housing project to show a loss for tax purposes; and the only way the taxpayer could realize the offered tax benefits would be to use them against taxable income from other sources. This would be easy if the housing investor is a large company with diversified interests, especially non-real estate interests because even ordinary real estate investments tend to show losses for tax purposes. To facilitate this use of excess deductions on the housing project, the bill also amends Subchapter S, the provisions that allow certain corporations to elect to be taxed in a way generally similar to the taxation of partnerships. This will permit the organization of an eligible housing project by a group of individuals with the intent of using the excess deductions against their ordinary income from other sources.

(3) Finally, the various tax benefits are designed to encourage a ten year holding period by the original investors. The provisions dealing with sale are also structured to encourage sale to another organization that will have the purpose of offering low-income housing.

General Remarks on the Tax Incentive Approach

I want to comment first on this use of tax incentives to encourage non-revenue objectives involving a narrow group of taxpayers.

My first point is that there are no special tax disadvantages to real estate investment. There would be a case for considering changes in the tax law if it were contended that the tax law provides special tax disadvantages or tax barriers to housing investment. The advocates of this legislation have not claimed that present tax law is loaded against real estate investment or against low-income housing investment. Rather they state that the problem arises within the housing field, that given the level of building and rehabilitation costs, construction cannot be undertaken which yields a positive profit when rents are charged which are a reasonable proportion of the income of moderate and low-income individuals. The advocates of S. 2100 contend that this inconsistency between building costs and reasonable rent levels should be offset by very generous tax provisions.

This makes S. 2100 plainly an effort to achieve non-revenue objectives through the tax system. What can be said about this?

To answer this question, I would like to start off by saying that we ought to begin with the assumption that an investor chooses between alternative investments on the basis of net after-tax income in relation to investment. I shall address myself later to the question of whether there are differences from the investor's standpoint or the Government's standpoint between dollars that are "paid" as tax reductions and dollars that are "paid" in other ways. It is useful first, however, to recognize the basic similarity between a dollar benefit received from tax savings and a dollar benefit from direct Government outlays. Each is a buck.

A tax saving can always be reproduced by some form of Government payment program. A tax credit of 10 percent of an investment provides the same result as giving an investor 10 percent of the cost of his investment. Allowing a taxpayer to speed up depreciation deductions by taking, say, 20 percent of the cost in the first year permits a corporate taxpayer to reduce its tax payment by 48 percent of this deduction in the first year, and it increases the tax payments at some future time when the deduction would otherwise have been taken. This benefit can be reproduced by offering the taxpayer an interest free loan equal to the amount of tax saving from the rapid depreciation to be repaid in the future when he would have otherwise taken the depreciation.

I cannot stress this point too strongly. There is no magic which permits Government to give away tax dollars and have a lesser budget impact than if it had given away expenditure dollars, nor does a dollar of net budget cost have a different impact on the investor's after-tax rate of return if it is incurred as tax reduction or as direct outlay.

While there is this broad comparability between tax incentive programs and loan or expenditure programs, there are some significant differences which must be kept in mind. To be very clear, let me specify that I am comparing a tax and an expenditure program which produces the same net benefits for the investor and has the same net cost to the Government. For illustration, one may want to think of a tax incentive which provides an annual tax credit for low-income housing investment exactly equal to the benefit that the investor would gain from an annual direct payment, which we might call a rent supplement. This hypothetical tax credit could be made available under exactly the same terms that rent supplements are made available under present law. The question comes down to: "What are the advantages or disadvantages of building this rent supplement program into the tax law?"

One difference is that the tax route does not provide assistance to the individual or corporation which has limited income from other sources and which therefore cannot make full use of the tax incentives. A

system of direct payments on the other hand could provide benefits even where the particular housing investment was the only activity of the investor being benefited. One would think that this was a general disadvantage of providing incentives through the tax system. The supporters of S. 2100, however, apparently believe that it is the large businesses which ought to be attracted into the low-income housing field and that they take it as no disadvantage to their tax approach that the benefits are only helpful to taxpayers with incomes from other sources. This I might add is not a particular advantage of the tax approach since this sort of condition could be built into the rent supplement program if we agree that the condition is a desirable one.

Another difference between the tax and expenditure routes is that the tax benefits, where they are related to increased deductions, vary in amount according to the effective tax rate of the taxpayer. The tax benefit of rapid depreciation can be as high as 70 percent for the individual taxpayer in the top bracket or as low as 14 percent for a low-income investor. S. 2100 does provide some tax benefits that work through extra deductions, so that it will thus afford different relief for different taxpayers.

This I should point out works in directly the opposite direction to the normal incentive generated by a free pricing system. In a free pricing system the usual response to shortages is an increase in price and, consequently, an increasing income to people who can provide the service in short supply. This increasing income would be subject to the usual tax rules, and a person in the 70 percent bracket would find that he could keep 30 percent of income earned by providing the services just as he could

keep 30 percent of any other income he had earned. The investor in the 30 percent bracket would find that he could keep 70 percent in both cases. When we structure the incentive, however, as an additional tax deduction rather than as a price increase, the incentive is far more attractive to the high-income taxpayer than it is to the low-income taxpayer.

It becomes a matter of careful calculation for each investor, and his tax adviser, to determine how much this extra depreciation is worth in the particular case and whether or not this justifies accepting a lower before-tax return. It may be useful to point to the analogous situation of tax-exempt bonds. One cannot answer the general question: "Are municipals a better investment than U. S. Governments?" without examining, and making assumptions, about the future total income prospects of the investor. The value of the tax exemption depends upon future tax rates. It is well known that tax-exempt bonds are attractive investments to high-income taxpayers but not to low-income taxpayers. It is also suggested in the literature on the tax exemption that this constitutes a rather inefficient incentive because the net incentive effect must work through the marginal investor who will get less advantage from the exemption than higher bracket investors, and some of the benefit afforded the high-bracket investor is wasted.

Another difference between the tax solution and the expenditure solution is that reliance on tax incentives for non-revenue objectives

divides the Government consideration of social problems. Let me go back to my hypothetical example of a tax credit system which provided exactly the same benefits as a rent supplement program. By throwing these benefits into the tax system we have not changed the basic fact that this is still a major housing problem, but we have gotten the Treasury Department and the Finance Committee and the Ways and Means Committee into the act at the cost of reducing the ability of the Department of HUD and the Congressional Committees that normally deal with housing problems to act on the total housing picture. I don't want to suggest that the two Tax Committees are necessarily inadequate to decide on housing policy -- or on all other social problems -- but I can speak from a personal standpoint that I see no reason why the Treasury Department has any particular competence in making judgments as to what constitutes good housing policy; and converting the rent supplement arrangement into tax credits would simply push the Treasury into this position.

A further aspect of converting an expenditure program into a set of tax benefits is that it tends to get isolated from the budget review process. An expenditure program is examined regularly in the preparation of the President's budget and in the appropriation process. A tax provision rarely gets reviewed. I might suggest that the whole problem of tax reform to a large extent comes down to incentives and preferences that have been adopted at various times and never systematically reviewed

to determine whether the Government is getting what it pays for. This does not mean that under a direct program we cannot provide a particular investor reasonable assurance that benefits agreed upon will in fact be forthcoming. It does mean that under a direct program we can make changes in the program when these become desirable, whereas experience has shown time after time that it is extremely hard to make changes where tax benefits are involved.

A final difficulty of structuring these benefits into the tax law is the precedent problem. There are an enormous number of other tax incentive proposals. The list is so long that I could not include them all, but let me give you the flavor of it. There are bills to provide --

A tax credit for tuition and expenses of higher education.

A tax credit to encourage contributions to higher education.

A tax credit to encourage worker training.

A tax credit to encourage industrial pollution control.

A tax credit to encourage airport development.

A tax credit for underground transmission lines.

A tax credit for exports.

A tax credit for freight cars.

A tax credit to encourage gold mining.

A tax credit to encourage hiring older workers,

and so on and so on.

I cannot help but observe that if we go along this tax incentive route the Treasury Department would soon be making the crucial decisions in almost all matters of domestic economic policy. This would, of course, require a larger staff; and it has enormous possibilities for empire building. We would, however, prefer to decline this honor.

The proponents of S. 2100 imply that there might be some net advantages of the tax approach over the expenditure approach. I shall address myself to two of these. One argument advanced is that the Congress might vote for a tax program where it would not vote for an expenditure program which provided precisely the same benefits at precisely the same cost -- or even a lower cost. I question the validity of this argument. In a democracy we must face up to some decisions, and we must be willing to abide by the decisions that our procedures reach. The Congress may or may not be willing to approve a program of budget losses and housing benefits. If that program is rejected on its own merits, it would seem that restating it as a tax reduction is akin to seeking a backdoor expenditure where it is harder for people to see just what are the costs and benefits involved in the expenditure.

Another argument which seems to be implied in support of S. 2100 is that the business response to a tax incentive would be better because there is a feeling that there is something wrong about accepting a direct payment from the Government but something honorable about earning one's tax bill through tax benefits. Basically, this viewpoint attributes a good deal of irrationality to business firms. It says in effect that they would not make a careful comparison of net returns but would arbitrarily reject some worthwhile profit prospects because the incentives were cast in the form of a direct subsidy rather than a tax subsidy. The experience with the SST program -- and other subsidy programs -- suggests that business firms do make careful calculations on their profit prospects taking direct subsidies into account. In fact, since the benefits

of tax incentives vary depending on the estimated tax position of the investor, the calculation of the expected returns in a specific case can become more complicated when special tax benefits are involved. It seems disingenuous to assume that investors will do a lot of things in order to gain somewhat uncertain benefits in the form of tax reduction that they would not do to win benefits of exactly calculable amounts through some other system.

The Particular Incentives of the Bill S. 2100

Secretary Weaver has discussed some cost comparison of S. 2100 and other methods of providing incentives to low-income housing. The evaluation of the particular incentives under S. 2100 in terms of returns to the investor requires analysis of the benefits under a variety of assumed patterns of investing in real estate and a variety of tax situations of the investor. The complexities here are so involved that we hesitate to offer any general conclusions. Some comments are appropriate, however.

The bill provides increasing tax benefits for investors with a higher portion of the cost of the project covered by equity investment. The bill defines equity investment as the difference between the total cost of the project and the face amount of any mortgage insured under Section 235 of the National Housing Act. This treats as a 100 percent equity case a project financed largely by a conventional mortgage. This would produce the result, for example, that if the project is financed

with a 78 percent commercial mortgage then the investment credit in the first year would be equal to the entire real equity investment in the project. After the first year the investor could have gotten the full amount of his own investment back from the investment credit alone and in addition would have substantial benefits from the accelerated depreciation which is offered and from the net return provided in the bill. The value of the depreciation deductions alone, in the first five years of operation for a taxpayer in the 70 percent bracket, would be equivalent to an additional return equal to more than his initial investment. Over a twenty year holding period the bill seems to provide tax benefits in gross amount equal to about the full cost of the project, even after making allowance for the payment on the mortgage if we assume that the mortgage is a twenty year - 6 percent loan. After the twenty years an investor who had put up a $1 million project and was in a sufficiently high tax bracket would seem to have made tax savings of $1 million; and he would be the outright owner of a housing project which on the basis of experience with real estate values would still be worth not much less than $1 million, and under the bill he would be entitled to start taking depreciation on a restored basis of $780,000.

In different circumstances, where there is no conventional mortgage, it appears that despite the intentions of the authors of the bill the rate of return under S. 2100 will not be better for a high equity investment than it will be for a low equity investment. This is likely

to be the case if the taxpayer is in a lower bracket. In one sense this is a problem that could possibly be modified by restructuring the bill. The apparent objective of making high equity investment relatively more attractive could be accomplished by either charging a higher rate on the guaranteed loan or by providing sharper graduation of the investment credit. The heavy reliance in the structure of benefits on rapid depreciation would seem to make the results of the bill necessarily erratic between taxpayers at high or low marginal tax rates.

One point to be drawn from this goes back to the point I made earlier that the use of tax incentive devices makes it extremely difficult to calculate how much we are paying for an increase in some desired investment.

Another problem in this portion of the bill has to do with whether or not we really want a very high equity investment. In a basic sense the cost to Government of any system of incentives for low-income housing will have to be the difference between what we expect the tenants to pay in rent and the total return necessary to make the investment attractive to an investor. Lenders expect a lower return than equity holders. If 90 percent of the initial investment can be accomplished through borrowing with a return of about 6 percent on that 90 percent, the cost of the total program to the Government will be less than it would be if 50 percent or 90 percent of the investment represented equity funds and which would

require Government contributions large enough to provide a prospective 12 percent to 15 percent after-tax rate of return on those equity funds. To accomplish our goals in the low-income housing field as economically as possible, it would appear that we should rely heavily on the use of borrowed funds. The leverage provided by borrowed funds can guarantee a sufficiently high return on a net equity investment so as to attract equity investors. Some advice that we have gathered from people in the real estate business suggests that increasing available mortgage money for low-income housing would be fully as effective, and cheaper, than attracting more equity money. On this point the Committee will want to get views from people with knowledge of the real estate business.

Since this Committee is particularly concerned with the Government's administrative budget, it should be pointed out that any program which can be operated through the private banking system with a loan guarantee will involve lower administrative budget deficits than a program which requires Government to provide the loans directly. The device of 2 percent interest in S. 2100 will require direct Government financing and mean substantially high short-term budget costs for any net incentive provided.

We have some technical problems with the draft of S. 2100 which I shall not go into, but I shall submit a statement for the record on these points.

The Tax Law and Real Estate Investment Generally

It is appropriate to add some remarks on the general situation of investment in real estate including housing under the present tax law.

Real estate investments qualify for the accelerated depreciation methods provided under the 1954 Code revision. There is no record of critical consideration at that time of the appropriateness of applying these methods to buildings, and indeed it appears that these methods were adopted entirely with investment in machinery and equipment in mind.

Due in part to the inappropriateness of the allowable [illegible]ation, a pattern has developed in building investment wherein the original investors often hold the property for much less than the useful life during which time the depreciation deduction is very high in relation to the cash flow, resulting in little or no current tax. When the depreciation base is largely exhausted, the property is sold; and a substantial capital gain is realized. The Treasury made recommendations in both [illegible] and 1963 for cutting back on this pattern of realizing normal investment returns at capital gain rates. A slight cutback was enacted by the Congress in 1964.

Another part of the picture of the tax treatment of real estate investment is that the 7 percent investment credit does not apply to buildings. In substance we have the result that real estate investment gets tax encouragements in forms different from those offered investors in machinery and equipment. The Treasury Department is engaged in research to evaluate the impact of present tax provisions and possible alternatives on real estate investment, and several outside consultants are involved in the research.

In conclusion let me repeat my initial comment that S. 2100 raises important issues. I have tried to draw attention to several major aspects, including the technique of casting benefits in the form of specialized tax reductions and the emphasis on high equity investment. Both of these aspects have disadvantages of which the Committee should be aware. I believe that these hearings, providing as they do, an opportunity carefully to consider and weigh as objectively as possible the varying approaches to an objective which we all share will prove to be a very helpful step forward in this area.

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TREASURY DEPARTMENT
Washington

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SATURDAY, SEPTEMBER 16, 1967

REMARKS OF THE HONORABLE FREDERICK L. DEMING
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
AT THE
GOLDEN ANNIVERSARY BANQUET OF THE LUTHERAN BROTHERHOOD
IN CHICAGO, ILLINOIS
ON FRIDAY, SEPTEMBER 15,1967, AT 7:00 P.M. DST

THE QUEST FOR LIQUIDITY

It is a pleasure to be with you tonight. I propose to discuss with you some matters that may seem at first glance a little removed from everyday business life, but which on further reflection are highly germane and current. They are as real and close as the businessman's ability to get a bank loan on reasonable terms, the home buyer's ability to obtain a mortgage, and the ability of the traveler abroad to feel confidence that the dollars he spends in other countries will be welcomed and highly regarded as a sound asset.

Since I divide my time as best I can between domestic and international financial matters, it is natural, in developing a theme for these remarks, to seek some unifying thread with which the different pieces can be sewn together. Looking back over the past year, I think that thread or theme could well be "The Quest for Liquidity."

The symmetry isn't perfect. The domestic quest for liquidity has been particularly evident on the part of private participants in the financial markets. In the international sphere, it is more a matter of governments seeking to construct new and additional types of liquidity. But the two quests have some common points. Both have been conducted with determination and both have made progress. And the two are related to one another. The striving for liquidity in our own domestic financial markets, and in those of other countries, is one of the factors that has drawn the world's financial markets closer together. And, in turn, these closer relationships -- developing possibilities for quick and large movements of funds across international borders -- are a part of the reason for additional international liquidity.

I

DOMESTIC DEVELOPMENTS

Let me turn first to the domestic side. Here, it seems to me, the present quest for liquidity is to a very considerable extent an outgrowth of the tightened credit market conditions that developed during 1966. Those conditions developed as unremitting demands for credit pressed upon supplies that expanded more and more grudgingly. Indeed, for a time in the latter part of 1966, supplies did not expand at all in respect to some major components.

Commercial bank credit, for example, increased by a seasonally adjusted $14.4 billion in the first half of 1966, but only $1 billion in the third quarter and $1.5 billion in the fourth. And looking within the quarters, there was actually a $2.7 billion decline in bank credit in September and October of last year. This was bound to cause some bruises in a financial system accustomed to fairly steady bank credit growth.

Another case in point is the savings and loan industry -- which had become accustomed to annual increases in the volume of shares of $7 billion to $11 billion in the years 1960 to 1965 -- but had to make do with just $3.6 billion in 1966. And to say "make do" is something of a euphemism for the circumstances in which some institutions found themselves, with heavy lending commitments piled up and share capital flowing out. In the April-July period of 1966, almost $700 million of savings flowed out, and it was necessary to borrow $1.8 billion, mainly from the Federal Home Loan Banks, in order to meet outstanding commitments to lend.

Sector by sector throughout the economy, liquidity was stretched taut as each participant sought to squeeze the last bit of fat from his cash supply and get by without having to borrow additional sums which, if they were available at all, came at the highest interest rates in several decades.

For corporations, a measure of the strain on liquidity was the drop in their ratio of cash and Government securities to current liabilities to a level, by late 1966, of only about 26%, down from 29% at the end of 1965, and 33% at the end of 1964. Corporate liquidity ratios have been drifting lower for some time, as businesses found new ways to economize on holdings of liquid assets; but in the period through mid-1966 it

was possible for corporations in the aggregate to add simultaneously to their loans from banks and to their holdings of bank deposits. By late 1966, the banks were not able to meet loan demands, even after heavy liquidations of Government securities holdings, while the corporations did not have the liquidity to invest in bank C/D's. So the net was drawn tighter and tighter.

The Treasury, too, felt the effects of strained liquidity, although partly for reasons other than limited credit availability. Our additional problem was a very tight debt limit, which caused us, last December, to run down our cash balance close to the vanishing point. We usually figure, in our debt and cash management projections, on an operating balance of about $4 billion. With average monthly expenditures in the cash budget running at about $13 billion, that is not really a very high cash balance. But in the middle of last December the operating balance was down to a minimal $800 million, which was just as low as it could be under existing tax and loan account arrangements.

The accompaniment to strained liquidity in 1966 was a sharp rise in interest rates, and a particularly steep rate rise in the shorter maturities that represent more liquid investments. At least, those are the maturities that one typically looks to for liquidity, although at times last summer it appeared that instruments ordinarily endowed with considerable liquidity came close to finding no market.

Beginning a little less than a year ago, a combination of events produced a dramatic turn-around in the credit markets -- reversing some of the forces that had led to earlier strains, but not erasing the memories of market participants by any means. The main factors leading to change included the temporary suspension of the investment tax credit, reduction and rearrangement of Federal Government demands on the credit markets (including the temporary suspension of participating sales), holdbacks in some Government spending programs, action to restrain the fierce competition for consumer savings, and a Federal Reserve move toward easier reserve availability. By early 1967, a flattening trend in the pace of business activity contributed further to the relaxation of credit market pressures, particularly as it was accompanied by further Federal Reserve action toward ease. This was accomplished with a combination of open market operations and reductions in reserve requirements and the discount rate.

Interest rates fell quickly under the combined influence of these forces. Further impetus was provided in January when the President's fiscal program called for a tax surcharge to begin around mid-year. By February, interest rates on long-term Treasury bonds had declined 1/2 of 1% from their high point in August 1966. Long-term corporate issues were down more than a full percentage point. Long-term tax-exempt issues dropped almost 7/8 of 1%. Mortgage rates, traditionally sticky at turning points, had continued to edge up through November 1966, but moved lower in December 1966, and continued to trend downward through April 1967.

Short-term rates also came down sharply and continued falling until this past June. Treasury bills and other short-term Government and Federal agency issues were down by two full percentage points from the earlier high points.

This heady atmosphere did not last, however, and in seeking reasons for the upturn in interest rates that has affected various sectors of the market in the past few months, I believe that the striving for liquidity must stand as a major factor. First, let us consider some factors that do not explain the rate upturn since early this year.

It was not, for example, a result of any renewed clamp-down on bank credit or money supply growth. Bank credit, after expanding hardly at all in the latter half of 1966, grew at a seasonally adjusted annual rate of some 13% in the first eight months of 1967. Money supply declined slightly from June to December 1966, but expanded at a 7.7% annual rate in the first eight months of this year.

Nor can the behavior of the financial markets in recent months be explained in terms of heavy credit demands by the Federal sector. Far from it, the fact is that the Treasury was actually repaying debt to the private sector rather than making net demands upon it. In the fiscal year ended last June 30, total Treasury debt issues outstanding increased $6.4 billion, but the Government investment accounts increased their holdings of Treasury debt by $9 billion and the Federal Reserve's holdings were up by $4.5 billion, so that the private market's holdings were down by more than $7 billion.

Even after adding in the net effect of Federal agency securities and participation certificates, there was still a net decline of more than $6 billion in the private sector's holdings of Federal credit instruments. In other words, instead of making a net credit demand on the markets, the

Federal sector made net repayments of earlier borrowings and, in effect, made more room for private credit demands to be met.

The net market effect of this paydown was not as great as the figures might indicate. These should be set off against the $6 billion paydown to the public in the $5 billion decline in Treasury balances with commercial banks. But even after making rough adjustment for this, one comes up with no net Federal credit demand on the private sector in the fiscal year that ended last June.

That, however, was "the fiscal year that was." When we look at the fiscal year that is to be, there is a different story. But before getting to that, let me go back to the experience of the last several months for further clues as to the performance of the credit markets.

If Government credit demands were negligible, or even negative, and bank credit supplies were expanding rapidly, where did the market pressure arise? Heavy corporate borrowing is part of the answer. New capital issues by corporations in the first seven months of 1967 were a record $16.1 billion, up 27% from the same period of 1966 -- which, itself, had been a record-breaking year. Market pressure was especially great in terms of public offering of corporate bonds by nonfinancial corporations. A total of $9.1 billion was offered in the first seven months of this year, as compared with the previous record of $8 billion offered during the whole of 1966.

The heavy pace of corporate borrowing is not easily explained in terms of corporate new money needs. Plant and equipment outlays have held about level in the past half-year, albeit at a high level, while the rate of inventory accumulation has dropped steeply. At the same time, however, there has apparently been a strong desire on the part of corporations to repair liquidity that was strained in last year's tight money market. In the summer of 1966, even the largest and most credit-worthy business borrowers found their access to bank loans limited, and this experience is still having its repercussions. It is inducing corporations to push ahead with bond issues to meet long-term capital needs, and perhaps repay some bank loans and open up leeway in credit lines with banks.

Another sector that has borrowed heavily so far this year is state and local governments. New tax-exempt issues by these units were $9.7 billion in the first seven months of 1967, up from $7.6 billion in the same period of 1966. This is partly a reflection of gradually increasing long-term needs. But another factor was the added borrowing to make up for delays imposed by last year's unreceptive money markets. This, too, is, in a sense, a refurbishing of liquidity.

One element adding to the volume of state and local government offerings in recent months is the sale of industrial revenue bonds -- bond issues sold on the strength of guaranteed rentals from particular business firms. Often, these are the bonds, technically, of small communities whose general obligations would not readily be sold in large volume, but which are accepted by the market on the strength of a national reputation of the industrial firm planning to use the facility. While such arrangements may have played a useful role at times in aiding economic development in particular areas where this was needed, it has become more recently simply a device to borrow more cheaply at the expense of the general taxpayer. It is a practice that needs to be curbed.

Rounding out the picture of credit market demands, mortgage credit growth appears to have been moderate during the first half of this year, against past standards. The growth might have been greater but for the fact that this sector, too, was affected by the striving for liquidity that I have mentioned. The notable example here is that of savings and loan associations. After their harrowing experience of last year, it was understandable that they would want to rebuild eroded liquidity as a first order of business. Accordingly, in the first half of this year, with an inflow of funds from savers much improved over last year, and a relatively low level of outstanding commitments for making new mortgage loans, the associations repaid an astonishing $2.6 billion of advances to the Federal Home Loan Banks. This made it possible for the Home Loan Banks both to pay off $2.2 billion of maturing securities without replacement and to build up a sizable liquid reserve, largely invested in Treasury securities. This performance helps explain the absence of a net credit demand on the private sector by the Treasury and Government agencies taken together.

No explanation of the market's behavior in the past several months is complete without mention of the important role of anticipations. For markets live on anticipations -- and this factor, as much as any other, accounts for the enormous appeal of restoring liquidity. In large measure,

anticipations about the future credit climate turn on the question of the Federal Government's budget position -- and that, in turn, depends on current tax and spending decisions that are now being aired and weighed.

From the standpoint of the credit markets, it is clear that the current fiscal year will not see a repeat of the last one, in which Federal credit demands on the private market were negligible -- and, in fact, not even demands at all but net supplies of credit. This year, in contrast, the question is rather how great the demands will be -- whether they will be the manageable demands that would result from responsible tax action and successful efforts to hold down and cut back expenditures wherever feasible, or the outsize credit demands that could emerge otherwise.

In late July, when we announced the terms for the August Treasury refunding, and a few days before the President's Tax Message to the Congress, we indicated that the Treasury's new cash borrowing from the market in the July-December period would be about $15 billion, together with about $2 billion of participation certificates. Of that, somewhat over $8 billion has already been done or announced.

How well those estimates stand up will depend on how speedily the Congress acts on the current tax proposals, and on how close Government expenditures may run to the lower end of the range outlined by the President. With no tax action this calendar year, and expenditures in the upper end of the range, Treasury cash borrowing plus participation sales could conceivably reach as high as $19 billion in the current half-year period.

Looking at this whole fiscal year, Treasury debt outstanding will have to rise about as much as the administrative budget is in deficit, since we cannot run down our cash balance as was done last year. If that deficit was, say, $14 billion, and that would assume prompt and full enactment of the President's tax proposals and successful efforts to hold down spending, then the Treasury's debt would have to be up by about that same amount. After allowing for purchases by the Government investment accounts and the Federal Reserve, and also allowing for net market sales of Federal agency issues and participation certificates, the net Federal sector demand on the private credit markets could be on the order of $10 or $12 billion.

A net demand on that general order would be large, but I believe it would be manageable in the context of rising total credit supplies and moderated demands from some other sectors that have made large net claims on the market recently. Hopefully, the Congress will respond favorably to the proposed surcharge and other tax proposals, and expenditures will be contained so as to keep the Federal demands on the private markets down to that $10 or $12 billion range.

Without a surcharge, our credit demands will be larger -- moderately larger in the current six-month period and substantially larger by the time we get into 1968. For the whole fiscal year, the demands on the private credit markets, with no tax surcharge and less success in holding back expenditures, could range to $20 billion or even higher. Again, this is after allowance for purchases by the Government investment accounts and the Federal Reserve.

The difference between our net credit demands, with and without tax action, arises from several factors. Most immediate is the need for the Treasury to borrow more if taxes do not bring in additional revenues. In addition, under the tighter credit conditions that would emerge, demands on Federal credit agencies, such as the Federal Home Loan Banks, Federal National Mortgage Association and Farm Credit Administration, would no doubt be greater than otherwise -- just as occurred in the tightened credit markets of 1966. Further, with the markets under greater pressure, we would have to expect higher levels of interest rates on all our borrowings -- for new cash and refundings alike.

Pressing a demand as large as $20 billion onto the private credit markets, I believe, would be far too much. It could not be accommodated without shouldering aside other would-be borrowers through a process that propelled interest rates sharply higher. The market conditions of a year ago -- when thrift institutions lost funds heavily to market instruments on which rates could fluctuate freely -- are not about to be repeated;

but neither is the possibility of repetion so remote that we can disregard it. And the excessive credit demands that could arise without a tax surcharge are just the factor that could bring that possibility about.

In theory, one could imagine a big enough supply of credit, including bank credit growth, so that any prospective demand from the Federal sector could be met. But that is not a realistic exercise. A large rise in bank credit will be needed even with Federal credit demands moderated by responsible fiscal action. To expect credit supplies to rise sufficiently further to accommodate an oversized Federal cash deficit would merely invite inflation, building up excess spending power, and destroying confidence in the stability of the dollar.

Against this background, the current concern about liquidity in the domestic credit markets should come as no surprise. Liquidity has been strained, is in process of being restored, but stands in danger of coming under greatly renewed strain unless responsible fiscal and monetary policies are pursued. The challenge is clear; and while decisions to raise taxes and contain spending are never easy, the alternatives in this case are thoroughly unacceptable.

II

INTERNATIONAL INTEREST RATE DEVELOPMENTS

There is some evidence that the industrial world may in recent years have moved, at least temporarily, to a higher plateau of long-term interest rates. Yields on long-term government bonds are higher today than they were four years ago in every major industrial country of the world. The increases range from roughly ½ of 1 percent to nearly 2 percent. Yields on prime industrial bonds are also higher in every major country with the single exception of Italy.

This higher level prevails despite the fact that pressures on recources and on prices are, in most foreign countries, far less today than they were four years ago. The year 1963 was a period of general inflationary pressure throughout Western Europe. Prices were rising and monetary authorities generally were following restrictive monetary policies in an effort to contain the inflationary pressure. Today, we have virtual stagnation in Germany, while growth rates in France and the Low Countries are well below capacity levels.

Against this background of slowed growth, monetary conditions in Europe have eased considerably. Monetary authorities in Germany and the Netherlands, particularly, are making a valiant effort to bring interest rates down in order to stimulate their domestic economies. Money market rates in Europe generally are below the peak levels reached last fall, but there has been a decided stickiness in long-term rates and even some increases, for example, in France and Switzerland. Rates, generally, have not come down as quickly and as far as might have been expected with the drastic reversal of monetary policy.

Institutional factors may play a part in this stickiness, but it may be that the major resistance to lower rates comes from the expectation factor. Europe has experienced a lengthy period of continuing inflation. This is the first widespread interruption in Europe's forward surge since 1958. Prices have been under pressure for most of this period. The authorities may have been depending too heavily on restrictive monetary policy and high interest rates in their efforts to combat this inflation. As interest rates in the United States

rose and external credit availabilities diminished, these policies became increasingly stringent. Consequently, even though the price pressures have receded in 1967 and the authorities have relaxed their monetary policies, investors seem reluctant to accept the new situation as lasting. They are not rushing to place their funds in long-term instruments before interest rates go down but, on the contrary, they appear to be holding off.

Despite the increase in U.S. interest rates, the gap between yields of long-term government bonds in the United States and yields in other major countries has increased moderately over the past four years. It is substantially wider in the Netherlands and the United Kingdom. There has been little change in the differential in Belgium, France, Germany, Sweden and Canada. Only in the case of Italy do we note a substantial narrowing.

There is growing recognition among the Finance Ministers and the central bank officials of the major countries that cooperative action must be taken to keep interest rates in check. Last winter, Secretary Fowler met with his colleagues from the United Kingdom, Germany, Italy and France at the country home of the British Prime Minister at Chequers, for a discussion of a cooperative approach to the problem. The Ministers agreed that they would all make it their objective within the limits of their respective responsibilities to formulate economic policy in such a way as to put less upward pressure on interest rates in their respective countries. We are most hopeful that cooperation in this area will continue and develop over the years to come and that the trend toward higher rates abroad can be arrested and reversed.

That depends in part upon our own policy mix. Without adequate use of tax and other fiscal policies to contain domestic demand, we could be forced to rely unduly on monetary restraint. Tightness of credit and high interest rates in our money market and banking system can be quickly translated into tightening money markets and rising interest rates abroad. During the 5½ months from the beginning of July last year, when shortages of liquidity here pushed CD market rates beyond the regulation Q ceilings, throught the middle of

December, American banks drew out of the Euro-dollar market in the form of borrowing from their branches abroad a total of, roughly, $3 billion. The effects of this on liquidity abroad, as reflected in prevailing interest rates in the Euro-dollar market and in the money markets of major European countries, was substantial -- despite a large offsetting movement of dollar funds out of the reserves of several European countries into money markets.

Following the reversal of monetary tightness here during the final months of last year, there was an equally prompt and quite substantial return flow of such Euro-dollar funds to foreign markets -- with aggregate liabilities of U.S. banks to their branches abroad declining, through early May this year, by, roughly, $1.4 billion below their December peak. More recently, however, there has been -- as you know -- a noticeable tightening of our markets again, beginning in the latter part of May. There has again been an equally noticeable inflow of Euro-dollar funds to U.S. banks, amounting, from early May through late August, to something over $1 billion. The Euro-dollar market, as you know, provides a significant link between the capital markets of the major industrial countries. That is another way of saying that it is playing an increasing role in the area of international liquidity. That is the area to which I now turn.

III

NEW INTERNATIONAL LIQUIDITY

The quest for <u>new</u> international liquidity perhaps has as many differences as similarities to the quest for domestic liquidity. Certainly, in the area of global international reserves there has been no "crunch" such as there was in domestic markets in Germany and the United States in 1966. Also, as I have noted, it has been national governments rather than businesses and individuals which have been engaged in seeking new international liquidity. But the fundamental underlying problem is quite similar -- if there is not enough international liquidity it tends to make those who seek liquidity uncomfortable -- although in this case it is governments and central banks rather than businesses and individuals. Protective measures taken tend to reduce world

trade and capital flows -- and, if there is a real international liquidity crunch, distortions and stresses appear in the world economy as well as in domestic economies.

The problem of international liquidity -- its adequacy and form -- has been under intensive study and negotiations for the past four years. Just three weeks ago, in London, the Ministers and Governors of the Group of Ten agreed on an Outline Plan "intended to meet the need, as and when it arises, for a supplement to existing reserve assets." And just last week the Executive Directors of the International Monetary Fund approved that same Outline Plan, and recommended it be put forth for approval by the Governors at the International Monetary Fund Annual Meeting at the end of this month. The Outline Plan was made public only on Monday of this week.

Now, let me briefly tell you about the problem and the solution devised to meet it. There are three components of international reserves -- gold, foreign exchange, and reserve claims on the IMF. The two major components are gold and foreign exchange -- the latter being primarily dollars and pounds held by official monetary authorities.

So far as gold is concerned, the amount available for monetary reserves is what is left after new gold production has met the demands for private industrial, artistic, and professional use. In addition, there is some hoarding of gold; and there is a speculative demand that fluctuates in intensity from time to time. The amount of new gold available for monetary purposes, which averaged $655 million a year in 1955-59 and $565 million in 1960-64, is likely to be much smaller in the future, unless there is a reflow of gold from speculative hoards. During 1965-66, the combined gold reserves of individual countries and international financial institutions rose only $170 million.

The other main component in the recent growth in reserves has been the accumulation of liquid dollar claims on the United States by other countries. This form of reserve creation has served the world well up to now. But the growing volume of dollar liabilities places an increasingly heavy potential strain on the gold reserves of the United States. Moreover, it provides reserves only to other countries, and does not provide any addition to the reserves of the United States. While it is recognized that the dollar will continue

to have an important or even a growing international role, as a private transactions currency, and through the voluntary holding of the dollar by foreign central banks, there is widespread belief that the dollar neither can nor should contribute as much to international liquidity in the future as it has in the past.

During the past 16 years, world imports have grown about three times as fast as global reserves. Imports rose from $59 billion in 1950 to $192 billion in 1966 -- an annual increase of 6.9 percent. Reserves increased at an annual average of $1.4 billion or 2.4 percent. But this figure marks the fact that U.S. reserves declined in this period. During these 16 years, the import trade of the world outside the United States increased at the very satisfactory rate of about 8 percent per annum, while reserves rose at the rate of about 5-1/2 percent per annum.

Even though the reserves of the rest of the world outside the United States have been growing at what appears to be a relatively high rate of 5½ percent per annum, the more rapid growth of imports has meant that reserveson the average now cover only about four months' imports for the rest of the world. In the last decade, total reserves of all members of the Fund have slipped from about 56 percent to 36 percent of world imports.

There was a substantial slowdown in the growth of reserves in 1965-66, largely because the United States provided much smaller amounts of dollars to add to the official reserves of the rest of the world and because additions to monetary gold stocks were small. In fact, about two-thirds of the additions to reserves outside the United States in 1965-66 came from other and non-traditional sources, largely related to the balance of payments of the United Kingdom. The United Kingdom made substantial drawings on the IMF which created for the time being reserve claims on the Fund for Continental European countries and some other nations, and the British also converted some $800 million of marketable securities into liquid reserve assets.

If the supply of new gold going into monetary stocks is no more than in 1965 and 1966 (or even the amount of earlier years), and the U.S. brings its balance of payments into equilibrium -- which is its firm intention as soon as the situation in Vietnam makes this feasible -- so that increases in official dollar liabilities are not forthcoming, then, obviously, a new source of reserves must be sought.

This is the essence of the problem that faced the international financial community and has engaged the attention of Treasury and central bank policy makers and technical experts for some time.

The Ministers and central bank Governors of the Group of Ten countries in October, 1963, asked their Deputies to "undertake a thorough examination of the outlook for the functioning of the international monetary system and of its future needs for liquidity." During 1963-64, the Deputies of the Group of Ten held a number of meetings and prepared a Report which was published along with a Ministerial Statement in August 1964. In this Statement, the Ministers and Governors agreed to establish a study group to "examine various proposals regarding the creation of reserve assets either through the International Monetary Fund or otherwise."

During 1964-65, this study group, under the Chairmanship of Rinaldo Ossola of Italy, undertook an interim technical analysis of ways and means of creating reserve assets, which was made public in August 1965. This study provided an inventory of several technical methods by which reserves could be created.

In July 1965, Secretary Fowler, in a speech at Hot Springs, Virginia, stated that the United States was ready to participate in negotiations of a political nature on reserve creation, thereby launching the initiative that culminated in the present agreement.

During the year 1965-66, the Deputies of the Group of Ten countries again met frequently, exploring national attitudes toward various proposals for reserve creation in order to ascertain whether or not there was a basis for agreement on major points. During this year, the Executive Directors and Staff of the International Monetary Fund also carried on constructive studies of the problem.

In July, 1966, the Ministers and Governors of the Group of Ten reviewed a second Report from their Deputies and concluded that there was a basis for specific negotiations on a contingency plan. The Deputies' Report narrowed down the many possible approaches to this problem and set out some of the main elements of a plan. The Ministers, also, in September, 1966, instructed their Deputies to undertake a further stage of negotiations, in which the views of the whole world would be represented, through a series of Joint Meetings between the Deputies of the Ten and the Executive Directors of the Fund, representing the 106 nations who are members of the International Monetary Fund.

Four such Joint Meetings of the Deputies and the Executive Directors were held in 1966-67. Finally, two meetings of the Ministers and Governors of the Group of Ten, on July 17-18 and August 26, produced agreement on an Outline Plan which, in early September, was agreed to by the Executive Directors of the Fund.

These negotiations thus have now brought all the diverse ideas and points of view into an agreed-upon Outline Plan.

The basic concept embodied in the Plan is quite simple. The Plan provides for a new international asset, a Special Drawing Right -- or SDR -- which will be an effective supplement to existing reserve assets -- gold, reserve currencies, and reserve claims on the Fund -- one that will be a permanent addition to world reserves. The problem of elaborating this simple concept was partly technical and partly political -- the new asset has to be endowed with qualities that would make it usable and acceptable. It not only had to be a high quality asset -- it had to be regarded as such.

Now, just what kind of asset will these countries have to supplement their other international reserves? What are the factors which give it high quality and acceptability?

Each SDR is to be denominated in terms of 0.888671 grains of fine gold. This is the gold value equivalent of one U. S. dollar. Thus, each SDR will be equal to the gold value equivalent of one dollar. Let me be clear that SDR will be gold value guaranteed, but they will not be redeemable in gold. Further, I also want it to be clear that it would be against the rules for a country to use its SDR merely to change the composition of its reserves. In other words, it would be inappropriate for any country observing the rules to use its SDR to obtain dollars and, in turn, use those dollars to buy gold from the United States.

Countries will earn net a modest rate of interest on holdings in excess of their cumulative allocations.

SDR will have an unimpeachable backing. It will consist of a firm, unequivocal, and solemn obligation to accept the new asset when it is presented and to pay a country's own currency, convertible in fact, to the country tendering the SDR. That obligation is the fundamental backing of the asset and is the principal factor which will give it value as an asset. The obligation is qualified as to amount, but the limits are

large enough so that there can be no doubt about the usability of SDR to obtain convertible currencies. Each participant will be obligated to accept SDR up to an amount equal to its cumulative allocations plus two times its cumulative allocations. This obligation makes unnecessary and takes the place of the pool of currency used to back present IMF drawing rights. This acceptance obligation is a central operating feature of the Plan.

I want to make one point very clear. I have called these acceptance obligations "obligations," and they are exactly that from two points of view. That is, (a) they are obligations to provide backing for the SDR, and (b) they are limited so that each country knows what its maximum constitutional obligation is. But I want to stress still a third viewpoint.

These new assets, as I have indicated, are high quality assets designed to supplement existing reserve assets. Countries that get SDR from other countries -- over and above their regular allocations -- normally will be surplus countries and, thus, countries gaining reserves. Some of their reserve gains will be in the form of the new asset -- which will be usable, as are its other reserves, when it needs to use them. Thus, accepting the new asset is no more of a burden than accepting gold or foreign exchange or reserve claims on the Fund. In this sense, the acceptance obligation is misnamed and, because of this fact, the acceptance limit of three times allocations is not a fixed limit. Countries, if they wish, can accept and hold more than their acceptance limits -- the limits merely state their obligations to accept.

Why, then, are any limits set for acceptance? There are none for holdings of gold and dollars. The answer is a simple one. In the initial periods, while the world gets used to these new assets, it was judged to be the conservative course to say that no country need take more than a proportion of the new assets. Their quality is good, but they are new and people proceed with more caution with a new asset. I suspect that, in time, the concept of acceptance limits will be dropped.

I have already made the point that SDR are usable to obtain convertible currencies, mainly dollars. This is essentially how countries use gold. They use gold to buy convertible currencies, mainly dollars. Because SDR are new and do not have a tradition of use as a monetary asset, as do gold and dollars, a few basic principles to guide their transfer have been provided. They are:

1. Countries will be expected to use SDR only for balance of payments needs or to protect their reserve position. A country's judgment as to its eligibility to use may not be challenged. This expectation simply expresses existing practice, under which present reserve assets are used almost exclusively for balance of payments needs or to protect reserve positions. It will help to assure an orderly flow of SDR and avoid instability resulting from shifts in the composition of reserves.

2. I have already mentioned that, normally, countries in strong balance of payments and reserve positions will be eligible to receive SDR. It is only natural that countries in this situation should receive SDR, since they would be the ones which would be gaining reserves because of their balance of payments positions. Transfers of SDR could also go to countries in a strong reserve position even though they have moderate balance of payments deficits. Among the countries eligible to receive SDR, the Fund will try to maintain equality, over time, in the ratios of their holdings of SDR to their total reserves or in the corresponding ratios to total reserves of their holdings in excess of their allocations. The purpose of this rule is to achieve a generally fair distribution of the SDR among the countries that meet the standards entitling them to receive SDR.

3. The third principle of use concerns what is known as reconstitution. I would expect that a very considerable amount of use of SDR will be reconstituted through the normal processes of balance of payments adjustment. Countries that are in deficit and that use the asset will switch to a surplus position and will become eligible to receive transfers of SDR. It is, of course, natural for countries that lose reserves when in deficit to try to regain them when in surplus. While all countries agreed that some reconstitution provisions were necessary, it was important to avoid a compromise of the quality of the asset as a supplement to gold and dollars. The rules on reconstitution that were adopted assure that the asset will not be abused, yet do not interfere with its reserve asset status.

First, a general obligation to reconstitute, related to time and amount of use, is set down. It was agreed that it was not possible to lay down reconstitution rules for all time, as they would have to be adjusted as experience is gained and, perhaps, in time dispensed with.

Rules were made for the first five years of creation of SDR. The rules will be reviewed before the end of this and each subsequent basic period. During this initial period, a country's average net use of allocations of SDR, calculated on the basis of the preceding five years, "shall not exceed 70 percent of its average net cumulative allocation during this period." If any country exceeds this rate of use, the Fund would direct part of the natural flow of SDR to it, in order to maintain this standard. The term reconstitution aptly describes the substantive intention. A country "reconstitutes" its reserve position in SDR by purchasing SDR from other countries. It should be clearly understood that there is no bar to the use of 100 percent of allocations of SDR; a reconstitution obligation is incurred only with respect to average use above 70 percent. In addition to the net average use rule, it is also provided that "Participants will pay due regard to the desirability of pursuing, over time, a balanced relationship between their holdings of Special Drawing Rights and other reserves." A rigid application of such a relationship is not called for; this provision is intended, rather, to draw attention to the idea of a balance in the holdings of assets over time and, thus, maintain stability, in a general way, over time, in relative holdings of the new asset and existing reserve assets.

In implementing the basic principles of use, the Fund will act as a kind of traffic director, making known to eligible users which countries are the eligible receivers of transfers and assuring that the flow to receivers is distributed in an equitable manner. It may provide that using and receiving countries may deal directly with each other in arranging transfers, and it may act as an intermediary to bring eligible users and receivers together. The Fund will also have the obligation to

direct the flow of SDR to countries that have become eligible receivers because they have incurred a reconstitution obligation and to promote voluntary reconstitution transactions between countries.

The Outline Plan represents, in a sense, a natural building upon the foundation begun 22 years ago at Bretton Woods. But, in a wider sense, it should be regarded as far more than a mere evolutionary step in the development of the IMF. After two years of intensive study by the major financial powers and two years of intensive negotiation on a worldwide scale, it really represents a major breakthrough in international monetary arrangements. It gives reasonable insurance that there can be orderly and adequate growth of monetary reserves in the future -- under a collective and responsible process of international decision. By so doing, it should guard against restrictionism in world trade and slowdown in world economic growth.

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TREASURY DEPARTMENT

WASHINGTON, D.C.
September 15, 1967

FOR IMMEDIATE RELEASE

The Joint Commission on the Coinage will hold its next meeting on Monday, September 18, at 10:00 a.m. in room 4121 of the Main Treasury Building, Washington.

The purpose of the meeting will be to review the coinage and silver situation two months after the July 14 action ending sales of silver at $1.29 an ounce. This will include a review of coinage production, inventories of coins and silver, silver prices, silver sales and the redemption and retirement of silver certificates.

This will be the Commission's third meeting since its creation under the Coinage Act of 1965. Its 24 members include 12 from the Congress, four from the Executive Branch, and eight public members. Secretary of the Treasury Henry H. Fowler is Chairman.

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F-1029

TREASURY DEPARTMENT

WASHINGTON, D.C.

R RELEASE 6:30 P.M.
nday, September 18, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury lls, one series to be an additional issue of the bills dated June 22, 1967, and the her series to be dated September 21, 1967, which were offered on September 13, 1967, re opened at the Federal Reserve Banks today. Tenders were invited for $1,400,000,000, thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day lls. The details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	91-day Treasury bills maturing December 21, 1967		182-day Treasury bills maturing March 21, 1968	
	Price	Approx. Equiv. Annual Rate	Price	Approx. Equiv. Annual Rate
High	98.875 a/	4.451%	97.490	4.965%
Low	98.856	4.526%	97.462	5.020%
Average	98.865	4.490% 1/	97.473	4.998% 1/

a/ Excepting 2 tenders totaling $499,000
12% of the amount of 91-day bills bid for at the low price was accepted
76% of the amount of 182-day bills bid for at the low price was accepted

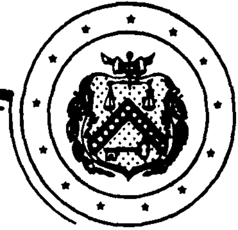
TAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	Applied For	Accepted
Boston	$ 23,538,000	$ 13,538,000	$ 25,599,000	$ 4,599,000
New York	1,392,096,000	899,496,000	1,316,228,000	686,948,000
Philadelphia	30,148,000	18,148,000	16,627,000	8,423,000
Cleveland	28,127,000	28,127,000	37,385,000	32,385,000
Richmond	20,469,000	20,469,000	6,249,000	6,249,000
Atlanta	51,273,000	50,273,000	39,721,000	31,521,000
Chicago	183,536,000	134,058,000	173,448,000	101,968,000
St. Louis	57,518,000	54,518,000	32,727,000	26,607,000
Minneapolis	25,466,000	20,290,000	17,178,000	11,078,000
Kansas City	28,077,000	28,077,000	13,679,000	13,679,000
Dallas	24,253,000	18,253,000	20,812,000	13,812,000
San Francisco	139,760,000	114,760,000	110,425,000	62,745,000
TOTALS	$2,004,261,000	$1,400,007,000 b/	$1,810,078,000	$1,000,014,000 c/

Includes $260,007,000 noncompetitive tenders accepted at the average price of 98.865
Includes $142,234,000 noncompetitive tenders accepted at the average price of 97.473
These rates are on a bank discount basis. The equivalent coupon issue yields are 4.62% for the 91-day bills, and 5.21% for the 182-day bills.

F-1030

TREASURY DEPARTMENT



WASHINGTON, D.C.

September 18, 1967

FOR IMMEDIATE RELEASE
TO WASHINGTON PRESS ONLY

The Joint Commission on the Coinage, meeting today at the Main Treasury Building, Washington, D. C., reviewed the coinage and silver situation as it stands two months after the July 14 action ending sales of silver at $1.29 an ounce. This included a review of coinage production, inventories of coins and silver, silver prices, silver sales and the redemption and retirement of silver certificates.

This was the Commission's third meeting since its creation under the Coinage Act of 1965. Its 24 members include 12 from the Congress, four from the Executive Branch, and eight public members. Secretary of the Treasury Henry H. Fowler is Chairman.

The next meeting will be January 15, 1968.

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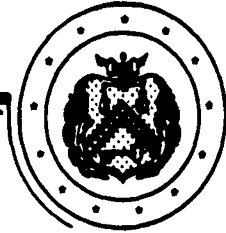
F-1031

TREASURY DEPARTMENT



WASHINGTON, D.C.

September 20, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $2,400,000,000 , or thereabouts, for cash and in exchange for Treasury bills maturing September 28, 1967, in the amount of $2,300,608,000, as follows:

91-day bills (to maturity date) to be issued September 28, 1967, in the amount of $1,400,000,000, or thereabouts, representing an additional amount of bills dated June 29, 1967, and to mature December 28, 1967, originally issued in the amount of $1,000,439,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated September 28, 1967, and to mature March 28, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Monday, September 25, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on September 28, 1967, cash or other immediately available funds or in a like face amount of Treasury bills maturing September 28, 1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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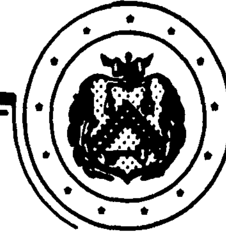
TREASURY DEPARTMENT



WASHINGTON, D.C.

September 20, 1967

R IMMEDIATE RELEASE

TREASURY'S MONTHLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders r two series of Treasury bills to the aggregate amount of ,500,000,000, or thereabouts, for cash and in exchange for easury bills maturing September 30,1967, in the amount of ,400,163,000, as follows:

272-day bills (to maturity date) to be issued October 2, 1967, the amount of $ 500,000,000, or thereabouts, representing an ditional amount of bills dated June 30, 1967, and to ture June 30,1968, originally issued in the amount of 1,000,547,000, the additional and original bills to be freely terchangeable.

366-day bills, for $1,000,000,000, or thereabouts, to be dated ptember 30,1967, and to mature September 30, 1968.

The bills of both series will be issued on a discount basis under petitive and noncompetitive bidding as hereinafter provided, and at urity their face amount will be payable without interest. They l be issued in bearer form only, and in denominations of $1,000, 000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 turity value).

Tenders will be received at Federal Reserve Banks and Branches to the closing hour, one-thirty p.m., Eastern Daylight Saving e, Tuesday, September 26,1967. Tenders will not be eived at the Treasury Department, Washington. Each tender must for an even multiple of $1,000, and in the case of competitive ders the price offered must be expressed on the basis of 100, h not more than three decimals, e. g., 99.925. Fractions may not be used. twithstanding the fact that the one-year bills will run for 366 days, discount rate will be computed on a bank discount basis of 360 days, is currently the practice on all issues of Treasury bills.) It is ed that tenders be made on the printed forms and forwarded in the cial envelopes which will be supplied by Federal Reserve Banks or aches on application therefor.

Banking institutions generally may submit tenders for account of omers provided the names of the customers are set forth in such lers. Others than banking institutions will not be permitted to it tenders except for their own account. Tenders will be received out deposit from incorporated banks and trust companies and from onsible and recognized dealers in investment securities. Tenders

F-1033

from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on October 2,1967, in cash or other immediately available funds or in a like face amount of Treasury bills maturing September 30,1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained fr any Federal Reserve Bank or Branch.

TREASURY DEPARTMENT
Washington

FOR RELEASE ON DELIVERY

REMARKS OF THE HONORABLE JOSEPH W. BARR
UNDER SECRETARY OF THE TREASURY
TO THE NATIONAL CONFERENCE OF FARM CREDIT DIRECTORS
AT THE ST. ANTHONY HOTEL, SAN ANTONIO, TEXAS
THURSDAY, SEPTEMBER 21, 1967, 12:00 NOON
ON
CURRENT ECONOMIC HAPPENINGS

It is a great pleasure indeed to meet with you today and share with you some of our thoughts about the economic and financial climate of recent past, present, and immediate future. Climate and weather have always been matters of priority concern to the farming sector of the economy, but I suspect that during the past year or so there has been a rising concern with the economic weather and financial climate that has been of enormous importance, too.

Even such a trying period as this past year or so has its fringe benefits, though, and one of them for us at the Treasury, and for me personally, is the closer contact into which we have necessarily been drawn with the different Federal credit agencies. I can think of none more rewarding than our relationship with the Federal Farm Credit institutions, and your distinguished Governor, Bob Tootell -- not because we always agreed at the outset on every point that came up, but because we could constructively work out programs and solutions to problems that have affected us all. Speaking just

for my own part, this has been very educational and satisfying.

We have come through a period in which not all the demands on the real and financial resources of the economy could be satisfied in full or all at once. Some sectors fared better than others. We hear a lot about "happenings" these days, but it is worth stopping to think now and then about some potential "happenings" that did not happen.

What _might_ have happened in the very tight financial markets of a year ago is that credit-worthy borrowers would have been unable to find investors willing to finance them, at virtually any price. That did _not_ happen. How close we may have come to such a panicky state of affairs we may never know. But there were days in that period some 12 to 14 months ago when we could just not be sure. Some major sectors of the financial market did come pretty near a standstill at times, unable to put buyers and sellers together. But there was no general panic.

That doesn't mean that we regarded last year's financial developments as wholly satisfactory. They were not. Credit restraint was highly uneven in its impact, taking a dis-proportionate toll particularly on the mortgage market and

homebuilding. And interest rates were competed up to levels that were distressingly high.

A major factor in the credit markets then was the insatiable appetite of business for credit to finance a rapid accumulation of inventories, especially for defense production, and rapid increase in fixed investment outlays for plant and equipment. Corporate demands on the capital market were of record proportions, and business borrowing from banks was proceeding very rapidly until the latter months of the year when the restraint on bank lending took a very tight grip.

State and local governments were also borrowing record amounts, although the rapid climb in interest rates was a discouraging factor to some of these borrowing units.

The Federal sector was also a net borrower last year, although its net demands on the credit market were not as great as what we seemed to be blamed for. If you add together, for calendar year 1966, the entire net increase in securities issued by the Treasury, the Federal agencies, and put in participation issues as well, but then subtract out the net takings by the Government investment accounts and the Federal Reserve, you arrive at a net credit demand by the Federal sector of just over $3 billion.

In a market where total flows of credit run on the order of $70 billion a year, this $3 billion net demand need not have been an excessive demand. If it seemed big it was partly because other demands were also strong, because it was higher than the Federal sector's demand of the previous year -- which netted approximately to zero -- and because some of it took a form which the market was less readily able to accommodate.

In particular, there had been a big bulge in sales of Federal agency securities and participation sales through the Federal National Mortgage Association and the Export-Import Bank. A great deal of this bulge in sales of agency issues and participation issues came in the spring of 1966, a period that saw the typical 1/4% spread between rates on Treasury and Federal agency securities widen out to 1/2% or even 3/4% for a brief time.

All of the Federal credit agencies made increased demands on the credit markets last year -- very substantially in the case of the home mortgage oriented agencies (the Home Loan Banks and the FNMA secondary mortgage market operation) and more moderately in the case of the farm credit agencies. This difference was understandable in view of the extraordinary drought in other sources of home mortgage credit. Even after using the Home Loan Banks and FNMA as major buffer, the flow

of mortgage credit was so restricted that the rate of new housing starts dropped more than one-third from late 1965 to late 1966.

To some extent, but less than in the case of mortgage credit, there were extra demands on the resources of the Federal farm credit agencies, too, and that probably underlay the somewhat greater demands of those agencies on the credit markets. In calendar year 1966, the increase in farm credit agency securities was about $1/2 billion more than in 1965, while for the housing agencies the increase in their net demands was nearly $2-1/2 billion.

The credit impasse that developed a year ago was dealt with in a number of ways, and it would be impossible to say which policy or event turned the trick -- but in combination there emerged a much improved set of credit market conditions going into 1967. These were the major elements:

- Congress suspended the investment credit and accelerated depreciation provisions that were adding unnecessary and temporarily undesirable stimulus to a sector of the economy -- business investment spending -- that was becoming over-extended.
- Congress passed a law, just one year ago today, giving financial regulatory agencies more authority, and more flexible authority, to put maximum interest rates on consumer savings accounts. By itself, that couldn't cut market interest rates, but it has

helped to keep banks and thrift institutions from bidding against each other for a limited total supply of consumer savings.

- The Federal Reserve urged commercial banks, about a year ago, to slow down in making business loans. Later, along about October and November 1966, a general shift toward ease in Federal Reserve monetary policy began to take effect, against a backdrop of slower expansion of business activity.
- The Administration took steps to relieve Federal credit demands on the markets, by seeking to hold down spending and lending activities, and then seeking to arrange necessary Treasury and agency borrowing in ways that the market could most readily accommodate.

Part of that latter program of restraint on borrowing and lending is no doubt familiar to you. All Federal lending agencies were urged to make only the most essential, nonpostponable loans. And in marketing new issues for the credit agencies, an effort was made to raise part or all of the new money portions by selling securities to the Government trust funds or other Government investment accounts. In a related step, sales of participation certificates were put off for several months, pending the arrival of more favorable market conditions.

No one can measure these things precisely, but it is our conviction that these restraint programs did have a noticeable and on the whole beneficial effect. Part of the beneficial effect derived from a slowdown in the rate of lending. It may be significant that the increase in Farm Credit Administration issues outstanding was some $250 million less in the first half of 1967 than in the comparable period a year earlier. At more than $700 million, it was still a good-sized expansion, enabling the Farm Credit banks to continue channelling funds to meet essential needs.

For a while, with the help of all these steps just mentioned, things went "swimmingly" in the credit markets. The President's proposal, first announced last January, of a tax surcharge to take effect later in the year, added impetus to the improvement in the credit markets. Interest rates fell dramatically and flows of funds improved. To cite just one instance, the highest rate paid on a Federal agency issue last year was the 6-/4% paid on Banks for Cooperatives 6-month debentures, issued last October. When it came time to refund that issue, in April of 1967, the rate was just 4.30% -- a drop of nearly 2 full percentage points. Longer term rates also declined, typically by 1/2 to 1%, affecting corporate, municipal, and Federal Government securities pretty much alike. Even mortgage rates, typically laggard, began to turn down a bit by the end of 1966.

With this dramatic change for the better, some of the earlier constraints were relaxed. Federal lending programs were able to shed some of their tight restrictions by January 1967. There was also an easing back in the policy of taking agency issues into the Government investment accounts. Participation sales were resumed. And the investment tax credit was restored, as it became apparent that because of the earlier suspension and of other factors tending to slow the pace of business expansion, this temporary suspension was no longer needed.

The improvement in financial markets which swept through the first several months of this year did not last, however, and its failure to endure longer points out the policy issues facing the economy today. At first blush there would seem to have been every reason for the relaxation of money market pressures to have continued as 1967 progressed. Business activity tended to level off while credit and money supply expanded.

- Gross National Product, in real terms, after adjustment for price factors, actually declined very slightly in the first quarter of this year, and in the second quarter, GNP increased only at a lackluster 2.4% annual rate.
- Industrial production edged off by 2.2% from December through June.

. Unemployment increased slightly, although it did not climb above 4% of the labor force and actually rose less than might have been expected alongside the flattening trend in manufacturing activity.

. As for the financial side, money supply has grown at 7.7% annual rate so far this year, compared with 2.2% in all of 1966.

. And commercial bank credit has increased at a 13% annual rate through August, against a rise of 6% in the whole of 1966.

Together, these factors should have produced continued credit easing and further rate reductions. Instead, rates began to level out by mid-winter and turn up in the spring, so that long-term rates have now come back to, or even a little above in some cases, the high levels of a year ago.

The key to the puzzle, I think, is that the flattening out of business activity in the early months of this year was not a sign of weakness, but just a phase of consolidation. Inventories had been accumulating too rapidly and reached too high a level by late 1966. The accumulation rate had to be cut back. That is what produced the two quarters of relatively little change in GNP in the first half of this year. If you look at just the "final sales" component of GNP -- thus leaving

out additions to inventory, the gains in the annual rate of production for final use in the first two quarters of this year were each at a substantial $15 billion rate.

Businessmen, perhaps realizing better than some others among us the temporary nature of any hesitation in aggregate production statistics from a cause of this sort, stayed right in the market and borrowed. Perhaps they remembered, too, how hard it was to get hold of money when they really needed it badly last year. Thus even though inventory growth slowed markedly and plant and equipment spending levelled off, corporations have been borrowing record amounts in the capital markets this year. Through August, they have borrowed some $16 billion, 27% ahead of the same months a year ago and nearly equal to the amount taken during all of 1966 -- which had been until now the record year for corporate borrowing in the market.

A further concern haunting the corporate treasurer was the thought that an awfully big Federal Government deficit and credit demand might lie ahead, and that it might be well to get in line early before the well threatened to go dry again.

A similar concern, plus a large current need for funds, may underlie the heavy pace of borrowing by state and local governments this year. Last year's record borrowing by these governmental units is well on its way to being far surpassed in 1967. In the first 8 months alone, borrowing by these government units is running 27% ahead of a year ago -- the same wide margin of extra demands as with corporate borrowers.

Time will tell the full extent to which those appraisals of the current business pattern may be right -- which would place the first half of 1967 as a mere hesitation and re-gathering of strength. But the evidence of the last month or two is certainly more consistent with that view than with interpretations that cast doubt on the underlying strength of business. The evidence generally confirms that the earlier hesitation was due to a let-up in inventory building, and that source of weakening has now just about run its course, while final demand has in the aggregate been rising quite steadily. Consider these recent facts:

- Manufacturing inventories, after climbing by steadily smaller amounts in the earlier months this year, and then actually declining as noted by 2.2% from last

December through June of this year, turned around and in July and August recovered nearly three-fourths of the earlier decline.

- Retail sales have been in a vigorous rise from February through August of this year, increasing 6% over those months. July and August retail sales weighed in at levels 5 to 6% ahead of the year ago levels. Some of this rise, unfortunately, represents price increases but the evidence of real buying power and willingness to exercise it is there to an increasing degree.

- The employment picture has also strengthened noticeably in the last couple of months, without ever having weakened significantly in the period of hesitation earlier this year. The unemployment rate most recently edged back down to 3.8% after creeping up to 4% in June.

- Business optimism is strengthening. Plant and equipment spending, after levelling out in the first half of 1967 in the wake of very large increases for several years, seems ready to pick up with

an increase again in 1968 according to one early survey recently reported.

Housing starts have been recovering solidly from the depressed levels of late 1966, aided both by good underlying demand and much improved mortgage credit availability. Whether mortgage credit availability can hold out is a constant threat to this area, however.

That brings us around again, quite naturally, to looking at Federal Government demands in the current period -- demands on the real and financial resources of the economy. Inevitably, while we are engaged in Vietnam those demands are going to be extra large. They are large anyway, even apart from Vietnam, but the non-Vietnam portion, while large, has grown about in line with our large and growing economy. That doesn't mean the non-Vietnam component of Federal expenditures should be immune from consideration when we look for ways to hold the budget within bounds. But it does mean that we need to keep a sense of perspective about us in trying to reach rational decisions about priorities and national goals.

Unquestionably, we can't proceed as fast as some of us would like on desirable domestic programs. But whether it makes sense to throw long-range programs into an abrupt reverse, and let urgent domestic problem areas mount, just so that we can fight a war in southeast Asia without raising taxes and asking some additional sacrifice from a prosperous America, is something else again. The fighting in Vietnam does not touch the majority of us directly, yet the possible consequences of that struggle can touch each of us, and future generations of Americans, very deeply and closely indeed. So can the consequences of being forced into excessively drastic cuts in domestic programs. That can have a direct observable cost in terms of unrest in our society, and perhaps more insidious, a hidden cost in terms of unfulfilled potential -- a falling short from the goals that are within our capabilities.

The problem of setting priorities and making painful choices among desirable alternatives is not, I know, entirely unfamiliar to you. In setting firm guidelines for Farm Credit borrowings a year ago, that is more or less the same kind of challenge that was faced, and met, by postponing, reducing, and doing without wherever it could be accomplished without serious damage to the broad objectives of financing needed

agricultural production. Those decisions did not come easily but they had to be made, and were made. We face now, with the Federal budget, the same kind of need for stringent control, to hold down the deficit and our demands on the credit markets.

When he sent up his tax recommendations on August 3, the President estimated that a 10% income tax surcharge taking effect July 1 and October 1, respectively, for corporations and individuals, in combination with certain other tax measures, would raise $7.4 billion in additional revenues in the current fiscal year. Given those added revenues, and given also a tight hold-down of expenditures which would involve some cuts in on-going civilian programs and savings in the defense budget to offset a possible addition of up to $4 billion because of Vietnam, the administratives budget deficit could be held to a $14-18 billion range. Without the tax proposals, with less success in restraining civilian expenditures, and with defense expenditures rising by $4 billion, that deficit could soar to $29 billion.

That $29 billion deficit is not an acceptable figure. By that I mean that our economy cannot tolerate it without bringing into play such undesirable consequences as to far over-shadow our natural reluctance and lack of enthusiasm about

paying higher taxes. One consequence would be a strong inflationary push. Upward price pressures, which were happily absent from 1961 to mid-1965, have been asserting themselves more actively in recent months. Prices certainly stand a far better chance of returning toward stability if net Federal demands on the economy can be restrained.

Interest rates and credit market conditions represent another area that cannot readily withstand the punishment that a huge Federal deficit could inflict, at a time when private credit demands are also running strong. We spoke earlier about the net credit demands of the Federal sector on the private credit markets, after taking account not only of Treasury borrowing but also of participation sales and net Federal agency borrowing, and then subtracting out the net purchases of these obligations by the Government investment accounts and the Federal Reserve. In calendar year 1966, that net demand worked out to be just over $3 billion.

In fiscal year 1967, the 12-month period ended last June 30, the net Federal credit "demand" on this basis turned out, surprisingly, not to be a demand at all but a net <u>supply</u> to the market of more than $6 billion. This reflected exceptionally heavy repayments of advances to the Federal Home Loan Banks in January-June 1967, letting them pay off

some of their heavy earlier borrowings from the market. It also reflected an unusually low Treasury cash balance at the end of last June, and if proper allowance is made for that it may be fairer to describe the Federal sector's net credit demand for the fiscal year at approximately a zero level, rather than speak of it as a big net supplier. But still, that was long way from making net credit _demands_ on a heavily burdened set of financial markets.

Now contrast that near-neutral position for fiscal year 1967 with the prospect for the current fiscal year. Assuming the tax increase as requested by the President, and assuming sufficient restraint on spending to keep the administrative budget deficit in the lower end of the $14-18 billion range, the Federal sector's net credit demand would be on the order of $10-12 billion. That assumes a $14 billion increase in Treasury debt, a $7 billion increase in agency debt and participation certificates, and sufficient takings by the Federal Reserve and Government investment accounts to pull the net rise down from $21 billion to the $10 or 12 billion range.

That $10 or 12 billion demand is substantial -- well above the experience of recent years -- but it should be possible for the credit markets to handle it, given a

reasonably accommodative monetary and credit policy. With good support from bank credit growth, these Federal sector demands would be part of a large total flow of credit that could be provided for. It would be rash to predict substantial interest declines in those circumstances, because demands would still be large, but there might well be some room for improvement in the credit markets and there would be little reason to expect much upward pressure on rates.

The picture is quite different if we consider how the credit demands might look in the absence of responsible action to raise taxes and hold down expenditures. In that case, instead of a net Federal credit demand of $10-12 billion we would be facing a net demand on the order of $20 billion or more -- and that is an amount, as best as we can judge, that is far in excess of what the credit markets can handle.

It just isn't reasonable to expect that in the absence of a tax rise and spending restraint, bank credit would go up by an additional $8 billion or more just to accommodate our additional borrowing. On the contrary, one would have to expect in that inflationary environment that the banking system would be provided with less rather than more reserves, so that the credit markets would be hit from two sides -- by bigger Federal demands and by smaller available supplies.

How the credit markets would go about parcelling out a smaller supply of funds to a longer list of prospective borrowers cannot be precisely foretold in advance. But it is safe to predict that the process would be disagreeable, with many borrowers unable to get credit at all and with borrowers who did get funds having to pay much higher rates.

The Federal Government would get its money. So would Federal agencies, with perhaps some rearrangements of Federal demands as was done a year ago. Big businesses would be likely to get their funds, too. Filling the needs of other borrowers might be more uncertain. Smaller businesses, farmers, local governments,and most of all housing credit, would have to be shouldered aside to whatever degree was needed to balance supplies and demands in the credit markets. In the process, interest rates would be bid severely higher.

No one can say how high interest rates might go under those conditions of an outsized Federal deficit. Looking at other countries around the world, one can find rates in other developed countries at least a full 1 per cent higher than ours -- but that could be just a starter. We can be pretty confident that there would be severe market pressure, but just where that would take us in terms of rate changes and distorted flows of credit is sheer conjecture.

A most important fact about our present and prospective economic and financial environment is that, as a nation, we can to a large extent shape that environment as we will. We have the natural and human resources, and productive capability -- not to do everything we might like all at once, but to do a very great deal, and to be able to choose among some alternative combinations of resource use within a framework of balanced economic growth. That does not make the decisions easy, but at least there are some reasonably well-defined areas in which rational decisions can be made. Compared, for example, with the problems of policy formulation on the international political and military scene, where so much depends on virtually unknowable actions and reactions from our oppononets and sometimes our allies, the economic problems may seem fairly tame.

Our economic problem today is one of balance -- a correct balance between the stimulus that the economy needed through the first half of this year as it worked through inventory adjustment, and the restraint that will become increasingly necessary when inventory building is resumed amidst further growth in defense and other final demands. Striking this

balance puts a premium on flexible economic policy -- just as in your own area of direct concern there must be flexibility for the farm credit system to respond to the changing needs for agricultural credit. On the national scale the numbers get bigger and the dust a bit thicker at times, but the essential problems of priorities, restraints, and encouragements are much the same.

TREASURY DEPARTMENT
Washington

FOR RELEASE: UPON DELIVERY

REMARKS BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
AT A
NATIONAL PRESS CLUB LUNCHEON
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The moment of truth is approaching for the Congress and the nation. In that moment the Congress will decide the foremost financial and economic policy issue of the year and, perhaps, many years. That question is whether Congress will enact the President's proposals for a 10 percent surcharge on existing income taxes and join with him in reducing planned Federal expenditures and avoiding some contingent increases.

If I don't register any other point, let us be clear that this proposed tax would not be 10 percent of your income, but 10 percent of your tax -- a tax on a tax -- equal to about 1 cent out of every dollar of your income.

It is the height of presumption for a downtown bureaucrat, who has never run for office, to give unsolicited advice to members of Congress on politics and taxes. Besides, I've heard how high the mail is running against a tax increase. So, I will confine my comments to what is good for the country. However, if you change the tense of the remarks that follow concerning a vote against the tax increase they might be what a hypothetical opposition candidate might say next summer or fall about a vote this fall against the tax increase by an incumbent -- particularly if the tax increase failed to pass.

A vote against the tax increase proposals is a vote for the biggest budget deficit for any fiscal year since World War II.

A vote against the tax increase is a vote to keep the heaviest foot since World War II on the nation's economic accelerator at a time when it has already rebounded to a safe cruising speed.

A vote against the tax increase is to risk throwing away an economic expansion which in November will reach its 80th month and become the longest and most rewarding period of sustained growth in the nation's history.

A vote against the tax increase is a vote for a resumption of the old boom and bust cycle that every American over twenty-one can remember with sadness, bitterness and apprehension.

A vote against the tax increase is a vote for a return to the excessive and unsustainable boom followed inevitably by the recession years like 1954 and 1958 when over a million jobs a year disappeared in sharp contrast to the years beginning with 1962 when every year more than a million new civilian jobs were created.

A vote against the tax increase is a vote for an overheated economy and spiraling inflation.

A vote <u>against</u> the tax increase that would temporarily take away on the average of 1 percent of the income of the individual taxpayers of America until June 30, 1969 is a vote <u>for</u> an inflation that will diminish the real income of these same individual taxpayers a number of percentage points a year for many years and unjustly place the cruelest tax of all -- spiraling inflation -- on the tens of millions of our low income families who pay no taxes or are exempt from the proposed surcharge.

A vote against the tax increase is particularly a vote to levy that cruel and unjust depreciation of income on those who are elderly and retired and must live on a fixed income with the prospect of increased earnings no longer a compensating factor.

A vote against the tax increase is a vote for sky-high interest rates and tight money for all borrowers that will be the consequence of the overcrowding of already crowded credit markets by government borrowings to meet the deficit.

A vote against the tax increase is a vote to bring demand into balance with supply by making credit unavailable to some which will bring depression once again to the housing industry, make credit less available to the small businessman and State and local borrowers, and leave the would-be home buyer out in the cold.

A vote against the tax increase is a vote for increased hardship for the young and the poor, whether in ghettos or outside of them, because they will bear the brunt of increased costs of the bare needs of living, the lack of adequate housing and the eventual loss of opportunity that can only come from a steadily growing economy that creates a million to a million and a half civilian jobs each year.

A vote against the tax increase is to strike a hard blow at our national competitive strength and our favorable balance of trade. If they are undermined by flooding imports to meet excessive demand and diminished exports because of price and supply problems, it will endanger the dollar and the international financial stability and progress which depend on it. It will diminish the ability of our country to play its historic and crucial part in Free World security and development.

These views reflect far more than my judgment. They embody the opinions of the President and Vice President, the Council of Economic Advisers, the Director of the Budget, the entire Cabinet, and the entire Federal Reserve Board. But this point of view goes far beyond those in the Executive Branch of the Federal Government concerned with public economic and financial policy. It embraces the leaders of the private sector.

In recent weeks a singular near unanimity has emerged among many of the nation's foremost businessmen and labor leaders, economists (both academic and in business), industrialists, bankers and financial leaders in recommending a tax increase. All of them, subjectively at least, have the normal human aversion to paying increased taxes. Objectively, however, and after appraisal of the unacceptable alternatives, they support the President's recommendations -- in substance, if not in each detail.

This consensus in favor of a tax increase is spread among responsible leaders throughout the country. It takes a sense of true responsibility for an industrialist, who is responsible to his stockholders, to recommend greater taxes. The labor leader, elected by the members of his union to represent their best interests, must show a similar sense of wise fortitude. The professional economist, who is paid to be right more often than he is wrong, evaluates the economic climate most carefully before he goes down the line for a tax increase. In a way, all of these have as much to lose from making a wrong judgment on this question as a member of Congress.

Let me recite a few expressions of this growing consensus for a tax increase:

-- In early August, Henry Ford was joined by other well-known members of the business community in supporting a tax increase. He simply said that "higher tax revenues are necessary to help control inflation".

-- George Meany, President of the AFL-CIO, told the House Ways and Means Committee that organized labor backs higher taxes under the current circumstances in both principle and practice.

-- Another group of twenty-four leading businessmen, headed by Howard Boyd, Chairman of the Board of El Paso Natural Gas Company, told the House Ways and Means Committee that "we believe a tax increase, together with the restriction of non-essential government spending, is vitally necessary to the continued economic health and well being of the Nation." Those joining Mr. Boyd included J. Peter Grace, President of W. R. Grace and Co.; Edgar F. Kaiser, President of Kaiser Industries Corporation, and James A. Linen, President of Time, Inc.

-- Leading business and financial organizations, reflecting their intimate knowledge of money and credit conditions and the economic outlook, unanimously supported the call for a tax increase and reduced expenditures. These included the Committee for Economic Development, the National Association of Manufacturers, the American Bankers Association, the U.S. Savings and Loan League, the Investment Bankers Association, the Life Insurance Association of America, the National Association of Home Builders, and the National League of Insured Savings Associations.

-- A group of 260 academic economists signed a statement circulated by Walter Heller, former Chairman of the Council of Economic Advisers; tax expert Joseph A. Pechman of the Brookings Institution, and George L. Bach of Stanford

University. They stated to the House Ways and Means Committee, in part: "We urge early enactment of tax legislation along the general lines proposed by President Johnson." While not necessarily agreeing on the timing and the amount of the increase, the group said the increase is needed "to maintain orderly growth, prevent a resurgence of inflation, and forestall excessive reliance on tight money".

-- Lined up in favor of the tax increase is every man who served as Chairman of the Council of Economic Advisers under Presidents Eisenhower, Kennedy and Johnson -- Dr. Arthur Burns, Dr. Raymond Saulnier, Dr. Walter Heller -- and such outstanding and experienced former members of that body as Dr. Paul McCracken, Dr. Kermit Gordon, Dr. Otto Eckstein, and Dr. Robert Turner.

-- In a letter submitted to the House Ways and Means Committee since the Labor Day recess, William H. Chartener, Vice President of the National Association of Business Economists, said a poll of the group revealed that three out of four economists employed by major U. S. business firms favor an increase in income tax rates immediately or in the near future.

-- Those supporting the tax increase include former Secretary of the Treasury, Douglas Dillon, and the former Under Secretary for Monetary Affairs, Robert Roosa. At the time these gentlemen, and Stuart T. Saunders, Chairman of the Pennsylvania Railroad, and Walter Wriston, President of the First National City Bank of New York, appeared before the House Ways and Means Committee, Mr. Saunders presented to the Committee a statement supporting the tax increase and the control and reduction in Federal expenditures that was signed by 445 of the nation's leading industrialists and banking and financial leaders. The statement said: "The combined result of the tax increase and expenditure reductions should hold the deficit to manageable proportions. These steps are necessary to prevent a deficit so large that it could lead to dangerous inflation, spiraling interest rates, tight money, and a serious weakening in our balance of payments position."

-- And the next day William McChesney Martin, Jr., Chairman of the Federal Reserve Board, told the Committee: "We have already clear and compelling evidence of a resurgence in inflationary pressures, which, if unchecked, would curtail our domestic expansion, aggravate an already serious balance-of-payments problem, and bring severe strains in the markets for credit, particularly the mortgage market.... Accordingly, I favor prompt enactment of the tax program proposed by the President."

-- In last Sunday's New York Times news analysis there was this observation:

> "The experts -- economists, businessmen, financiers, union leaders -- agree to a remarkable extent that a tax increase is needed this year to stop inflation and a rapid rise in interest rates that could seriously damage many areas of the economy. The near-unanimity of those who have educational and professional qualifications to speak out on economic issues was, beyond question, the most dramatic and startling aspect of the hearings on President Johnson's proposed 10 percent tax surcharge that came to a close last week in the House Ways and Means Committee. That those who were heard by the committee constituted a truly representative cross-section of their various fields could not be doubted. The witness list was in no way stacked.
>
> "Yet the number of those who opposed a tax increase could be counted on the fingers of one hand: the Chamber of Commerce of the United States (but not the National Association of Manufacturers), one prominent economist and a couple of businessmen."

Why did I stress at the outset of my remarks, in the tones and words of a political stump speaker, the fact that a Congressman who votes against the tax increase is practicing political Russian roulette?

Why do I outline the basis for a telling political appeal to people who think of themselves as consumers, the poor and untaxed, the elderly and those who live on fixed incomes, the businessman and the worker, those who would build a home, by anyone who would run next year in primary or general elections against a member of the House who votes against the tax increase?

It is because representative government may face a breakdown. There is considerable danger that many of the people's elected representatives in the Congress may accede to wholly normal but uninformed taxpayer reaction and vote against the tax increase. There is a risk that the House of Representatives will not lead public and voter opinion to the almost uniform judgment of those in both public and private life who are expert in the way our economy works.

For this is not the simple issue of voting to increase taxes to pay for some desired objective, as we face it at the State and local level. No one is per se for increasing taxes. Voters who reflect the taxpayer syndrome will naturally react against an increase. There are few who feel passionately with Justice Holmes that "Taxes are what we pay for civilized society."

Indeed, this Secretary of the Treasury, who had fought for three significant reductions in Federal taxes in the last five years which are saving taxpayers $24.2 billion this year, recommended to the President this tax increase for only one reason and with great reluctance.

And the President recommended it to the Congress for only one reason and with great reluctance.

It was because the alternative -- an economy in shambles -- with incalculable damage to the individuals and efforts that depend on it -- was far more unhappy.

One who is importantly involved in this issue remarked recently that old age was very unwelcome, but the alternative is worse.

So it is with this tax increase.

As of this hour, this date, it may be politically realistic for a member of Congress to state, and with perfect honesty, that "my mail is running heavily against this tax increase" and, consequently, "I don't propose to vote for it."

My first plea would be that he put the welfare of his country ahead of his own political interests. But I wouldn't stop there.

Let him look a ahead to next fall. Let him look at what may well turn into a voter back-lash with painful political consequences if he reads only his current mail and ignores the economic indicators.

Let him remember that, however unwelcome to Americans as taxpayers, the President's program is in the best interest of those same Americans -- as consumers who want prices to be as stable as possible consistent with reasonably full employment and a healthy rate of growth -- as wage and salary earners who have or seek jobs -- as businessmen whose life blood is credit and steadily expanding demand from confident customers -- as home buyers, farmers and small businessmen to whom ever higher interest rates, tight money and increased costs are far more cruel than taxes -- as poor, elderly or living on a fixed income to whom a spiral of inflation is ruinous -- as fighting men whodream of returning some day to a job and a home.

If the President's program is rejected -- with the economic consequences that those most familiar with the economy fear and predict with near unanimity -- then the members of Congress who voted against the tax increase, regardless of their reasons, are likely to find a large share of the responsibility placed on their doorstep by all of their constituents -- not just a few who responded as natural, normal Americans by writing a letter to their Congressmen objecting to increased taxes.

To illustrate, let us consider the alternative from the consumer point of view of a tax increase versus no tax increase for the people of America, including both the 125 million men, women, and children who are taxpayers or members of taxpaying families, who would be asked to give up an average of 1 percent of their income for the surcharge, <u>and</u> the 75 million men, women and children who would not be touched at all by the surcharge either because

of the low income exemption from the surcharge or because no tax is paid by them or their families under present law.

As a benchmark, over the first two years of the Korean War prices rose at an annual rate of 5½ percent. This is 3 percentage points more than the 2½ percent rise that might be expected with the surcharge.

Let us consider the impact on all of us of an additional rise of 3 percent in consumer prices which, using the Korean experience as a guiding benchmark, might result in the absence of the surcharge.

The figures are both shocking and very instructive. A single individual with $900 of money income would pay no surcharge; he would be exempt. But a 3 percent additional rise in prices would actually decrease the real income of this individual 4 percent since such a person typically must spend more then his meager income on current living, making up the difference by going into debt or drawing down on savings. This would be equivalent to a 4 percent tax on his income.

For the single individual living on $5,000, the surcharge would impose a tax of $33, equal to 1.3 percent of his income. The burden of the additional 3 percent rise in prices would amount to $144, equal to 2.8 percent of his income -- a smaller relative burden than for the individual with $900 income, but still be above the burden of the surcharge. At the $20,000 income level the surcharge burden would rise in relative terms to 2.5 percent of income and amount to $492, while the additional 3 percent rise in prices would amount to $540.

Turning to a family of four we again see the same unjust pattern of the burden distribution of inflation compared to the surcharge. At $2,500 and at $5,000 of family income no surcharge is paid. In contrast, the burden of the additional price rise is equal to $82 or 3-1/3 percent of income at $2,500, and $147 or 3.1 percent at $5,000.

At $10,000 of family income, the surcharge would amount to $111 or 1.1 percent of income. The burden of the 3 percent prise rise would be $285 or 2.9 percent. This is substantially higher than the surcharge but less in relation to income than the burden on lower incomes.

Some individuals and families in each of these ranges will, of course, experience a rise in incomes when prices rise. These people would not be hurt as much by inflation as would others whose incomes are fixed, but in the end everyone loses. While the surcharge exempts entirely the low income families and individuals, the price rise would place its heaviest relative burden on families and individuals in the lowest income ranges.

But the overall result of a 3 percent additional price rise would be to diminish the real income of the overwhelming majority of the American people far more than the average loss of 1 percent flowing from the tax increase.

Does that make a vote against the increased tax reflect the right measure of the political risks?

But there are others who place their opposition to the tax increase on higher ground than mail from home. Let us turn to them.

Some of the reluctance to support a tax increase wholeheartedly and see it move along promptly through the legislative process comes from those in Congress and out who believe that a balanced program of fiscal restraint, including both tax increases and reductions in Federal expenditures, is necessary and desirable. Many of those who stress the importance of reducing Federal expenditures along with any tax increase share the point of view expressed in my comments concerning the danger to the economy from operating the government on the very large deficit in the current and prospective economic environment.

During the course of this week the members of the House Ways and Means Committee are beginning their closed door deliberations on the tax increase. Many members of this determinative body have no secret of their concern that adequate treatment of the problem of reducing expenditures be geared by Congress and the Administration.

There is no disagreement in principle between the President and his Administration and the members of the Ways and Means Committee or the Congress on the substantive importance of coupling expenditure reductions with tax increases, while minimizing and avoiding any contingent increases in expenditures that are not now definitely provided for in law and appropriations.

The President in his Tax Message of August 3, 1967 pledged to the country and the Congress that he will make every possible expenditure reduction -- civilian and military -- in the Budget submitted last January, short of jeopardizing the nation's security and well-being.

He outlined a procedure for effecting these expenditure reductions, stating that as Congress completes each appropriation bill affecting Fiscal 1968 expenditures, "we will examine at once very, very carefully" the results of those actions, and determine where, how, and by how much expenditures under these appropriations can be reduced. He also, at the same time, announced that he was directing each Department and Agency head to review every one of his programs, to identify reductions which can be made, and to report to the Director of the Budget in detail on the actions he is taking to put those reductions into effect.

But he noted that action by the Executive Branch alone to reduce expenditures would not serve the purpose if every time the Executive Branch saves a dollar the Congress adds another dollar -- or more -- to the expenditures recommended in the January Budget by appropriation or legislation increasing expenditures outside of appropriations such as the Employee Pay Bill.

In every case in which the Congress has completed the appropriation bill for a Department or Agency affecting Fiscal 1968 expenditures this process has been followed. Appropriation bills covering the operations of the Treasury, Post Office and Interior Departments are the only ones completed to date. The heads of those Departments, pursuing an extensive review, are identifying the reductions that can be made over and beyond those resulting from Congressional appropriation action. They are taking steps to put into effect both the reductions in expenditures for Fiscal 1968 reflecting Congressional action and additional Executive action.

This sets a pattern for the procedure which will be followed for the remaining appropriation acts as soon as Congress sends them to the President.

Moreover, following the presentation of his Message the President met with every Democrat in the House and at least fifty Republicans and talked extensively about the problem of the deficit, the tax increase proposal, and the need to reduce expenditures -- as well as take other action necessary to diminish the deficit.

In his statement to the House Ways and Means Committee on August 14, the Director of the Budget made clear that these cuts would bite into projected non-defense or civilian type expenditures. He said:

> "We have begun a concerted effort to achieve every reduction and deferral which can reasonably be made in order to lower non-defense expenditures. We are determined to cut more than the $1.5 billion, which would offset the release of 1967 withheld funds and the uncontrollable increases in CCC, public assistance, and other outlays. Such a cut would bring civilian expenditures -- exclusive of changes in participation sales and in the President's pay proposals -- back to the $59.5 billion level estimated in the January budget. Our actual reduction target is larger than that -- we are aiming at a cut of over $2 billion -- as a means of holding civilian expenditures <u>below</u> the January estimate. Such an expenditure reduction would require cuts in obligational authority and program levels of some $4 billion. Whether we will be able to achieve our target fully, I cannot predict at this time. But we are setting our sights high in order to insure signficiant reductions, when the actual results are all in. The outcome will, of course, depend in part upon Congressional action on the budget, as well as our own efforts."

I am confident that the discussions being currently held in the Executive Session of the House Ways and Means Committee will produce an agreement which will give every member of Congress an opportunity to cooperate with the President in bringing the deficit in the 1968 Budget to manageable proportions by increasing taxes and reducing or holding down expenditures.

We cannot afford a failure or delay in acting affirmatively on the tax increase proposal because the procedures of the appropriation process and the administrative follow-up promised by the President have not yet supplied the detailed particulars of the reductions that will be forthcoming.

Everyone knows that after a Report by the House Ways and Means Committee and House action, there must be hearings by the Senate Finance Committee and debate under the Senate rules prior to Senate action. Everyone knows that during this period final action on appropriation bills by the Congress, putting the President in the position to make positive identification of the areas of expenditure reduction to be effected, will proceed in piecemeal fashion. Everyone knows that only when all of these actions have been completed and the Congressional decisions on appropriations and reductions in programs are finally taken can the President make the additional decisions on expenditures that may be necessary and supply the Congress and the nation with a bill of particulars identifying in orderly fashion the reductions in expenditures -- military and civilian -- in the context of up-to-date Budget totals. For the President to transmit to the Congress a new series of budget recommendations at this time would only serve to compound the delays in the appropriation process. Many of the appropriation bills already have been acted on by the House appropriation committee and subcommittees and passed by the House.

Everyone knows that there are various provisions in law or statements in the House Committee Report that could be devised to protect the position of the House in any final insistance its members may require on expenditure policy as a prerequisite to voting a tax increase. Moreover, final House action on the Conference Report that is usually required on revenue bills to settle differences between the Senate and House versions -- which is some weeks away -- would provide an opportunity to affect the bill if appropriate expenditure control has not been manifest in the interim. It is not necessary now to hold up the processing of the tax measure until the passage of the appropriation bills and the President's action on expenditure reductions are complete.

Therefore, the appropriate and statesman-like method of dealing with this problem in the national interest is for the House Ways and Means Committee and the House to proceed promptly to dispose of the tax proposals. They can proceed on the basis of either the earlier pledges and commitments by the Administration to do its share in this area of joint responsibility or such further statements or provisions in the Report and in the law as will assure a reasonable combination of tax increase and expenditure control.

There have been many other statements on Capitol Hill that for reasons of equity and justice loopholes in our existing tax laws should be closed before, or coincident with, enactment of any tax increase.

It does not require a superior memory to recall the time -- and tedious work -- necessary to move a tax reform measure through the Congress.

My predecessor, former Treasury Secretary Douglas Dillon, emphasized this fact in recent testimony before the House Ways and Means Committee.

Mr. Dillon agreed, as do we, that further study and action in the area of tax reform are needed, but added:

> "As a result of experience we had and the estimates we were able to develop at the Treasury it is very clear that any of these loophole closings that are at all possible and advisable -- even adding them all together -- have a very small effect, as far as overall revenues, on the economy....
>
> "We were developing in 1963 what came as the 1964 tax cut. We were trying to develop possible sources of revenue through loophole closings that would enable us to have as large as possible a reduction in the overall tax rates and we just were not able to find areas that would be tremendously significant.
>
> "Some of these were enacted and.... a number of them were not accepted for very good reasons by the Congress, and I think that this clearly holds. You might if you work very hard save a billion dollars .... through very hard work, very difficult work, upsetting people .... but it would have very little effect as compared to the $6 or $7 billion we are talking about here....
>
> "So loophole closing, while I think it is primarily a moral issue, and that doesn't mean it isn't important .... does not have the economic impact and therefore can't be considered at all an economic substitute for the tax increase."

Our position, in terms of priorities, is simply to put the imperative needs of the Nation first.

Loophole closing at the best is a long process. The 1962 and the 1964 tax acts, which included reforms, required 15 to 17 months for Congressional approval.

We have stated, and we repeat, that tax reform proposals for permanent revision of the laws are under intensive preparation in the Treasury. The President has promised that tax reform proposals will be forwarded to the Congress at this session for the deliberate study, debate, and action they require during the session next year.

In conclusion, the alternatives to prompt and positive action to increase taxes in line with the President's proposals are clearly unacceptable.

Our role in world leadership and the solution of our pressing problems at home depend on a healthy economy, growing at a robust and sustainable rate, characterized by both reasonably full employment and relative price stability. The program of temporary fiscal restraint proposed by the President is necessary for the preservation of this healthy balanced economy.

The Congress of the United States, controlling the purse strings of government under Constitutional authority granted to it, has voted and appropriated for the expenditure of every dollar that enters into the 1968 Budget -- whether it be for the discharge of our commitment in Southeast Asia, the treatment of some of the ills and inadequacies of our society at home, or the maintenance of Federal services in a growing and rapidly expanding population. Congress has the responsibility to see to it that the nation's bills, which it authorized, are paid from taxes collected or money borrowed in a mix and manner designed to keep the economy healthy and well balanced.

The consensus among the vast majority of knowledgeable and responsible leaders in economic and financial circles, public and private, is remarkably undivided in recommending prompt action in increasing taxes, combined with strict expenditure control, as indispensable steps in preserving that kind of an economy. Our economic course is clear. Only an act of political will remains.

I have every confidence that the Congress will discharge its responsibility by increasing taxes temporarily for the duration of the conflict in Vietnam while it and the President strive, in the words of the President "to make every possible reduction, civilian and military, short of jeopardizing the nation's security and well-being."

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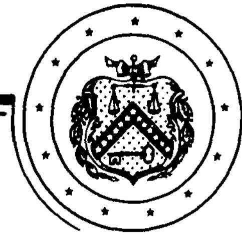
TREASURY DEPARTMENT



WASHINGTON, D.C.
September 22, 1967

FOR IMMEDIATE RELEASE

ROY C. CAHOON NAMED
ASSISTANT TO THE DIRECTOR OF THE MINT

U.S. Mint Director Eva Adams today announced the appointment of Roy C. Cahoon as Assistant to the Director in charge of Coin Management and Public Information.

Mr. Cahoon succeeds Kenneth M. Failor, who retired this month after more than 30 years service with the Mint. Mr. Failor's most recent position was that of Executive Director for the Joint Commission on the Coinage.

As Chief of the Coin Management and Public Information Division, Mr. Cahoon will work closely with the Federal Reserve Banks and Branches in carrying out the Mint's coin distribution and coin forecasting programs. He will be in charge of the Mint's public information functions and will serve as liaison with Congressional and Executive Offices. In addition, Mr. Cahoon will assume the post of Executive Director for the Joint Commission on the Coinage.

Mr. Cahoon has served with the Office of the Secretary, Treasury Department, for the past 18 years. He came to the Treasury as an Administrative Assistant before serving in his most recent position as a Public Information Specialist in the Treasury's Office of Information. Prior to his Treasury service, Mr. Cahoon held administrative posts with the Agricultural Adjustment Administration in North Carolina and the Department of Agriculture in Washington, D. C.

Mr. Cahoon, 47, was born in Swan Quarter, North Carolina, where he received his early education. He is a graduate of Kings Business College and attended the American University in Washington, D. C. He was in the U.S. Army Air Force from July, 1942 to January, 1946, serving in the European Theater of Operations in England and France.

Mr. Cahoon is married to the former Anna Marie Hetchko of Wheeling, West Virginia. They have two sons, Craig and Chris, and reside in Falls Church, Virginia.

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F-1036

TREASURY DEPARTMENT

WASHINGTON, D.C.

FOR P.M. RELEASE
TUESDAY, SEPTEMBER 26,1967

September 22, 1967

TREASURY OFFICIAL CALLS FOR POSITIVE
ACTION FROM BANKS IN HIRING NEGROES

Assistant Secretary of the Treasury Robert A. Wallace today told bankers they must take "positive action" to hire Negroes in order to keep deposits of Federal money.

He said that positive action meant "applying controls over personnel actions that are normally applied to any program that you want to succeed," including clear statements in writing, frequently reiterated to recruitment sources, that the bank follows equal employment policies; recruitment among minority groups; help-wanted advertising in minority group publications as well as the general press; contact with local schools to establish needed courses, and periodic review of minority employees' records to see that they can reach their highest capability.

Speaking before the American Bankers Association Convention in New York, Mr. Wallace blamed the fact that there are not many Negroes employed by banks on "following the same old recruitment practices which have become a matter of habit over a period of many years." He said "this type of picture can be changed by positive action; the mere absence of open discrimination is not enough."

President Johnson's Executive Order 11246 is the authority under which the Treasury Department requires banks to adopt equal employment practices in order to get Federal deposits. These deposits average $4 billion a year and are a valuable source of income for some 12,000 banks in the United States.

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F-1037

TREASURY DEPARTMENT

WASHINGTON, D.C.

FOR P.M. RELEASE
TUESDAY, SEPTEMBER 26,1967

September 22, 1967

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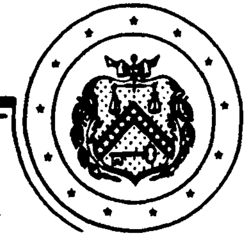
F-1037

TREASURY DEPARTMENT



WASHINGTON, D.C.

For Release at 3:30 p.m. September 22, 1967

Treasury Borrowing Plans

The Treasury Department announced today that it plans to raise $4.5 billion through the sale of tax anticipation bills maturing in April and June of 1968. The bills are to be auctioned on Tuesday, October 3, for payment on Monday, October 9.

Of the $4.5 billion total, $1.5 billion represents an additional offering of tax anticipation bills maturing April 22, 1968, of which $2 billion are already outstanding. The remaining $3 billion will be a new issue of tax anticipation bills maturing June 24, 1968.

Commercial banks will be able to pay for the tax anticipation bills, to the extent of 75%, through crediting Treasury tax and loan accounts. The remaining 25% must be paid for in immediately available funds.

The Treasury also announced that it plans to continue adding $100 million each week to the weekly offerings of 3-month bills through another full 13-week cycle. The current cycle of $100 million weekly additions will be completed with bills to be paid for October 5, it was noted. Subsequent weekly bill offerings will include $1.5 billion of 3-month bills and $1.0 billion of 6-month bills.

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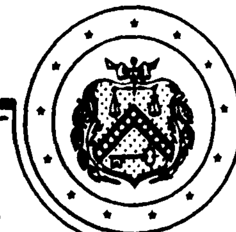
TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR IMMEDIATE RELEASE September 22, 1967

TREASURY OFFERS $4.5 BILLION OF APRIL AND JUNE TAX BILLS

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills designated Tax Anticipation Series to the aggregate amount of $4,500,000,000, or thereabouts, as follows:

196-day bills (to maturity date) to be issued October 9, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated July 11, 1967, and to mature April 22, 1968, originally issued in the amount of $2,000,967,000, the additional and original bills to be freely interchangeable. The bills will be accepted at face value in payment of income taxes due on April 15, 1968.

259-day bills, for $3,000,000,000, or thereabouts, to be dated October 9, 1967, and to mature June 24, 1968. The bills will be accepted at face value in payment of income taxes due on June 15, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided and at maturity, to the extent they are not presented in payment of income taxes, their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Taxpayers desiring to apply these bills in payment of income taxes may submit the bills to a Federal Reserve Bank or Branch or to the Office of the Treasurer of the United States, Washington, not more than fifteen days before the appropriate income tax payment date. In the case of bills submitted in payment of income taxes of a corporation they shall be accompanied by a duly completed Form 503 and the office receiving these items will effect the deposit on the date the taxes are due. In the case of bills submitted in payment of income taxes of all other taxpayers, the office receiving the bills will issue receipts therefor, the original of which the taxpayer shall submit on or before the date the taxes are due to the District Director of Internal Revenue for the District in which such taxes are payable.

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Tuesday, October 3, 1967 Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

F-1039

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

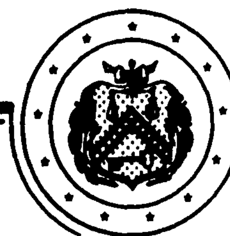
All bidders are required to agree not to purchase or to sell, or to make any agreements with respect to the purchase or sale or other disposition of any bills of the issue for which they are bidding at a specific rate or price, until after one-thirty p.m., Eastern Daylight Saving time, Tuesday, October 3, 1967.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for $300,000 or less for the 196-day bills and $400,000 or less for the 259-day bills, without stated price from any one bidder will be accepted in full at the average price (in three decimals of accepted competitive bids for the respective issues. Payment of accepted tenders at the prices offered must be made or completed at the Federal Reserve Bank in cash or other immediately available funds on October 9, 1967, provided, however, any qualified depositary will be permitted to make payment by credit in its Treasury tax and loan account for not more than 75 percent of the amount of Treasury bills allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits when so notified by the Federal Reserve Bank of its District.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR RELEASE 6:30 P.M.,
Monday, September 25, 1967

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury bills, one series to be an additional issue of the bills dated June 29, 1967, and the other series to be dated September 28, 1967, which were offered on September 20, 1967, were opened at the Federal Reserve Banks today. Tenders were invited for $1,400,000,000, or thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day bills. The details of the two series are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	91-day Treasury bills maturing December 28, 1967		182-day Treasury bills maturing March 28, 1968	
	Price	Approx. Equiv. Annual Rate	Price	Approx. Equiv. Annual Rate
High	98.834 a/	4.613%	97.406	5.131%
Low	98.827	4.640%	97.394	5.155%
Average	98.830	4.629% 1/	97.400	5.143% 1/

a/ Except 1 tender of $100,000
83% of the amount of 91-day bills bid for at the low price was accepted
72% of the amount of 182-day bills bid for at the low price was accepted

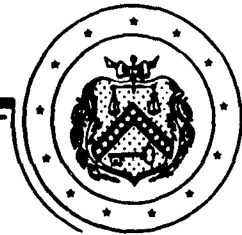
TOTAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	Applied For	Accepted
Boston	$ 20,982,000	$ 9,604,000	$ 14,930,000	$ 4,490,000
New York	2,131,485,000	1,095,248,000	1,342,775,000	725,157,000
Philadelphia	26,238,000	12,487,000	13,295,000	4,652,000
Cleveland	43,539,000	25,819,000	23,007,000	22,346,000
Richmond	12,497,000	10,501,000	5,367,000	5,067,000
Atlanta	47,784,000	31,375,000	32,977,000	23,277,000
Chicago	251,217,000	74,197,000	181,076,000	70,766,000
St. Louis	59,223,000	46,180,000	44,870,000	39,670,000
Minneapolis	20,009,000	7,209,000	14,490,000	5,990,000
Kansas City	31,768,000	18,789,000	15,274,000	12,877,000
Dallas	15,995,000	10,645,000	12,958,000	8,678,000
San Francisco	160,668,000	58,048,000	143,691,000	77,291,000
TOTALS	$2,821,405,000	$1,400,102,000 b/	$1,844,710,000	$1,000,261,000 c/

b/ Includes $218,572,000 noncompetitive tenders accepted at the average price of 98.830
c/ Includes $133,835,000 noncompetitive tenders accepted at the average price of 97.400
1/ These rates are on a bank discount basis. The equivalent coupon issue yields are 4.76% for the 91-day bills, and 5.37% for the 182-day bills.

F-1040

TREASURY DEPARTMENT



WASHINGTON, D.C.

'OR RELEASE 6:30 P.M.,
uesday, September 26, 1967.

RESULTS OF TREASURY'S MONTHLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury ills, one series to be an additional issue of the bills dated June 30, 1967, and the ther series to be dated September 30, 1967, which were offered on September 20, 1967, ere opened at the Federal Reserve Banks today. Tenders were invited for $500,000,000, r thereabouts, of 272-day bills and for $1,000,000,000, or thereabouts, of 366-day ills. The details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	272-day Treasury Bills maturing June 30, 1968		:	366-day Treasury Bills maturing September 30, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	96.154	5.090%	:	94.835	5.080%
Low	96.095	5.168%	:	94.745	5.169%
Average	96.113	5.145% 1/	:	94.791	5.124% 1/

3% of the amount of 272-day bills bid for at the low price was accepted
62% of the amount of 366-day bills bid for at the low price was accepted

TAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 302,000	$ 302,000	:	$ 40,507,000	$ 30,507,000
New York	967,840,000	396,715,000	:	1,302,088,000	718,338,000
Philadelphia	5,390,000	1,390,000	:	11,390,000	3,290,000
Cleveland	6,633,000	6,633,000	:	23,399,000	23,399,000
Richmond	14,237,000	7,237,000	:	22,762,000	17,762,000
Atlanta	15,204,000	6,604,000	:	21,547,000	12,947,000
Chicago	138,638,000	18,259,000	:	119,970,000	46,970,000
St. Louis	11,726,000	2,816,000	:	20,346,000	8,346,000
Minneapolis	14,080,000	13,580,000	:	15,096,000	15,096,000
Kansas City	1,940,000	1,940,000	:	5,360,000	5,360,000
Dallas	11,414,000	4,414,000	:	13,272,000	8,272,000
San Francisco	68,175,000	40,175,000	:	144,717,000	109,717,000
TOTALS	$1,255,579,000	$ 500,065,000 a/		$1,740,454,000	$1,000,004,000 b/

Includes $21,707,000 noncompetitive tenders accepted at the average price of 96.113
Includes $56,666,000 noncompetitive tenders accepted at the average price of 94.791
These rates are on a bank discount basis. The equivalent coupon issue yields are 5.39% for the 272-day bills, and 5.42% for the 366-day bills.

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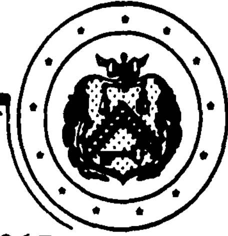
TREASURY DEPARTMENT



WASHINGTON, D.C.
September 27, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $2,400,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing October 5,1967, in the amount of $2,302,245,000, as follows:

91-day bills (to maturity date) to be issued October 5, 1967, in the amount of $ 1,400,000,000, or thereabouts, representing an additional amount of bills dated July 6, 1967, and to mature January 4,1968, originally issued in the amount of $1,000,092,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated October 5, 1967, and to mature April 4, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Monday, October 2, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on October 5, 1967, in cash or other immediately available funds or in a like face amount of Treasury bills maturing October 5, 1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained fro any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE

REMARKS OF THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY OF THE UNITED STATES
AND
UNITED STATES GOVERNOR OF THE INTERNATIONAL MONETARY FUND
BEFORE THE
ANNUAL MEETING OF THE INTERNATIONAL MONETARY FUND,
RIO DE JANEIRO, BRAZIL, TUESDAY, SEPTEMBER 26, 1967

I

I take special pleasure in participating in this Annual Meeting in Rio de Janeiro. I am very grateful to the Government and the people of Brazil for their gracious hospitality on this occasion. The beauty of this city, the breathtaking potential of this huge vibrant country, form a backdrop to the conference that can inspire us all.

The personal experience of viewing at first-hand the problems and potentialities of economic growth in Brazil and in her neighboring nations will, I trust, stimulate us all to assist in further efforts to reinforce international collaboration to support economic development.

I am very glad to see among us once again Governors for Indonesia representing that large and important nation, and to note that both the Fund and Bank have been able, in the past year or so, to play a helpful, constructive role in assisting Indonesia to deal with a most difficult and trying period of economic stabilization. I know that all of us wish the Indonesian authorities well in the courageous efforts they are making.

It is also a pleasure to welcome to membership in our organizations The Gambia, which last week completed the formalities to assume membership, and Botswana, whose membership resolutions are before this meeting of governors.

The Fund and Bank have had another highly successful year, the highlights of which have been recorded in their excellent annual reports. Mr. Woods and Mr. Schweitzer have summarized the activity of the past year in the Bank family and in the Fund and I will not retrace the ground they have covered so well.

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But the events of the year in the usual pattern have been crowned by an unusual, indeed, unique achievement -- the creation of a facility to meet the need, as and when it arises, for a supplement to existing reserve assets. This is to be established within the framework of the Fund, and is embodied in the Outline Plan for a Special Drawing Rights Facility which is the principal business of this meeting.

II

Last year we urged joint meetings of the Executive Directors representing all member countries of the Fund and the Deputies of the "Group of Ten." It was our hope and trust that from these meetings a specific plan for deliberate reserve creation would emerge to become the subject of action by the Fund Governors at this Annual Meeting. This hope and trust have been fulfilled. The joint meetings have produced results which exceeded expectations and the United States is grateful to all the Ministers and Deputies of the Group of Ten and to the Executive Directors, Managing Director and staff of the Fund.

So at last we, at this meeting, come to the final and logical forum for an International Monetary Conference to consider what steps we might jointly take to secure substantial improvements in international monetary arrangements looking to the creation of a facility to provide, as and when needed, a supplement to existing reserve assets. Despite twenty-two years of steady progress since Bretton Woods, we need to assure a world monetary system conducive to a more rational and orderly expansion of global reserves. It would be a grave error, however, to assume that a strong, flexible and adequate international monetary system begins and ends with the assurance of adequacy of global reserves. There are other essential elements which require both international cooperation and a responsible approach of national monetary authorities. Two particularly deserve mention, and the assurance to my fellow Governors is that the United States will play its full part.

The maintenance of convertibility of the dollar and gold for international monetary purposes is also essential to a regime of stable exchange rates, which is a primary objective of the Fund recalled to us yesterday by the Managing Director in his notable address.

Nothing in the new arrangements on liquidity is designed to alter the present relationship between gold and the dollar. The United States' commitment to the convertibility of the dollar into gold at $35.00 an ounce remains firm. This has been, and will continue to be a central factor in the monetary system.

Another element deserving comment is the process of adjusting payments imbalances. International cooperation is important here also, for it is difficult without it to make this process work effectively in the complex world today. The continuing expansion of world trade and investment carries with it a corresponding tendency toward a higher absolute level of international imbalance. An improved adjustment process can serve to moderate this trend, and especially to reduce or eliminate persistent or excessive deficits and persistent or excessive surpluses.

The Fund report calls attention to some of the difficulties encountered in improving the adjustment process. At the present moment, in my own country there is clear need to apply fiscal restraint to what may otherwise soon become an expansion so excessive as to create serious inflationary strains and an increasing balance of payments deficit. Meanwhile, many countries of Continental Europe are still in need of stimulus to restore more satisfactory rates of economic growth. This would also reduce their balance of payments surpluses and thereby promote the international adjustment process.

A perfectly even rate of growth is not to be expected either in national economies or in world trade. The recent situation has been marred by sluggish advances in output -- and in some instances, contractions -- in a number of key industrial nations. If this state of affairs were to continue, or, worse still, to intensify, strains on the international payments mechanism would surely become severe. In particular, the world's primary producing nations would bear a heavy burden of adjustment.

In many of the industrial nations, a slower advance in output was consciously sought by national policy in order to reduce inflationary pressure. With the adjustment completed, the basis for a more enduring expansion has been laid. Essential as these adjustments in separate countries have been, policies of contraction in surplus countries must not be allowed to continue so long as to prejudice the prospects for an expanding volume of world trade, severely aggravating

imbalances in international payments. A constantly expanding volume of trade, well-distributed regionally, is essential if acceptable levels of well-being are to be sustained in developed countries and promoted in the developing countries of the world.

A common theme in the recent experience of many industrial nations has been the monetary strains that are the consequence of too rapid internal expansion, and too sparing reliance on fiscal restraint. In general, this year has seen some easing of the most severe financial strains. But, in turn, the welcome moderate reduction in upward pressure on money markets internationally has only been achieved, in the main, along with a slowing in the growth of output in some major industrial nations below the rates that are desirable and feasible from a long-term point of view. Despite this, long-term interest rates have remained high.

There will be a need to harmonize national economic and financial policies in the interest not only of balanced expansion at home, but also of a balanced expansion of trade internationally. We are all aware that both deficit and surplus countries share the responsibility for continuous efforts to improve the process of adjustment. Deficits and surpluses are after all two sides of the same coin. There should be no presumption that either the deficit or surplus country is the one that is delinquent. Cooperative action by both parties is essential.

Let me turn now to the main subject of interest -- on the Fund side -- at this Annual Meeting.

This twenty-second Annual Meeting has a special meaning for all Fund members. After nearly a quarter-century of experience with the Articles of Agreement prepared at Bretton Woods in 1944, we are now asked to approve a procedure leading to the first amendment to those Articles.

The plan for Special Drawing Rights is important to all our member nations. There is no area of the world that does not have a vital interest in the expansion of international trade. Moreover, the flow of public and private capital across national boundaries is of the greatest concern to the developing world, and these flows can quickly feel the adverse effects of inadequate reserves.

At the end of August, President Johnson, commenting on the London meeting, said: "Without such a scheme, the increasing inadequacy of the world's money supply will make it progressively harder for national governmentsto follow liberal trade and employment policies. The livelihood and even the lives of literally hundreds of millions of people over the next decade or two could be at issue especially in the less-developed countries."

Since the war, gold and dollars have provided a flow of new reserves, But gold is not now adding to global reserves, nor can it confidently be assumed that it will do so to a very large extent in the future. Total monetary gold stocks, including those held by the Fund and other international financial institutions, are not significantly larger today than they were at the end of 1964.

Dollars, sterling and temporary reserves created by the Fund under existing procedures are for the time being carrying on growth of reserves. But it is clear that future reserve growth cannot rely, as in the past, on U.S. payments deficits.

It is against this background that the negotiations on the Outline Plan have proceeded. And the Plan makes crystal clear that it is possible to reach agreement on a specific course of action despite differences in approach to the problems of the monetary system and despite widely varying national reserve positions and policies. We have progressed toward agreement in a pragmatic spirit, recognizing that no one participating in these negotiations could expect the outcome to coincide in full with his own ideas. The judgment and good will of a large number of responsible officials of Governments and Central Banks have combined to bring about this result after some years of intensive work. The Outline

Plan is now before us. We have the responsibility -- and the opportunity -- to adopt a resolution to begin the process of giving it life. This is our unique opportunity, meeting as a body, to act on the Outline Plan, before it is committed to our Executive Directors for final drafting, then to this Board for approval, and to Governments for acceptance.

The Outline Plan has the full support of my country. It provides the framework for an effective and workable structure for meeting future global needs for reserve assets. While there are many aspects of the Plan that are noteworthy, I shall confine myself to a few observations:

1. The Outline Plan is a universal plan. It is open to all members of the Fund, and I hope that all will wish to participate.

2. The facility is intended to meet the need, as and when it arises, for a supplement to existing reserve assets. While each country will make its own decision, it is expected that these Special Drawing Rights will be treated as first-line reserves. The United States intends to do so.

3. The new reserve asset should provide insurance against an excessive cumulative competitive pressure for restrictions on international finance and trade transactions. It can also act as a counter to such interacting national moves toward unduly high interest rates as are brought about by competitive actions of those countries that are protecting their reserves. At one and the same time, it will permit growth in world reserves and buttress confidence in the stability of the entire system of world finance. In a word, it should operate to relax appreciably some of the unnecessarily painful strictures on international finance that come from fears of actual or impending reserve shortage.

4. Endorsement of this Outline Plan should in itself provide smoother sailing in the world's money and exchange markets. Anticipation of the future is a powerful present factor in all things financial. Gold and exchange markets should reflect a new sense of confidence in the adequacy of future reserve supplies.

5. We are gratified that the Outline Plan recognizes that international liquidity is the business of the Fund, and clearly provides that the Board of Governors, where every member of the Fund is represented, will have the final responsibility for the vital decisions to creat new Special Drawing Rights. However, as to the role of the Fund in the use of Special Drawing Rights, the Outline Plan wisely leaves scope for development through experience. The Fund's role may well become one of general guidance, more than one of detailed operation. While some basic rules for use need to be maintained, they need not be numerous or complex. The essential part of the Fund's role would seem to lie less in the area of specific transactions than in the process of taking decisions to create Special Drawing Rights and in clarifying and maintaining the basic rules governing their use.

6. A very considerable amount of reconstitution of Special Drawing Rights may be expected to occur through the normal balance of payments processes. Still it has been agreed that some explicit reconstitution provision was necessary. At the same time, it was important to avoid compromising the quality of the Special Drawing Rights as a supplement to existing reserve assets. The principles for reconstitution that have been adopted for the first 5-year period assure that the Special Drawing Rights will not be abused, yet do not interfere with their reserve asset status.

In addition to the net average use provision adopted as the initial operating rule, it is also provided that "participants will pay due regard to

the desirability of pursuing, over time, a balanced relationship between their holdings of Special Drawing Rights and other Reserves." This provision is intended to encourage a balanced use of all three assets over time and thus maintain stability, in a general way, in relative holdings of the new asset and existing reserve assets, as well as to promote equivalence between the new asset and the traditional reserve assets.

My country subscribes strongly to the view that the new facility is designed to assure a satisfactory rate of growth in global reserves. It is not designed to meet an individual country's balance of payments problems.

Let me make it clear that the new facility should in no sense be regarded as a solution to the balance of payments problem of the United States or to the corresponding surplus problem of Continental Europe. This is a matter that falls under the heading of the continuing effort to improve the adjustment process. As the Hague Communique of the Group of Ten in July, 1966 noted, "The prerequisite for the actual creation of reserves should include the attainment of a better balance of payments equilibrium between members and the likelihood of a better working of the adjustment process in the future."

Of course in determining his view as to global needs for reserves, presumably the Managing Director will take into consideration prospective future additions to reserves in the form of dollars or other foreign exchange, as well as a number of other factors and developments, both quantitative and qualitative. I doubt that an elaborate or detailed listing of criteria and relative priorities can be established, because conditions change and the relative importance of criteria change. I believe it would not be useful to incorporate a fixed list of criteria in the agreement or the report.

The United States Delegation has great pleasure in giving its support to the Resolution that calls on the Executive Directors to propose the necessary amendments to the Articles of Agreement. It is my strong recommendation that the work of the Executive Directors to this end be completed with dispatch. We hope to propose legislation to the Congress of the United States in the early spring of 1968.

The Resolution before us also requests that a report be made on such other possible amendments as may be recommended at the same time. We are clearly at a much earlier stage of our consideration of other proposals for changes in the Articles and By-Laws. Nevertheless, my Delegation concurs in proceeding to an examination of such proposals.

The proposals will have to be judged on their own merits, and accepted, altered or rejected on this basis in the report to be submitted by the Executive Directors. Some suggestions may prove relatively easy either to accept or reject. If, however, some suggestions are found to be complicated and/or controversial, the Executive Directors could not be expected to put forward next year specific proposals for change based on such suggestions. Adequate time should be allowed to permit a mature, broad, and certain meeting of minds. This is the way we have approached the question of Special Drawing Rights.

For the above reasons, I believe that specific substantive decisions on all these matters should not be regarded as a precondition to taking action on the Special Drawing Rights amendment.

III

I turn now to matters relating to long-term economic development. The improvements we are now setting in motion in the international monetary mechanism are, I believe, essential to the long-term well-being of the developing countries. Economic interdependence of the developed and the developing countries is a fact of the present and of the future that must be a guiding principle in the direction we give to international economic policies.

It is a paradox that the problem of development, while infinitely complex in its economic, social, cultural and even moral ramifications, is also blindingly simple in its barest elements. These can be reduced to three in number:

(A) Domestic self-help policies by the developing country sufficient to;

(B) attract external resources, public and private, drawn from countries able to provide them resulting in a;

(C) diligent application of the combined domestic and external resources along lines conducive to long-term development rather than exhausting immediate consumption.

The major factor in the history of successful development lending by the World Bank may well be its devotion to these principles. The Bank outstandingly reflects them today.

The subject of International Development Association replenishment, while not formally on our agenda, is nevertheless the most important business pending before the Governors of the Bank family of institutions. It should be evident from my remarks today that President Johnson fully supports the efforts of the World Bank management to achieve a replenishment for IDA on a substantially enlarged scale. I am hopeful that in their statements here, other Governors will share this attitude.

We are mindful, of course, that external assistance such as IDA provides can only supplement sound national development efforts. Only in association with self-help efforts -- coordinated and soundly applied domestic policies and actions -- can the application of external assistance bring developing countries to sustained growth.

Further, domestic self-help policies which need not be catalogued here are of vital importance to create a climate in the developing countries conducive to maximizing the flow of external resources -- public and private. Where these measures are lacking, the task of commanding the support of the electorates of high-income countries for continued assistance with public funds will be made far more difficult. Where these are lacking, private resources will not flow in desired directions and amounts.

Two developments of the past year are especially noteworthy for us here in relation to the object of encouraging greater foreign and local private capital participation in the growth process.

The initial use of the authority granted under earlier Charter amendments was made by the Executive Directors approving a $100 million line of credit from the World Bank to the International Finance Corporation. As a result, we may expect even more substantial increases in IFC financing of the private sector -- and in the much larger volumes of foreign and local private capital that are associated with it.

Second, the inauguration of a new and useful facility within the IBRD institutional structure -- the International Centre for the Settlement of Investment Disputes -- through arbitration and conciliation services will contribute materially to an improvement of the climate in which international private investment takes place. In so doing, it will extend the area that can benefit from private investment. It merits the support of the entire membership of the Bank.

I cannot over-emphasize the importance of policies conducive to a strong and dynamic private sector, offering opportunities to both foreign and local capital, and serving as the pace-setter of the economy.

In stressing the role of private finance, I am, of course, ever mindful of the need for effectively mobilized and effectively applied public finance. We heard in the opening addresses yesterday and will in the next days learn more of the urgent need for the developed countries to find the ways and means of promoting increases in the volume of real resources available for development. We have too long remained on the so-called aid "plateau". It is time to strike out for higher ground. The World Bank family, and with it the regional banks, offer a promising channel for doing just this.

I would be taking an unrealistic view of the world if I were not to recognize, however, that, leaving aside the budgetary problem we all face, there are at least two other constraints that tend to hold back the steadily increasing availability of resources to these multilateral lending institutions.

(A) Capital markets everywhere are under pressure from mushrooming domestic requirements. The price of capital in many markets is touching historic highs. The World Bank should not be forced to place excessive reliance on any single market for its rising capital needs. A sustainable mechanism for providing development finance to the Bank through

private markets requires an equitable sharing of the total efforts -- and the concept of equity embraces reasonable terms as well as adequate amounts. Certainly, surplus countries should contribute positively to the adjustment process through granting preferred and substantially increased access to their capital markets by the Bank and other multilateral lending agencies.

(B) Balance of payments factors are the other special constraint. Rather than permit our serious and continuing balance of payments difficulties -- made still more complex by the foreign exchange cost of our effort in Vietnam -- we in the U.S. have found ways to maintain a high level of aid through the transfer of real resources to the developing world.

We would prefer, in an ideal world, to make our assistance available in the form of financial resources. However, when balance of payments realities confront us, our choice is clear: we strive not to reduce the level of our assistance -- but instead to make our assistance available through transfer of real resources. This approach requires that the real resources represent an addition to, not a substitute for, goods and services moving in normal commercial channels.

If serious and continuing balance of payments difficulties constitute a constraint on the ways the U.S. can provide assistance, persistent balance of payments surpluses constitute an imperative to countries enjoying such a position to expand their assistance in the form of finance. A sensible policy for such countries, and a policy which can make a contribution to the over-all adjustment process in the international payments system, is one of increasing the volume, easing the term, widening the geographic scope and eliminating procurement limitations on the flow of development funds.

These thoughts are relevant to the unresolved question of IDA replenishment.

As of last March, I was authorized by President Johnson to support the IDA replenishment at a substantially increased level, provided that account should be taken of the balance of payments problems of deficit donor countries in deciding how IDA's new resources would be made available. Such a feature will in fact speed agreement leading to transfer of resources to less-developed countries through IDA.

If the multilateral agencies themselves are to achieve our hopes for them, they must have increasing funds committed by the donors for a long-term period. Balance of payments safeguards will help assure that long-term contributions are made, since only with their protection will Finance Ministers be in a position to assure their legislatures that the uncertainties of the future have been taken into account.

In thus referring briefly to IDA replenishment discussions I would like to make one further point very clear. Nothing in the United States plan would require IDA to make any changes in its present policies with respect to the allocation of its resources to countries and projects, or with respect to international competition in procurement, and no such changes are contemplated in this proposal.

The magnitude of the tasks ahead requires that we strive to improve the quality of the development efforts of both the advanced and the developing countries. In so doing, we must recognize that certain economic sectors demand greater concentration of these improved efforts. The twin problems of food and population should now occupy the forefront of our attention. The U.S. is emphasizing assistance in agricultural improvement -- including land reform as well as direct production improvements -- in its own programs. The international institutions are giving increased attention on their part. Nothing less than the highest priority attention to these problems will provide the basis for averting the potential disaster that looms in the food-population race.

In closing my remarks I would like to quote to you the words of the Brazilian Representative, Mr. Souza Costa, who in offering a resolution of thanks at the final session of the Bretton Woods Conference, said:

> "As the knowledge of these results becomes more widespread,. a corresponding increase will take place in the number of those who, realizing the greatness of the objectives sought, will wish to be counted among the supporters of this undertaking."

How correct this prophesy has been with respect to the Fund and the Bank. Let us hope that our successors will say the same of the work that we have launched at this Annual Meeting.

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TREASURY DEPARTMENT
Washington

FOR P.M. RELEASE
SATURDAY, SEPTEMBER 30,1967

REMARKS BY THE HONORABLE TRUE DAVIS
ASSISTANT SECRETARY OF THE TREASURY AND
UNITED STATES EXECUTIVE DIRECTOR
OF
THE INTER-AMERICAN DEVELOPMENT BANK
BEFORE THE EXECUTIVES' SECRETARIES, INC.
KANSAS CITY, MISSOURI
SATURDAY, SEPTEMBER 30, 1967, 10:30 A.M., CDT

YOUR BENEFITS FROM GOVERNMENT SPENDING

This morning I would like to talk with you about your government's gathering and spending of money -- your money. And this, as any taxpayer would quickly point out, is not very funny. There are occasions, of course, when the American public views the payment of taxes with a sort of grim humor. But on the whole, the raising of federal revenues and their subsequent spending is a serious business, affecting not only the lives and welfare of every American, but also millions of people throughout the world.

In a democracy such as ours, every citizen has a right to know why he is being taxed and what happens to the money he contributes through his taxes -- whatever form they may take. And government, on the other hand, whether it is local, State, or federal, is obligated to explain and justify its expenditures. This explaining and justifying on the federal level takes place not only in committee hearings of the Congress, on the floors of both the House and the Senate, but also in the American press, including radio and television. The federal arena of public inquiry is every cultural institution where public policy is discussed and debated. The participants in this important discussion are the millions of Americans who are concerned with how the federal government spends its revenues, where it spends them, who benefits directly, and what we ultimately hope to achieve.

Before discussing how, why, and where we spend federal funds, let's look for a moment at the source of these funds. The amount of money your federal government spends every year depends primarily upon the economic health of our country and the financial well-being of our citizens. This is true not only of the United States but of every country. Countries that are economically poor usually are economically underdeveloped countries or countries which have little or no natural resources capable of intelligent development and exploitation. On the other hand, countries that are economically prosperous usually are highly developed, industrialized countries. The economic health of a nation, in other words, determines the economic health and financial well-being of its citizens. I would like to emphasize that as a people and as a government, we are committed to maintain a healthy, viable economy, to provide maximum employment to an ever-increasing population, and to use, in an intelligent, fully-productive manner, our country's natural resources, as well as our human resources -- the work of our people -- which is the most important resource of all.

One reflection of the health of our economy and the financial well-being of our citizens is in the amount of revenues the federal government receives. In examining the federal administrative budget for the fiscal year that ended June 30, 1967, we find that the government received some 61½ billion dollars from individual taxpayers, 34 billion dollars from corporations, and 20.3 billion dollars from other sources, such as excise, gift, and estate taxes. Our total federal administrative receipts amounted to 115 billion, 794 million dollars. The amount of money that the federal government spent during this same twelve month period, totaled 125 billion, 700 million dollars.

In other words, we spent almost ten billion dollars more than we received. We were able to do this through borrowing from the American public by selling Treasury bills, notes, certificates, and Savings Bonds.

Each year the government estimates what it thinks it will receive during the coming fiscal year. Estimating revenues is always a ticklish business, for the government has no way of guaranteeing in precise terms the amount of revenues that our economy will generate. We can only estimate what the tax structure may yield under certain assumed economic conditions. As conditions change, estimated tax revenues may vary substantially from prior estimates, resulting either in a budget surplus or a budget deficit. Last

year we would have had a budget surplus had it not been for additional costs of the Vietnam war.

During the present fiscal year ending June 30, 1968, we anticipate a budget deficit that may go as high as 28 billion dollars unless we take important steps to increase federal revenues and reduce federal expenditures. It was for this reason that the President recommended to the Congress last August a program that would substantially increase revenues by speeding up corporate tax collections, continuing existing excise taxes,and placing asurcharge on corporate and personal income taxes. Taken together, these tax measures would raise some 7½ billion dollars during the current fiscal year.

Depending upon the ability of the Congress and the Executive Branch of the federal government to hold down expenditures, the estimated deficit could be reduced to a manageable range of between 14 and 18 billion dollars. Unless the recommended tax proposals are adopted soon there is a strong possibility, as President Johnson emphasized, that inflation and tight money will tax the American people cruelly and capriciously. Enactment of the President's tax proposals, on the other hand, would mean that the burden of financing the war and carrying out essential domestic programs would be more equitably shared by the many elements of our society which contribute to the vitality of our economy.

We read a lot and we hear a great deal said about the necessity for reducing government expenditures. What we don't read and don't hear a great deal about are the continuous demands for increasing government expenditures. These demands do not come from people or groups of people who are financially irresponsible or ignorant of fiscal, economic, and tax policy. Nor do they come from isolated pressure groups within our society. These demands come from the entire spectrum of our society and from well-educated, highly sophisticated people who believe that our economy is sufficiently dynamic to support domestic programs necessary to strengthen our institutions and enrich the lives of all Americans.

It is impossible for me, in this brief time, to chart for you the flow of funds from your federal government back into the small towns and large urban centers of our country, or into the cultural institutions that are concerned with the health, welfare, and education of our citizens. Suffice it it say that your tax dollars do flow, both directly and indirectly, into every conceivable endeavor or pursuit that we are engaged in as a nation of some 200 million people. Where we differ as Americans is in the assignment of priorities -- in determining which endeavors, which projects,

should receive a proportionally greater or lesser amount of federal funds.

As a nation, we have at times been unjustifiably criticized, I believe, because we have been overly concerned with how other countries spent money we lent them, either directly, through bilateral arrangements, or indirectly, through regional or international banks. How a government spends its money, however, is extremely important. Money spent for the education and health of its people, for example, will enrich the resources of that country and provide greater personal happiness for its people -- two bulwarks against social revolution. Money spent by a government on unnecessary military armament, or on projects which do not develop its technological and scientific resources -- which do not benefit the people -- will never enrich the country's economy. So how a government spends its money is the indispensable criterion in determining whether a government serves its people and strengthens those institutions that give meaning and substance to their culture.

Many of you grew up after World War II, and I rather imagine that many of your fathers went to college on the GI Bill of Rights. Under this bill, your federal government invested 14½ billion dollars to send more than eight million veterans to schools. This program, I believe, clearly illustrates what I am trying to convey to you about the wise use of federal funds to strengthen and enrich the resources of our country.

What did our society receive for its investment of some 14½ billion dollars? In human terms we got 450,000 doctors and nurses; 180,000 teachers; 360,000 scientists; 107,000 lawyers; 36,000 clergymen; 243,000 accountants; 700,000 businessmen; 83,000 police and fireman; 17,000 journalists; and over one and one-half million construction, metal, and electrical workers and printers. This is what our nation received in human terms.

In economic terms how did the nation benefit? In dollars and cents our veterans paid over one billion dollars a year in income taxes that they would not otherwise have paid without their advanced education. The World War II Bill of Rights paid for itself in less than fifteen years. Our country will continue to reap the benefits of this federally financed investment for decades -- and not just economically. Already the contributions by these veterans to the cultural institutions of our country -- as a direct result of their pursuit of knowledge -- has been of inestimable value.

Earlier this month President Johnson signed into law a new GI Bill of Rights. This extends to young men and women who have served in our armed forces since January 31, 1955, the same educational opportunity that we provided an older generation. In doing this, we are continuing a valuable tradition that will mutually benefit our veterans and our nation. Both will be immeasurably enriched.

During the last fiscal year that ended June 30, the federal government spent, as I mentioned earlier, 125 billion dollars. More than half of this amount -- some 68 billion dollars -- went for defense. Another 13½ billion dollars went for interest on the public debt. Approximately 14 billion dollars -- and this figure is extremely important -- was spent enlarging equality of opportunity denied millions of our citizens, and in promoting the general welfare of all our citizens. The domestic areas in which we channeled some 14 billion dollars include our public health, labor, and welfare programs; economic opportunity projects; urban renewal, public, and private housing; and the vast field of education, from elementary schools into post graduate research in our colleges and scientific institutions.

You know without my having to remind you of the numerous problems existing in these areas of human relations. As long as these problems remain -- as long as millions of human beings are denied equality of opportunity in education, health coverage, housing, and employment -- we are not adequately fulfilling our obligations -- as citizens and as a government -- to the political democracy which we profess and in which we believe. As long as these problems remain they weaken the structure of our society and our cultural institutions.

Yet it is in precisely these areas where so much misunderstanding prevails and where so many conflicting philosophies exist. Enlightened Americans realize the necessity for providing equality of opportunity to all our citizens -- equality of opportunity in all areas; education, employment, housing, and as participants in the democratic process. There is nothing wrong with conflicting philosophies when the conflict arises over the best way to provide this equality of opportunity. Differences in approaches can always be satisfactorily resolved.

Unfortunately, however, there are too many unenlightened Americans who resent and prevent the constructive use of federal funds to help eradicate the social diseases that corrupt our society. We must not let the voices of the unenlightened, the prejudiced, the immature Americans deter us from the important tasks we face as a people.

Out of this 14 billion dollars spent last fiscal year in areas that I have mentioned, almost three billion went directly into the field of education to improve our schools, to help insure every person's receiving an opportunity to obtain an education, to provide better educational facilities and services, and to pursue basic research across the spectrum of our intellectual activity. "We have entered an age," President Johnson recently said, "in which education is not just a luxury permitting some men (and women) an advantage over others. Education has become a necessity without which a person is defenseless in this complex, industrialized society. And the education our children get now charts the course not only for their individual lives but for the welfare of our country in the coming decades."

A few years ago, Dr. John W. Gardner, then president of Carnegie Corporation of New York and Carnegie Foundation for the Advancement of Teaching, and now Secretary of the Department of Health, Education and Welfare, headed a task force to chart our national goals in education. His thesis is well worth repeating: "In our society, education, ultimately serves all of our purposes -- liberty, justice and all our other aims -- but the one it serves most directly is equality of opportunity. We promise such equality, and education is the instrument by which we hope to make good the promise."

In emphasizing the importance of education and the use of federal funds in helping us achieve our goals in this area, I am not forgetful of the great work that needs to be done in correlated areas. Nor is the President, who recently reminded the Congress and the American people of the number of essential programs proposed by the Administration during the current fiscal year which are concerned entirely with or significantly with the tremendous urban problems of our nation -- programs that have yet to be acted upon by the Congress.

In these areas, as in others, the federal government must lead the way -- as it is doing -- in directing our national energies toward the realization of our national goals. These goals have been established in all areas of human endeavor, and the taxes we pay provide the necessary revenues through which we can move toward the realization of these objectives. This does not mean that private capital and private initiative should not be used in helping the federal government direct the nation toward achieving our national objectives. On the contrary, local community action, State-wide action, and regionally-wide action involving several States with mutual interests, must be a constant energizing force not only in financing essential projects, but in providing dynamic leadership so essential to any undertaking. Without such leadership and assistance the federal government's tasks become more difficult and the realization of our national objectives less imminent.

We must also realize and remember that local and State taxes, which are constantly rising, are essential in providing necessary services in local communities. They are needed for better roads, better schools, better salaries, better recreational facilities, better housing, cleaner air and purer streams, in short -- for a better physical and intellectual environment for Americans.

The tasks before us -- locally and nationally -- are not difficult to fulfill. As long as we continue to work together in unison toward their realization, we will constantly improve the general welfare and open wider the doors to equality of opportunity for all our citizens. In doing this we enrich the legacy we bequeath to successive generations of Americans.

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TREASURY DEPARTMENT
Washington

FOR RELEASE: ON DELIVERY

REMARKS BY THE HONORABLE TRUE DAVIS
ASSISTANT SECRETARY OF THE TREASURY
AND
UNITED STATES EXECUTIVE DIRECTOR OF
THE INTER-AMERICAN DEVELOPMENT BANK
BEFORE THE
HEART OF AMERICA LAW ENFORCEMENT ASSOCIATION
SHERATON-ELMS HOTEL, EXCELSIOR SPRINGS, MISSOURI
SATURDAY, SEPTEMBER 30, 1967, 7 P.M., CDT

It is a real pleasure to be with you this evening, for you dedicated individuals are making this country a safer place to live.

In this day and age there is a greater need for good law enforcement than ever before for the law violator is tougher, stronger, and better equipped than ever before. Both at the Federal and the local levels the last twenty years have brought dramatic and important changes to enforcement work. Our United States population has increased over forty percent in the last twenty years; and since crime depends upon people, crime, too, has vastly increased and with it the task of enforcement. At the same time, the complexity of effective enforcement has become formidable, requiring no small understanding of law and a thorough understanding of the conditions deep down in the community. What is more important, enforcement work and enforcement resources represent a far higher priority claim on community and national program resources as compared to twenty years ago.

More people are unhappy about crime because they live closer to it than they used to, and, like anyone who is unhappy over a problem, they want greater resources and more advanced methods to make the problem go away. Our large city areas have more voters, more crime, and demand more enforcement; and it would be surprising if it were otherwise.

The Treasury Department has been concerned with law enforcement programs longer than any other department of the Government. The Bureau of Customs was created in 1789, and it was the first Federal agency to be established by the Congress. In fact, it precedes the United States Treasury of which it is now a part. Other law enforcement agencies we have within the Treasury are the Bureau of Narcotics, the Secret Service, the Intelligence Division, and the Alcohol and Tobacco Tax Division of the Internal Revenue Service, and, up until this past April, the United States Coast Guard. So we, too, at the Treasury are concerned with law enforcement in a big way and can appreciate the myriad problems attendant.

My good friend, and a most capable man, James Hendrick, who is Special Assistant to the Secretary for Enforcement, is charged with the responsibility of supervising and coordinating these various enforcement groups. He and the able heads of these bureaus and divisions, I feel, perform a most exacting task in the finest manner conceivable.

By now every school child knows of the efforts and successes of Eliot Ness in Treasury enforcement activities against the forerunners of today's organized crime figures. Most adults are aware that when Al Capone was finally convicted, it was for violation of the laws enforced by the Internal Revenue Service. But I suspect very few persons outside the law enforcement field realize that 60 percent of the organized crime figures now under detention are there as a result of Internal Revenue Service convictions.

The Customs Service has responded to a rapid increase in attempted narcotics importation by an equivalent increase in its effectiveness resulting in the largest seizures of marihuana in its history this past year. I might say that the Customs Service has found itself in an extraordinary administrative predicament as a result of these seizures. The amount of marihuana now being stored by the Customs Bureau as evidence pending trial of the importers has reached such proportions that it is outgrowing the available secure storage space. An arrangement is being worked out with the Justice Department to permit destruction of large portions of this material, reserving samples for use as evidence.

Seizures by other Bureaus continue to mount rapidly. The Secret Service seizes approximately 90 percent of the counterfeit currency manufactured in this country before it reaches the public; notwithstanding the fact that counterfeiting activity has tripled within the last four years.

The Bureau of Narcotics has some reason to believe it is approaching the crest of the hill in its long war against the dark, desperate business of the heroin traffic. There are increasing indications that the purity of heroin sold on the street is declining, the strength of the individual dose diminishing, and the cost to the addict rising. There have been recent reports that organized crime may be considering abandoning the heroin traffic altogether because of the increasing effectiveness of the law enforcement activity directed against it.

These impressive indications of increased effectiveness in criminal investigation have been accompanied by technical and scientific developments in the Treasury enforcement agencies which should lead to even greater successes in the future. The Secret Service Ninhydrin Fingerprint Laboratory with its capability of raising latent fingerprints from even lightly touched paper is the most advanced fingerprinting facility in the country.

The Alcohol & Tobacco Tax Laboratory's neutron activation analysis has provided a major breakthrough to all law enforcement agencies. As you no doubt know, this process enables absolute identification of true elements in inorganic materials so that a fleck of paint, a piece of hair, or a soil sample may be identified as part of another sample with absolute certainty rather than as a matter of subjective opinion. The importance for evidentiary purposes of such identification is hard to exaggerate.

The Secret Service, Customs Bureau, and Internal Revenue Service are, of course, expanding their use of computers in the law enforcement area. Within the month the Treasury will be linked into the National Crime Information Center of the F.B.I. In the immediate future it will be possible for an agent at a pay phone to dial a number and know within seconds whether the automobile he is watching has been stolen anywhere in the United States, or whether there is a valid warrant for the arrest of a given person outstanding in any jurisdiction in the United States.

The Bureau of Narcotics is participating in studies of the application of techniques of economic market theory to determine, from studies of heroin pricing in New York and Chicago, additional information about the structure of the organizations distributing the heroin. The results of such studies may be of considerable assistance to augment the intelligence derived from traditional investigative work.

These achievements are all the more remarkable when one considers the size of the total force which is producing them. Altogether there are 4950 law enforcement agents in the Treasury. As has been suggested by certain car-rental firms, this makes us only "second biggest" and I might suggest that perhaps our motto might be "We try harder." The accomplishments certainly do not receive the recognition they deserve. Director Rowley of the Secret Service has on his desk a motto, cast in bronze, to the effect that there is no limit to what you can accomplish if you don't care who gets the credit.

These new techniques, the new processes, the new procedures, methods and tools that will help us do our work better are certainly useful; however, there is a new dimension to our work. It is one which I expect you are already finding yourself and your staffs spending more and more time exploring. I refer to being aware of, and understanding, the importance of economic and social factors that are creating and shaping many kinds of problems with which law enforcement officers must cope.

No longer is it enough for a law enforcement official to understand the law or to understand the techniques for apprehending those who break the law.

But we must now understand the <u>why</u> of those people, those movements and those processes which threaten law and order. For only through understanding <u>why</u> law and order is threatened, can we take steps to prevent disturbances before they occur, to find the pressure points behind them and move quickly to alleviate these pressures before they explode.

Simply stated -- it means preventing trouble before it happens. If we can accomplish this, we will be performing in our most effective manner. For we are most effective at our jobs when we understand not only ourselves, not only our profession, not only our problems, but also our enemies.

Equally as important as knowing those individuals and groups that threaten law and order is earning and maintaining the respect of law abiding citizens.

This, as we all know, means that we must continually strive for a higher degree of professionalism. We must always be willing to re-examine old ways, old procedures, old techniques, in the light of current knowledge and information and new interpretations of law.

Here in this country our President has launched a vigorous campaign against crime. President Johnson initiated the first systematic, nation-wide study of lawlessness, law enforcement and the administration of justice in our history; and our children and our children's children will be the beneficiaries.

Two weeks ago, President Johnson spoke to the International Association of Chiefs of Police in Kansas City and pledged that he was ready and willing to do his part on the Federal level to undertake a far reaching program to reduce our nation's crime. But he further pointed out that all citizens must "be willing to pay the bill for improving the performance of our police, and our courts, and our correctional institutions and give them the salary, pay, and equipment they need."

The President realizes, perhaps more than any other person in this nation of ours, that lawlessness and crime must be brought under control. The President further stated, "let us act instead of talk against crime. Let us repair as many shattered lives as we can. Let us do it within and through the American system of due process and in keeping with our tenacious regard at all times for the blessings of individual freedom."

As crime trends ascend, enforcement must do its job better. This means that enforcement organizations must possess the analytical faculty to determine how well they are doing, what needs to be done, what facilities they need, and how to employ them. They must know, or find out, these things with a high degree of precision. It is going to be difficult, but so all important, for Federal and community enforcement to muster the resources, the raw human material, and the training programs to put men in the Field who are consistently up to the extraordinary demands of enforcement work at its best. This becomes a complicated

business for many high priority programs are advancing together, each competing for the men, women and resources that it needs: medical programs, educational programs, military programs, urban recovery programs, enforcement programs. However, as the President has indicated, he is willing to take the lead in insisting that enforcement resources be given a far greater priority than ever.

There is an absorbing fascination in your work as enforcement officers. It is hard work, often dangerous, sometimes straining your family tranquility as a result of irregular hours. But, on the other hand, I know you all have felt the challenge of the problem to be solved -- the pride of pitting your wits against a suspected violator -- the camaraderie of working with trusted fellow officers -- the satisfaction inherent in a case successfully completed. In other words, you have a justifiable pride in your work. You gentlemen are one of the most valuable assets of our nation.

In recent years our higher courts have handed down decisions which have compelled you to change and improve your law enforcement methods. Many of these changes may not be to your liking; however, they represent the law of our land and as good citizens we must obey these laws for they make up the backbone of our nation and civilization.

The Government and the people of our nation trust us to maintain our individual and professional integrity, beyond the shadow of a doubt.

They trust us to protect them from unseen dangers, regardless of risk.

They trust us to move forcefully and effectively when danger shows itself.

They trust us never to use unnecessary force and never to interfere with those individual rights which the people of all free nations cherish.

Finally, they trust us to carry out our work in such a fashion that the police power of the Government, and the State, is used for the benefit of all the people. When it is so used, the democratic institutions and processes are strengthened.

These are heavy responsibilities which none of us take lightly. They carry a single reward, the reward of public trust. They carry a single opportunity, the opportunity for public service -- a trust and an opportunity that we share alike. This view we must keep always with us, especially when the trust bears heavily upon us and the responsibilities seem oppressive.

You men by your very profession are patriots, and patriots in the true sense of the word in that you have dedicated your lives to making this nation a better place to live and, accordingly, I do want to advise with you a minute concerning the conflict in Vietnam.

Our President has tried hard -- believe me, he has -- to end this conflict in Vietnam. He has offered the Communists every possibility of meeting them at the conference table that any honorable person could. He has stated many times that we are in Vietnam because the great majority of our people believe that the citizens of Vietnam should have a free choice.

Our nation is a democracy, and we believe in the right of the minority to express themselves. Yet I do not believe that extremist groups, leaning heavily to the right or to the left, should conduct themselves in a manner which sows seeds of treason.

There is disagreement among loyal and earnest citizens as to our role in the Vietnam conflict. I do not think that disagreement over our role in Vietnam runs along ideological lines. I think, rather, that it arises largely from lack of information and perspective.

The basic elements of the situation in Vietnam are the facts that:

1. A long lasting, and growing, attempt has been made by the Communist powers in the North (North Vietnam, encouraged and supported by Red China) to take over South Vietnam.

2. There is absolutely no indication of any kind that the aggression against South Vietnam would halt there, if it were successful. Every other country in Asia, in an ever widening circle, would be menaced by an ever-narrowing pair of pincers, consisting of Red China and a collection of countries impressed in the Marxist world in Southeast Asia. These pincers would end by closing upon India and Pakistan. Then, a new expansionist movement would be ready, with Asia Minor and the Middle East as its target. The problem is not merely South Vietnam and its 15 million people. It is a problem concerning, more nearly, half the population of the world, spread over all Asia and the Middle East.

3. The third critical consideration is that only with the help of the United States is it possible to halt this disastrous entombment of half of mankind in the grave Marxism has ready for the free and beneficial life that the world has been struggling toward since civilization began. If we do not help halt it, no one can do so!

That, to my way of thinking, is what it is all about in Vietnam.

What, then, is the prospect?

I think that the prospect is for bringing the advance of Marxist fear, class hatred, and economic failure to a complete halt, at a known and generally recognized line in Asia, just as we did earlier, by military firmness, in Europe. The Communist part of the world only knows force -- and firmness.

That is a result of such tremendous significance that the sacrifices and dangers of Vietnam stand forth as one of those great hinges upon which history turns. With a line drawn in Asia, we can begin the long and arduous process, there, as we have begun it in Europe, of opening the tomb once again to the light of freedom. With the line drawn, with aggression halted, with a wide and evermore prosperous world of freedom

preserved and secure, we can entrust the task of eventual world victory for freedom to the kind of world that freedom builds once we have made certain that it has room to do its work.

Liberty is precious -- far more precious than riches -- and we must fight and be willing to fight to defend it. Those patriotic forebears of ours at Bunker Hill, Lexington, Saratoga and Yorktown placed liberty above their lives and gave willingly to establish our way of life on this continent. One hundred and ninety years later we are faced with the same choice in the free world.

Recently, I have noticed that some of our young people have sneered at the word "patriotism." To me, this is an outrage. But perhaps we must assume part of the blame, for possibly we have not awakened in our young people the true meaning of the word "patriotism." I feel that it is the responsibility of each one of us to re-awaken the burning light of freedom in our hearts; and by our very enthusiasm, carry this to our young people. Defenders of liberty, believers in freedom, we shall prevail as we have in the past. We all may have some political differences -- but first of all, and always, we are Americans!

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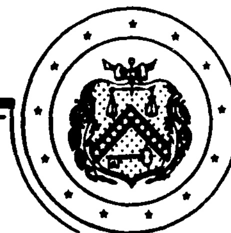
UNITED STATES SAVINGS BONDS ISSUED AND REDEEMED THROUGH October 31, 1967

(Dollar amounts in millions – rounded and will not necessarily add to totals)

DESCRIPTION	AMOUNT ISSUED 1/	AMOUNT REDEEMED 1/	AMOUNT OUTSTANDING 2/	% OUTSTANDING OF AMOUNT ISSUED
'URED				
eries A-1935 thru D-1941	5,003	4,995	8	.16
eries F and G-1941 thru 1952	29,521	29,469	52	.18
eries J and K-1952 thru 1954	2,236	2,215	21	.94
IATURED				
eries E 3/:				
1941	1,866	1,632	235	12.59
1942	8,243	7,225	1,018	12.35
1943	13,269	11,658	1,610	12.13
1944	15,468	13,495	1,972	12.75
1945	12,144	10,407	1,737	14.30
1946	5,495	4,515	980	17.83
1947	5,203	4,104	1,099	21.12
1948	5,368	4,135	1,234	22.99
1949	5,294	4,005	1,289	24.35
1950	4,627	3,444	1,183	25.57
1951	4,006	2,982	1,024	25.56
1952	4,197	3,093	1,104	26.30
1953	4,789	3,430	1,358	28.36
1954	4,877	3,409	1,469	30.12
1955	5,079	3,472	1,607	31.64
1956	4,898	3,289	1,609	32.85
1957	4,604	2,987	1,616	35.10
1958	4,475	2,742	1,733	38.73
1959	4,186	2,512	1,675	40.01
1960	4,185	2,391	1,794	42.87
1961	4,214	2,279	1,935	45.92
1962	4,059	2,132	1,927	47.47
1963	4,514	2,182	2,332	51.66
1964	4,403	2,084	2,319	52.67
1965	4,309	1,946	2,363	54.84
1966	4,624	1,732	2,892	62.54
1967	2,807	581	2,226	79.30
Unclassified	589	593	-4	-
Total Series E	151,789	108,454	43,335	28.55
ries H (1952 thru May, 1959) 3/	5,485	2,875	2,610	47.58
H (June, 1959 thru 1967)	6,373	1,121	5,252	82.41
Total Series H	11,858	3,996	7,862	66.30
Total Series E and H	163,647	112,450	51,197	31.29
ries J and K (1955 thru 1957)	1,515	1,201	313 4/	20.66
l Series — Total matured	36,760	36,679	80	.22
l Series — Total unmatured	165,162	113,652	51,510	31.19
l Series — Grand Total	209,921	150,331	51,591	24.58

es accrued discount.
it redemption value.
ion of owner bonds may be held and will earn interest for additional periods after original maturity dates.
es matured bonds which have not been presented for redemption.

TREASURY DEPARTMENT



WASHINGTON, D.C.

›R RELEASE 6:30 P.M.,
›nday, October 2, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury
lls, one series to be an additional issue of the bills dated July 6, 1967, and the
her series to be dated October 5, 1967, which were offered on September 27, 1967, were
ened at the Federal Reserve Banks today. Tenders were invited for $1,400,000,000, or
ereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day bills.
e details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	91-day Treasury bills maturing January 4, 1968		:	182-day Treasury bills maturing April 4, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.868 a/	4.478%	:	97.440 b/	5.064%
Low	98.852	4.542%	:	97.418	5.107%
Average	98.859	4.514% 1/	:	97.427	5.089% 1/

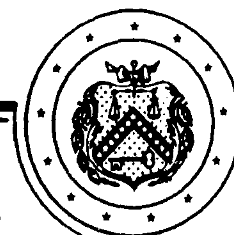
a/ Excepting 2 tenders totaling $325,000; b/ Except 1 tender of $200,000
53% of the amount of 91-day bills bid for at the low price was accepted
86% of the amount of 182-day bills bid for at the low price was accepted

ΓAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 20,383,000	$ 10,383,000	:	$ 15,563,000	$ 10,563,000
New York	1,483,499,000	962,927,000	:	1,340,050,000	681,680,000
Philadelphia	25,725,000	13,725,000	:	16,659,000	8,659,000
Cleveland	22,633,000	22,633,000	:	40,895,000	31,895,000
Richmond	20,666,000	11,196,000	:	16,731,000	6,731,000
Atlanta	44,639,000	28,347,000	:	33,204,000	17,104,000
Chicago	209,876,000	159,989,000	:	201,175,000	107,175,000
St. Louis	36,317,000	28,706,000	:	28,811,000	19,081,000
Minneapolis	25,558,000	20,781,000	:	18,393,000	8,393,000
Kansas City	25,119,000	24,119,000	:	18,221,000	13,196,000
Dallas	25,913,000	16,913,000	:	20,282,000	10,282,000
San Francisco	124,140,000	100,705,000	:	157,021,000	85,341,000
TOTALS	$2,064,468,000	$1,400,424,000 c/		$1,907,005,000	$1,000,100,000 d/

Includes $226,964,000 noncompetitive tenders accepted at the average price of 98.859
Includes $148,067,000 noncompetitive tenders accepted at the average price of 97.427
These rates are on a bank discount basis. The equivalent coupon issue yields are
4.64% for the 91-day bills, and 5.31% for the 182-day bills.

TREASURY DEPARTMENT



WASHINGTON, D.C.

R RELEASE 6:30 P.M.,
esday, October 3, 1967.

RESULTS OF TREASURY'S OFFERING OF $4.5 BILLION TAX ANTICIPATION BILLS

The Treasury Department announced that the tenders for two series of Treasury
‹ Anticipation bills, one series to be an additional issue of the bills dated July
, 1967, and the other series to be dated October 9, 1967, which were offered on
›tember 22, 1967, were opened at the Federal Reserve Banks today. Tenders were
ited for $1,500,000,000, or thereabouts, of 196-day bills and for $3,000,000,000,
thereabouts, of 259-day bills. The details of the two series are as follows:

GE OF ACCEPTED PETITIVE BIDS:	196-day Treasury bills maturing April 22, 1968		259-day Treasury bills maturing June 24, 1968	
	Price	Approx. Equiv. Annual Rate	Price	Approx. Equiv. Annual Rate
High	97.327	4.910%	96.381	5.030%
Low	97.306	4.948%	96.250	5.212%
Average	97.314	4.933% 1/	96.325	5.108% 1/

6% of the amount of 196-day bills bid for at the low price was accepted
100% of the amount of 259-day bills bid for at the low price was accepted

L TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

strict	Applied For	Accepted	Applied For	Accepted
ston	$ 131,654,000	$ 48,084,000	$ 139,103,000	$ 139,103,000
w York	1,342,095,000	585,895,000	1,671,272,000	1,402,272,000
iladelphia	177,414,000	45,534,000	85,881,000	85,881,000
eveland	153,840,000	65,620,000	160,298,000	160,298,000
chmond	65,030,000	14,830,000	60,027,000	60,027,000
lanta	115,790,000	57,560,000	58,750,000	58,750,000
icago	379,470,000	213,970,000	332,446,000	331,946,000
. Louis	78,895,000	45,275,000	77,386,000	77,386,000
nneapolis	93,375,000	42,255,000	117,315,000	117,315,000
nsas City	72,126,000	27,316,000	35,017,000	34,717,000
llas	104,220,000	23,720,000	86,320,000	82,320,000
n Francisco	488,931,000	330,231,000	449,111,000	449,111,000
TOTALS	$3,202,840,000	$1,500,590,000 a/	$3,272,926,000	$2,999,126,000 b/

ncludes $181,790,000 noncompetitive tenders accepted at the average price of 97.314
ncludes $191,776,000 noncompetitive tenders accepted at the average price of 96.325
hese rates are on a bank discount basis. The equivalent coupon issue yields are
.15% for the 196-day bills, and 5.35% for the 259-day bills.

F-1045

TREASURY DEPARTMENT
Washington

FOR RELEASE: UPON DELIVERY

REMARKS OF THE HONORABLE JOSEPH W. BARR
THE UNDER SECRETARY OF THE TREASURY
BEFORE THE
BOSTON ECONOMIC CLUB
BOSTON, MASSACHUSETTS
WEDNESDAY, OCTOBER 4, 1967, 1:00 P.M., EDT

"IN TIMES OF PROSPERITY...GOOD LORD PRESERVE US"

One of the oldest litanies in the Christian Church is one that I believe dates back to around 400 A.D. The priest chants the theme, and the congregation responds with "Good Lord Preserve Us." The priest chants, "In times of bereavement...." and the congregation responds, "...Good Lord Preserve Us," or "In times of plague..." and the response, "...Good Lord Preserve Us." One section of the litany has always intrigued me. It goes, "In times of prosperity.." "Good Lord Preserve Us."

I am sure that this ancient bit of human wisdom is repeated in most other religions in one form or another. My friends who are better acquainted than I am with theology have explained to me that the chant refers to the theological belief that men tend to become morally flabby in times when life is easy.

I have often thought, however, that the ancient litany has a different and special significance for Secretaries of the Treasury of the United States. A distinguished resident of this community, Professor Paul Samuelson, has said on occasion that "The job of Secretary of the Treasury can't be an easy one; it's to suffer." I will argue today that their suffering is compounded in times of prosperity, and most particularly in times of excessive prosperity.

Today, a Secretary of the Treasury who fought long and hard for tax reduction as the keystone of long-run national economic policy is pressing the case for a tax increase. And, throughout government, the public purse strings must be pulled tighter. For these are the times when the lessons of the "new" economics merge with those of the "old". Economy takes on its traditional meaning and a measure of fiscal restraint is essential to the national interest.

I now would like to take just a few moments to place my theme and our current dilemma in a historic perspective.

The economic debate in this country over the past quarter-century has in large measure revolved around the question of how to maintain prosperity through the full utilization of our labor, our plant, and our savings. In 1940, when our GNP was running at a rate then estimated at some $97 billion, I can remember my distinguished professors at Harvard exhorting everyone in sight to use all possible ingenuity to get rates well beyond $100 billion per year. With unemployment still far too high in 1940, there was ample cause for concern.

It has often been pointed out that the great depression left my generation oriented towards material considerations. I believe that this is probably correct. We were -- and perhaps are -- rather materialistic in our outlook.

Perhaps it is time someone said a few words in defense of materialism. As is so often the case, I find that someone has already said them. Not Professor Samuelson this time, although they do appear as a preface to a chapter in his textbook, where Francis Hackett is quoted to good effect:

> "I believe in materialism...I believe in all the proceeds of a healthy materialism -- good cooking, dry houses, dry feet, sewers, drain-pipes, hot water, baths, electric lights, automobiles, good roads, bright streets, long vacations away from the village pump, new ideas, fast horses, swift conversation, theatres, operas, orchestras, bands... I believe in them all, <u>for everybody</u>. The man who dies without knowing these things may be as exquisite as a saint, and as rich as a poet; but it is in spite, not because, of his deprivation."

A materialistic outlook in this better sense possibly accounts in some measure for the emphasis we have seen in this past quarter-century on science and technology, on sophisticated techniques of business management, and on conscious use of national economic policy to promote economic expansion.

Our success in all these areas has been little short of spectacular. As a result, the vast majority of the people in this nation have reached a level of affluence few would have dreamed possible in 1940. The interaction of our success in the areas of science and technology, business management, and our use of national economic policy has changed this country mightily.

On the whole, I believe that the change has been to the good. I believe that the American economy running at full employment is a mighty engine of social progress and reform. I believe that it has brought the opportunity for a useful and productive life to millions of American men and women whose usefulness might well have been lost -- as it was, for a time, in the depression decade. I believe that our success has enabled us to export a measure of hope to a large portion of the world where in much of recorded history hope had been nonexistent.

Having said all this, I must also say that no human situation is perfect, and even prosperity -- as the ancient divine so clearly recognized -- has its problems. The problems are clearly visible from the United States Treasury. Let me cite just a few of the problems that have developed in the wake of the prosperity that has characterized this last quarter-century.

-- Twenty-five years ago the problems of pollution, decay in our cities, and the gap between the haves and have-nots in our country were present, but not in the magnitude nor with the urgency that they afflict us today.

-- The pressures on our systems of transportation and our higher educational complex were simply not present twenty-five years ago.

-- The intensity of present demands on our capital markets and our savings was not dreamed of during an era in which 3-month Treasury bill rates had remained below 1 percent for 15 years (between 1932 and 1947).

-- The perils of inflation were usually shrugged off as pure theory or applicable only to situations in which "printing press" money was used.

-- The danger implicit in a balance of payments deficit was a subject so esoteric that it was rarely alluded to in academic circles.

The real measure of a nation, in my opinion, is its willingness to recognize and acknowledge new problems as they arise. I personally take great pride in the fact that we in this nation do recognize and are fighting for answers in the areas of pollution, urban decay, transportation, education, poverty, financial imbalances, homebuilding, inflation, and the balance of payments. Solving many of these problems will not be easy -- perhaps not as easy as resolving the question of how best to promote overall economic growth. But we are attacking these areas; we are responding to the challenge.

These problems -- the ones associated with normal, healthy economic growth -- have been under attack for several years. They must be attacked head-on, for they cannot be avoided. We cannot and should not accept stagnation as an escape from the difficulties that come with healthy and desirable growth. At the moment, however, the country is preparing to attack a new issue -- the question of how to head off the perils of an unhealthy and excessive rate of expansion resulting from a resurgent demand from the private sector and a continuing heavy demand from the Federal government. These new perils can and must be avoided.

You may well ask at this point, "Why all the fuss?" "What is so different in this current situation?" "Just what are the perils of an unhealthy and excessive rate of expansion?" Let's try to answer the second question first and examine some of the differences between the current situation and those of, say, a few years ago. It seems to me that the main differences are:

1. The economy is operating in the full employment range. In contrast to the situation of a few years ago, there is no longer any sizable margin of unutilized resources upon which the economy can draw, and skilled labor is scarce. To be sure, the slowdown in the early part of this year caused the average industrial operating rate to fall back somewhat, but unemployment remains below 4 percent. Relatively full utilization of resources places a fairly definite limit on the rate at which national output can safely expand.

It is estimated that at full employment the overall productive capacity of the economy now grows by about 4 percent annually. Over the next year or so, real output could probably grow at a little more than 4 percent, perhaps 4-½ or even 5 percent, while plant utilization rates are rising. Allowing for a 2-½ percent rise in prices -- as measured by the so-called

GNP deflator -- GNP in current prices might safely rise by 7 percent or so in the next year. As a steady diet, this would be a shade too much since price rises of 2-½ to 3 percent annually are too large. But, if the rise of GNP in current prices were held to 7 percent or so in the next year, we would be on a path leading to a less inflationary environment.

We no longer are in a situation where strong rises in demand will yield sizable gains in output and employment. Instead, if the total of public and private spending were allowed to rise at an excessive rate, the consequences would be sharply higher prices. Therefore, with the economy nearing unsafe speed, we cannot keep a heavy foot on the accelerator. We must throttle back to a safer cruising speed.

2. Price and cost pressures are readily apparent. The upsurge in demand in late 1965 and early 1966, associated with the early impact of the Vietnam build-up, was checked by monetary and fiscal restraint. But, one unwelcome consequence of that burst of spending was the disruption of a previous pattern of cost-price stability. For example, the wholesale price index rose by 3-½ percent between mid-1965 and mid-1967 in contrast to a total increase of less than 3 percent during the previous four years. Similarly, the wholesale prices of industrial commodities rose by about 3-½ percent between mid-1965 and early 1967 in contrast to a total increase of less than 2 percent during the previous 4-½ years. The consumer price index rose by 5-½ percent between mid-1965 and mid-1967, only slightly less than its total rise in the previous 4 years.

In delayed reaction to the burst of demand in 1965 and 1966, cost pressures have intensified. By the middle of 1966, labor costs per unit of output in manufacturing had risen about 2-¼ percent over mid-1965, but were still below the level of early 1961. But, by the middle of this year, they had risen a further 6-½ percent. With strong "cost-push" factors already present in the economy, a renewed burst of demand could start wages and prices on an upward spiral.

3. Interest rates are already at or near last year's levels. Another crucial difference between the present situation and that of several years ago, is the height of interest rates and the degree of credit availability. Let me say that after last year's "credit crunch", I have no desire whatsoever to see a repeat performance -- and I don't think anyone else does either.

But, wishing will not make it so. If we are determined to avoid a repetition of last year's difficulties, we must avoid undue reliance on monetary policy to achieve restraint.

Last year the combination of strong credit demands and monetary restraint pushed interest rates to peak levels. By late summer and early fall, not only was credit expensive, its availability was severely limited.

Prompt action was necessary last fall to relieve the overall pressure on financial markets and calm the feverish competition for savings. That action was forthcoming. It included temporary suspension of the investment credit, interest-rate ceilings on consumer-type time deposits, and a temporary slowdown on agency financings and sales of participation certificates. The improvement in financial markets was dramatic. Now, a year later, the situation is substantially different.

Savings flows to thrift institutions have been at record levels this year. Mortgage commitments have been rising strongly. The recovery in residential building has carried the seasonally adjusted annual rate of housing starts back to nearly 1.4 million units in contrast to an August 1966 low of about 850 thousand. Commercial bank credit has risen at a 13 percent annual rate in the first 8 months of this year as the Federal Reserve has pursued a course of relative monetary ease.

In short, credit is much more readily available now than it was a year ago. But, there is a disturbing similarity between the two periods. Interest rates, especially long-term rates, are back at very high levels despite a continuing policy of monetary ease since last fall. Basically, this is because private demands for credit have been extremely heavy this year, partly in reaction to last year's squeeze. Also, the private demands for credit are probably reflecting the faster pace of economic activity since late spring.

Net Federal credit demands have been relatively modest although the picture is changing now. Net Federal demands on the private credit markets can be measured by the change in private holdings of Federal credit instruments, including Federal agency securities and participation certificates along with Treasury issues, by excluding the change in holdings of the Government investment accounts and the Federal Reserve. On this basis, Federal credit demands were only about $3 billion during calendar 1966 in a total credit flow of some $70 billion. In the fiscal year ending this past June 30, the net contribution of the Federal sector to total credit demands was actually negative, or near neutrality after allowance for an unusually low Treasury cash balance at the end of the fiscal year. But, in the current fiscal year, even with tax and expenditure action, net Federal demands on the credit markets will rise to the $10 to $12 billion range. In the absence of tax action, that figure would soar to the $20 billion range. This would be beyond the capacity of the markets to handle at anything like the current level of interest rates.

Frankly, even current levels of interest rates are higher than we like to see them. And, without tax and expenditure action, there would be only one way for interest rates to go -- up from their present high levels. In contrast to the situation of several years ago, interest rates are already high and the financial system is wound up pretty tightly. Liquidity is at a premium. We have to operate cautiously in such an environment. Therefore, we need -- and need very badly in my opinion -- an extra degree of fiscal restraint.

4. Too rapid expansion can hurt our trade balance. Recent experience also highlights the importance from a balance of payments standpoint of holding the domestic expansion within prudent limits. During the years 1961 through 1964, GNP in current prices rose by an average of about 6 percent per year -- more in some years, less in others. During that period, our trade surplus rose by nearly $2 billion. It was $4.8 billion in 1960 and $6.7 billion in 1964, when there were special favorable factors. Not all of the improvement is directly attributable to the relatively moderate rate of domestic expansion. Our exports depend upon the pace of business activity abroad and there are other complicating factors.

In striking contrast, during 1965 and 1966 when GNP in current prices rose at rates between 8 and 9 percent, there was an extremely sharp rise in our imports. Even though exports continued to rise, the trade surplus narrowed to $4.8 billion in 1965 and to $3.7 billion in 1966. Indeed, by the last quarter of 1966, the trade surplus had shrunk to a $2.9 billion annual rate. With a slower rate of expansion this year, the trade surplus recovered to a $4.0 billion rate in the first quarter and improved further to a $4.5 billion rate in the second quarter.

An overly rapid rate of domestic expansion can hit our trade balance from both sides. As recent experience clearly shows, the rise in imports is abrupt when the economy presses hard against capacity. Too rapid domestic expansion can also undercut our ability to export. In the interest of payments equilibrium, we must keep our exports competitive. There can be little doubt that a sustained upward drift in our costs and prices relative to those abroad would soon begin to affect our competitive position adversely.

5. We are fighting a costly war. Extra expenditures for Vietnam are running at a rate in excess of $22 billion dollars per year. While those expenditures do not bear as heavily on the economy as defense expenditures did at the time of Korea, their impact most certainly is felt. Without Vietnam, Federal administrative budget expenditures would amount to only some 14 percent of Gross National Product in fiscal 1968; with Vietnam included, Federal expenditures may rise to 17 percent or a bit more. This would be about the level of 1955 and 1959 and well below the 21 percent reached at the time of Korea. But, it would amount to an appreciable rise over the 14.8 percent ratio in fiscal 1965.

These are the crucial differences in the economic picture at the moment and the picture as it appeared in 1964. Now, what about those perils of an unhealthy and excessive rate of expansion? I would list them as follows:

- -- We are in grave danger of losing control of a relatively stable price structure.
- -- Sharply higher prices throw wage-price relations out of kilter and set the stage for a cost-push inflation.
- -- Cost-push pressures tend to narrow profit margins and encourage efforts to raise prices.

-- Sharply higher prices put the nation at a severe disadvantage in our competitive relationships internationally.

-- At home, the burden of higher prices falls cruelly on those least able to protect themselves.

-- And, of course, a strong resurgence of private demand, unchecked by tax and spending actions,can create some very bad days ahead for the Treasury debt managers and for everyone who borrows money.

If our experience since 1960 is any guide, it would seem that we as individuals, as corporations, and as a nation prosper most when our rate of growth is held within the bounds of our productive capacity. Perhaps in this town of investment advisors you believe that you can protect yourselves against inflation. Perhaps you can protect a small minority of our people for some period of time. But inevitably the well-being of your clients can not be divorced from the well-being of the nation as a whole. Parenthetically I might add that I do not envy those of you who are keeping your clients ahead of the game as "in and outers" in stocks that I can only rarely identify.

In conclusion, I would argue that the risks and perils that confront us are formidable but avoidable. The prudent course for this nation to follow is clearly set forth in the President's recommendations. I can only hope that next year as I join the litany "In Times of Prosperity...Good Lord Preserve Us," I will be referring to our moral fibre and not our national economic well-being.

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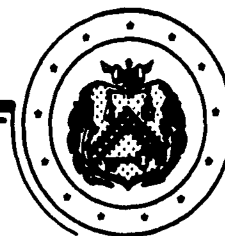
TREASURY DEPARTMENT



WASHINGTON, D.C.

October 4, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $ 2,500,000,000,or thereabouts, for cash and in exchange for Treasury bills maturing October 13,1967, in the amount of $2,400,976,000, as follows:

90-day bills (to maturity date) to be issued October 13, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated July 13, 1967, and to mature January 11,1968, originally issued in the amount of $ 1,000,444,000,the additional and original bills to be freely interchangeable.

181-day bills, for $1,000,000,000, or thereabouts, to be dated October 13, 1967, and to mature April 11, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Monday, October 9, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

F-1047

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on October 13, 1967, in cash or other immediately available funds or in a like face amount of Treasury bills maturing October 13, 1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained fr any Federal Reserve Bank or Branch.

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STATEMENT BY THE HONORABLE STANLEY S. SURREY,
ASSISTANT SECRETARY OF THE TREASURY, BEFORE THE
SENATE COMMITTEE ON FOREIGN RELATIONS ON THE INCOME TAX
TREATIES WITH BRAZIL, CANADA AND TRINIDAD AND TOBAGO
Thursday, October 5, 1967 at 10:00 A.M.

Mr. Chairman, Members of the Committee:

I am pleased to appear before your Committee this morning to discuss three tax treaties -- with Brazil, with Canada, and with Trinidad and Tobago -- that are pending before the Committee. I hope that your Committee will be able to take prompt action on these conventions because the problems they seek to meet are urgently in need of this action.

The proposed conventions with Canada and with Trinidad and Tobago are limited in scope. I should like to discuss them first and then turn to the convention with Brazil, which involves the whole range of international tax relationships generally covered by our income tax conventions with other countries.

CANADA

The proposed convention with Canada would modify the existing Canadian treaty by denying the reduced rate of U.S.

withholding tax that exists under that treaty to certain Canadian corporations which are nothing more than conduits for investment in the United States by persons who are not residents of Canada and who would not otherwise be entitled to the benefits of the tax treaty. They are persons whom the tax treaty with Canada was not intended to benefit.

The existing tax treaty between Canada and the United States provides that investment income flowing from the United States to Canadian residents and corporations shall be subject to U.S. withholding tax at the rate of 15 percent instead of our statutory rate of 30 percent. The treaty defines a Canadian corporation to include corporations that have received their charter under the laws of Canada. Canadian corporations are normally subject to Canadian tax on their income at the rate of 50 percent. However, there is a group of Canadian corporations which are tax-free in Canada because they are not considered to be resident in Canada, but which nevertheless fall within the definition of a Canadian corporation for purposes of the treaty. These are corporations which derive all their income from sources outside Canada and are managed and controlled outside Canada. As

a result, individuals resident in, say, Latin America or Asia, that is in countries with which we do not have tax treaties, have been able to use such Canadian corporations as a vehicle for the purpose of making their investments in the United States, with the result that they derive their investment income from the United States subject only to the 15 percent U.S. withholding tax, rather than the statutory 30 percent withholding tax, and pay no additional tax to Canada, or even, perhaps, to their own country.

The existence of this loophole was called to the attention of the Canadian Government several years ago, and legislation was enacted in Canada which eliminated the tax-exempt status accorded such nonresident companies. However, the legislation applied only to newly created Canadian corporations. Pre-existing Canadian corporations continued to retain their tax-exempt status in Canada. At about the same time that the Canadian Government adopted its legislation, the income tax treaty between the United States and the Netherlands, as it applied to the Netherlands Antilles, was modified to eliminate a similar loophole for foreign investors arising out of the interaction of that tax treaty

and the Antilles tax laws. This elimination of the tax advantages that accrued to Antilles investment companies placed a premium on Canadian tax-exempt corporations. Since the use of new Canadian corporations could not be created for this purpose, trafficking developed in dormant Canadian corporations created prior to the change in Canadian law.

Neither we nor Canada see any reason to perpetuate the existing state of affairs. The proposed amendment to the existing U.S.-Canadian tax treaty would therefore eliminate the opportunity that exists for this avoidance of U.S. tax by residents of countries with which we do not have tax conventions. This corrective action is accomplished by denying the reduced rate of withholding tax on investment income under the treaty to a corporation whose exemption from tax in Canada is based on the ground that it is regarded as not being resident in Canada.

There are unlikely to be any adverse consequences to either the United States or Canada from this corrective change. We have explored the question whether the change might adversely affect the volume of foreign investment in the United States and have concluded that it would not.

Alternative portfolio investment opportunities for residents of countries with which we do not have treaties are limited. On the other hand if we fail to modify the convention in the manner proposed, we are likely to see a proliferation of Canadian companies used for tax avoidance. There are at present U.S. investment companies which find themselves at a disadvantage in competing for business with other firms that operate through Canadian companies of the type I have described, and in order to achieve tax equality they have been seeking out dormant Canadian companies through which to conduct their investment operations. The fact that a modification of our treaty with Canada is pending has restrained some of these companies from initiating such operations. Failure to make the change will remove this restraint.

TRINIDAD AND TOBAGO

The proposed convention with Trinidad and Tobago (for simiplicity I shall refer to that country as "Trinidad") is an interim agreement which deals only with the rate of withholding tax on dividends. Until January 1, 1966 a tax convention of the traditional scope was in effect. It was

a legacy from the time when Trinidad was a dependent territory of the United Kingdom and when the tax treaty between the United States and the United Kingdom applied to it. When Trinidad achieved independence that treaty continued in effect as between two sovereign countries. However, in accordance with procedures in the treaty, the Trinidad Government gave notice of its desire to terminate the treaty and this took effect January 1, 1966. At the same time Trinidad requested negotiation of a new treaty which it hoped would be more appropriate to the economic relations between the United States and Trinidad. Negotiations for such a treaty have been under way but have not been concluded.

Termination of the old income tax convention means that the full weight of the Trinidad tax law applies to income generated in that country without any of the moderating effects of a treaty as respects income flowing across international boundaries. The unrestrained application of Trinidad law would impose a heavy burden on American firms operating there, much heavier than that in effect when the treaty applied. As an interim measure, the Trinidad Government has agreed to modify its withholding tax with respect to dividend income

while discussions continue on a tax treaty of general application.

Accordingly, the convention before you provides that dividends paid by a corporation of one country to residents in the other country shall be subject to a withholding tax rate of 25 percent rather than the statutory rate of 30 percent which applies in both countries. However, when the dividends are paid to a parent corporation, the withholding tax is reduced to 5 percent. For this purpose, a corporation is regarded as a parent of the dividend-paying corporation if it owns 10 percent or more of the outstanding voting stock of the latter corporation. Trinidad law also imposes the equivalent of the withholding tax on profits earned by a foreign corporation that operates a branch in Trinidad and does not reinvest those profits there. The proposed treaty recognizes the similarity of the two situations and therefore limits the branch tax on distributed earnings to the same 5 percent that would apply to dividends distributed by a Trinidad subsidiary. Both the 5 percent rate of tax and the definition of a parent-subsidiary relationship are to be found in other treaties to which the United States is a party. However, application of the lower rate to branch profits is somewhat unique.

Generally those countries with which we now have income tax treaties do not impose a tax on branch profits transferred to the home office just as the United States does not impose such a tax. Accordingly, usually we have not found it necessary to have treaty provisions dealing with such a special tax.

We recommend that you approve the convention with Trinidad to give effect to the reduced rate. The Trinidad Government is also desirous of effectuating this interim arrangement. It is likely that we shall submit to you next year a full-scale convention with Trinidad.

BRAZIL

Turning now to the proposed treaty with Brazil, this agreement for which we are asking your approval will be the 28th U.S. income tax convention.[1/] It is, on the one hand, an extension of our already widespread treaty network, and on the other hand our first tax treaty with a major Latin American country. It incorporates provisions which in our view can constitute the framework for treaties with the other Latin American countries.

1/ Six of the 27 treaties now in effect are with former U.K. colonies which were covered by the U.K. treaty prior to their independence.

Before going into the details of the proposed treaty with Brazil, I should like to develop some overall observations concerning the purpose and objectives of the tax treaty program.

General Philosophy of Tax Treaties

Our income tax treaties with the industrialized countries date back to 1935 when the first treaty between the United States and France was ratified, clarifying the French and U.S. taxing jurisdiction in cases where a resident of one country derived income from the other. With the increased pace of international economic activity since the end of World War II, many new treaties were concluded and old ones revised to reflect changes in tax legislation and underlying changes in economic conditions. Other industrialized countries of the world have responded in the same way and now participate with each other in an extensive web of treaties. The United States, for example, has entered into tax treaties with virtually every industrialized country. 1/

These treaties set forth rules whereby the contracting states agree on those situations in which the country that is

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1/ Excluding the U.S.S.R., Spain and Portugal; discussions with the latter two are already well advanced.

the source of income shall have the prior right to tax and those situations in which it shall refrain from imposing a tax. The contracting states then agree on how the country of which the taxpayer is a resident (or also a citizen in the U.S. case) shall give recognition to the tax levied in the source country, so as to avoid or minimize the double taxation that would otherwise result from the fact that both countries may levy a tax on the same income. In addition, and corollary to these objectives, the treaties seek to perform four other services: (1) to adjust the rates of withholding tax in the source country with the object of avoiding to the extent possible a heavier aggregate tax burden on income which a taxpayer derives from foreign sources than would result if the income originated in his own country; (2) to eliminate wherever appropriate the requirement to file tax returns, and therefore to be conversant with the tax laws, in more than one country; (3) to prevent discriminatory tax treatment on the basis of nationality; and (4) to provide machinery for consultations between the tax officials of the two governments to seek equitable solutions to tax problems that may arise in implementing the treaty.

Returning to the first point I mentioned -- that the treaty partners acknowledge the prior right of each state to tax in certain cases and abandon its right in others --

I should like to illustrate how important a part of a treaty it may be. Statutory definitions of where income originates frequently vary and unless rules of priority to tax or rules of source of income are established, the result may be unintended double taxation of the same income. Suppose a travel agent in a foreign country X sells seats on a U.S. airline for transportation between points which lie outside that country. Country X may consider the airline to derive income there because the ticket was purchased there. Other countries may consider the airline to have derived the income within their territories because a flight segment originated or terminated there. Total taxable income may thus be more than the profit earned by the airline. Or suppose an architect in the United States draws up plans for a building to be constructed in another country. Does the income paid him for those services arise in the United States where he performed the services or in the foreign country where the plans are put to use? The two countries may have different rules so that both countries would tax the same income without making any allowance for the fact that the other country has levied a tax.

A treaty seeks to establish order on such issues as these by arriving through negotiation at a set of rules that is mutually acceptable. This normally involves concessions by both sides concerning their statutory jurisdiction. In

some cases these rules establish uniform criteria for determining the source of a given item of income. Thus as to the two examples above referred to, our treaties generally provide that only the country of registration may tax revenue from airline transportation, and that the source of personal service income is where the services are rendered. In other cases, the source rules may not be disturbed but the country of source may abandon its tax on income from a given activity even though it has the power to tax under its law. A common treaty provision having this effect is the so-called permanent establishment article. This provides that a country will not tax the industrial or commercial profits of a resident of the other country unless that resident has a permanent place of business within its borders, even though both countries are agreed that the source of at least some of the profits is in the country which gives up its right to tax. The objective of such a provision, among others, is to remove a tax obstacle to early stages of a firm's participation in international trade.

Where the treaty assigns to a country priority to tax because it is the source country, the country where the taxpayer resides then agrees in the treaty either to give its residents a credit against their tax liability for taxes paid on income which the country of source taxes, or to exempt such income from tax. A country may agree by treaty to adopt a credit

similar to that which the U.S. provides by statutory law, even though that country's own law may provide less generous relief.

With respect to withholding tax rates on investment income paid to nonresidents, we have sought and agreed to reductions in rates in order to come to an aggregate of taxes on foreign income that is as close as possible, consistent with other factors, as the tax on a similar amount of domestic income. Thus, for U.S. firms having subsidiaries or branches in Brazil, the Brazilian 25 percent withholding tax on their dividends or branch profits raises their total Brazilian tax on distributed profits to more than 50 percent, resulting in unused foreign tax credit in the United States on that income. Our statutory withholding rate of 30 percent has the same effect on dividends obtained by foreign residents of those countries with similar investments in the United States. Other problems regarding withholding rates arise from the fact that withholding taxes are applied on the gross amount of income without taking into account costs, personal deductions and the like. Brazil, for example, in most cases imposes its 25 percent withholding tax on the gross amount of income remitted to a nonresident. For U.S. individuals and corporations deriving income from Brazil in situations in which there are expenses involved in earning that income, this will represent a high effective rate of tax if the net amount taxable in the United States because of those expenses is low in relation to the gross

payment from Brazil. The Brazilian tax will in such cases be too high to be fully offset by the foreign tax credit in the United States. For example, suppose a U.S. citizen derives rent of $100 from leasing property owned in Brazil and has costs of $50 associated with that income. The Brazilian 25 percent tax on the gross amount means a tax of 50 percent on the net income, which is almost certain to be higher than the recipient's effective rate of U.S. tax. The purpose of the treaty provisions in this area of withholding taxes is to reduce the frequency and size of excess tax burdens of this type through negotiated adjustments in withholding rates.

The treaty objective of reducing the need to file multiple tax returns may sound less important than the attempt to avoid the same income being taxed by two countries neither of which accepts the other as the country of source, but it may be no less troublesome in many instances. A U.S. business executive on temporary assignment to a foreign subsidiary can credit against his U.S. income tax the tax paid to the foreign country on income earned for the services he performed there. He does not need a treaty to permit this. But if he is taxable in the foreign country he commonly has to file a return there declaring his taxable income according to the rules employed there. If he is concerned with operations in a region encompassing several countries, the obligation to be familiar with varying tax systems and to submit returns

to each is troublesome and costly in terms of time and energy which could be more efficiently employed in other tasks. A similar situation could confront any number of persons whose activities involve international travel. Tax treaties meet this difficulty by exempting from tax in one state the personal service income of working visitors who are self-employed or employed by a resident of the other state, within specified limits of time and remuneration.

The nondiscrimination provisions of tax treaties ensure that a U.S. corporation operating in a foreign country through a branch or through a foreign subsidiary will not have those business activities taxed more heavily than are the businesses or corporations of the foreign country, and that an individual U.S. citizen resident in a foreign country will not be taxed more severely than a national of that country in comparable circumstances.

The administrative provisions of tax treaties implement their application by providing for consultation on such matters as proper intercorporate pricing, exchanges of information and procedures for hearing taxpayers' grievances.

The need for solutions to these types of international tax problems is unquestionable. Taxes can be an effective barrier restricting the international mobility of capital, labor and skills, a mobility which economically is highly desirable. We have to proceed to achieve such solutions by

means of bilateral agreements which conform as closely as possible to the standards considered to represent the most rational international treatment of each type of income-generating transaction.

OECD Model Treaty and Developing Countries

Currently, the point of departure for treaties between industrialized countries is the "Draft Double Taxation Convention", prepared by the Organization for Economic Cooperation and Development, to which certain improvements have been introduced by the United States and other countries since its adoption. As between an industrialized country and a developing country, however, the OECD model treaty needs more substantial alterations. The economic relationship between two such countries is apt to be significantly different from that prevailing between two industrialized countries, and the traditional answers are not always satisfactory. The income flows between any two industrialized countries may not be exactly in balance, but if their multilateral relationships are taken into account there is a reasonable mutuality of income flows, so that revenue and balance of payments considerations can take a secondary place to trade objectives, consistency, equity and similar elements that enter into tax treaty discussions. When an industrial country undertakes to enter a tax treaty with a less developed country, on the other hand, it must recognize that most of the income flows will be largely out of the less developed

country with much smaller amounts flowing into it. To this large imbalance in income flows must be added the fact that a fundamental objective of all less developed countries is the attraction of foreign capital and skills. Local resources are inadequate to finance a rate of economic development commensurate with their needs.

Most of the substantive provisions of the OECD model tax treaty that have revenue effects require the giving up of tax revenue by the country in which the income is earned or has its source in favor of the country in which the taxpayer resides in order to make the necessary accommodation to desirable international tax relationships. Since the less developed country is usually the country of source, the revenue loss under a standard tax treaty is apt to rest largely on the developing country rather than the industrialized country. To compensate for this revenue loss, developing countries have pressed for concessions by industrialized countries. These concessions take either of two forms: one is to grant to their taxpayers who invest in the developing country tax exemption on profits derived there and remitted home; the other is to grant a so-called "tax-sparing" credit. Under such a credit, the industrialized country allows its investors in a developing country a credit against its tax not only for the tax actually paid to the developing country but also for the taxes that for one reason or another have been waived or reduced by the developing

country. We have reviewed over 40 treaties written by other industrialized countries with developing countries and find that, with a few minor exceptions, each treaty contains provisions under which those industrialized countries either exempt their residents on one or more types of income received from the developing country or give their residents a tax-sparing credit for the tax foregone by the developing country.

Our approach to tax treaties with developing countries has differed in some respects from that of other industrialized countries. We have sought -- and in general I believe so have the other industrialized countries -- first, to minimize the adverse revenue effect of a treaty upon a developing country by limiting our demand for reductions in foreign taxes to the poir where those taxes would equal our tax on the income brought int the United States. In other words, we have not sought to increase our revenue at the expense of the revenues of the developing country. We have sought reductions where the taxes of the developing country would act as a deterrent to investment and trade. Conversely, we have discouraged the developin country from seeking reductions of U.S. tax on investment income on the grounds that the treaty should not encourage capital flows to the United States when capital is so urgently needed at home.

As to capital flows to the developing country, however, we believe that neither the exemption approach nor the tax-spa approach is desirable. If we were to grant tax exemption

to firms making investments in a developing country, taxpayers engaged in business solely in the United States would regard that as highly inequitable. It would be inconsistent with the principle of tax neutrality as between domestic and foreign economic activity which our foreign tax credit mechanism seeks to maintain. Moreover, a tax-sparing credit would provide the largest tax benefits to investors in countries which have the highest nominal tax rates, and it would promote the repatriation of profits from developing countries instead of encouraging reinvestment of profits in those countries. In contrast to the methods pursued by other industrialized countries, therefore, we have included in this treaty with Brazil a provision which would extend our domestic investment credit to investments made by American firms in the treaty country. I shall shortly develop the details of this provision as it is incorporated in the Brazilian treaty. Here I should like to stress that the extension of the investment credit serves to make the treaty reciprocal in character and at the same time is consistent with our own law.

Under our tax law we give our taxpayers a credit against their tax equal to 7 percent of the amount spent on machinery and equipment for use in the United States. What we propose to do by this treaty is to extend this credit to similar investments

when made in Brazil. Our existing tax law has established a tax benefit for investment in the United States in machinery and equipment. By the same token, we have made investment in developing countries less attractive than at home. An extension of this investment credit by treaty will re-establish the tax neutrality that formerly prevailed as between domestic investment and investment in the treaty country. A developing country can view this as a device to facilitate capital movements to its borders, as indeed it is compared with the present situation. We may look upon it as the elimination of a disincentive to investment in the treaty country.

Principal Features of Brazil Treaty

I should like to turn now to the substantive provisions of the income tax convention between Brazil and the United States which is now before you for consideration.

Industrial and commercial profits

Under the convention Brazil agrees not to tax the industrial and commercial profits of a firm in the United States (and vice versa) unless the firm derives profits through a permanent establishment within Brazil. The value of this provision to U.S. enterprises is apparent when we consider some of the features of Brazilian law. One provision makes a U.S. firm that sells goods to Brazil subject to tax there even if the

firm has no place of business in Brazil. The firm need merely receive orders from Brazil through an agent there, even though the agent is entirely independent, has no authority to conclude any contracts on behalf of the U.S. firm, and maintains no stock of goods in Brazil from which to fill orders. Moreover, if the U.S. firm is thus subject to tax in Brazil, it also becomes taxable on all sales made by it to residents of Brazil, including those made without any participation by the Brazilian agent. In the latter case, the American firm is considered to have derived a profit equal to 20 percent of the gross sales price of the goods sold. Brazilian tax applies even though under U.S. law the American firm may be considered not to have derived any income at all from Brazilian sources. If title to the goods purchased by the Brazilian buyer passes in the United States, the income from the sale of those goods is considered to have its source in the United States, and any tax paid by the American firm to Brazil would not be eligible for credit against U.S. tax. These differences in tax rules hinder U.S. trade with Brazil not only by causing double taxation but also by imposing a compliance burden of filing tax returns and understanding the intricacies of a foreign tax system. Such burdens may effectively hamper U.S. exports especially on the part of smaller American business firms and cause financial loss to those unsophisticated in tax matters.

Under the treaty no tax would apply in Brazil unless the U.S. firm has a permanent place of business there through which it conducts its activities. (Article 8). Consequently American firms will be able to solicit business in Brazil through an agent, and may even send their own travelling salesmen to Brazil and not be concerned about the impact of the Brazilian tax law on their sales. The treaty facilitates other activities in Brazil by providing that, even if a U.S. firm has a permanent place of business there, if that place of business is only used for purchasing, the storage of goods, or advertising and research, the firm would not be regarded as having a permanent establishment and would not be taxable by Brazil. Of course these provisions are reciprocal, so that Brazilian firms may also seek to develop markets in the United States without becoming involved in U.S. tax law so long as their activities do not constitute the maintenance of a permanent establishment in the United States.

Under Brazilian law, an American firm that sends its employees to Brazil to install, say, an electric generator or to oversee the installation of factory machinery, or to do an engineering job is considered to be engaged in business in Brazil and is subject to Brazilian tax. Under the treaty, however, Brazilian tax would be eliminated in such cases unless the activities involved are rather extensive. The treaty defines a permanent establishment to exclude a

construction, assembly, or installation project unless the project exists for at least six months.

Dividend income and branch profits

Brazil imposes a general tax on total corporate profits at the rate of 30 percent and a 5 percent tax on distributed corporate profits. It also imposes a 25 percent tax on dividends paid to a foreign shareholder. Consequently the total Brazilian tax on the profits earned by a Brazilian subsidiary and distributed to its parent company in the United States amounts to 50.12 percent. This is higher than the tax the United States would levy on the profits received by the parent company. (The U.S. tax on such income is even less than the normal 48 percent for technical reasons related to the method of determining taxable income when dividends are received from a foreign subsidiary in a developing country.) Consequently, part of the Brazilian tax represents a burden on American firms that they may not be able to offset, through our foreign tax credit provision, against their U.S. tax. To reduce Brazilian tax to a level that would reflect the U.S. corporate rate, Brazil agrees in the treaty to lower its 25 percent withholding tax on dividends to a rate of 20 percent. (Article 12.). A Brazilian branch of a U.S. firm is taxed in Brazil at about the same rate as a subsidiary, and in order to maintain a tax on branch operations comparable to

that on a subsidiary, Brazil has also agreed to limit its withholding tax on branch profits transferred to the U.S. home office to 20 percent.

The reduced Brazilian withholding tax on dividends (and branches) will apply only when paid to a U.S. parent company, as defined for purposes of our foreign tax credit, because it is only in these instances that the present Brazilian tax rate produces an unused credit. In portfolio investment situations, as where an individual has an interest in a Brazilian company or where a U.S. corporation owns less than 10 percent of the Brazilian firm, the present Brazilian taxes will not usually generate any excess credits, and the treaty therefore does not lower Brazilian withholding tax rates.

It is of interest to note that this feature of the treaty is not reciprocal. It does not provide a reduction in U.S. withholding tax rates on dividends flowing to Brazilian investors in U.S. corporations. This is attributable, as indicated earlier, to a mutual desire that the treaty should not divert investment from Brazil to the United States. If the United States were to lower its withholding taxes on dividends going to Brazilian residents, it might induce Brazilian capital to flow into American securities, contrary to one of the objectives of the convention, which is to promote capital formation and economic development in Brazil.

Interest and royalties

The supply to foreign users of capital, know-how, patents, and the like, which is valuable to our export program, is now hindered by the high taxes levied by Brazil on interest and royalties. A resident of the United States who derives interest from a Brazilian debtor is subject to a withholding tax in Brazil of 25 percent of the gross amount of interest. If the interest is received by an individual or a firm that is not engaged in the business of lending money, the gross amount of interest received presumably will be generally equivalent to the net return, since there would be little or no cost incurred in making the loan. Consequently, in such cases the U.S. tax on the interest may be as high as or higher than the Brazilian tax. Since the Brazilian tax may be credited against the U.S. tax, it does not constitute any net additional burden on the U.S. lender. The treaty therefore does not disturb the Brazilian withholding tax on interest in such cases.

However, when interest is received from Brazil by a U.S. bank or other financial institution, the net earnings may be a significantly smaller amount than the gross interest received. A financial institution incurs various expenses in doing business, such as the interest it pays to obtain the funds that have been loaned out. These costs must be charged against the gross interest received. Since expenses represent

a substantial share of gross income, a 25 percent Brazilian withholding tax on the gross interest represents a much higher percentage of the net income accruing to a financial institution. In all cases where expenses are more than 48 percent of the gross income, the present Brazilian withholding tax rate of 25 percent on gross income exceeds the U.S. tax on the net income and generates an unused foreign tax credit. To minimize the cases where unused credits occur, Brazil has agreed to reduce its withholding tax on interest paid to financial institutions to 15 percent. (Article 13.) At that rate, unused foreign tax credits will not be generated unless expenses exceed 68.7 percent of gross income. In some cases expenses may go as high as 80 percent or 90 percent, so that unused credits will continue to exist.

For similar reasons the Brazilian withholding tax rate on royalties is also reduced to 15 percent. (Article 14.) This provision is reciprocal since royalties are not likely to involve an outflow of capital from Brazil. I should note in passing that the tax treatment of royalties is complicated by the fact that under Brazilian law royalty payments are frequently disallowed as a deduction to the payer. This is true when they are paid by a Brazilian subsidiary to a U.S. parent company. When royalties are disallowed as a deduction, Brazil in effect treats the royalty as a dividend. Hence, the reduction in withholding tax on dividends also acts to

bring the Brazilian tax on royalties down to a level where it is less likely to exceed the U.S. tax.

Deduction of expenses

As in some other less developed countries where American firms have subsidiaries and branches, Brazil does not allow as a deduction for Brazilian tax purposes certain expenses which are incurred outside Brazil. This disallowance is contrary to the principles governing the allocation of expenses which have been developed under international standards. For example, the overhead costs of the home office of a U.S. company doing business abroad would normally be allocated among all of the countries in which the company has branch operations. Indeed, such an allocation is required under U.S. law and regulations, and this principle of allocation is recognized in the OECD model treaty. However, under its internal law, Brazil may not allow a deduction to be taken by a U.S. branch in Brazil, in computing its Brazilian tax, for the amount allocated to the branch operations. Under the convention, however, Brazil does agree to allow deductions in computing taxable income for expenses which are reasonably connected with the profits taxed by Brazil, whether incurred within Brazil or outside it. (Article 8(3).)

A similar situation exists in connection with the determination of taxable income from real property. Under Brazilian

law, an American would pay tax on the gross rentals received from real property located in Brazil without any allowance for the expenses involved in maintaining and operating the property. However, under the convention Brazil is obliged to compute tax on a net basis as if the property owner were engaged in business in Brazil, so that the expenses will be deductible. (Article 15.)

Personal service income

An American engineer or other technician who goes to Brazil for a brief period as a consultant or to perform other services for a Brazilian employer is subject to tax under Brazilian law on the income he earns while there, irrespective of how much he earns or the period of time he has spent there. Tax is imposed at the rate of 25 percent of the gross amount received. Similarly, a Brazilian temporarily employed in the United States by a U.S. company is subject to U.S. tax on the income earned for those services, irrespective of the amount he earns or the period of time he spent here. Under the treaty, both Brazil and the United States adopt the approach of granting an exemption to persons who are present for less than 183 days and earned less than $4,000. (Article 17.)

The treaty also solves a related problem concerned with personal services. Under Brazilian law, an American technicia

or lawyer who performs services in the United States for a Brazilian client becomes subject to tax in Brazil because he receives payment from the Brazilian firm. Yet the source of those earnings, according to the standards used by most countries, would be here in the United States since the individual actually performed the services here. Therefore, as I indicated earlier, the tax imposed by Brazil in such a case would not be credited against United States tax. To eliminate the problem of double taxation that thus arises in these cases, the treaty provides that personal service income shall be considered to have its source in the country where the services are performed. The result is that Brazil will not tax in those situations where an American law, accounting, management or engineering firm performs services in the United States for Brazilian clients. (Article 5.)

Shipping and aircraft

At present American shipping and airline companies are exempt from Brazilian income tax on the basis of reciprocity, but this can be altered by action on either side. The treaty confirms the existing situation but strengthens the commitment by making the exemption a matter of international agreement. (Article 10.)

Administrative cooperation

At present, there is no basis for administrative cooperation between the tax authorities of Brazil and the United States,

and therefore there exists no medium for eliminating double taxation in certain cases or resolving tax controversies involving the two countries even though the amounts may be substantial.

Suppose there are transactions between a parent company in the United States and a subsidiary in Brazil or between two sister companies, one in Brazil and one in the United States, and the prices at which those transactions take place are considered by either country or both to be other than on an arm's length basis. The company which buys a product may be required to recompute its taxable profit on the basis of a lower price than that used in recording the transaction originally, and on the basis of which the company selling the product computed its taxable profits. Unless there is a downward adjustment in the seller's taxable profits, both countries will be taxing all or a part of the total profits that should be taxed only in one country. The treaty therefore provides for consultation between the two countries in order to arrive at the same prices for tax computations or the same allocation of income or expenses in transactions between related companies. After such consultation and agreement, the country which is obliged to grant a refund is empowered to do so even though the statute of limitations has expired. The importance of this provision, especially as to exporters, cannot be overemphasized, because the statutes of limitations governing

refunds and assessments are frequently different from one country to the other, and tax justice frequently cannot be achieved in cases of the kind I have mentioned. One country may assert a deficiency after the other country has lost its power to make a refund. The treaty would cure this situation. (Article 24.)

Extension of investment credit

These and other principles incorporated in the convention with Brazil are not significantly different from those to be found in the conventions we have with other countries. Nevertheless, when considered in relation to its existing law, the treaty rules are important changes in the Brazilian tax treatment of international transactions. In return for these changes the treaty extends to investment in Brazil the 7 percent tax credit granted under our law to investment in the United States.

A firm in the United States which purchases machinery or equipment for domestic use is allowed a reduction in its tax liability equal to 7 percent of the amount spent on such equipment. There were a number of considerations that justified the adoption of this investment credit for domestic purposes. At the same time, for a variety of reasons, we were not interested in granting an incentive to investment in European plants owned by American firms, and hence the credit was confined to investment within the United States. However, as a result of our

preoccupation with our position relative to European countries, we have tipped the scales against investment in developing countries. What we look upon as an appropriate treatment for domestic investment is regarded by developing countries as an obstacle to investment within their borders. It is one coin but observed from different sides.

Extension of the investment credit is a valuable and, realistically, the only instrument for obtaining tax treaties with countries such as Brazil and other Latin American countries, and through such treaties removing the tax obstacles to international trade and investment that result from differences in national tax concepts and the fact that each country administers its taxes independently of every other country. In a world where international trade and investment are of major importance and are becoming increasingly more so, these obstacles should be eliminated wherever possible. Tax treaties move in that direction, and yet, as I have indicated, the fact that tax treaties involve revenue losses for developing countries can constitute, without some balancing factor, a barrier to such treaties even though in the long run they are of interest to all concerned.

With this in mind, the treaty with Brazil extends the investment credit to investment made by American firms in Brazil. (Article 7.) In all essential respects the credit granted under the treaty would be the same as the credit granted for domestic investment. Variations from our own law

have been made to take account of the fact that investment abroad frequently is made through a foreign corporation rather than a foreign branch of a domestic corporation, and to assure that the investment credit is associated with a net increase in the capital of the eligible enterprise in Brazil. Thus, the credit would be granted to an eligible American company whether its activities in Brazil are conducted in branch form or through a Brazilian subsidiary. Under our domestic law, a firm may purchase machinery or equipment out of depreciation reserves, out of borrowed funds or out of new equity contributions, and irrespective of the source of funds it is allowed a credit against its tax liability of 7 percent of the amount thus spent. However, under the treaty approach the credit would not be granted to the U.S. company unless it has made a net addition to the funds available to the enterprise operating in Brazil. Moreover, the new capital added to the venture in Brazil must be committed for a minimum period of five years. If the capital is withdrawn in a shorter period, provision exists for the recapture of the tax credit.

As in the United States, qualified machinery and equipment must have a minimum useful life of eight years for the full credit to be obtained. With respect to equipment having a useful life of between four and eight years, a partial credit would be granted similar to that allowed under domestic

law. To the extent that the net new investment remained in the enterprise in Brazil, replacements of qualified machinery and equipment would also be eligible for the investment credit, just as replacements in the United States qualify for the investment credit.

The treaty credit treats as net new investment amounts in excess of one-half the profits earned each year in Brazil which are reinvested in the business. Reinvestment of one-half the profits of an enterprise is considered a normal re-investment practice and would not be regarded as a net addition to the capital of the company for purposes of the investment credit. Thus, if 50 percent or less of the profits are re-tained in Brazil, then no reinvestment is considered to have occurred. But if 60 percent of the profits are reinvested then the excess over half, that is 10 percent, would be con-sidered to be net new investment and qualified equipment purchases, to the extent of the 10 percent, would give rise to an investment credit.

Conclusion

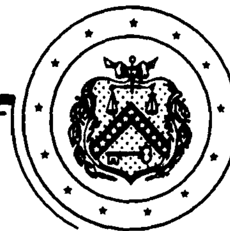
There can be no doubt that tax treaties have a beneficial effect in facilitating the movement of goods, services and capital between countries. The efforts of other nations to develop a network of treaties indicate the importance of these international agreements. The support we have received from

the business communities engaged in international trade and investment at each stage in the development of our own now extensive network of treaties also attests to their utility. But it is time that we moved further along in our efforts to mitigate the effects of the anarchistic system where, despite the economic interdependence of nations, each country applies its tax system as if it were alone in the world. This is an anachronism that should be eliminated. A major achievement in this process will be the establishment of agreements with the countries of Latin America. And to reach such agreements we are required to make our contribution to accommodation to proper international tax relationships, just as those countries are required to make their contribution to such an accommodation. The Brazilian treaty is the first step in this direction. The treaty is a balanced agreement that can be considered to be of equal worth to both parties, which is the essence of international negotiations and arrangements.

The United States in many ways has indicated that wherever possible it seeks to have private capital, rather than public aid, move to these Latin American countries. The treaty before you is an effort to remove tax impediments to the participation of American private enterprise in Brazilian economic development. I therefore urge your approval of this treaty with Brazil, so that the United States can thereby make its proper contribution to international tax relationships

that will assist in the furtherance of private investment and trade with the Latin American countries.

TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR RELEASE SUNDAY
OCTOBER 8, 1967

October 6, 1967

CONLON NAMED DIRECTOR OF
BUREAU OF ENGRAVING AND PRINTING

Secretary of the Treasury Henry H. Fowler today announced the appointment effective tomorrow, October 9, of James A. Conlon, a 25-year career employee, as Director of the Bureau of Engraving and Printing.

Mr. Conlon, who had served as Deputy Director, succeeds Director Henry J. Holtzclaw who retires today, the 50th anniversary day of his service at the Bureau.

Mr. Conlon, 46, a native of New York City, joined the Bureau in 1942 as an apprentice plate printer. He subsequently advanced to journeyman plate printer; technical assistant in the Examining Division; Head of the Quality Control Branch; Assistant to the Chief, Assistant Chief, and Chief, Office of Currency and Stamp Manufacturing; Director of Manufacturing; Acting Assistant and Assistant Director, and Deputy Director.

Mr. Conlon attended George Washington University, studying business administration at night. He has received two Treasury High Quality Performance Awards and in 1955 was nominated for an American Management Association Scholarship Award.

Mr. Holtzclaw's career -- like Mr. Conlon's -- reads like a Horatio Alger novel. He never completed grammar school and is largely self-educated. Coming to the Bureau in October, 1917 as a machinist's helper, he later became an engineering draftsman, an associate mechanical engineer, a mechanical expert and designer. He stepped into a management role in 1938 when he became Chief, Office of Research and Development Engineering, a post he held for 11 years before becoming Assistant Director. He was named Associate Director in 1951, and has been Director for the past 13 years.

F-1048

Mr. Holtzclaw's period as Director has been called the "modernization years" for the Bureau, and has been marked by better efficiency and lower costs in its services to nearly 70 federal agencies. In 1954 the Bureau had over 6,000 employees but modernization of facilities and equipment has permitted a reduction to 3,200 employees today, during a time when production has greatly increased.

In 1951 it cost $9.92 to print 1,000 notes but under Mr. Holtzclaw's leadership the cost today has dropped to $8.14. During his 13-year career as Director, the Bureau printed $26 billion in notes, and the total value of all notes, bonds, and other securities printed was $4 trillion.

Some 600,000 visitors tour the Bureau annually. Eighteen million people have visited it since 1920, making it one of the most popular attractions in Washington.

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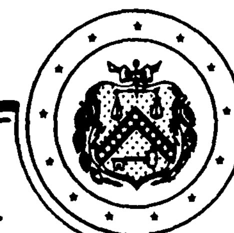
TREASURY DEPARTMENT



WASHINGTON, D.C.

R RELEASE 6:30 P.M.
nday, October 9, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury
lls, one series to be an additional issue of the bills dated July 13, 1967, and the
ıer series to be dated October 13, 1967, which were offered on October 4, 1967, were
ened at the Federal Reserve Banks today. Tenders were invited for $1,500,000,000,
thereabouts, of 90-day bills and for $1,000,000,000, or thereabouts, of 181-day
lls. The details of the two series are as follows:

NGE OF ACCEPTED PETITIVE BIDS:	90-day Treasury bills maturing January 11, 1968		:	181-day Treasury bills maturing April 11, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.870	4.520%	:	97.491	4.990%
Low	98.852	4.592%	:	97.467	5.038%
Average	98.859	4.564% 1/	:	97.475	5.022% 1/

73% of the amount of 90-day bills bid for at the low price was accepted
54% of the amount of 181-day bills bid for at the low price was accepted

AL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 20,434,000	$ 10,434,000	:	$ 17,183,000	$ 6,983,000
New York	1,571,812,000	1,021,432,000	:	1,366,991,000	686,211,000
Philadelphia	36,583,000	29,583,000	:	15,772,000	6,772,000
Cleveland	28,686,000	28,686,000	:	24,525,000	20,369,000
Richmond	12,290,000	12,290,000	:	7,945,000	6,845,000
Atlanta	44,357,000	39,195,000	:	40,203,000	26,727,000
Chicago	186,544,000	125,017,000	:	201,086,000	126,658,000
St. Louis	51,595,000	48,595,000	:	38,478,000	28,778,000
Minneapolis	26,998,000	26,931,000	:	25,107,000	18,607,000
Kansas City	29,964,000	29,964,000	:	18,599,000	15,507,000
Dallas	26,739,000	21,739,000	:	22,336,000	14,336,000
San Francisco	146,430,000	106,780,000	:	113,583,000	42,753,000
TOTALS	$2,182,432,000	$1,500,646,000 a/		$1,891,808,000	$1,000,546,000 b/

Includes $247,599,000 noncompetitive tenders accepted at the average price of 98.859
Includes $161,681,000 noncompetitive tenders accepted at the average price of 97.475
These rates are on a bank discount basis. The equivalent coupon issue yields are
4.69% for the 90-day bills, and 5.24% for the 181-day bills.

STATEMENT OF FRED B. SMITH
GENERAL COUNSEL, DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON IMPROVEMENTS IN JUDICIAL MACHINERY
OF THE SENATE JUDICIARY COMMITTEE
ON S. 2041
OCTOBER 11, 1967, 10:00 A.M. EST

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before you and state the views of the Treasury Department on S. 2041 relating to modifications of the Tax Court.

On its face, the bill appears to involve relatively minor changes in the status of the Tax Court and of its Judges, and in Tax Court procedures. But the direction of some of these changes, and additional changes which might logically be considered as flowing from them, give us serious concern. We do not believe there is a real need for the proposed changes, and we fear that they could disrupt the existing machinery for the timely and equitable disposition of tax disputes.

The Tax Court as presently constituted is an integral part of the largest tax system in the world. It is the only Court in which a taxpayer can challenge a proposed deficiency in income, estate or gift tax without first paying the tax involved. There are presently over a billion dollars in tax deficiencies pending before this Court.

Under our self assessment system, each year some 80 million taxpayers file income tax returns. Of this number in fiscal year 1966, 3,300,000 tax returns were examined by the I.R.S.; 1,900,000 were notified of deficiencies or adjustments. 1,800,000 of these agreed with the Government and paid the deficiency. Of the remaining 100,000, most of these were settled under conference procedures at the District level.

27,652 taxpayers took their cases to the Appellate Division of the Internal Revenue Service where the bulk of the cases were disposed of administratively. Only 2,385 taxpayers went to the Tax Court from the Appellate Division. This plus 4,489 cases appealed directly from the District Audit to the Tax Court made a total of only 6,874 taxpayers who petitioned. And this out of a total of 3,300,000 tax returns which were examined!

In fiscal year 1966, 6,234 docketed cases were disposed of by the Tax Court, and only 726 of these required hearings. Indeed, for the past several years approximately 85 per cent of the cases docketed in the Tax Court have been disposed of without hearing. This remarkable settlement record is due in large part to the fact that the Office of the Chief Counsel and the Internal Revenue Service are within the same Department and work closely together.

I have gone into some detail to show the operation of a vast machinery for the resolution of tax disputes which starts at the District level, proceeds through the Appellate Division, and in a relatively few cases, ends in the Tax Court. On the whole, we think the system operates quite well. And in this process for the disposition of tax cases, we believe the present system has basically the right mixture of administrative and judicial attributes.

A fundamental and complex problem arises from the fact that the bill would change the status of the Tax Court from that of an independent Court in the Executive branch described in Article I of the Constitution to that of a judicial Court described in Article III of the Constitution.

This proposal logically raises the issue of representation of the Government before the Tax Court.

Absent a statutory exception, the attorneys of the Justice Department represent the Government before Article III courts. There are presently several such exceptions for various agencies and departments of the Government. Existing law expressly provides that in cases before the Tax Court the Commissioner of Internal Revenue shall be represented by Chief Counsel of the Internal Revenue Service. The bill before you retains this provision. This, we regard as essential.

An important aspect of continuing the right of representation in the Office of the Chief Counsel, Internal Revenue Service, lies in the significant role that Office plays in the settlement of cases in the Tax Court. The attorneys who represent the Government in the Tax Court and the administrative personnel who develop the cases for the assertion of deficiencies work together under closely coordinated control to assure uniformity in the administration of the revenue laws. The fact that responsibility for the presentation of issues in tax cases before the Tax Court is under the control of a single Executive department has made possible an outstanding record of settlements both administratively and before the Court.

The existing machinery is geared to the settlement of the vast majority of deficiency cases within the I.R.S. procedures. Any separation of the administrative and litigation responsibilities could lead to a disruption of this system with a concomitant increase in the trial dockets of the Tax Court. As a result, there would be deferred

the collection of even larger amounts of revenue than the $1 billion as at present. It should be recalled that a taxpayer appealing a deficiency notice does not have to pay until his case is finally decided.

For these reasons, we feel strongly that whatever is done with this legislation, the provision for representation of the Government by I.R.S. attorneys must be retained. But essentially, the issue should not be reached because we believe that the Tax Court is, and should continue to be, the final judicial step in an over-all Executive branch process of disposing of tax issues between the citizen and the Government, in other words an Article I independent Executive branch court.

Further, the introduction of more formal procedures in the Tax Court, as is contemplated by the proposed section 2652(a), could tend to encourage the bypassing of administrative settlement processes and the placing of undue reliance on the resolution of issues by the Court, which issues can and ought to be resolved by the parties themselves.

Finally, we believe that there is no real need for most of the changes proposed by S. 2041. We would like to see Tax Court judges get retirement benefits equivalent to those of District court judges. We think that the responsibilities they perform are equivalent, and they should have equivalent benefits. However, there seems to be no reason why this objective cannot be achieved through the amendment of the provisions in Title 26, governing the retirement benefits for Tax Court judges.

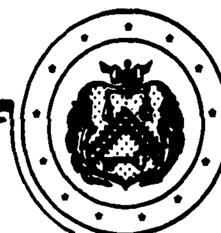
The granting of life tenure is a controversial issue and deserves careful consideration. As a practical matter, however, it does not appear necessary in the case of the Tax Court. Almost without exception, in the 43 years of its history, Tax Court judges have been reappointed upon completion of their 12-year terms.

In theory also, the Court should have the power to compel compliance with its subpoenas and to punish for contempt. However, as a practical matter, it has been necessary to resort to the authority of the District courts in this regard only in a very few cases over the years.

Finally, the proposal does not achieve Article III status for the Tax Court for many years because of its provision for retaining judges under their present appointments for limited terms.

For these reasons, the Treasury Department is opposed to S. 2041.

TREASURY DEPARTMENT



WASHINGTON, D.C.

October 11, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $ 2,500,000,000 or thereabouts, for cash and in exchange for Treasury bills maturing October 19,1967, in the amount of $2,401,606,000, as follows:

91-day bills (to maturity date) to be issued October 19, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated July 20,1967, and to mature January 18,1968, originally issued in the amount of $1,000,696,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated October 19,1967, and to mature April 18, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Monday, October 16, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

F-1050

Immediately after the closing hour, tenders will be opened at t Federal Reserve Banks and Branches, following which public announce- ment will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasu expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on October 19, 1967, cash or other immediately available funds or in a like face amount of Treasury bills maturing October 19, 1967. Cash and exchange tend will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are exclude from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereund need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which th return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and th notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained any Federal Reserve Bank or Branch.

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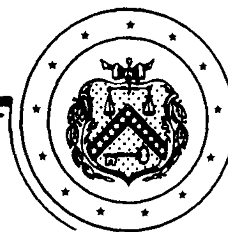
TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR IMMEDIATE RELEASE October 12, 1967

TREASURY TO CHANGE FINENESS OF SILVER BARS

The Treasury Department announced today that effective November 1, silver bars issued in exchange for silver certificates at the New York and San Francisco Assay Offices will be of finenesses of .996 to .998 rather than the .999 fine bars presently issued.

The change will not affect the amount of silver exchanged for the certificates. Holders of silver certificates will continue to receive silver equal to the face amount of their certificates at the monetary value of $1.292929292 per fine troy ounce.

The change in the fineness of the bars is being made to comply with a request by the Office of Emergency Planning that the silver transferred to the stockpile be .999 fine. Because of this, the General Services Administration has announced that commencing October 20, 1967, future sales of silver by that agency will be in silver ranging in fineness from .996 to .998.

For small transactions, the Assay Offices will continue to issue small manila envelopes which contain .77+ ounces of fine silver in the form of granulations or pellets.

The Treasury has adequate supplies of silver on hand to fill all requests for exchanges of silver certificates made before June 24, 1968, the date on which exchanges are to be terminated under Public Law 90-29, and to satisfy all presently scheduled needs including the continued sales of silver to industrial users and the transfer on June 24, 1968, of 165 million ounces to the emergency stockpile as required by the same law.

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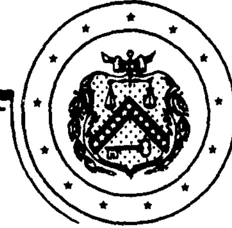
-1051

TREASURY DEPARTMENT



WASHINGTON, D.C.

October 13, 1967

FOR IMMEDIATE RELEASE

TREASURY MARKET TRANSACTIONS IN SEPTEMBER

During September 1967, market transactions in direct and guaranteed securities of the government for Government investment accounts resulted in net purchases by the Treasury Department of $61,489,000.00.

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F-1052

TREASURY DEPARTMENT

Washington

FOR RELEASE ON DELIVERY

REMARKS OF FRED B. SMITH
GENERAL COUNSEL, TREASURY DEPARTMENT
BEFORE THE NATIONAL CONFERENCE ON PROFESSIONAL ETHICS
OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
NEW YORK HILTON HOTEL, NEW YORK, N. Y.
MONDAY, OCTOBER 16, 1967, 9:00 A.M., EDT

Mr. Chairman, Distinguished Guests, Ladies and Gentlemen:

It is a special pleasure for me to participate in this Conference today because the matter of professional ethics not only falls within the ambit of my responsibilities in the Treasury Department, but is also a matter of special personal concern to me.

I have a few thoughts that I would like to share with you, but I also want to take advantage of this Conference, hopefully to get some ideas from you on how to deal with some difficult problem areas that are of mutual concern both to the Treasury Department and to practicing certified public accountants and attorneys.

Let me start by laying down a few initial premises. Some 70 million taxpayers annually file income tax returns under our self-assessment system, not to mention many other Federal tax returns. Last year under this system we raised some $148 billion in taxes. The system is absolutely and utterly dependent upon the responsibility and honesty of the taxpayers in this country and their professional representatives.

As you know, until the enactment of the Agency Practice Act, we had in the Treasury a system of requiring special licenses for attorneys, certified public accountants, and others to practice before

the Treasury Department; and we had regulations which were very broad in their scope. In effect, we made a second judgment on a certified public accountant's competence and personal and moral qualifications to represent taxpayers before the Internal Revenue Service. I was one of those in the Government who led the fight in opposition to the bill which eventually became the Agency Practice Act. We opposed this bill solely out of our concern for the protection of the taxpayers and for the protection of the revenue of the United States. Nevertheless, the Act was passed, and, upon reflection, I am satisfied that we were wrong and the Congress was right in passing that Act. I am satisfied, that is, if, as I fully hope and expect, the State licensing authorities and the professional associations, such as yours, now assume and proceed to carry out faithfully the responsibility which the Congress has rightfully said is theirs, to maintain high standards of ethics and morality amongst their membership, and to weed out those disreputable and dishonest members who cannot be depended upon to live up to their high professional responsibilities.

In any event, the Agency Practice Act was passed and we drastically revised Treasury Department Circular 230, which constitutes the rules governing the practice of attorneys and agents before the Internal Revenue Service. The special licensing or admission requirement was, as you know, dispensed with. However, the Act left in the hands of Government agencies, including the Treasury Department, the authority to discipline attorneys, certified public accountants, and agents practicing before the Service for misconduct.

It was clear to us from the records of the hearings and the debates that Congress intended us to concern ourselves primarily with matters of misconduct relating more or less directly to the work of the Internal Revenue Service. Accordingly, the revised Circular 230 now sets forth standards of conduct, the violation of which would be the basis for suspension or disbarment, which fall principally into two categories: (1) those which more or less directly affect the right of taxpayers to sound representation before the Service, and (2) those which relate to the ability of the Service to carry out its functions and missions. Let me give some examples of the kinds of things which might justify disciplinary action by the Treasury. If a practitioner willfully misrepresented facts to the Service with respect to his client's affairs, this would clearly be a matter of concern. Also, if he were guilty of willful tax fraud or evasion with respect to his own personal affairs, there would be serious doubt as to his qualifications to represent other taxpayers.

On the other hand, a great number of things that we used to consider in determining whether to grant a practitioner a license, or to discipline once admitted to practice before the Service, have now been eliminated. For example, imparting to a client false information relative to the progress of a case or other proceeding before the Internal Revenue Service; improper retention of a fee for which no services were rendered; obtaining or attempting to obtain money or

other thing of value from a client or other person by duress or by undue influence; endorsement of a Government check drawn to the order of the client without authority of the client; charging unreasonable fees, etc.

The new provision on fees provides that the practitioner shall not charge an "unconscionable" fee. Under our interpretation, this means more than just charging a fee in excess of the professional association's accepted standards. We interpret it to mean an unscrupulous fee. Well, I think these examples will give you an idea of the new attitude which we now have with respect to the discipline of practitioners, and suggest the broad scope of the area of responsibility which we now regard as falling upon the State licensing authorities and the professional associations.

Since the enactment of the Agency Practice Act and the issuance of our revised Circular 230, we have heard from a great number of groups and individual practitioners, many of whom are somewhat overwhelmed and concerned with the situation that they have helped to create in supporting the enactment of the Agency Practice Act. I think it is particularly true of a large number of those who specialize in tax practice. They realize that the "bug is now on their backs," and they are not entirely happy to have this responsibility. This is recognizable because as we have discovered over a great many years, it is not easy to police the membership of a profession. Those who serve on grievance committees perform a very delicate job of making

initial judgments on the conduct of their fellow practitioners. In addition, the proper performance of this responsibility requires a great deal of time and effort on the part of very busy men. But, I want to emphasize that, in my opinion, there are few undertakings which a professional man can perform which are more worthwhile. In the field of taxation alone, for example, practitioners are rendering a service which affects every taxpayer in the country practically, and in a vital way.

The integrity of our whole tax system is heavily dependent upon the ethical conduct of these representatives of the people. I am proud that in my whole adult life, I have been engaged in the practice of an honorable profession. In the not too distant future, I may well be returning to private practice. The reputation of the profession to which I belong is a matter of great concern to me, and I know it is also to you. I realize that a few bad apples practicing among the legal profession can bring disrepute upon the profession as a whole, and I am sure you feel the same way about the practice of certified public accountancy. Both of these professions have a very high reputation in this country today, but it is something that must be vigilantly maintained.

The Commissioner of Internal Revenue and I have both been the recipients of requests by professional associations for cooperation, particularly in the area of making available to State licensing authorities and professional associations derogatory information which comes to our attention. I can say without qualification that

both of us are anxious to be of assistance in every way possible as you assume a greater proportion of the responsibility for maintaining the ethics of your profession. We have given quite a bit of thought to this matter, and we are engaged in studies looking toward appropriate avenues of assistance. I am sorry to say that I cannot provide you with any very clear-cut conclusions at this point. Rather, as I indicated at the beginning of my statement, I am afraid that the most I can do this morning is bring to your attention certain problem areas that have arisen in connection with our thinking up to date on this subject.

Let me take a relatively easy one first. Every year a certain number of disciplinary proceedings are initiated by the Director of Practice against practitioners for violation of the rules of conduct under Circular 230. Parenthetically, I might say that the Director of Practice is completely independent of the Internal Revenue Service, and organizationally is a part of the Office of the Secretary of the Treasury, operating under my general supervision. These proceedings are brought before an independent Hearing Examiner pursuant to the Administrative Procedure Act.

Evidence and testimony on the charges are heard and weighed by the Examiner who ultimately produces findings of fact and an order which may call for the disbarment or suspension from practice before the Service of a practitioner. We regularly publish in the Internal Revenue Bulletin the names and addresses of those who are disbarred or suspended as a result of such proceedings. However, the published notice does not give any details as to the nature of the violation.

Query: Can a State licensing authority or professional grievance association take action against one of those members solely on the basis of a published notice of such a decision? It would seem to me that they might need more than this. At the present time, I am exploring the question of how we can make available to appropriate bodies the findings of fact and order of the Hearing Examiner in this category of cases. One avenue to be explored is whether this can be done on the basis of requests under the Freedom of Information Act effective July 4, 1967. I am hopeful that we will be able to work out a satisfactory system so that this can be done. There are problems with doing so, particularly as regards professional associations, since from profession to profession and from State to State there are great variances in what you might call the legal standings and procedures of grievance committees. It may prove to be appropriate in some cases to recommend amendments of particular State laws to set up an adequate procedure for doing this.

There is a much broader area of adverse information which comes to the Treasury Department where the problem of cooperation with local authorities and professional associations is much more difficult. Many of these cases never go to a hearing before an Examiner. After derogatory information is made known to a practitioner, he may consent to suspension, and that is the end of it. One might suggest that in such cases, guilt could be presumed and the adverse information and evidence which we have should also be made available to appropriate authorities. However, this may not be the case. A practitioner, in

theory at least, might feel that he has such a small amount of tax work that he really doesn't care about being authorized to practice before the Service, and he doesn't want to go to the time, effort and expense to contest the charges and produce the evidence. In any event, there would not have been a production of all the evidence in a due process type of proceeding, a weighing of such evidence and a decision; and we have great difficulty at the moment in seeing our way clear to make this type of information available to local authorities under the circumstances -- absent some statutory basis for doing so. This is an area concerning which I would be very interested to hear the comments and suggestions of any of those participating in this Conference.

Finally, in the course of its review and investigation of tax matters all over the country, agents of the Internal Revenue Service may discover some derogatory information about practitioners, but this is derogatory information which does not relate to the matters encompassed by Circular 230. You might say it is accidental or incidental evidence and information which they acquire in carrying out their regular responsibilities. This is "raw" data which has not been tested, and we have great difficulty in seeing our way clear to make this type of information available to professional organizations. Bear in mind that among other things, we are tremendously concerned not to cause any unfair harm to any individual practitioner. We are well aware that the disclosure of derogatory information which may

ultimately be proven to be of absolutely no validity whatsoever can nevertheless do untold damage to the reputation of the practitioner. The vindication almost never catches up with the publication of sensational charges and, of course, to a professional man, his reputation is his life blood.

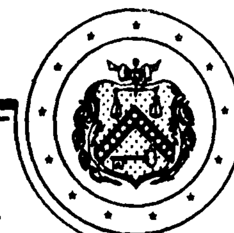
I should like to touch on one further area which we are studying. Under our present regulations, flagrant misconduct by a practitioner before another agency of the Federal Government or, for that matter, State and local government, is not a basis for disciplinary action by the Treasury Department's Director of Practice. Nevertheless, we are well aware that an attorney or certified public accountant who files fraudulent statements with, for example, my colleague in the Securities and Exchange Commission, is certainly of dubious qualification to represent taxpayers before the Treasury's Internal Revenue Service. Of course, the initial responsibility for coping with this type of an incident lies with the other Federal agency. But, supposing a practitioner is disbarred from practice before the Securities and Exchange Commission. Some contend that this should be grounds for disbarment by the Treasury, but this can create problems. For example, I know of a similar case not involving Treasury's Director of Practice, but involving a Treasury license of a different sort where a man was denied a Treasury license on the basis of his having been found guilty of violations of an act administered by another Department, resulting in the denial to him of certain privileges under that Department's regulatory program. Subsequent to our action, this person

provided the other Department with additional information and evidence, and was completely reinstated and vindicated by the other Department. We were considerably embarrassed by this incident because we had not held a proceeding in which an independent Examiner had heard all of the evidence and come to a decision. My tendency is to feel that while we can explore possibilities for cooperative arrangements among the various Federal departments and agencies, essentially the task is going to devolve principally upon the State licensing authorities and the professional associations to keep track in the Federal Register and Internal Revenue Bulletin of decisions in disciplinary proceedings by the various departments and agencies, and to take the matter from there themselves. However, I will be very much interested to hear the views of my colleagues on the panel, or of the other participants in this meeting on this difficult question.

These are a few rambling thoughts which I have, which I hope may make some contribution to the deliberations at this Conference. We are very pleased that by and large our new Circular 230 has found favor among the various professional associations. As you know, in the development of these regulations, we received great help in the form of suggestions from the various associations, and in particular, very thoughtful and constructive suggestions from the American Institute of Certified Public Accountants. It goes without saying that the Director of Practice and I, and I know the Commissioner of Internal Revenue, are always happy to discuss with representatives

of your organization and other similar organizations, any problems which may arise for you in connection with the way we carry out our responsibilities. And, as I have said, we are tremendously interested and anxious to be of whatever assistance we can in helping the various professional associations as they move into action to tighten up the quality and integrity of the services performed by their membership.

TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR RELEASE 6:30 P.M.,
Monday, October 16, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury bills, one series to be an additional issue of the bills dated July 20, 1967, and the other series to be dated October 19, 1967, which were offered on October 11, 1967, were opened at the Federal Reserve Banks today. Tenders were invited for $1,500,000,000, or thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day bills. The details of the two series are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	91-day Treasury bills maturing January 18, 1968		182-day Treasury bills maturing April 18, 1968	
	Price	Approx. Equiv. Annual Rate	Price	Approx. Equiv. Annual Rate
High	98.827	4.640%	97.403 a/	5.137%
Low	98.808	4.716%	97.376	5.190%
Average	98.818	4.676% 1/	97.389	5.165% 1/

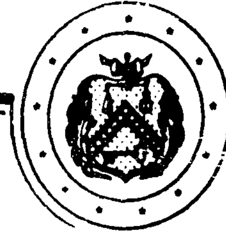
a/ Excepting 1 tender of $200,000
7% of the amount of 91-day bills bid for at the low price was accepted
14% of the amount of 182-day bills bid for at the low price was accepted

TOTAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	Applied For	Accepted
Boston	$ 19,572,000	$ 9,572,000	$ 5,572,000	$ 5,572,000
New York	1,786,151,000	988,441,000	1,414,269,000	625,929,000
Philadelphia	25,029,000	18,029,000	17,997,000	9,997,000
Cleveland	32,217,000	30,357,000	53,313,000	37,453,000
Richmond	9,918,000	9,918,000	5,276,000	5,276,000
Atlanta	42,440,000	38,580,000	31,231,000	25,231,000
Chicago	302,140,000	199,457,000	281,183,000	140,883,000
St. Louis	43,431,000	35,431,000	25,388,000	18,528,000
Minneapolis	16,626,000	13,876,000	15,017,000	11,727,000
Kansas City	30,013,000	26,013,000	18,527,000	16,527,000
Dallas	26,602,000	18,602,000	15,828,000	10,828,000
San Francisco	117,996,000	111,996,000	122,378,000	92,058,000
TOTALS	$2,452,135,000	$1,500,272,000 b/	$2,005,979,000	$1,000,009,000 c/

b/ Includes $232,583,000 noncompetitive tenders accepted at the average price of 98.818
c/ Includes $151,765,000 noncompetitive tenders accepted at the average price of 97.389
1/ These rates are on a bank discount basis. The equivalent coupon issue yields are 4.81% for the 91-day bills, and 5.39% for the 182-day bills.

TREASURY DEPARTMENT



WASHINGTON, D.C.

October 18, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $2,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing October 26, 1967, in the amount of $2,400,935,000, as follows:

91-day bills (to maturity date) to be issued October 26, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated July 27, 1967, and to mature January 25, 1968, originally issued in the amount of $1,000,293,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated October 26, 1967, and to mature April 25, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Daylight Saving time, Monday, October 23, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

F-1054

Immediately after the closing hour, tenders will be opened at th Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasur expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on October 26,1967, in cash or other immediately available funds or in a like face amount of Treasury bills maturing October 26,1967. Cash and exchange tende will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunde need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and thi notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained i any Federal Reserve Bank or Branch.

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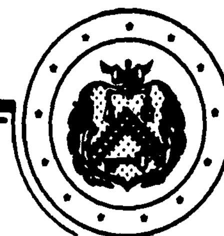
TREASURY DEPARTMENT



WASHINGTON, D.C.

October 18, 1967

IR IMMEDIATE RELEASE

TREASURY'S MONTHLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders r two series of Treasury bills to the aggregate amount of ,500,000,000, or thereabouts, for cash and in exchange for easury bills maturing October 31, 1967, in the amount of ,405,740,000, as follows:

274-day bills (to maturity date) to be issued October 31, 1967, the amount of $ 500,000,000, or thereabouts, representing an ditional amount of bills dated July 31,1967, and to ture July 31,1968, originally issued in the amount of ,000,551,000, the additional and original bills to be freely terchangeable.

366-day bills, for $ 1,000,000,000, or thereabouts, to be dated tober 31,1967, and to mature October 31, 1968.

The bills of both series will be issued on a discount basis under mpetitive and noncompetitive bidding as hereinafter provided, and at turity their face amount will be payable without interest. They ll be issued in bearer form only, and in denominations of $1,000, 000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 turity value).

Tenders will be received at Federal Reserve Banks and Branches to the closing hour, one-thirty p.m., Eastern Daylight Saving e, Tuesday, October 24, 1967. Tenders will not be eived at the Treasury Department, Washington. Each tender must for an even multiple of $1,000, and in the case of competitive ders the price offered must be expressed on the basis of 100, h not more than three decimals, e. g., 99.925. Fractions may not used. (Notwithstanding the fact that the one-year bills will run for days, the discount rate will be computed on a bank discount basis of days, as is currently the practice on all issues of Treasury bills.) is urged that tenders be made on the printed forms and forwarded in special envelopes which will be supplied by Federal Reserve Banks or nches on application therefor.

Banking institutions generally may submit tenders for account of tomers provided the names of the customers are set forth in such ders. Others than banking institutions will not be permitted to mit tenders except for their own account. Tenders will be received hout deposit from incorporated banks and trust companies and from ponsible and recognized dealers in investment securities. Tenders

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from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at th Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasur expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank cash or other immediately available funds or in a like face amount of Treasury bills maturing Cash and exchange tend will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are exclude from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereund need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which th return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and th notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained any Federal Reserve Bank or Branch.

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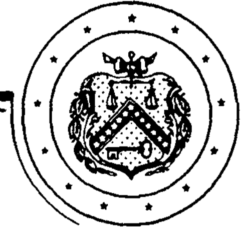
TREASURY DEPARTMENT



WASHINGTON, D.C.

October 18, 1967

FOR IMMEDIATE RELEASE

Secretary of the Treasury Henry H. Fowler today sent the following letter to Senator Russell B. Long, Chairman, Senate Finance Committee.

Attachment

F-1056

THE SECRETARY OF THE TREASURY
WASHINGTON

OCT 18 1967

Dear Mr. Chairman:

I am writing to you to express my judgment that the recently proposed import quota bills, if enacted, would worsen our balance-of-payments problem, already aggravated by the Vietnam conflict.

During the post-war period, our substantial trade surplus has been the major sustaining element in our balance-of-payments picture. This trade surplus has provided the financial means for carrying on necessary military, economic, and diplomatic activities throughout the world with a convertible dollar of constant gold value. Because of this trade surplus, we have not had to resort to the restrictions on personal freedom of travel abroad or on direct investment abroad which so many countries have used. I shudder to contemplate what would have happened to our balance-of-payments position and our gold reserves in the absence of this strong plus factor in our payments situation.

A country with a large trade surplus is uniquely vulnerable to the adverse effects of a quota war and that is what wide use of import quotas would create. To incite such a war would be a fool's game since the U. S. would be bound to end up as a loser. The broad use of import quotas may, at times, make temporary sense for inward-looking trade deficit countries; but it has no place in the policy of a major trade surplus country such as ours.

Import quotas would probably reverse the continued recovery of our trade balance upon which the solution to our balance-of-payments problem so heavily depends.

They would do this by causing a loss of U. S. exports that would almost certainly exceed any reduction in U. S. imports that they would produce.

There are three reasons for anticipating a substantial adverse effect on our exports as a result of widespread imposition of import quotas. These may be referred to as the "feedback" effect, the "retaliation" effect and the "competitive loss" effect. Let me describe each of these, in turn.

Feedback Effect. When we import, we put dollars in the hands of foreign countries which are likely to use the bulk of them directly or indirectly either to purchase U. S. goods, U. S. services or U. S. long-term investments.

Experience suggests that for each $1 billion reduction in our merchandise imports, we will lose somewhat over half a billion dollars of exports. Other items in our balance-of-payments accounts will also change; but I am speaking of the observable statistical relationship between our merchandise imports and exports over a period of years.

If foreigners earn less from us because of quota barriers which we erect against their goods, we can surely anticipate that their purchases of our goods will decline even in the absence of retaliatory action against our goods. But there will certainly be such action--and this leads me to the second adverse effect that the proposed quotas would have on our exports.

Retaliation Effect. President Kennedy in his Balance of Payments Message to the House of Representatives on February 6, 1961, warned:

> "A return to protectionism is not a solution. Such a course would provoke retaliation; and the balance of trade, which is now substantially in our favor, could be turned against us with disastrous effects to the dollar."

President Johnson in his Balance of Payments Report to the Congress on February 10, 1965, emphasized our obligation to avoid "beggar thy neighbor" restrictions on trade.

If we start down the quota path, there will be retaliatory action abroad and our trade surplus position will suffer.

The six Common Market countries have already given a veiled warning that they would retaliate. I do not think they are bluffing. The Commission which is the executive arm of the European Community is reported to have already undertaken a study of possible retaliatory action. A Commission recommendation along this line to the Community's Council of Ministers would certainly receive very careful consideration.

Other countries would follow suit. I understand the Australian Government has estimated that the proposed quotas would apply to 60% of Australia's exports to us. I hardly think that country, or other countries in comparable situations, would remain passive in the face of U. S. quota limitations affecting so large a portion of exports to us.

Let me add that foreign countries have a variety of devices with which they could retaliate against the proposed U. S. quotas. These include not only counterquotas but also administrative devices such as licensing requirements which are not so obvious but which could be quite effective in reducing their imports from the U. S. There is no doubt in my mind that these instruments would be brought into play within a short time after action by the U. S. along the lines of the proposed legislation.

In addition, then, to the adverse "feedback" effect on our exports resulting from a quota-induced reduction

in our imports, there would be a decline in our exports due to foreign retaliation. Loss of U. S. exports due to these two reasons alone might well exceed any reduction in our imports resulting from the proposed quotas. But the above losses would be supplemented due to a third adverse effect resulting from imposition of import quotas.

Competitive Loss Effect. Imposition of the proposed quotas, by curtailing competition from foreigners, would encourage higher domestic prices for various materials and components which enter our export products. As a result, our exports would tend to be less competitive in foreign markets, and we could expect foreigners to buy less of them for this reason.

In August I testified before the House Ways and Means Committee on the President's fiscal program. In that testimony I emphasized the importance of keeping our exports competitive over the longer run and pointed out that the requested tax increase would contribute to this end. Maintaining an open economy--that is, one free from widespread quotas and other barriers to trade--also contributes to this end. We cannot hope to produce in a highly protected domestic market and sell successfully in highly competitive international markets.

I have described above three adverse effects that the proposed import quotas would have on U. S. exports. I cannot predict exactly what their combined effect would mean in terms of dollar loss of U. S. exports for each dollar reduction in U. S. imports brought about by the proposed quotas. But my judgment is that the ratio would be considerably greater than one for one--that is, more than one dollar's loss of exports for every dollar reduction of imports. In summary, the proposed quotas would hurt our trade balance and, therefore, our balance of payments.

The approach under our balance-of-payments program has been in exactly the opposite direction--namely, to

achieve an expansion of exports that would outstrip the rise in our imports. In short, we are striving for a balance-of-payments solution in the context of a healthy, expanding international economy such as has been developing in the last decade or two. The proposed legislation, by contrast, would foster a retreat to protected markets which could easily become cumulative. Protectionism is like inflation. There is never enough of it for the firm whose costs are seriously out of line.

Any adverse effects of increased imports on particular firms or individuals are not remedied from the national point of view by transferring the disruption to firms and workers engaged in exporting. Adverse effects, in any event, are likely to be temporary in a period of healthy domestic growth and near capacity utilization of domestic resources. We are not facing a period of mass unemployment and low rates of plant capacity utilization such as featured the 1930's. The Administration's policy has been directed more and more firmly towards the maintenance of a full employment, non-inflationary economy in which international trade in both directions plays an important role.

Enactment of the proposed bills would bring to an end an era of progressive liberalization in international trade--an era which has witnessed the highest growth rate that the industrialized area of the world has ever experienced.

The U. S. has played a leading role in this liberalization process. In addition to completing successfully the Kennedy Round of trade negotiations, the U. S. and other Free World countries have recently agreed on a facility for supplementing existing international reserve assets, as needed, in order that a shortage of such reserves will not impede the continued growth of world trade.

Our best interests at home and abroad would suffer if the U. S. were suddenly to forsake its role in the

expanding Free World economy for the illusory benefits of an import quota system.

Sincerely yours,

Henry H. Fowler

Henry H. Fowler

The Honorable
Russell B. Long
Chairman
Senate Finance Committee
Washington, D. C. 20510

TREASURY DEPARTMENT
Washington

FOR RELEASE ON DELIVERY

REMARKS OF THE HONORABLE FREDERICK L. DEMING
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
AT THE
MID-CONTINENT EAST REGIONAL MEETING
OF THE
AMERICAN ASSOCIATION OF COLLEGIATE SCHOOLS OF BUSINESS
IN MINNEAPOLIS, MINNESOTA
ON THURSDAY, OCTOBER 19, 1967, AT 9:00 A.M., CDT

FINANCIAL FRONTIERS

It is always a pleasure to return to Minneapolis -- and the opportunity to meet and exchange ideas with this distinguished group makes the occasion still more satisfying.

One of the great strengths of the American system, I believe, is the interchange of ideas and people between business and Government, Government and the academic community, and business and academic life. If not an eternal triangle, it is, at least, a long-lasting and fruitful one -- with solid ties and tensions in each of those interconnections. Each of the three components benefits from the relations with the other two.

This productive partnership shows up particularly in the development of new frontiers of economic knowledge and institutions. A striking example of this, which I have seen at first hand, is the effort of the past several years to create new international liquidity. There is not time today to discuss this subject at length or in substantive fashion. I want to spend most of my time on domestic matters. But a brief historical and procedural comment is in order.

Much of the original thinking in this area came through the interchange of ideas and people in Government and the academic community. A succession of ideas was fostered in Government circles here and abroad. In that process, the business and financial world was drawn in, too, at first with some healthy skepticism and then with increasing conviction that this was an appropriate, desirable and necessary path to follow.

The international liquidity exercise has gone through several phases of study and negotiation with most of the frontline work being done by representatives of Treasuries and Central Banks. Government positions, of course, have reflected widespread intra-Government study and consultation. In the United States, both the executive and legislative branches contributed to this work. And, in the United States, an important role has been played by the Advisory Committee on International Monetary Arrangements -- a group that illustrates my point very well.

The Committee is composed of nine men from business, financial and academic life -- many of whom have served in important Government positions. From the financial and business world are its Chairman -- Douglas Dillon (former Secretary of the Treasury), Robert Roosa of Brown Brothers Harriman (former Under Secretary of the Treasury), Andre Meyer of Lazard Freres, David Rockefeller of The Chase Bank, and Frazar Wilde of the Connecticut General Life Insurance Company and the Committee for Economic Development. From the academic community are Walter Heller of Minnesota (former Chairman of the Council of Economic Advisers), and Kermit Gordon of Brookings (former Director of the Bureau of the Budget.) Charles Kindleberger of MIT served as a member for a year; and Francis Bator of Harvard, who has just returned to academic life after four years in Government -- most recently as a White House Adviser -- has become a member. Edward Bernstein, who has been in academic life, the Treasury and the IMF and is now a consulting economist, completes the Committee.

This Committee is a working group which has met some 25 times in all-day working sessions with the Secretary of the Treasury and other Government officials concerned with the international liquidity exercise. It has given advice and counsel on both points of substance and negotiating strategy.

The steps taken, and the agreements reached in the past two months -- in London among the ten major nations in world trade and finance, and in Rio by all 106 members of the International Monetary Fund -- are important, historic moves in the process of creating new international liquidity. But the process does not stop with these steps -- nor does the interchange cease among business, Government, and the academic community as we proceed to flesh out the framework now agreed upon.

Let me switch now to another area of extremely valuable interchange among these same three groups -- and one that is also very timely at this moment. I refer now to the area of fiscal policy -- Government spending and lending, and taxing and borrowing -- to serve broad national purposes. Here, I want to comment at some length and substance.

The role of the academic community in educating Government and business to the merits of flexible fiscal policy needs no elaboration here. The success of the 1964 tax reduction was most impressive, not only in stimulating a robust and healthy economic expansion -- now in its 80th month -- but also in bringing revenues from a prosperous economy up to a level that produced a surplus in the national income account budget in calendar years 1965 and 1966.

But there is another chapter in the book of "new economics" which sets out circumstances in which tax increases rather than cuts are the right medicine, and when tax increases are the appropriate way to bring in more revenue -- even though under other conditions a reduction in tax rates had the effect of augmenting revenues along with stimulating business activity.

The difference, of course, lies in taking account of what the rest of the economy is doing. The Federal sector does not operate in a vacuum, but in an economy which may be booming, sagging, or operating somewhere in between -- perhaps en route from one of these stages to another. In the early 1960's, the economy was not exactly sagging, but it was also far from booming. Unemployment hovered around 5-1/2% -- better than the 7% recession level touched in 1961, but still distant from the desired 4% level and not clearly headed either up or down. In this case, an economic stimulus was appropriate, and it could be provided by an expansionary fiscal policy that would operate alongside an expansionary monetary policy -- without requiring monetary policy to provide so much of the push that it produced distorted financial flows within this country and capital outflows from this country.

Compare that set of conditions with our current economic position. Unemployment has held steady at around 4% of the labor force. Consumer and Government demands have been rising briskly. An inventory adjustment apparently has been weathered without producing general weakening in the economy, and renewed inventory demand is now ready to take its place as a source of added aggregate demand. In the meantime, there are strong credit market demands from virtually all types of borrowers.

Granted, the economy is not, at this moment, in the grip of clearly excessive demand. There have been times when unemployment was lower, capacity utilization higher, and the pull of excess demand more clearly evident. Those were times such as in the Korean War period, when demand inflation was gaining an upper hand and clearly needed strong restraint. But, just as clearly, that is the kind of economic structure we may well be heading into in a matter of months -- given a continuation of present trends in consumer and government demand.

That we have not felt the hot breath of demand inflation more strongly in recent months is a result of an inventory adjustment of considerable proportions -- which, had it arrived under different circumstances, without the offset of strongly rising final demands, would have caused a general softening in economic activity and called for consciously stimulative fiscal policy. With inventories now about in line, and the adjustment pretty well completed, the fiscal stimulus that had been appropriate earlier is less and less desirable with each passing month -- and, in fact, it is now becoming positively harmful.

The role of inventories is most clearly seen in looking behind the quarterly changes in the annual rate of gross national product -- to see how much was due to inventory building and how much to final demands from Government, consumers and business. In the first quarter of this year, the annual rate of GNP was up a scant $4.2 billion; and, in fact, not up at all in real terms, after correcting for price changes. But final demands in that quarter were up more than $15 billion while the rate of inventory accumulation fell about $11 billion. A $15 billion quarterly gain, or about 2%, is about as much as we should want to see; and, in fact, it's a bit faster than we can tolerate for long without getting too much price pressure. Of course, in the first quarter of this year, we did not get that excessive pressure because the big rise in final demand was offset by a large drop in production for inventories.

The picture began to change a little in the second quarter of this year. Final demands were up another $15 billion, and the rate of inventory accumulation declined again, but not as

much as in the first quarter so that total GNP increased by nearly $9 billion. That was enough to provide a little real growth but still not a satisfactory total increase, so it was appropriate that a fiscal stimulus continue to be provided through a budget deficit on the national income accounting basis.

For the third quarter, it is estimated that final demand continued to push up -- this time by about $14 billion -- while the rate of inventory building increased slightly from the second quarter's pace. In real terms, GNP increased at a slightly better than 4% annual rate. With that performance, the continuation of substantial fiscal stimulus is already becoming questionable; and, when one looks ahead, the continuation of that stimulus becomes positively objectionable.

In the current quarter, statistics may be distorted by the automobile strike -- but the trend is clear in pointing to a steadily rising head of steam. Every major work stoppage in recent years has had the effect, once it is settled, of imparting further stimulus to the economy as it seeks to make up for lost production. I would not argue that the current auto strike is an additional reason for going ahead with the President's tax proposals -- but we should not let ourselves be persuaded that the strike is a reason for delaying that needed fiscal action.

Participants in the credit markets seem to have had few doubts about the basic trend of economic activity through the past year of irregular growth. Particularly outstanding has been the heavy demand for capital by corporations -- reaching record proportions, even though capital needs for financing inventories were lessening and needs to finance current fixed investment outlays held about steady. How does one account for the fact that corporations borrowed $17.9 billion in the capital markets through the first nine months of this year -- an amount somewhat exceeding the total of such borrowing during all of 1966, and 27% ahead of the amount borrowed in the first 9 months of that year? And 1966 was not a slack year -- it was the record year to date. Underlying this enormous demand was a combination of conviction and fear -- conviction that liquidity positions run down during 1966 should be restored and dependence on short-term borrowing from banks reduced, and fear that a failure to tie up some available funds when they are available might mean an inability to get funds at all when they really are needed later on.

A special source of concern for the corporate treasurer has been the possibility of an oversized Federal Government deficit. The recollection of tight money markets in the summer of 1966 is still quite vivid. Yet, tight as the markets were at that time, the Federal sector's demands on the credit markets were quite modest through that period. The contemplation of a period of heavy private sector credit demands augmented by an overgrown Federal deficit raises the possibility -- or spectre, if you will -- of an even tighter set of credit conditions in the future. Corporate borrowers have realized this and sought to make preparation for it.

Credit demands from state and local governments have not been laggard, either. These governments, in the first 9 months of the year, have borrowed $10.7 billion, or 25 percent more than in the comparable months of 1966. Part of this reflected borrowings postponed from the very tight money period of a year ago, which was marked not only by high interest rates but also an unavailability of funds to some prospective borrowers. Part of it, too, simply reflects greater current needs by these governmental units, to provide increases in things and services more quickly than current tax revenues rise. Some of it, also, is due to the rising volume of tax-exempt industrial revenue bonds -- borrowing by a local government unit to build industrial facilities which are then leased to corporations. This, incidentally, should be a source of growing concern to the state and local governments themselves, as it is making their own borrowings for schools, roads, and other traditional state and local needs significantly more costly.

Looking at the Federal sector's credit demands for 1967 thus far would tend to give a somewhat distorted picture because of the very heavy debt repayments that occurred from January to June 1967. That was partly seasonal, but the seasonal factor was accentuated because of accelerated corporate tax payments, unusally heavy repayments by savings and loan associations to the Federal Home Loan Banks, and an unusual absence of the seasonal build-up in the Treasury's cash balance that typically occurs in the first half of the calendar year.

Because of these factors, net Federal demands on the private credit markets from January to June 1967, as measured by the increase in outstanding Treasury issues, agency issues, and participation certificates, less the increase in holdings of these obligations by the Government Investment Accounts and the Federal Reserve, was actually negative by $11 billion. That is, the Federal sector was supplying that amount of credit to the rest

of the economy, rather than making a net demand on it. And so great was the net paydown in that half-year period, that even taking the whole of Fiscal Year 1967, to wash out purely seasonal forces, there was a net paydown by the Federal sector of some $6 billion. Even after adjusting for the $5 billion decline over the year in the Treasury's cash balance, the result still stands for that period -- the year ended June 30, 1967 -- that the Federal sector, in effect, made no net credit demands on the private market.

The picture in this current fiscal year stands in some considerable contrast to last year, however, for there will be a significant net Federal credit demand, and it is already being exerted on the markets. How big that net demand will be depends on several factors, prominently including the President's tax proposals which are now before the Congress.

Essentially, it comes down to a question of whether the net Federal credit demand, with the benefit of a tax increase and firm restraint on expenditures, will be large but still of manageable proportions, or whether it will assume outsized proportions with hard-to-determine consequences for the credit market at large, for interest rates, and for the general economy.

We have estimated that with the President's tax program, as recommended on August 3, and with Federal spending held to the lower end of the band that would produce an administrative budget deficit in the $14-$18 billion range, net Federal credit demands on the financial markets -- that is, including Treasury issues, agency issues and participation certificates -- in the sense defined above, would come out somewhere in a $10-$12 billion range in the current fiscal year. That would still be a sizable demand, coming after a year of no net Federal credit demand in that sense -- but it could probably be managed within the context of financial markets that handle flows in the range of some $70 billion or so a year, provided there was a good-sized increase in bank credit.

Without prompt tax action and expenditure restraint, however, hat net credit demand from the Federal sector could bulge to 20 billion or more, and there would be a real question about hether that sort of demand would be "manageable," in the sense f preserving reasonably orderly markets. One cannot, for example, imply expect a sufficient expansion in bank credit to accommodate hatever demands emerged from the Federal sector -- any more than his sort of accommodation could be expected on behalf of any

other borrowing sector in the economy. The monetary authorities would want to appraise the total demands carefully and accommodate, only with increasing reluctance, the larger volume of aggregate demands.

The process through which the market would allocate a limited supply of credit among an excess of would-be borrowers can be described, ahead of time, only in qualitative terms and generalities. The particulars might work out differently under slight variations in circumstances. In general, though, it may be predicted that the Federal Government's credit needs would be met, one way or another, as would also the credit needs of larger business firms. The cost might be high -- even in comparison to the high rates prevailing today -- but the supply probably would be there because some other borrowers would be "pushed off the end of the bench" and unable to find money, except perhaps at rates that were considered exorbitantly and prohibitively high.

Consumers might fare unevenly in the scramble for available credit. Funds for installment purchases, and other short-term credit, would probably be available -- but money for home mortgages would quite likely be a major victim. As, in fact, it was the major victim in the tight money period of 1966 and in similar past episodes. Business might also fare unevenly, with large firms, as noted, getting their needs filled, and small ones having to make do with less -- drawing on every last ounce of spare liquidity in the sytem, leaning on trade credit, and cutting corners wherever possible in cash management. State and local governments would also feel the pinch, especially if bank credit expansion potential was under some restraint. In the summer months of 1966, this was one of the areas where we seemed closest to the stark possibility of non-functioning credit markets in which funds were unavailable at virtually any price.

This is not a prediction, but an outline of possibilities that would conceivably develop in the absence of responsible fiscal policy action on both taxes and expenditure restraint. We had a taste of this in 1966, and that did not particularly whet our appetite for more of the same.

As to where we are now, at this point in the fiscal year, in accomplishing our needed borrowing, we have done a good bit of the job already -- but much of this represents the seasonal portion of the job. Without timely tax action, some additional borrowing will remain to be done at the time of the year when we are normally making substantial seasonal repayments.

With respect to cash needs for the July-December period, we are now in the home stretch. In late July, we estimated that Treasury needs for market borrowing in the July-December period would be about $15 billion. That assumed timely action to bring in some revenues from a tax increase before year-end; it assumed participation sales of about $2 billion in this 6-month period, so that the total financing need, in that sense, was $17 billion; and it assumed that spending would be near the lower end of the range outlined in the President's tax message of August 3.

If the spending and tax assumptions do not stand up, that total need of about $17 billion for this 6-month period could turn out to be higher -- perhaps $1 to $2 billion more. But, as noted, the major change could be reflected in borrowings over the following six months. Thus far, we have already either borrowed, or announced the specific plan to borrow, close to $14 billion in Treasury securities, including $8.5 billion in tax anticipation bills, nearly $3 billion in regular weekly or monthly bills, and $2½ billion in coupon-bearing securities. We have not yet sold participation certificates in Federal agency loan portfolios in this fiscal year, but we still expect to do some in the current half-year, and, thus, avoid bunching up too great a volume of these sales in the January-June half of the fiscal year.

It is fair to ask, in view of the many comments made on the need for a tax rise to hold down Treasury borrowing and avoid excessive monetary strains, "How is it that the Treasury has been able to borrow as much as it has without greater disturbance to the market?" The answer, I think, is twofold. First, there has been a large expansion in bank credit that has greatly facilitated the amount of borrowing we have had to do thus far. From January through September 1967, seasonally adjusted commercial bank credit increased $29 billion, and bank holdings of Treasury securities increased by $8 billion. Second, the receptivity of the market has been conditioned by an expectation that responsible fiscal action will be forthcoming -- forthcoming in time to make a considerable difference in borrowing needs during the months ahead.

Even with these expectations, though, interest rates are now high. Long-term rates on Treasury and corporate securities are above the very high levels reached in August and September 1966 -- mainly pushed aloft by the extremely heavy pace of corporate borrowing earlier this year. Long-term, tax-exempt issues have also risen in rate during recent months; and, in just the last few days, these yields have pushed above last year's peaks to the highest levels since the early 1930's. Commercial banks have continued to invest in tax-exempt issues; but they have tended recently to shy away from longer term issues.

Mortgage rates, typically sluggish, did not begin to decline until several months after more sensitive rates turned down a year ago. But mortgage rates, too, have been rising steadily in recent months. They remain below the late 1966 highs, in part because of the continuing good inflow of funds to the traditional mortgage lenders -- notably, the thrift institutions. Those flows are vulnerable, however, if rates on short-term marketable debt instruments rise to levels that begin to attract funds that might have gone into the savings institutions, or that succeed in pulling funds out of the thrift institutions, as occurred last year.

The big difference between interest rates now and a year ago is in the short-term area. Even though these short rates have risen since last spring, they are still well under the levels of a year ago -- especially in the maturities of

one year or less. Rates on somewhat longer maturities -- those of a few years, say -- are not so very far from the rates of a year ago, however, and this is an area of some concern with respect to competition for funds going to the thrift institutions. When rates available on Treasury and Federal agency securities push significantly above the rates offered on various types of savings accounts, the possibility of "disintermediation" or divergence of funds from these thrift accounts, and, hence, from the mortgage market, must be reckoned with.

Let me turn now to a little different area -- or, rather, a different focus. Instead of the matter of current tax policy and its possible effects on the economy and the credit markets, I want to consider certain points relating to credit programs that are carried out, guided or encouraged by the Federal Government. In referring to this as a change of focus, rather than a wholly new topic, I have in mind that both Federal fiscal policy (taxing and spending) and Federal credit policy (lending, or loan guarantees and borrowing) are concerned with the use of resources, the degree and kind of Governmental influence over that use, and the method or methods of financing. This is an area of inquiry and endeavor that is admirably suited to injections of new ideas and interpretations from the academic community, or wherever else these ideas might be generated. It is, indeed, a financial frontier, in need of exploration and development.

The subject is scarcely new, but some of the developments and applications are new -- and we continually find, in returning to this area, that there are many facets remaining to be analyzed and organized. The first broad look at this area in recent years was taken by the privately sponsored Commission on Money and Credit, which produced its Report in 1961. One of the members of that distinguished Commission was our present Secretary of the Treasury, Henry Fowler.

This Commission's study was followed by a Federal Government study by a Committee on Federal Credit Programs, chaired by then Secretary of the Treasury, Douglas Dillon. The Committee reported on its study in 1963. A major study of Federal credit programs was also sponsored by the House Banking and Currency Committee, and published in 1964. More recently, just about a year ago, the Treasury made a study

on certain aspects of Federal credit programs, as provided in the Participation Sales Act of 1966. The particular focus of that study was an evaluation of the advantages and disadvantages of direct Federal loan programs, as compared with guaranteed or insured loans.

One may well ask whether, with all those studies of the past several years, any questions could possibly remain unanswered. The answer is assuredly in the affirmative. That this was so has shown up clearly in still another related study -- that of the Budget Concepts Commission, which has wrestled at some length with the question of how to treat loans, loan repayments, and loan participations in the Federal budget. The Commission said this was one of the most difficult questions it faced. This has a significance that goes well beyond the mere accounting technique -- for a different budgetary treatment may tend to encourage or discourage particular types of loans and particular methods of financing them. There can be significant differences, also, in the way that subsidies are accounted for under various lending programs -- whether they are to be buried as deeply as possible, or exposed with explicit disclosure and, perhaps, with a need for specific Congressional appropriations to cover a subsidy element.

Other things equal, most of us would have a predilection for keeping credit programs a part of the private sector as far as possible -- bringing in the Federal influence only where needed to fill gaps that the private sector does not cover adequately and that social policy demands be filled. But the United States is a big economy with many credit needs, and there is no reason to believe that the place of Federal credit programs, in the aggregate, will be diminished -- more probably it will grow.

For example, one area of national effort that clearly needs greater attention is that of urban redevelopment -- rebuilding the living quarters and employment opportunities in our central cities, avoiding economic and racial concentrations that become breeding grounds for progressive deterioration, and permitting our society to be enriched by the full potential of its human resources. This cannot be a task for Government alone, and certainly not for the Federal Government alone. Much of the drive, much of the resources,

and much of managerial talent must come from the private sector. But, in partnership with various levels of Government, through constructive and imaginative credit-support programs among other aspects, there is a real potential for worthwhile achievement in this area. This cannot mean, in the present context, large commitments of additional Federal funds from an already overstrained Federal budget. Nor should it mean searching for budgetary accounting devices so that Federal expenditures can be hidden away. But there is room, and need, for Government stimulus and support for programs that have up to now been insufficiently attractive to draw forth adequate private effort.

This brings me back to two points about Federal credit programs -- their financing and the kinds of control or guidance that should apply to them. Should the funds used for loan disbursements be recouped by selling off the loans, or by selling participations in the loans? Should there be direct access to the Treasury by the Federal lending agencies so that their financing comes in the form of direct Treasury issues? Should there be more consolidation of the borrowing -- not the lending -- functions of the Federal agencies and have financing done with issues of a combined institution designed for this purpose? And what kind of control or guidance should be exercised by the Federal Government? A form of "debt limit" that puts a ceiling on over-all loan volume outstanding or on particular kinds -- or limits on new loan volume in a particular period -- or merely the setting of standards and, perhaps, a regulation of interest rate ceilings on such loans?

At the extreme, one might say that the Federal Government's role should stop with the mere provision of a guarantee or partial guarantee of a loan that remains in the private sector. Then, the volume of such loans can be regulated by market forces, just as would any privately arranged loans. But if the Federal Government's aegis is there, it is hard to say that no limit or restraining force should be placed on the underlying credits. For, otherwise, there is a Federal Government involvement -- and potential for loss -- in a wholly open-ended volume of credit, which might or might not promote expansion along lines consistent with over-all economic objectives. The balancing of prudent public responsibility, with as full rein as possible to private initiative,

is a neat trick indeed -- but one that is well worth the prize, if it can be achieved.

I think it obvious from these few comments that, despite the study and work devoted to the broad question of Federal credit programs, there is much more work to be done. Here is an area -- in applied finance -- where the business schools might well make a contribution. I commend it to you.

Finally, turning back again to our more immediate problems of economic and financial management, the number one fact is the clear and present need for a responsible Federal fiscal policy -- a moderate tax increase, as proposed by the President, and a firm restraint on spending. This is a prerequisite to the successful resolution of deeper seated economic and social problems, for without a reasonably balanced general economic condition there is slim prospect of being able to employ resources as needed to meet the problems we can all identify around us. We need imaginative financing and new techniques to help mobilize private capital and initiative effectively. But, even with the most ingenious techniques, it is hard to see how the economy and the financial markets could function properly with an outsized Federal budget deficit that provided excessive spending stimulus and excess credit-market drag.

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October 3, 1967

TECHNICAL MEMORANDUM OF TREASURY DEPARTMENT CONCERNING UNITED STATES - BRAZIL INCOME TAX CONVENTION

Article 1. TAXES COVERED.

Article 1 designates the taxes of the respective States which are the subject of the convention. Generally, the provisions of the convention concern only the United States Federal income tax, including surtax, imposed by subtitle A of the Internal Revenue Code (but not including the accumulated earnings tax or the personal holding company tax) and the Brazilian income tax imposed by the Federal Income Tax Law, except the tax on activities of minor importance and the excess remittance tax.

The convention also applies to taxes substantially similar to those taxes specified which are subsequently imposed in addition to, or in place of, the existing income taxes. For purposes of the nondiscrimination provisions of Article 6, however, the convention applies to taxes of every kind which are imposed by the respective States, at the national, state, or local level.

Article 2. GENERAL DEFINITIONS.

This article sets out definitions of certain of the basic terms used in the convention and provides that any undefined term shall, unless the context otherwise requires, have the meaning which it has under the laws of the State imposing the tax.

Article 3. GENERAL RULES OF TAXATION.

The general rules of taxation applicable under the convention are as follows:

(a) A resident or corporation of one of the States will be taxable by the other State only on income derived from sources within that other State and only in accordance with the limitations set forth in the convention. The rules set forth in Article 5 will be applied to determine source of income. The effect of this general rule read together with Article 5 (9), dealing with the source of industrial and commercial profits, is to provide that a resident of one State may be taxed by the other State only on (1) industrial or commercial profits attributable to a permanent establishment located in that other State, and (2) other income from sources within that other State, subject to the limitations of the convention. The jurisdictional rules of the proposed convention are substantially similar to those set forth in section 872 (a) of the Code, relating to nonresident alien individuals, and section 882 (b), relating to foreign corporations engaged in trade or business in the United States, as amended by the Foreign Investors Tax Act of 1966.

(b) Income from sources within a State to which the provisions of the convention are not expressly applicable will be taxed by such State in accordance with its own law. Thus, for example, because prizes and awards are not expressly covered by the convention, such income will be taxed by the State from which such income is derived in accordance with the internal law of such State.

(c) No provision of the convention will be construed so as to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance presently or subsequently accorded (1) by the laws of one of the States in determining the tax imposed by that State or (2) by any other agreement between the two States. This provision reflects the policy of the United States under all conventions to which it is a party.

(d) With specified exceptions, the United States may tax its citizens, residents, and corporations as if the convention had not come into effect. A clause of this nature is found in most existing United States income tax conventions. The exceptions to the "savings clause" provision are made to preserve benefits which are specifically intended to apply to citizens or Brazilian nationals resident in the United States, _viz._ relief from double taxation (Article 4), the investment credit (Article 7), and the deduction for charitable contributions (Article 22). The benefits conferred on teachers (Article 18), students and trainees (Article 19), and governmental salaries (Article 20), are also excepted from the "savings clause" but only with respect to individuals who are not citizens of, and do not have immigrant status in, the United States. Corresponding rules apply to the right of Brazil to tax its citizens, residents, and corporations except that Brazil is not obligated to allow an investment credit or a deduction for charitable contributions.

Article 4. RELIEF FROM DOUBLE TAXATION.

This article provides that each State will allow a foreign tax credit for the appropriate amount of taxes paid to the other State.

For purposes of the United States foreign tax credit, the source of income rules set out in Article 5 may be used in lieu of the source rules provided in the Internal Revenue Code. Moreover, even though Article 4 contains a per-country limitation, such provision will not affect the right of a United States taxpayer to elect the overall limitation under section 904(a)(2) of the Internal Revenue Code. See Article 3 (2) of the convention and the accompanying explanation.

A Brazilian resident or corporation will be allowed a credit against Brazilian income tax for the appropriate amount of taxes paid to the United States. For this purpose, such amount will be limited to that portion of the Brazilian tax which net income from sources within the United States bears to the total net income of such resident or corporation subject to Brazilian tax. Moreover, in the case of a Brazilian corporation receiving dividends from a 10 percent or more owned United States corporation, Brazil will also allow an indirect credit for United States taxes paid with respect to the profits out of which such dividends are paid. This provision corresponds generally to section 902 of the Internal Revenue Code. For Brazilian credit purposes, the source rules set out in Article 5 will be applied to determine source of income.

Article 5. SOURCE OF INCOME.

This article sets forth the rules for determining source of income for purposes of Article 3 (General rules of taxation) and Article 4 (Relief from double taxation).

The following items of income are to be considered from sources within a State:

(1) Dividends paid by a corporation of that State, or by any corporation which had a permanent establishment in that State and derived 85 percent or more of its gross income from sources within that State for the 3-year period preceding declaration of the dividends. Dividends paid by any other corporation are treated as income from sources outside that State. This source rule conforms to United States statutory law except that, under section 861 (a) (2) (B) of the Internal Revenue Code, if 50 percent or more of a foreign corporation's gross income is effectively connected with a United States business conducted by such foreign corporation, a pro rata share of such corporation's dividends is treated as from sources within the United States. The treaty rule permits taxation of all corporate dividends by a State if the corporation derives 85 percent or more of its income from such State, while the Code requires proration.

(2) Interest paid by that State, including any local government within such State, or by a resident or corporation of such State. Interest paid by any other person will be treated as from sources outside that State. However, interest paid by a resident or corporation

of any State with a permanent establishment in another State, directly out of the funds of such permanent establishment on indebtedness incurred for the sole use of, or on banking deposits made with, such permanent establishment will be treated as income from sources within the State where such permanent establishment is located. The rules set forth in the first two sentences of this paragraph correspond generally to the Internal Revenue Code provision dealing with interest (other than interest on deposits with persons carrying on the banking business), except that under section 861(a) (2) (C) of the Internal Revenue Code if 50 percent or more of a foreign corporation's gross income is effectively connected with a United States business conducted by such foreign corporation, a pro rata share of such corporation's interest (not all of such interest as provided by the treaty rule) is treated as from sources within the United States. The permanent establishment source rule for interest set forth in the third sentence of this paragraph is not contained in the Internal Revenue Code provision.

(3) Royalties paid by a resident or corporation of one State for using, or the right to use, in the State, copyrights, artistic or scientific works, patents, designs, plans, secret processes or formulae, or information concerning industrial, commercial, or scientific knowledge, experience, or skill or trademarks related to any of the foregoing items. This rule is of more limited application than the rule set forth in the Internal Revenue Code which relies solely on

the place where rights are used ignoring the residence of the payor. The Code rule would control in those cases in which the two tests of the treaty rule were not satisfied.

(4) Income from real property located in the State, including the gain from the sale or exchange of real property, and royalty income from the operation of mines, quarries, or other natural resources located within the State. This rule conforms to the rules set forth in section 861(a)(4) and (5) of the Internal Revenue Code. Interest income from mortgages or bonds secured by real property is not considered income from real property, but see (2) above.

(5) Income from rentals of personal property located within the State. This rule conforms to the rule set forth in section 861(a)(4) of the Internal Revenue Code.

(6) Compensation for personal services performed within the State; income from providing personal services performed within that State; and compensation for personal services performed aboard ships or aircraft operated by a resident or corporation of that State and registered in that State, provided the services are performed by a member of the regular complement of the ship or aircraft. For source purposes, compensation for personal services includes private pensions or annuities paid in respect of such services. The rule set forth in the first clause of this paragraph conforms generally to that set forth in section 861(a)(3) of the Internal Revenue Code. The other rules are not specifically covered by the Code rules and serve to provide certainty in several common

types of cases.

(7) Income from the purchase and sale of personal property if such property is sold within that State. This rule conforms to the rule set forth in section 861(a)(6) of the Internal Revenue Code.

(8) Income from the production of personal property to the extent that such property was produced in that State. Income from the sale of such property will be treated as from sources within the State in which the property is sold. These rules conform generally to the rules set forth in section 863(b) of the Internal Revenue Code and the regulations thereunder. It should be noted that, under Article 29(3)(a), this provision of the convention will have effect only after the competent authorities have established mutually acceptable rules for its implementation, and, under Article 29(5)(a), such rules may be terminated by either State at any time. However, under Article 29(7) any termination may be prospective only.

(9) Industrial and commercial profits attributable to a permanent establishment situated in that State. Such profits include dividends, interest, royalties, and income from real property which is effectively connected with such permanent establishment. The factors taken into account in determining whether such income is effectively connected will include whether the income is derived from assets used, or held for use, in the conduct of a trade or business by the permanent establishment and whether

the activities of the trade or business are a material factor in the realization of the income. In applying these factors, due regard will be given to the manner in which the asset or income is accounted for on the books of the recipient of such income. There is no comparable source rule provision in the Internal Revenue Code.

The source of any item of income to which the convention is not expressly applicable will be determined by each of the States in accordance with its own law.

It should also be noted that the source rules do not extend the benefits of this treaty to persons other than residents or corporations of the two States. Generally, the rules are applicable only to residents or corporations of either State, and, therefore, are not applicable in determining the source of income of residents of other States, although the income of such other residents is of a type referred to in this article.

Article 6. NONDISCRIMINATION.

This article provides that the United States and Brazil will not discriminate in their tax law against their residents who are citizens of the other State nor against permanent establishments within their jurisdiction owned by nationals or corporations of the other State. This does not prevent either State from imposing whatever tax it desires on citizens of the other State, resident within its border, so long as such residents are are taxed in the same manner as citizens of the State imposing the tax. Furthermore, this Article does not require a State which grants personal allowances or deductions only to its residents to grant such allowances or deductions to nonresidents who are nationals of the other State.

A corporation of one State, the stock of which is completely or partly owned by citizens or corporations of the other State, may not be subjected to more burdensome taxes than a corporation owned wholly by citizens or corporations of the former State.

The provisions of this article apply to state and local as well as national taxes.

Article 7 INVESTMENT CREDIT.

The purpose of this article is to encourage investment in Brazil by extending to such investment a credit similar to that allowed for investment in the United States under sections 38 and 46 through 48 of the Internal Revenue Code. The concepts employed in this Article are patterned as closely as possible after the concepts employed in the domestic investment credit except for necessary changes to reflect the fact that the investment will generally be in stock or debt obligations of a corporation which will purchase machinery and equipment rather than directly in such machinery and equipment. The amount and terms of the credit allowed by this article will be governed by the same principles as are applicable to the credit for investment in the United States.

The United States agrees to allow a credit against United States income tax for investment in Brazil by an eligible investor (as defined below) in an eligible corporation (as defined below). The credit will be allowed in the eligible investor's taxable year in which or with which the eligible corporation's taxable year ends, and will be based on 7 percent of an appropriate amount of qualified property (as defined below) placed in service by the eligible corporation during such corporation's taxable year. Reference is made to an "appropriate" amount because several limitations discussed below together with the ownership interest of the investor must be taken into account in determining the proper amount of qualified

property. Moreover, in addition to the limitations discussed below, as is the case under the domestic investment credit, a limitation, determined with reference to the amount of the tax liability of the eligible investor for the taxable year will be imposed on the amount of credit allowed for such taxable year. In the event of insufficient liability in the taxable year in which the eligible investor becomes entitled to credit, a carryback or carryover patterned after the comparable provisions of the domestic investment credit will be provided. See section 46 of the Internal Revenue Code.

Qualified property is "section 38 property" which is used exclusively in Brazil in connection with a qualified trade or business. "Section 38 property" is defined in section 48 of the United States Internal Revenue Code except that, for purposes of this article, section 48(a)(2), relating to the limitation of the credit to property used in the United States, is not applicable. Moreover, for purposes of this article, the limitations applicable to "used section 38 property" will not apply. Generally, qualified property includes tangible depreciable property which is either personal property or is used as an integral part of industrial, transportation, communication, or other similar processes, or as a research or storage facility (but not including a building or its structural components). The amount of the property placed in service for which a credit will be allowed depends upon the useful life of such property. Thus, the percentage of the basis of the property for which a credit will be

allowable is 100 percent, 66 2/3 percent, or 33 1/3 percent where the property has a useful life of 8 years or more, 6 years or more but less than 8 years, or 4 years or more but less than 6 years, respectively. If property is sold before the end of its original estimated useful life, the amount of the credit allowed when such property was placed in service will be recomputed with reference to the actual period the property was used and any excess credit will be recaptured. The recapture rules will also be applied if (a) the eligible corporation placing the property in service ceases to be eligible, (b) the eligible investor ceases to be eligible, or (c) the qualified property ceases to be qualified, and any such cessation will be treated in the same manner as if the corporation disposed of the property before the end of the useful life of the property.

In no event will the credit exceed the lesser of--

(1) 7 percent of the eligible investor's net new investment (as defined below) in the eligible corporation; or

(2) the amount of United States property (as defined below) acquired by the eligible corporation, during such corporation's taxable year in which such corporation placed in service the property for which a credit is allowed, or during the preceding taxable year, and attributed to the eligible investor.

As indicated in an exchange of letters, the concept of "net new investment" represents a running account covering a period of up to 10 years. The account is determined as of the end of the taxable

year in which or with which the eligible corporation places qualified property in service, as follows:

(a) the sum for the eligible corporation's taxable year and its 9 preceding taxable years (but excluding any taxable year to which this article is inapplicable) of:

(1) any property transferred to the eligible corporation by the eligible investor as a contribution to capital or in exchange for stock or indebtedness of the eligible corporation, but only to the extent that such property does not represent, directly or indirectly, funds borrowed within Brazil;

(2) the eligible investor's allocable share of creditable reinvested earnings (as defined below) of the eligible corporation;

(3) the eligible investor's allocable share of the amount of the reserve for depreciation with respect to the cost of any qualified property with respect to which the eligible investor previously was entitled to a credit; but during the first 5 years of the life of the property only to the extent that, and in the year in which, an amount equal to that reserve is used to purchase qualified property;

(4) in the case of a disposition by the eligible corporation of any qualified property for which the eligible investor was previously entitled to a credit, the eligible investor's allocable share of the undepreciated cost of such property at the time of disposition;

(b) less the amount of the credits allowed to the eligible investor with respect to the eligible corporation during the 9 years

preceding the taxable year (determined without regard to any recaptures of the credit) divided by 7 percent.

In the event of a withdrawal, described below, of property by the eligible investor, the amount of such withdrawal shall reduce the new investment, to the extent thereof, made in the year of withdrawal, the 3 years preceding withdrawal, and the year subsequent to the withdrawal. With respect to the 3 years preceding the withdrawal, a recomputation of the credit allowed in those years will be required. The taxes otherwise payable by an eligible investor in the year of withdrawal shall be increased by an amount equal to the aggregate decrease in credits allowed for the prior 3 years which would have resulted solely from subtracting, in the computation of the limitation of the credit for such years, the amount of the eligible investor's net new investment in the eligible corporation in such years.

Creditable reinvested earnings is defined as an amount equal to one-half of the earnings and profits of the eligible corporation for its taxable year, reduced by the amount of any dividends distributed by such corporation during such year.

A withdrawal is defined as (1) a distribution made by an eligible corporation (or by another corporation conducting in Brazil a trade or business similar or related to the trade or business conducted by the eligible corporation) to the eligble investor (or to a related person) which (a) is not a distribution of earnings and profits,

(b) is in excess of 50 percent of earnings and profits for the year of distribution, or (c) is in cancellation or redemption of the stock of the eligible corporation; (2) the payment by the eligible corporation of an indebtedness to the eligible investor; and (3) the sale or other disposition by the eligible investor of stock or indebtedness of the eligible corporation. An accompanying exchange of letters provides that a transfer of stock or indebtedness of an eligible corporation to a resident or corporation of the United States will not be considered a withdrawal of property if the transferor, transferee, and competent authority of the United States mutually agree to defer recognition of the withdrawal. Under such circumstances, a later withdrawal by the transferee will be considered a withdrawal by the transferor.

The term "eligible investor" means a resident of the United States or a United States corporation which owns, or is a member of a group of United States residents or corporations which owns, at least 25 percent of the total combined voting power of the stock of an eligible corporation. The term "eligible corporation" means a United States corporation or a Brazilian corporation if, for its taxable year, such corporation derives at least 80 percent of its gross income, if any, from, and at least 80 percent of its assets (including assets located outside Brazil) are used or held for use in connection with, one or more qualified trades or businesses (as defined below).

The term "qualified trade or business" means, unless otherwise agreed by the competent authorities of the States, any trade or business conducted within Brazil, and consisting of:

(i) the manufacture or production of personal property (not including the extraction of any mineral, ore, oil, or gas, or any processing which does not involve a substantial transformation thereof, but not excluding smelting or refining) or the processing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, fur-bearing animals, or any kind of fish);

(ii) the catching or taking of any kind of fish;

(iii) the marketing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, fur-bearing animals, or any kind of fish);

(iv) the marketing of goods and merchandise to the general public through one or more retail establishments, unless the business consists primarily of the distribution of goods or merchandise manufactured or produced outside Brazil by a person who is a related person with respect to the eligible corporation;

(v) the operation of hotels and related facilities;

(vi) the transportation within Brazil of passengers and/or freight;

(vii) the performance of services rendered as an incident of a trade or business described in (i) through (vi); or

(viii) the performance within Brazil of services utilized either within Brazil or within a less developed country if the services are industrial, financial, technical, scientific, engineering, or architectural in nature. The preceding sentence will not apply if the services are performed for any person who is a related person with respect to the eligible corporation and if the payments made in consideration of such services are not reasonable in amount or are contingent either in whole or in part on the sales, productivity, or profits of the person for whom these services are performed; and

(ix) any other trade or business agreed upon by the competent authorities of both contracting States.

The term "United States property" means any tangible property which has been manufactured, constructed, produced, grown, extracted, or created in the United States and thereafter continuously used, if at all, only in the United States.

If the domestic investment credit is modified, amended, suspended, or terminated, the comparable provisions of this article will be deemed modified, amended, suspended, or terminated so as to conform the investment credit allowed by this article to the domestic investment credit. The United States will notify Brazil through diplomatic channels of any such change. If Brazil considers that any modification or amendment as a result of this paragraph

materially and adversely affects the credit allowed by this article, Brazil may, by giving notice to the United States through diplomatic channels, treat such modification or amendment as a suspension of the credit under Article 29(6)(b) and suspend the reduced rates for dividends, interest, and royalties (Articles 12, 13, and 14). In such a case, Brazil and the United States will consult together. However, at any time prior to such consultation and until such time as a supplementary agreement is reached, the United States may, by notice given to Brazil through diplomatic channels, suspend the application of the investment credit.

The investment credit will be subject to such regulations as are prescribed by the Secretary of the Treasury of the United States or his delegate, after consultation with the competent authority of Brazil, to effectuate the provisions of this article and to further define and determine the terms, conditions, and amounts referred to in this article.

Article 8. BUSINESS PROFITS.

This article corresponds generally to the article dealing with taxation of business profits which is found in other tax conventions to which the United States is a party. It provides that industrial or commercial profits of a resident or corporation of one State will be exempt from tax in the other State if such resident or corporation does not have a permanent establishment in the latter

State. If such resident or corporation does have such a permanent establishment, the latter State may tax all of the commercial or industrial profits which are attributable to such permanent establishment. Profits which are derived from sources within such latter State from sales of goods or merchandise of the same kind as those sold, or from other business transactions of the same kind as those effected, through the permanent establishment, are deemed attributable to the permanent establishment.

In determining the proper attribution of industrial or commercial profits, the permanent establishment is to be treated as an independent entity and considered as realizing the profits which would be realized if the permanent establishment dealt with the resident of which it is a permanent establishment on an arm's length basis. All expenses, including executive and general administrative expenses, wherever incurred will be allowed as deductions by the State in which the permanent establishment is located in computing the tax due to such State, if such expenses would be deductible if the permanent establishment were an independent enterprise and such expenses are reasonably connected with profits attributable to the permanent establishment. An exchange of letters accompanying the proposed convention sets forth the understanding that in accordance with established Brazilian juridical principles, the foregoing language will be interpreted to include all such expenses,

whether incurred in Brazil or abroad. Such expenses are those actually incurred, directly connected with the activities of the permanent establishment, and necessary to the production of its taxable income. The understanding is reciprocal in form though the result merely conforms to United States internal law.

The mere purchase of goods or merchandise in a State by the permanent establishment, or by the resident of which it is a permanent establishment, for the account of such resident will not by itself cause attribution of any profit to such permanent establishment. This rule conforms to existing United States statutory law. (See section 862(a)(6) of the Internal Revenue Code.)

The term "industrial or commercial profits" is defined as income derived from activities which constitute the active conduct of a trade or business, including agricultural activities, the furnishing of personal services, the rental of tangible personal property, and insurance activities. The term also includes investment income but only if the right or property giving rise to the income is effectively connected with a permanent establishment. Income received by an individual as compensation for personal services either as an employee or in an independent capacity is not treated as industrial or commercial profits.

Article 9. DEFINITION OF PERMANENT ESTABLISHMENT.

This article defines the term "permanent establishment". The existence of a permanent establishment is, under the terms of the convention, a prerequisite for one State to tax the industrial or commercial profits of a resident or corporation of the other State. The concept is also significant in determining the applicability of other provisions of this convention, such as Articles 12, 13, and 14 dealing with dividends, interest, and royalties, respectively.

The definition of "permanent establishment" is a modernized version of the definition found in most conventions to which the United States is a party. The term "permanent establishment" means "a fixed place of business through which a resident or corporation of one of the Contracting States engages in trade or business". Illustrations of the concept of a fixed place of business include an office; a store or other sales outlet; a workshop; a factory; a warehouse; a mine, quarry, or other place of extraction of natural resources; and a building, construction, or installation site. As a general rule, any fixed facility through which business is conducted will be treated as a permanent establishment unless it falls within one of the specific exceptions described below.

Under the specific exceptions, a permanent establishment does not include sites or facilities used as follows:

(a) for the processing by another person, whether related or unrelated, under arrangements or conditions which are or would be made between independent persons, of goods or merchandise belonging to the resident or corporation;

(b) for the purchase, under arrangements or conditions which are or would be made between independent persons, of goods or merchandise for the account of the resident or corporation;

(c) for the storage and/or delivery of goods belonging to the resident or corporation, other than goods or merchandise:

(i) held for sale by such resident or corporation in a store or other sales outlet; or

(ii) purchased and resold in that Contracting State by the resident or corporation, or by an independent agent or agents for or on behalf of the resident or corporation;

(d) for the collection of information for the resident or corporation;

(e) for advertising, the conduct of scientific research, the display of goods or merchandise, or the supply of information if such activities have a preparatory and auxiliary character in the trade or business of the resident or corporation; or

(f) for construction, assembly, or installation projects if the site or facilities are used for such purpose for less than 6 months.

These exceptions are cumulative and a site or facility used solely for one or all of these purposes generally will not be considered a permanent establishment under the convention.

A person will be considered to have a permanent establishment if he engages in business through an agent who has and regularly exercises authority to conclude contracts in the name of such person unless the agent only exercises such authority to purchase goods or merchandise. In addition, a permanent establishment will be considered to exist if an agent maintains a stock of goods or merchandise belonging to such person from which he regularly makes deliveries. However, these rules will not apply merely because a resident or corporation of one Contracting State uses the services in the other Contracting State of a bona fide broker, general commission agent, forwarding agent, custodian, or other agent of independent status acting in the ordinary course of its business.

Whether a corporation of one State has a permanent establishment in the other State will be determined without regard to any control relationship between such corporation and a corporation organized or engaged in trade or business in the other State. Therefore, a United States subsidiary of a Brazilian corporation may be considered an independent agent of such corporation if it otherwise qualifies as an agent of independent status acting in the normal course of its business.

A person of one State will be deemed to have a permanent establishment in the other State if such person provides the services of public entertainers (described in Article 17(4)) in the latter State.

If a resident or corporation of one State maintains a permanent establishment in the other State at any time during the taxable year, the permanent establishment will be considered to have existed for the entire taxable year.

The general effect of this article will be to eliminate some existing uncertainties respecting the application of Brazilian income tax to business activities in that country in the situations described above. This article will also operate to restrict Brazilian taxation of income from certain activities conducted by U. S. citizens, residents and corporations in Brazil.

Article 10. SHIPPING AND AIR TRANSPORT.

This article provides that a resident of one State will be exempt from tax in the other State on income derived from the operation in international traffic of ships or aircraft registered in the former State. A similar provision is found in most conventions to which the United States is a party.

Article 11. RELATED PERSONS.

This provision corresponds in purpose and scope to section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to reallocate income in cases in which a resident of one

State is related to a resident of the other State if such related persons impose conditions between themselves which are different from conditions which would be imposed between independent persons.

Article 12. DIVIDENDS AND BRANCH PROFITS.

This article provides that dividends paid by a company which is a resident of one State to a resident or corporation of the other State may be taxed by both States. However, the rate of withholding tax imposed by Brazil on dividends paid by a Brazilian corporation to a United States corporation will not exceed 20 percent if the recipient corporation owns 10 percent or more of the outstanding voting shares of the paying corporation and, generally, not more than 25 percent of the paying corporation's gross income consists of dividends and interest. The rate of withholding tax imposed by Brazil on profits of a Brazilian branch of a United States corporation is also limited to 20 percent. In the absence of a convention, the Brazilian withholding tax on dividends and branch profits remitted to nonresidents of Brazil is 25 percent.

The reduced rate provision is limited to intercorporate dividends because its purpose is to encourage direct investment in Brazil. Another provision of the convention designed to encourage such direct investment is the investment credit provision (Article 7). The reduced rate is nonreciprocal in form. Thus, the United States remains free to impose its 30 percent withholding tax on dividends paid by United States corporations to Brazilian corporations. This

lack of reciprocity is in accordance with the desires of both Brazil and the United States to encourage the formation of local Brazilian capital sources and not to encourage the flow of such capital to the United States.

This article also includes a provision under which Brazil may increase the rate of withholding tax on dividends and branch profits to the same extent as any reduction below 28 percent in the rate of tax applicable generally to business profits of corporations in Brazil.

The term "dividends" is defined, in the case of the United States, as any item which under the law of the United States is treated as a distribution out of earnings and profits, and, in the case of Brazil, generally as income from shares including all distributions of profits made by any company or individual enterprise situated in Brazil. The definition employed by Brazil is adopted, in part, from the OECD model convention. However, the OECD draft definition does not include the language relating to distributions by any company or individual enterprise. Under Brazilian law, such distributions of partnerships and single proprietorships are treated as dividends.

Dividends paid by a corporation of one State to a person other than a resident or corporation of the other State are exempt from tax in such other State. However, the exemption does not apply in the following cases: (1) if the recipient of a dividend paid

by a Brazilian corporation is a citizen of the United States, even though a nonresident of the United States; (2) if the dividends are treated as income from sources within such other State under Article 5(1)(b); or (3) if the recipient of the dividend has a permanent establishment in such other State and dividends are effectively connected with such permanent establishment. The first exception represents a specific application of the traditional "savings clause" under which the United States reserves the right to tax its citizens as though the convention had not come into effect. See Article 3(3). With respect to the United States, the second and third exceptions represent reservations of the right to tax dividends paid by Brazilian corporations when either the payor or the recipient of the dividends is, to a significant extent, commercially involved in the United States.

It is important to note that the reduced 20 percent rate on dividends received by certain United States corporations from their Brazilian subsidiaries is available without regard to whether such United States corporation has a permanent establishment in Brazil and without regard to whether such dividends are effectively connected with such a permanent establishment.

Article 13. INTEREST.

Under this article, interest derived from sources within one State by a resident or corporation of the other State may be taxed in both States. However, interest derived by a Government of a State, or any agency or instrumentality wholly owned by that Government, will

be exempt from tax in the other State. Moreover, the rate of tax on interest derived from sources within Brazil by a bank or financial institution which is a resident or corporation of the United States will not exceed 15 percent of the amount paid. However, if such bank or financial institution has a permanent establishment in Brazil, the 15 percent reduced rate will not apply and the interest of such a recipient may be taxed as industrial and commercial profits attributable to the permanent establishment.

In the absence of a convention, interest derived from sources within Brazil by a nonresident of Brazil would be subject to withholding tax of 25 percent on the gross amount paid. The United States remains free to impose its withholding tax at the statutory rate of 30 percent on interest derived by residents or corporations of Brazil from sources within the United States except that interest derived by the Government of Brazil is exempt from tax. The lack of reciprocity arises out of the mutual desire of the United States and Brazil to encourage and maintain investment in Brazil.

Interest is defined generally as income from any kind of debt-claim or any income treated as interest under the tax law of the State of source. In cases in which excessive interest is paid by reason of a special relationship between the payor and the recipient, the provisions of the interest article do not apply to the excess part of the payments. Excess interest payments may, in certain cases, be taxed as dividends under Article 12.

Interest paid by a corporation of one State to a person other than a resident or corporation of the other State is exempt from tax in such other State. However, the exemption does not apply in the following cases: (1) if the recipient of interest paid by a Brazilian corporation is a citizen of the United States even though a nonresident of the United States; (2) if the interest is treated as income from sources within the other State under Article 5(2)(b); or (3) if the recipient of the interest has a permanent establishment in the other State and the interest is effectively connected with such permanent establishment. These rules parallel those found in the dividend article and reserve the right of the United States to tax interest paid by Brazilian corporations to United States citizens and interest derived under circumstances in which either the payor or the recipient of the interest is, to a significant extent, commercially involved in the United States.

Article 14. ROYALTIES.

This article provides that the tax imposed by one State on royalties derived from sources within the other State by a resident or corporation of the other State will not exceed 15 percent of the gross amount of such royalties. In cases in which the recipient of royalties has a permanent establishment in the other State, the reduced rate does not apply. Thus, the proposed convention retains the so-called "force of attraction" principle with respect to royalties.

In the absence of a convention, the Brazilian withholding tax on royalties is 25 percent and the United States withholding tax on royalties is 30 percent.

The term "royalties" is defined as including any royalties, rentals, or other amounts paid for specified types of intangible property, including trademarks related to such property, and know-how.

The reduced rate does not apply to natural resource royalties or to rentals for films and similar property. See Article 15 (Income from real property) for rules governing the treatment of natural resource royalties.

If excessive royalties are paid by reason of a special relationship between the payor and recipient, the provisions of the royalties article do not apply to the excess part of such payments. Excess royalty payments may, in certain cases, be taxed as dividends under Article 12.

Article 15. INCOME FROM REAL PROPERTY.

This article provides a net basis election with respect to income from real property. Thus, a resident of one State will be subject to tax in the other State on income from real property and natural resource royalties if the property or natural resource is located in such other State. However, such resident may elect for any taxable year to compute the tax on such income on a net income basis which takes account of expenses relating to the property. The income referred to in this article includes gain from the sale or exchange of real property. A similar provision appears in many conventions to which the United States is a party and in internal U. S. law (see IRC, §§871(d) and 882(d)).

Article 16. INVESTMENT COMPANIES.

This article denies the benefits of the dividends, interest, and royalties articles to a corporation of one of the States deriving such income from sources within the other State if (1) such corporation is entitled to special tax benefits which result in the tax imposed on such income being substantially less than the tax generally imposed on corporate profits in such State, and (2) 25 percent or more of the capital of the corporation is owned directly or indirectly by persons who are not individual residents of such State or, if residents of Brazil, are citizens of the United States.

The purpose of this article is to deal with a potential abuse which could occur if one of the States provided preferential rates of tax for investment or holding companies. In such a case, residents of third countries could organize a corporation in the State extending the preferential rates for the purpose of making investments in the other State and, but for this article, also obtain reduced rates or exemptions in the source State. At present, neither the United States nor Brazil extends special benefits of the type referred to in this article to investment or holding companies.

Article 17. INCOME FROM PERSONAL SERVICES

This article provides that an individual resident of one State

is exempt from tax by the other State with respect to income from personal services performed in such other State if such person is physically present there for not more than 183 days during the taxable year and such income does not exceed $4,000 or its equivalent in Brazilian cruzeiros.

In the case of employment income which exceeds $4,000 or its equivalent in Brazilian cruzeiros, in addition to the physical presence limitation the individual must be an employee of a resident or corporation of a State other than the State of source (or an employee of a permanent establishment of a resident or corporation of the State of source located outside such State) and the amount must not be deducted in computing the profits of a permanent establishment of the State of source. If, however, such individual's employment income does not exceed $4,000 or its equivalent in Brazilian cruzeiros, such individual need only satisfy the physical presence limitation in order to qualify for the exemption.

Compensation for services performed as a member of the regular complement aboard ships or aircraft operated by a resident or corporation of one State and registered in such State is exempt from tax in the other State. This exception does not limit a State's right to tax its own citizens or residents.

"Income from personal services" includes income from the performance of personal services in an independent capacity and "employment income". Employment income includes income from

services performed by officers and directors of corporations. However, income from personal services performed by partners is treated as income from the performance of services in an independent capacity.

The exemption applicable to personal service income is limited in the case of public entertainers, such as musicians, actors, or professional athletes. These persons are taxable if their income from such activities exceeds $100 (or its equivalent in Brazilian cruzeiros) for each day the individual is present within the State.

Article 18. TEACHERS

This article provides a reciprocal exemption from tax for personal service income of visiting teachers. It applies only if the teacher is invited by the Government, a university or other accredited educational institution to teach or engage in research activities, or both, at a university or other accredited educational institution. The exemption applies only to income received by the visiting teacher as compensation for such teaching or research activities. If the visit exceeds a period of 2 years, this exemption applies only to the income received by the visiting teacher before the expiration of such 2-year period. The exemption does not apply to income from research undertaken not in the public interest but primarily for private benefit.

Article 19. STUDENTS AND TRAINEES.

This article provides that a resident of one State visiting the other State for the purpose of studying at a university or other accredited educational institution, securing training for qualification in a profession or professional specialty, or studying or doing research as a recipient of a grant, allowance, or award, is exempt from tax in the host State on:

(1) Gifts from abroad for his maintenance or study;

(2) The grant, allowance, or award; and

(3) Income from personal services performed in the host State not in excess of $2,000 (or its equivalent in Brazilian cruzeiros) for any taxable year. This exemption is increased to $5,000 (or its equivalent in Brazilian cruzeiros) if the student is training for qualification in a profession or professional specialty.

These exemptions continue for such period of time as may be reasonably or customarily required to effectuate the purpose of his visit but in no event for more than 5 taxable years.

Furthermore, a resident of one State, employed by or under contract with a resident or corporation of that State, who visits the other State for a period not in excess of 1 year for the purpose of studying or acquiring technical, professional, or business experience, is exempt from tax in such other State on income from personal services rendered there not in excess of $5,000 (or its equivalent in Brazilian cruzeiros). In order to qualify for the

exemption, the visiting individual must study at a university or accredited educational institution in the host State, or receive his experience from a person other than the resident or corporation by which he is employed or under contract (including a 50-percent or more owned subsidiary of such corporation).

A resident of one State who visits the other State for a period not in excess of 1 year as a participant in a program sponsored by the Government of the host State for the primary purpose of training, research, or study shall be exempt from tax in the host State on income not in excess of $10,000 (or its equivalent in Brazilian cruzeiros) received for personal services performed in the host State in respect of such training, research, or study.

Article 20. GOVERNMENTAL FUNCTIONS.

This article exempts from tax in one State any wages, salaries, and similar compensation, and pensions, annuities, or similar benefits paid by, or from public funds of, the other State, or a political subdivision thereof, to a national of that other State for services rendered to it or its political subdivisions in the discharge of governmental functions.

Article 21. RULES APPLICABLE TO PERSONAL SERVICE ARTICLES.

This article provides that under Articles 17 through 20 reimbursed travel expenses will be exempt as income from personal services but will not be taken into account in determining whether the maximum income exemptions in Articles 17 and 19 have been exceeded. If an individual qualifies for the benefits of more than one of the provisions of Articles 17 through 20, he may choose the provision most favorable to him but he may not claim the benefits of more than one article in any one taxable year.

Article 22. DEDUCTION FOR CHARITABLE CONTRIBUTIONS

This article provides that a United States citizen, resident, or corporation may deduct for United States tax purposes contributions made to charitable organizations in Brazil if the following conditions are met:

(1) The Brazilian organization has qualified as a nonprofit organization exempt from tax under the income tax laws of Brazil;

(2) The contributions are used entirely within Brazil;

and

(3) The Brazilian organization has qualified as a tax-exempt organization under section 501 (c) (3) of the Internal Revenue Code.

If these conditions are met, the contribution will be treated as a charitable contribution as defined in section 170 (c) and will

be deductible subject to the limitations contained in section 170 of the Internal Revenue Code.

Article 23. PENSIONS AND ANNUITIES

This article provides an exemption from tax in the State of source for private pensions and private life annuities paid to individuals who are residents of the other State. A life annuity is a stated sum paid periodically at stated times during life, or durin a specified number of years, under an obligation to make the payments in return for adequate and full consideration. A pension is a periodic payment made after retirement or death for, or by way of compensation for injuries received in connection with, past employment, and does not include social security type payments.

Article 24. CONSULTATION

This article provides that the competent authorities of the two States may--

(1) Settle by mutual agreement all questions of interpretation or application of the convention;

(2) Resolve any matter concerning the relation of this convention to any convention concluded by either State with third countries;

(3) Consult regarding the application of the source rules in Article 5 to particular items of income;

(4) Consult in regard to reaching a fair and equitable apportionment of industrial or commercial profits between a

resident or corporation of one State and its permanent establishment in the other State; and

(5) Consult concerning the allocation of gross income and deductions between related enterprises as provided in Article 11, and to adopt appropriate procedures for effectuating such apportionment or allocation.

This article also provides that if the competent authorities reach agreement, taxes may be imposed and refund or credit may be allowed in accordance with such agreement. A similar provision has been included in recent supplementary protocols to the conventions with the Netherlands, Germany, and the United Kingdom.

Article 25. EXCHANGE OF INFORMATION

Article 25 provides for a system of administrative cooperation between the competent authorities of the two States and specifies conditions under which information may be exchanged to facilitate the administration of the convention and to prevent fraud or fiscal evasion of taxes to which the convention relates. This provision is substantially similar to those found in existing tax conventions to which the United States is a party.

Article 26. ASSISTANCE IN COLLECTION

This article, which corresponds to articles in our existing treaties, provides that each State will assist the other in the collection of taxes imposed by such other State to the extent necessary

to insure that any exemption or reduced rate of tax granted under the convention by the other States will not be enjoyed by persons not entitled to such benefits. However, neither State is required to take measures at variance with its administrative practice or which would be contrary to its sovereignty, security, or public policy. Nor is either State required to enforce the tax claims of the other or entertain suits on such claims in its courts.

Article 27. TAXPAYER CLAIMS

Under this provision, where a citizen, resident, or corporation of either State shows proof that the action of the other State's tax authorities has resulted, or will possibly result, in taxation in contravention of the provisions of the convention, such person may present his case to his State's competent authority, who may attempt to come to an agreement with the competent authority of the other State with a view to the avoidance of double taxation.

Article 28. EXCHANGE OF LEGAL INFORMATION

This article specifically provides that the competent authority of each State shall advise the competent authority of the other State of any addition to or amendment of the tax laws of the State which concern the imposition of taxes which are the subject of this convention.

This article also provides that for the purpose of mutual assistance in development and maintenance of sound fiscal policies

and tax administration, the competent authorities may consult together and make mutually acceptable arrangements, including exchanges of personnel, technical memoranda, and studies.

Article 29. DIPLOMATIC AND CONSULAR OFFICERS

This article preserves the existing fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Article 30. EFFECTIVE DATES AND RATIFICATION

This article provides that the convention will be ratified and the instruments of ratification exchanged at Washington as soon as possible.

In general, the convention will be effective for taxable years beginning on or after January 1 of the year following the date of exchange of instruments of ratification.

Special exceptions to the general effective date are as follows:

(1) The source rule governing income from the sale of personal property produced in one State and sold in the other State (Article 5 (8)) will have effect only after the competent authorities of both States have established mutually acceptable rules for the implementation of the rule.

(2) The investment credit provision (Article 7) will have

effect with respect to property placed in service and net new investments made on or after January 1, 1968.

(3) The dividends, interest, and royalties articles (Articles 12, 13, and 14) will have effect with respect to amounts paid on or after January 1, 1969.

The convention will continue in effect indefinitely but may be terminated by either of the States at any time after 3 years from the general effective date described above if at least 6 months' prior notice of termination is given through diplomatic channels. In such event, the convention will cease to be effective for taxable years beginning on or after January 1 of the year following the expiration of the 6-month period.

In addition, upon 6 months' prior notice given through diplomatic channels, the following may occur:

(a) Any rules established for the implementation of the source rule discussed at (1) above may be terminated by either State at any time;

(b) The investment credit provision (Article 7) and the deduction for charitable contributions (Article 22) may be terminated by the United States at any time after 3 years from the general effective date of the convention; and

(c) The reduction in rate for dividends and branch profits (Article 12 (3) and (4)), the reduction in rate for interest

derived by banks or other financial institutions (Article 13 (3)), and the reduction in rate for royalties (Article 14 (1)) may be terminated by Brazil at any time after 3 years from the general effective date of the convention.

Further, by notice given by Brazil to the United States through diplomatic channels, the reduced rates discussed in (c) above, may be terminated by Brazil at any time after the date on which the investment credit is terminated pursuant to Article 7 (4) or suspended by Brazil at any time after the date, and for the period, of any suspension of the investment credit provided by Article 7 (4).

Any termination or suspension under the preceding two paragraphs will not prejudice benefits available with respect to transactions entered into prior to such termination.

TREASURY DEPARTMENT
Washington

FOR RELEASE: UPON DELIVERY

REMARKS OF THE HONORABLE JOSEPH W. BARR
THE UNDER SECRETARY OF THE TREASURY
BEFORE THE
NATIONAL ASSOCIATION OF THEATRE OWNERS
BAL HARBOUR, FLORIDA
FRIDAY, OCTOBER 20, 1967, 1:00 P.M., EDT

THE IMPORTANCE OF SAVINGS BONDS IN THE CURRENT ECONOMIC PICTURE

I am glad to be with you this afternoon. A year ago I had the pleasure of speaking before you at the 1966 convention of the National Association of Theatre Owners in New York City. I believe that was your first meeting following the formation of this new exhibitor organization. So you may well be wondering today if an appearance by the Under Secretary of the Treasury is to be a regular feature of the annual NATO conventions. I assure you that it is not - much as I would enjoy it.

The fact of the matter is that the promotional job you were asked to undertake for our Savings Bond program a year ago is still unfinished - not for any failure on the part of the motion picture industry - but because the task itself has grown in both size and importance. So I am grateful - as are Secretary Fowler and the President himself - that the leaders of your organization have seen fit to invite me back to re-state our case and appeal for your renewed support.

You are well aware that as a nation we are beset with problem on many fronts. On the economic front - the major area of the Treasury's responsibilities - we are faced today with a growing threat of serious inflation and sharply rising interest rates larg as the result of special Vietnam costs. To combat that threat and ensure sound and stable economic growth, President Johnson has pro posed a program of temporarily raising taxes and restraining gover ment expenditures.

Today I want to talk to you about one frequently overlooked b nevertheless important complementary aspect of the President's pro It is one in which - by the very nature of your business - you are a position to give direct and effective assistance.

I am talking, of course, about United States Savings Bonds, f which your industry has a long and distinguished record of support It is a popular program. It is a practical and effective program. It is one in which the individual citizen can serve both his own a his country's best interests.

The Current Need for Savings Bonds

There have been few times in our economic history when the ne for Savings Bonds purchases by Americans has been as great as it i today. With the economy gaining greater upward momentum month by month, and a rising Federal budget deficit putting pressure on the nation's credit markets, the Savings Bond program serves two vital and related purposes:

-- First, it channels a part of consumers' income out of current spending and into savings, thus directly relieving inflationary pressures by reducing buying power that tends to drive prices up.

-- Second, it means that a part of the budget deficit can be financed without having to turn to the nation's money markets to draw funds away from other uses at higher and higher interest rates.

Stepped-up purchases of U. S. Savings Bonds and the companion Freedom Shares will not solve, of course, all of our present economic problems. The need for the temporary 10% surcharge coupled with firm restraint on Federal expenditures proposed by the President are more urgent now than before. I firmly believe only these basic measures will help to avoid the twin problems of very tight money and cruel inflation by holding down the Federal deficit and holding down the aggregate demands on the economy's resources.

But, to a significant degree, the Savings Bonds program serves the same broad purposes of relieving pressure on the nation's productive and financial resources. To the extent that these purposes can be served through increased sales of Savings Bonds, there can be some progress in meeting the need to which the tax increase and expenditure restraint are addressed.

Let me hasten to add that I do not, for a moment, hold out the prospect that bigger sales of Savings Bonds will make it possible to drop the plans for a tax increase, but it is fair to say that

without solid support for the Savings Bonds program our need for higher tax revenues would be even more pressing. I, for one, would prefer to put a few extra dollars aside every payday and have those dollars earning interest and be available to me at some future time of need, rather than to have the extra dollars taxed away however worthwhile the purpose for which they are currently spent.

In the year ended last June, Federal government borrowings were not a source of pressure on the nation's financial markets. Just looking at Treasury debt alone, there was an increase of some $6.4 billion for the year, but marketable issues had to be increase by only $1-1/2 billion while the balance was made up by increases i special issues for the trust funds, sales of U. S. Savings Bonds, and minor changes in other nonmarketable issues. The $1.1 billion rise in holdings of Series E and H Savings Bonds by the public dur Fiscal Year 1967 was certainly a big help in keeping down the incr needed in our marketable issues.

This fiscal year, we are talking about a much bigger Federal increase. Even the tax increase as requested by the President in August, and firm restraint on spending, would leave a Federal budg deficit of $14-18 billion in this fiscal year, and an inevitable rise in debt. Clearly, a larger part of this rise, compared with year's, will have to be raised through selling additional debt iss in a crowded credit market. But just as clearly, every additional million dollars of borrowing that can be placed in Savings Bonds

Freedom Shares, is a million dollars less to pry out of an unreceptive money market. Like additional tax dollars, additional Savings Bonds dollars will make the credit markets more tolerable this year.

The Meaning of intolerable credit conditions

I have very deep concern about the pressures that would be exerted on the money markets by borrowing requirements associated with a deficit in excess of the $14-18 billion range. To be sure, the credit markets can accommodate a Federal deficit of considerable size. But given present private demands for credit, an outsized Federal deficit, such as would result without the proposed tax rise, expenditure restraints and Savings Bond sales, cannot be accommodated without severe disruption to the credit markets, sending interest rates sky-high.

The precise pattern and sequence of events through which very tight money would envelop the nation's credit markets in the absence of adoption of the President's program are only open to conjecture at this point. But one could expect, for example, that as the Federal government borrowed in greater and greater volume, higher rates would have to be paid to attract additional investors.

In the meantime, corporate borrowers would bid rates up, and attract investment from institutional lenders that have the flexibility to shift among Government securities, corporate issues and mortgages. Banks might well face insistent business demands to draw

on credit lines, while lessened reserve availability kept a tighter lid on the banks' total portfolio, so that less could be put into Federal government securities or tax-exempt issues even at steeply higher interest rates.

Along with the mortgage market, and state and local government borrowers, other borrowers with relatively limited bargaining power and limited flexibility of alternative credit resources would also be likely to suffer disproportionately at the hands of tightened credit conditions -- including small business and farmers. As Secretary Fowler has told Congress, "It would be a case of 'pay up or do without', and perhaps a case of 'doing without' even for those willing to 'pay up' to a considerable extent."

In short then, without the President's program and without the sales of Savings Bonds we will probably have a "credit crunch" as bad if not much worse than the one last year. It will seriously hurt home-buyers and home builders by forcing them to seek increasing expensive and scarce mortgage loans; it will seriously hurt businessmen, who may cancel expansionary plans rather than pay very high interest rates lenders will demand; and it will seriously hurt local communities that will have to pay increasingly higher rates on the sale of bonds for roads, schools, hospitals, community centers and other public projects.

To illustrate, let us consider what could happen to borrowing costs for the homebuyer. As I mentioned before, we can not predict

how much interest rates will rise next year without the President's program, but it would be safe to expect about a 1 per cent increase in home mortgage rates for instance. Let us consider the impact of this rise. The figures are instructive.

With a 1% increase in mortgage rates, a $15,300, 25-year mortgage loan would cost in principal and interest an additional $112 the first year and a total of $2,800 over the full term of the mortgage. A $19,800 mortgage would cost $145 more the first year and $3,625 more overall. And a $27,000 home mortgage would cost $198 more the first year, and $4,950 more over the life of the mortgage.

I hasten to remind you that adding the extra costs of a cruelly accelerated spiral of inflation to the higher borrowing costs would make for a very unfair, very painful and totally unacceptable alternative to the surcharge proposal for the average American.

Building a Bigger Program

It is in context I have described that U. S. Savings Bonds play a vital complementary role to the President's tax and expenditure restraint program. And to ensure that this role is fulfilled completely, there is an impelling need today for a stepped-up bond program.

I am convinced our program can be expanded. We have good "products". Savings Bonds are an attractive investment. To be sure, higher rates are available in today's markets than the 4.15 per cent rate of interest on our Savings Bonds. But our bonds do

have advantages, namely, safety, convenience, liquidity, and certair tax benefits in terms of deferred income as well as exemption from state and local income taxation. Similarily, our newer "Freedom Shares" with a 4.74 per cent rate of interest are very attractive a worthwhile investments too.

Let me spend a few moments to give you a little history of Savings Bonds. In May, 1941 the Treasury issued its first Series E Defense Bonds. After the U. S. entered World War II, American industry was called upon to encourage employees to buy E bonds throug automatic payroll deductions. As a result, the payroll method of saving became one of the most successful features of the War Bond Drive and has contributed significantly to the more than $165 billion worth of Savings Bonds sold since 1941.

A peacetime version of the Bond sales effort so successful during the war was organized in 1963. Then Secretary of the Trea Douglas Dillon called a team of top businessmen to organize what has now become the U. S. Industrial Payroll Savings Committee. Th group is presently under the able chairmanship of Daniel J. Haught president of the Lockheed Aircraft Corporation.

It has been through the joint efforts of government and indus that the Savings Bonds program has become such an important force in helping to bolster the nation's financial position and steady economic footing. The Bonds program, thanks to your help and that

so many other volunteers, has done well in the past fiscal year as sales of nearly $5 billion were the highest since fiscal 1956. Holdings of Savings Bonds now stand at a record high of more than $51 billion. The current outlook is for sales of E and H bonds to show a gain in this fiscal year of some $265 million over fiscal 1967.

This rate of gain, while commendable, however, is not good enough. To help us counter the threat of inflation and high interest rates, a greater gain is needed. To achieve this objective, the program needs to involve more families; it needs to attract more savers and investors of all classes; it needs to produce more regular buyers and many more dollars. In particular, it needs to sell more participants on buying the new higher-interest Freedom Shares in combination with their Bond purchases. In short, the Bond program needs to break out of its normal mold and become a much bigger contributor to the solution of our financing problems.

You people in the theatre business can help make this happen. You can dramatize the Savings Bonds Program and bring this patriotic opportunity to the attention of your patrons - through special films, through lobby displays, and through your own personal participation in the Share in Freedom Bond drives to be held next spring all over the country.

When you registered for this convention you were given an envelope containing a special message on this subject from Secretary

Fowler. It expressed his own and the President's confident hope that once again the motion picture industry would give leadership to this vital national cause.

Secretary Fowler said in part:

"In the President's view, the theatre screen could well serve as a rostrum to rally public concern about our Nation's problems; and to persuade all Americans that the Savings Bonds program offers a ready way to support their country while providing for their future."

The Secretary's message also outlined a program of action - and it included a pledge card on which you could indicate your intention to participate. We have additional copies of this pledge card on the luncheon tables today. I hope that if you have not already filled one out, you will do so now - and will turn it in at the clos of the luncheon to one of the "Share in Freedom" girls who are stationed at the doors.

In a few minutes you will be hearing from your guest of honor Gregory Peck - who, like many other great stars of motion pictures, has contributed his talents to Savings Bonds. Tonight you will be honoring Bob Hope - who, just a month ago, was received at the White House as America's number one Bond salesman.

But whatever the magnitude of the star, or whatever the importance of his message, it is the medium of your theatre screen that

brings our story to the American people. As theatre owners, you are the real key to our success in this undertaking. I know we can count upon you, as we have so many times in the past.

Thank you for letting me be with you - and thank you for your help.

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TREASURY DEPARTMENT
Washington

FOR RELEASE UPON DELIVERY

STATEMENT OF THE HONORABLE JOSEPH W. BARR
UNDER SECRETARY OF THE TREASURY
AT A PRESS CONFERENCE HELD IN MIAMI BEACH, FLORIDA
AT THE CONVENTION OF THE NATIONAL ASSOCIATION OF
THEATRE OWNERS, THURSDAY, OCTOBER 19, 1967, 3:15 PM, EDT

WHAT KIND OF A PEOPLE ARE WE?

What kind of a people are we? This question can be asked by reasonable men in this country and all over the world at this particular moment in our history. I have served the Government of the United States in its Armed Forces, as a Member of Congress, and in the Executive Branch for a period of approximately 12 years. I can say candidly that I have never seen a more crucial testing time for this Nation.

These comments are prompted by certain disturbing developments: the emergence of a full-fledged drive for protectionism in the guise of import quotas, the increasingly savage attacks on foreign aid programs, efforts to tie the President's hands in the conduct of this Nation's foreign policies, a seeming reluctance to come to grips with the problems of poverty and the cities, and a tendency to take either a casual or an unrealistic approach toward the financial position of this country.

The world has caught up with us with a vengeance and as a result there is abroad in the land and in the Congress a sense of restlessness, frustration and disquiet. We, as a people, do not like to be confronted with an array of problems whose solutions are difficult and complex. In this regard, however, I suppose that we do not differ from other nations and other peoples.

If one listens to the debates that rage within and without government, one can only conclude that there are lots of things that we as Americans do not like about the world today. There are lots of things that fall far short of our ideals and our goals. Let me name a few.

-- We don't like the fact that 20 years after the end of World War II, we are still forced to maintain roughly six divisions in Europe at a heavy cost to our tax resources and our balance of payments.

-- We don't like the fact that in spite of our carrying this load, many of our colleagues in Europe are all too prone to criticize our policies and our balance of payments deficits.

-- We don't like the fact that many of the small nations that were created in the breakup of the colonial empires following World War II must look to us for protection if they are to remain free and independent.

-- We don't like the fact that there are less developed parts of the world that need our help and support if they are to develop economies that can feed, house and educate their people.

-- We don't like the fact that nations which benefit from our aid sometimes publicly disagree with our foreign policy objectives.

In short, if we look beyond our shores, there is a lot we see that we don't like.

The same is true of the problems that beset us at home.

-- We don't like the fact that our technology has literally outpaced the abilities of a sizable minority of our citizens, who need retraining to become fully useful members of our society.

-- We don't like the fact that our cities have tended to become increasingly polarized along racial lines.

-- We don't like the fact that as this country grows, its people inevitably demand more services that only the Government can provide.

-- We don't like the corollary fact that services cost money and money means taxes.

-- We don't like the fact that at times such as this we are forced to pay higher taxes in one form or another -- either the tax surcharge proposed by President Johnson, or the far more cruel tax of inflation and high interest rates.

I might add, parenthetically, that I personally don't like to pay $3 for a movie ticket.

There is nothing particularly new and different in the existence of a long list of things that the people of this country don't like -- or at least what they say they don't like. The list has probably been as long at most periods in our history. But the question that many thoughtful observers raise today is whether this nation is prepared to develop reasonable and orderly solutions to the problems we face.

One measure of gauging tne effectiveness of a nation or of a people has always appealed to me. I have always found merit in Professor Toynbee's thesis that the true measure of a nation or a people is the manner in which they respond to the challenges that confront them.

Our history as a nation measures up well by this standard and applying this standard to the current scene, an impartial observer can give us high marks for responsibility and courage.

-- Despite the grumblings we recognize and respect our obligations to our allies in the North Atlantic Treaty Organization.

-- We have recognized the fact that only we can offer much hope of protection to many new nations that are trying to carve out a decent life, in freedom, for their people.

-- We are living up to our solemn international commitments.

-- We have recognized the fact that many of the nations in Africa, Asia and Latin America simply cannot compete in a

world of vast markets and complex technology unless they join together in cooperative efforts. The regional development banks which we support are one response to this challenge.

-- We have recognized the simple fact that our own national interest requires a world economic order in which the people of all nations can attain a measure of economic dignity, and this means we must continue to work toward low trade barriers and sensible international financial arrangements. Completion of the Kennedy Round, and the recent agreement upon a new international monetary reserve unit, are our responses.

On balance I can say that our record in the international area shows that this government has a clear view of the problems; we are taking the world as it is; and we are trying to meet our responsibilities -- perplexing and agonizing as they often can be.

At home, we also are acting responsibly: We have recognized and are trying to meet squarely the problems of those who need assistance in order to participate adequately in our economy.

We have faced squarely the explosive issue of race which has been submerged for far too long.

-- We have recognized and are trying to answer the problems of our cities.

-- We have had the courage to try to make the new economics work both ways -- by tax reduction when our economy is operating far below its potential and by tax increases when the demands of the Federal and private sectors place impossible strains on our domestic economy.

None of the answers we have advanced to the issues that confront us at home or abroad is simple, easy, or, in most instances, popular. But they constitute a serious, thoughtful response to the realities of the world we live in. They may or may not be correct; they should be subjected to severe and strenuous debate, but they do constitute a meaningful response. On those who object lies the burden of offering alternatives.

The problems are not about to go away -- the problems are there and will remain there until they are supplanted by a whole new set of problems. This has been the history of this nation and indeed of mankind. So the essential test of a nation, and the answer to the question of "What kind of people are we?" lies in the manner in which we respond to the challenges that confront us. I can only admit that the going is tough, but I personally feel like an honest man and not an ostrich.

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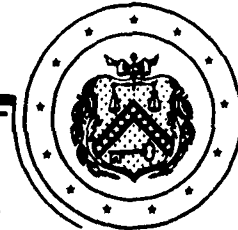
TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR RELEASE 6:30 P.M.,
Monday, October 23, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury bills, one series to be an additional issue of the bills dated July 27, 1967, and the other series to be dated October 26, 1967, which were offered on October 18, 1967, were opened at the Federal Reserve Banks today. Tenders were invited for $1,500,000,000, or thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day bills. The details of the two series are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	91-day Treasury bills maturing January 25, 1968		:	182-day Treasury bills maturing April 25, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.841	4.585%	:	97.421	5.101%
Low	98.836	4.605%	:	97.402	5.139%
Average	98.838	4.597% 1/	:	97.409	5.125% 1/

52% of the amount of 91-day bills bid for at the low price was accepted
27% of the amount of 182-day bills bid for at the low price was accepted

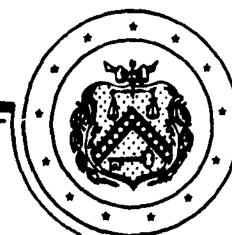
TOTAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 21,469,000	$ 10,499,000	:	$ 9,869,000	$ 9,869,000
New York	1,897,577,000	1,089,091,000	:	1,377,252,000	671,287,000
Philadelphia	28,952,000	16,547,000	:	12,854,000	4,854,000
Cleveland	32,153,000	19,045,000	:	33,261,000	20,217,000
Richmond	13,766,000	9,662,000	:	10,983,000	9,217,000
Atlanta	45,495,000	25,788,000	:	28,061,000	14,801,000
Chicago	288,059,000	119,343,000	:	187,732,000	78,242,000
St. Louis	63,628,000	33,997,000	:	44,187,000	17,281,000
Minneapolis	22,362,000	8,382,000	:	18,885,000	10,655,000
Kansas City	37,740,000	27,811,000	:	16,410,000	15,891,000
Dallas	23,531,000	12,781,000	:	20,244,000	10,244,000
San Francisco	282,164,000	128,144,000	:	204,524,000	138,000,000
TOTALS	$2,756,896,000	$1,501,090,000 a/		$1,964,262,000	$1,000,558,000 b/

a/ Includes $241,231,000 noncompetitive tenders accepted at the average price of 98.838
b/ Includes $138,941,000 noncompetitive tenders accepted at the average price of 97.409
1/ These rates are on a bank discount basis. The equivalent coupon issue yields are 4.73% for the 91-day bills, and 5.35% for the 182-day bills.

F-1060

TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR RELEASE 6:30 P.M.,
Tuesday, October 24, 1967.

RESULTS OF TREASURY'S MONTHLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury bills, one series to be an additional issue of the bills dated July 31, 1967, and the other series to be dated October 31, 1967, which were offered on October 18, 1967, were opened at the Federal Reserve Banks today. Tenders were invited for $500,000,000, or thereabouts, of 274-day bills and for $1,000,000,000, or thereabouts, of 366-day bills. The details of the two series are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	274-day Treasury bills maturing July 31, 1968		366-day Treasury bills maturing October 31, 1968	
	Price	Approx. Equiv. Annual Rate	Price	Approx. Equiv. Annual Rate
High	95.982 a/	5.279%	94.637 b/	5.275%
Low	95.944	5.329%	94.592	5.319%
Average	95.956	5.313% 1/	94.610	5.302% 1/

a/ Excepting 1 tender of $3,000,000; b/ Excepting 1 tender of $238,000
100% of the amount of 274-day bills bid for at the low price was accepted
31% of the amount of 366-day bills bid for at the low price was accepted

TOTAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	Applied For	Accepted
Boston	$ 12,330,000	$ 6,330,000	$ 42,275,000	$ 22,275,000
New York	964,192,000	398,192,000	1,488,845,000	757,145,000
Philadelphia	4,761,000	761,000	10,418,000	2,418,000
Cleveland	12,772,000	2,772,000	54,062,000	4,062,000
Richmond	9,773,000	1,773,000	12,777,000	1,777,000
Atlanta	8,650,000	3,650,000	11,789,000	2,789,000
Chicago	103,406,000	22,156,000	210,981,000	109,291,000
St. Louis	16,397,000	6,197,000	23,136,000	6,886,000
Minneapolis	12,700,000	3,700,000	13,428,000	3,428,000
Kansas City	1,557,000	1,557,000	3,333,000	3,333,000
Dallas	10,806,000	2,806,000	11,707,000	1,707,000
San Francisco	124,635,000	50,635,000	190,443,000	86,214,000
TOTALS	$1,281,979,000	$ 500,529,000 c/	$2,073,194,000	$1,001,325,000 d/

c/ Includes $14,968,000 noncompetitive tenders accepted at the average price of 95.956
d/ Includes $39,337,000 noncompetitive tenders accepted at the average price of 94.610
1/ These rates are on a bank discount basis. The equivalent coupon issue yields are 5.58% for the 274-day bills, and 5.62% for the 366-day bills.

F-1061

TREASURY DEPARTMENT
Washington

ADDRESS OF THE HONORABLE ROBERT A. WALLACE
ASSISTANT SECRETARY OF TREASURY
BEFORE THE 24TH ANNUAL CONVENTION OF THE
NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS
FAIRMONT HOTEL, SAN FRANCISCO, CALIFORNIA
OCTOBER 24, 1967 11:30 A.M.

THE TAX SURCHARGE AND THE NATIONAL ECONOMY

IT'S A SPECIAL PLEASURE FOR ME TO MEET WITH YOU HERE AT THE 24TH ANNUAL CONVENTION OF THE NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS. I HAVE WORKED CLOSELY WITH THIS GROUP ON ISSUES OF MUTUAL CONCERN FOR OVER 15 YEARS -- FIRST AS ASSISTANT TO SENATOR PAUL DOUGLAS, THEN AS STAFF DIRECTOR OF THE U. S. SENATE BANKING AND CURRENCY COMMITTEE, AND FOR NEARLY SEVEN YEARS, AS AN OFFICIAL OF THE TREASURY DEPARTMENT. I BELIEVE IN SAVINGS ASSOCIATIONS AND ADMIRE YOUR WORK IN CHANNELLING SAVINGS INTO THE HOMEBUYING MARKET WHICH CONTRIBUTES OVER $25 BILLION A YEAR TO OUR GROSS NATIONAL PRODUCT.

BUT I AM SAD, TOO, BECAUSE OF THE TRAGIC DEATH OF A DEAR FRIEND OF MANY YEARS WHO SERVED YOUR INDUSTRY SO WELL -- BILL KERWIN. WE WERE ALL PROUD OF HIS ABILITIES AND HIS WORK, AND ASK GOD'S BLESSINGS ON HIS WONDERFUL FAMILY.

AS WE MEET HERE TODAY, THE FATE OF THE PRESIDENT'S PROPOSED TAX SURCHARGE IS BEING HOTLY DEBATED. SECRETARY FOWLER HAS PREDICTED ITS ULTIMATE ENACTMENT AND I AGREE WITH HIM. IT IS TRUE THAT NO ONE LIKES TO PAY MORE MONEY TO THE GOVERNMENT. BUT, LET US HOPE THAT AFTER THE POLITICAL SMOKE HAS CLEARED AWAY, FISCAL RESPONSIBILITY WILL CARRY THE DAY, ALL BUT ABSOLUTELY ESSENTIAL EXPENDITURES WILL BE CUT AS MUCH AS POSSIBLE, AND THE 10 PERCENT SURCHARGE WILL BE ENACTED. WITH A POTENTIAL DEFICIT OF $29-30 BILLION THIS FISCAL YEAR WE SHALL BADLY NEED BOTH. THE IDEA THAT WE CAN FIGHT A WAR COSTING $25 - $30 BILLION A YEAR WITHOUT RAISING TAXES IS SIMPLY WISHFUL THINKING.

F-1062

NEXT WEEK AN EVENT OF GREAT HISTORICAL SIGNIFICANCE WILL TAKE PLACE. THE PRESENT ECONOMIC EXPANSION WILL ENTER ITS 81ST MONTH, BECOMING THE LONGEST IN THE HISTORY OF OUR NATION, SURPASSING IN LENGTH EVEN THE EXTRAORDINARY EXPANSION DURING WORLD WAR II.

IS THIS RECORD-BREAKING 80 MONTHS OF UNINTERRUPTED ECONOMIC EXPANSION SIMPLY AN ACCIDENT? I THINK NOT. THE PREVIOUS 80 MONTHS, JUNE 1, 1954 TO FEBRUARY 1, 1961, STARTED IN A RECESSION, ENDED IN A RECESSION AND HAD STILL ANOTHER RECESSION IN BETWEEN.

WHAT DOES AN UNBROKEN EXPANSION MEAN? IT MEANS MORE JOBS AND HENCE MORE EARNINGS. IT MEANS HIGHER PROFITS, SMALLER UNEMPLOYMENT AND RISING LIVING STANDARDS. RECESSIONS, ON THE OTHER HAND, MEAN FEWER JOBS, MORE UNEMPLOYMENT, LOWER PRODUCTION, AND LOWER PROFITS. THUS, 80 MONTHS WITHOUT A RECESSION IS AN ACHIEVEMENT OF UNPARALLELED ECONOMIC SIGNIFICANCE.

BUT, A CYNIC MIGHT SAY, IT HAPPENED ONLY BECAUSE OF VIET NAM! ON THE CONTRARY, IT HAPPENED DESPITE VIET NAM.

IN THE FIRST PLACE, BEFORE THE VIET NAM ESCALATION BEGAN IN JULY 1965, THE NATION HAD ACHIEVED THE LONGEST <u>AND STRONGEST</u> PEACETIME EXPANSION IN HISTORY -- WHILE YET MAINTAINING THE MOST STABLE PRICE LEVEL OF ANY MAJOR INDUSTRIAL COUNTRY OF THE WORLD.

VIET NAM RAISED NEW PROBLEMS -- INFLATED DEMAND, IMBALANCES IN PRODUCTION AND MONETARY STRINGENCY. BY HOLDING DOWN EXPENDITURES AND RAISING REVENUES IN 1966, WE AVERTED A BOOM AND BUST CYCLE BUT IT WAS A NARROW ESCAPE. THE FIRST QUARTER OF THIS YEAR SAW OUR REAL GROWTH SHRINK TEMPORARILY TO ZERO BECAUSE OF THE HUGE INVENTORY BUILD-UP IN LATE 1966. BUT THE EXPANSION CONTINUED, STILL SLUGGISH IN THE 2ND QUARTER OF 1967, BUT GOING FULL BLAST IN THE 3RD QUARTER.

HOW HAS THE RECORD-BREAKING 80-MONTH EXPANSION BEEN ACHIEVED? THE MOST BASIC FACTOR WAS THE ACTIVE USE OF FISCAL POLICY, INCLUDING TAX CHANGES.

IN THE EARLY DAYS OF 1961 WHEN THIS POLICY WAS BEING DESIGNED, THERE WERE FEARS THAT CONGRESS COULD NOT ACT WITH APPROPRIATE TIMING. BUT THEY DID, WITH TAX REDUCTIONS WHICH FISCAL POLICY CALLED FOR IN 1962, 1964 AND 1965. THE RESULT WAS A STEADILY EXPANDING ECONOMY. AFTER THE VIET NAM ESCALATION BEGAN, CONGRESS ENACTED THE TAX ADJUSTMENT ACT OF 1966, SPEEDING UP TAX COLLECTIONS AND RESTORING EXCISE TAX CUTS ON AUTOS AND TELEPHONE SERVICE. LATER THAT YEAR, THEY SUSPENDED THE INVESTMENT TAX CREDIT, RESTORING IT LAST SPRING AS THE PRESSURE ON FINANCIAL MARKETS EASED.

THE USE OF FISCAL POLICY AS A TOOL TO PROMOTE STABLE ECONOMIC EXPANSION HAS GREAT PROMISE. UNDER NORMAL CONDITIONS, WHEN THERE IS STEADY EXPANSION, THE GOVERNMENT TAKES IN SOME $8 TO 9 BILLION A YEAR IN EXTRA REVENUES AS A RESULT OF HIGHER TAXABLE EARNINGS PRODUCED BY THE EXPANSION. THIS "FISCAL DIVIDEND" CAN BE USED TO CUT TAXES, PAY FOR BETTER PROGRAMS, REDUCE THE NATIONAL DEBT, OR SOME COMBINATION OF THESE DESIRABLE ALTERNATIVES.

BUT WITHOUT STABLE ECONOMIC EXPANSION, WE WILL SOON LOSE THIS FISCAL DIVIDEND. FOR IF INFLATED DEMAND AND RISING INTEREST RATES LEAD TO EXCESSIVE INVENTORY BUILDUPS, WE WOULD NOT ONLY PAY THE IMMEDIATE COST OF HIGHER PRICES AND HIGHER INTEREST RATES BUT ALSO THE LATER COST OF RECESSION CAUSED BY ECONOMIC IMBALANCE.

I DO NOT HAVE TO TELL THIS AUDIENCE THAT HIGHER PRICES LEAD TO HIGHER WAGES WHICH LEAD TO HIGHER PRICES, AND SO ON -- THE INFLATIONARY SPIRAL. YET THIS IS EXACTLY WHAT OUR PROBLEM COULD BECOME IF WE DO NOT RAISE TAXES AS WELL AS CUTTING EXPENDITURES TO KEEP DOWN THE SIZE OF THE DEFICIT. THE FEDERAL GOVERNMENT SIMPLY CANNOT RUN A DEFICIT OF THE SIZE NOW IN PROSPECT WITHOUT A TAX INCREASE DURING A PERIOD OF LOW OVERALL UNEMPLOYMENT WITHOUT RISKING INFLATION.

FROM 1962 THROUGH 1965 TAX CUTS OF SOME $24 BILLION AT PRESENT LEVELS OF INCOME WERE ENACTED. THE PURPOSE OF THESE CUTS WAS TO HELP THE ECONOMY, AND THEY DID. IN LATER YEARS THERE WILL BE OTHER OPPORTUNITIES TO CUT TAXES OR IMPROVE PROGRAMS FROM OUR FISCAL DIVIDEND IF WE CAN KEEP A STABLE ECONOMY. BUT FUTURE TAX CUTS WILL NOT BE AS LIKELY IF WE DO NOT RAISE TAXES WHEN NEEDED. FOR FUTURE PRESIDENTS AND MEMBERS OF CONGRESS MAY OPPOSE SUCH CUTS ON THE GROUNDS THAT WE CANNOT ACHIEVE INCREASES WHEN THESE ARE NECESSARY. THUS, KILLING THE TAX SURCHARGE MIGHT VERY WELL KILL THE GOOSE THAT LAID THE GOLDEN EGGS.

FISCAL POLICY AS A TOOL FOR ACHIEVING STABLE ECONOMIC GROWTH MUST BE USED BOTH WAYS. USING IT ONLY TO CUT TAXES WHEN THAT COURSE IS INDICATED, BUT NEVER TO RAISE TAXES WHEN THAT IS APPROPRIATE, WILL DESTROY ITS USEFULNESS. SINCE THIS HAS BEEN THE PRIMARY FACTOR IN ACHIEVING OUR RECORD BREAKING 80 MONTH EXPANSION, THE DESTRUCTION OF FISCAL POLICY AS AN ECONOMIC TOOL WILL SEVERELY HAMPER FUTURE GROWTH AND STABILITY.

WHAT HAS 80 MONTHS OF UNINTERRUPTED EXPANSION MEANT TO US? FROM THE FIRST QUARTER OF 1961 THROUGH THE THIRD QUARTER OF 1967, GNP ROSE MORE THAN $285 BILLION, OR 57 PERCENT. PRICES WERE AMONG THE MOST STABLE OF ANY INDUSTRIALIZED NATION IN THE WORLD. UNEMPLOYMENT RATES WERE CUT FROM NEARLY 7 PERCENT TO AN AVERAGE LEVEL BELOW 4 PERCENT. CORPORATE PROFITS AFTER TAXES ROSE 71 PERCENT OVER EARLY 1961 LEVELS BY MID-1967. GAINS OF THIS SIZE ARE OBVIOUSLY BENEFICIAL TO THE WHOLE NATION.

IN JANUARY OF THIS YEAR OUR FORECASTS INDICATED THAT THE PACE OF ECONOMIC ACTIVITY WOULD SLACKEN IN THE FIRST HALF OF 1967 AND ACCELERATE IN THE LAST HALF OF THE YEAR. THE ADMINISTRATION THEREFORE PROPOSED THAT A TAX SURCHARGE BE ENACTED TO RESTRAIN AGGREGATE DEMAND IN THE LAST HALF OF THE YEAR. THIS ECONOMIC FORECAST HAS SINCE PROVED CORRECT AND THE ADVISABILITY OF A TAX SURCHARGE IS MORE APPARENT TODAY THAN IT WAS WHEN THE PRESIDENT FIRST PROPOSED IT.

THE OVERALL IMPROVEMENT IN ECONOMIC ACTIVITY THIS YEAR CAN BE SEEN IN THE QUARTERLY BEHAVIOR OF GROSS NATIONAL PRODUCT. IN CURRENT PRICES GNP ROSE $15 BILLION IN THE THIRD QUARTER OF 1967 TO A SEASONALLY ADJUSTED ANNUAL RATE OF $790 BILLION. THIS COMPARES WITH THE SLUGGISH $8.8 BILLION GAIN IN THE SECOND QUARTER AND THE VERY SLUGGISH $4.2 BILLION RISE IN THE FIRST QUARTER.

OUTLOOK FOR 1968

LOOKING AHEAD, THE OUTLOOK FOR ACCELERATED EXPANSION IS CLEARLY EVIDENT. THIS JUDGMENT IS BASED ON SEVERAL CONSIDERATIONS.

1. EXPENDITURES BY GOVERNMENT, BOTH FEDERAL AND STATE AND LOCAL, WILL CONTINUE TO RISE SUBSTANTIALLY THROUGHOUT THIS YEAR AND INTO 1968.
2. THE INVENTORY ADJUSTMENT, WHICH RETARDED ECONOMIC GROWTH IN THE FIRST HALF OF THE YEAR, HAS BEEN LARGELY COMPLETED. INDEED, INVENTORY ACCUMULATION OCCURRED IN THE THIRD QUARTER OF THIS YEAR AND IS EXPECTED TO CONTINUE IN THE CURRENT QUARTER AND INTO 1968.
3. DATA ON RETAIL SALES AND PERSONAL INCOME SUGGEST THAT CONSUMPTION OUTLAYS WILL RISE STRONGLY IN THE MONTHS AHEAD.
4. A STRONG REVIVAL IN RESIDENTIAL CONSTRUCTION IS UNDER WAY AND THIS SHOULD CONTINUE UNLESS FAILURE TO ENACT THE SURCHARGE LEADS TO SKYROCKETING INTEREST RATES.

PRICE INCREASES HAVE RECENTLY BECOME MORE WIDESPREAD. PRICES OF WHOLESALE INDUSTRIAL COMMODITIES ROSE IN AUGUST AFTER NEARLY A HALF YEAR'S STABILITY.

THE PRICES OF SERVICES HAVE CONTINUED TO RISE SUBSTANTIALLY AND THIS, COMBINED WITH INCREASED FOOD PRICES, LARGELY EXPLAINS THE MORE RAPID EXPANSION IN CONSUMER PRICES IN RECENT MONTHS. WITH ECONOMIC ACTIVITY LIKELY TO RISE EVEN MORE RAPIDLY. WITH SHORTAGES OF SKILLED LABOR LIKELY TO BECOME MORE WIDESPREAD, AND WITH PRESSURES FROM THE COST SIDE LIKELY TO REMAIN INTENSE, THE NEED TO GUARD AGAINST DAMAGING INFLATION AND TO MAINTAIN THE STABLE ECONOMIC GROWTH WHICH THIS COUNTRY HAS EXPERIENCED FOR NEARLY SEVEN YEARS WOULD SEEM TO BE OBVIOUS. THAT IS WHY THE TAX SURCHARGE IS NECESSARY.

DESPITE THE MUCH EASIER MONETARY POLICY FOLLOWED THIS YEAR, HEAVY DEMANDS FOR FUNDS TO MEET BOTH CURRENT AND ANTICIPATED NEEDS, ESPECIALLY FROM CORPORATIONS, HAVE PUSHED INTEREST RATES HIGHER. MOST LONG-TERM RATES OF INTEREST ARE CURRENTLY AT OR NEAR THEIR HIGHEST LEVELS IN MORE THAN 40 YEARS. CONSIDERING THIS AND THE FACT THAT MORTGAGE EXTENSIONS BY THRIFT INSTITUTIONS HAVE GENERALLY CAUGHT UP WITH SAVINGS INFLOWS, PRESSURES ON THRIFT INSTITUTIONS, SUCH AS THOSE WHICH OCCURRED IN 1966, COULD EASILY REAPPEAR IF THE DEFICIT IS NOT CUT BY A TAX SURCHARGE.

THRIFT INSTITUTIONS ARE CERTAINLY IN MUCH BETTER FINANCIAL CONDITION TODAY THAN THEY WERE IN THE THIRD QUARTER OF 1966 WHEN DISINTERMEDIATION BECAME SUCH A PROBLEM. FURTHERMORE, NEW RATE REGULATIONS ADOPTED BY FEDERAL AGENCIES WOULD SEEM TO IMPLY THAT ANY DISINTERMEDIATION WHICH MIGHT OCCUR COULD BE MORE EVENLY DIFFUSED RATHER THAN CONCENTRATED ON SAVINGS AND LOAN ASSOCIATIONS AS IT WAS IN 1966.

BUT, IF WE HAVE TO FINANCE THE DEFICIT WITHOUT HELP FROM A TAX INCREASE, LONG-TERM INTEREST RATES COULD VERY WELL RISE TO THE HIGHEST LEVELS SINCE THE CIVIL WAR WHEN SOME OF THE LONG-TERM GOVERNMENT SECURITIES ISSUED YIELDED OVER SIX PERCENT.

THE ECONOMIC CASE FOR THE TAX SURCHARGE RESTS ON THE PREMISE THAT ECONOMIC ACTIVITY IS STRONG, THAT PRICE PRESSURES ARE EXCESSIVE AND LIKELY TO INTENSIFY, AND THAT FINANCIAL MARKETS ARE VULNERABLE. I THINK THE CASE IS A GOOD ONE AND MOST EXPERTS AGREE WITH THIS POINT OF VIEW. EXPRESSIONS OF SUPPORT HAVE COME NOT ONLY FROM THIS LEAGUE BUT ALSO FROM ALL SECTORS COVERING THE SPECTRUM FROM THE NATIONAL ASSOCIATION OF MANUFACTURERS TO THE AFL-CIO.

SPENDING CUTS NECESSARY BUT MUST BE ACHIEVABLE

OPPONENTS OF THE SURCHARGE BUILD THEIR CASE ON THE PREMISE THAT MASSIVE CUTS IN CIVILIAN SPENDING SHOULD ACCOMPANY ANY TAX INCREASE. WE AGREE THAT SPENDING :UTS MUST BE MADE, BUT IT IS ESSENTIAL TO UNDERSTAND THAT THOSE CIVILIAN EXPENDITURES WHICH CAN BE REDUCED REPRESENT ONLY A SMALL PORTION OF THE TOTAL BUDGET. OF THE 'OTAL AMOUNT NOW BUDGETED FOR NONDEFENSE OUTLAYS BY THE FEDERAL GOVERNMENT, MORE 'HAN TWO-THIRDS IS NOT SUBJECT TO EXECUTIVE REDUCTION. MUCH OF THE SPENDING BUDGETED FOR FISCAL 1968 IS DEVOTED TO PROGRAMS FOR WHICH PAYMENT IS FIXED BY AW, SUCH AS INTEREST ON THE PUBLIC DEBT. FURTHERMORE, MUCH OF THE SPENDING IS EQUIRED TO COMPLETE CONTRACTS OR HONOR OBLIGATIONS ENTERED INTO IN PRIOR YEARS. AKING ACCOUNT OF THESE ITEMS AND ALLOWING FOR A REDUCTION IN TOTAL OUTLAYS ACHIEVED HROUGH THE SALE OF FINANCIAL ASSETS LEAVES ONLY $21 BILLION IN OUTLAYS OVER WHICH NY DISCRETION IS ACTUALLY EXERCISED. EVEN THIS AMOUNT INCLUDES FUNDS FOR LAW NFORCEMENT AND OTHER ACTIVITIES VITAL TO THE NATION. ANY SIZEABLE SPENDING CUTS OULD HAVE TO COME OUT OF THIS PORTION OF THE BUDGET.

CIVILIAN SPENDING HAS ALREADY BEEN SEVERELY PARED BY THE PRESIDENT AND THE BUD- T DIRECTOR. NEVERTHELESS, RECOGNIZING THE GOVERNMENT'S FISCAL PROBLEMS, THE ESIDENT LAST AUGUST CALLED ON FEDERAL AGENCIES TO REVIEW THEIR BUDGETS AND TO

MAKE FURTHER CUTS CONSISTENT WITH THE NATION'S SECURITY AND WELL-BEING. ALL GOVERNMENT AGENCIES ARE IN THE PROCESS OF REDUCING THEIR BUDGETS AND, ACCORDING TO BUDGET DIRECTOR SHULTZE, A TARGET REDUCTION IN THE NEIGHBORHOOD OF $2 BILLION SEEMS POSSIBLE. THIS IS A SIZEABLE REDUCTION, PARTICULARLY WHEN ONE CONSIDERS THAT THESE EXPENDITURES ARE EVERY BIT AS URGENT AS THEY EVER WERE AND THAT PLANS HAD BEEN MADE AND PROGRAMS ARE IN MANY CASES ALREADY UNDER WAY.

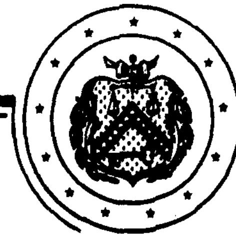
CONCLUSION

THERE IS AN IMPORTANT LESSON TO BE LEARNED FROM THIS CONTROVERSY OVER THE TAX SURCHARGE. WHATEVER THE REASON, IF FISCAL POLICY LACKS THE NECESSARY FLEXIBILITY TO BE USED AS A COUNTERCYCLICAL TOOL, THE TASK OF ECONOMIC STABILIZATION WILL, OF NECESSITY, FALL SQUARELY ON THE SHOULDERS OF THE MONETARY AUTHORITIES. I DOUBT THAT IT IS NECESSARY TO RECOUNT FOR THIS AUDIENCE THE UNDESIRABLE CONSEQUENCES WHICH MAY FOLLOW FROM PLACING UNDUE RELIANCE ON MONETARY POLICY, BUT THIS IS EXACTLY THE KIND OF ALTERNATIVE WE FACE. SPENDING CUTS OF THE MAGNITUDE CURRENTLY BEING CALLED FOR AS A PREREQUISITE TO CONSIDERATION OF A TAX CUT CANNOT BE REALIZED WITHOUT MAJOR DISRUPTION OF BADLY NEEDED PROGRAMS; AND IF NO ACTION IS TAKEN ON THE SURCHARGE, MONETARY POLICY WILL BE SIGNIFICANTLY FIRMER THAN IT OTHERWISE WOULD HAVE BEEN.

FURTHERMORE, UNLESS TAXES CAN BE USED TO RESTRAIN THEEECONOMY IN A PERIOD OF INFLATIONARY EXCESSES, THERE IS A DANGER THAT FUTURE ADMINISTRATIONS AND CONGRESSES MAY NOT BE WILLING TO REDUCE TAXES TO STIMULATE ECONOMIC ACTIVITY WHEN THIS IS CALLED FOR. THIS WOULD, OF COURSE, FURTHER REDUCE THE FLEXIBILITY OF FISCAL POLICY AND INCREASE THE RELIANCE ON MONETARY POLICY AS A COUNTERCYCLICAL WEAPON.

OUR POSITION AS LEADER OF THE FREE WORLD AND THE SOLUTION OF OUR PRESSING DOMESTIC PROBLEMS ARE AT STAKE AND THEY BOTH DEMAND THAT WE HAVE A HEALTHY AND GROWING ECONOMY CHARACTERIZED BY FULL EMPLOYMENT AND PRICE STABILITY. IF WE ARE TO PRESERVE THE HEALTHY, BALANCED ECONOMY WHICH WE HAVE ENJOYED FOR ALMOST SEVEN YEARS, THE PROGRAM OF TEMPORARY FISCAL RESTRAINT WHICH THE PRESIDENT HAS PROPOSED MUST BE ENACTED.

TREASURY DEPARTMENT



WASHINGTON, D.C.

October 24, 1967

FOR IMMEDIATE RELEASE

WILLIAM N. GRIGGS NAMED
SPECIAL ASSISTANT TO ASSISTANT SECRETARY WALLACE

William N. Griggs has been named Special Assistant to Assistant Secretary Robert A. Wallace. He succeeds Thomas W. Wolfe, who is now Director of the Office of Domestic Gold and Silver Operations.

Mr. Griggs will aid Mr. Wallace in carrying out his responsibilities for fiscal policy planning and the direction of departmental activities relating to Federal budgetary policies as well as policy supervision of the Bureau of the Mint. He will also serve as the Treasury representative on a number of intergovernmental committees.

Mr. Griggs joined the Treasury in February 1965 as a Financial Economist in the Office of Financial Analysis. Prior to his Treasury service, Mr. Griggs taught Economics at universities in Oklahoma, Ohio, and Texas and served for several years as Financial Economist for the Federal Reserve Bank of Dallas.

He was born in Tulsa, Oklahoma, November 18, 1931, and attended public schools in Oklahoma City. He received a Bachelor of Science degree in Personnel Management in 1956 and a Master of Science degree in Economics in 1957, both from Oklahoma State University. Mr. Griggs received the American Bankers Association's Harold Stonier Fellowship in Banking for the academic year 1959-60. He received a Ph.D. degree in Economics from Ohio State University in 1966. He served in the U. S. Air Force during the Korean War.

Mr. Griggs is married to the former Darlene Tillman of Oklahoma City. They have one daughter, Lisa, 3, and reside in Arlington, Virginia.

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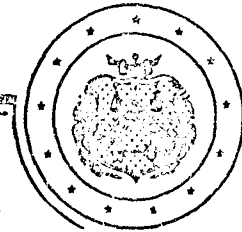
F-1063

TREASURY DEPARTMENT



WASHINGTON, D.C.

FOR IMMEDIATE RELEASE

October 25, 1967

TREASURY ANNOUNCES NOVEMBER REFUNDING TERMS

The Treasury will borrow $12.2 billion, or thereabouts, through the issuance of 15-month and 7-year Treasury notes for the purpose of paying off in cash $10.2 billion of Treasury securities maturing November 15, 1967, and borrowing new cash. The amount of the maturing issues held by the public is $2.6 billion.

The notes to be issued are:

$10.7 billion of 5-5/8% Treasury Notes of Series A-1969, to be dated November 15, 1967, and to mature February 15, 1969, at par; and

$1.5 billion of 5-3/4% Treasury Notes of Series A-1974, to be dated November 15, 1967, and to mature November 15, 1974, at par.

The maturing securities are:

$8,135 million of 4-7/8% Treasury Notes of Series F-1967, dated May 15, 1966; and

$2,019 million of 3-5/8% Treasury Bonds of 1967, dated March 15, 1961.

Interest will be payable on the 15-month notes on February 15 and August 15, 1968, and February 15, 1969, and on the 7-year notes semiannually on May 15 and November 15.

The notes will be made available in registered as well as bearer form. All subscribers requesting registered notes will be required to furnish appropriate identifying numbers as required on tax returns and other documents submitted to the Internal Revenue Service.

Payment and delivery date for the notes will be November 15. Payment may be ade in cash, or in 4-7/8% notes of Series F-1967, or 3-5/8% bonds of 1967, which ill be accepted at par, in payment or exchange, in whole or in part, for the notes ubscribed for, to the extent such subscriptions are allotted by the Treasury. The otes may not be paid for by credit in Treasury Tax and Loan Accounts.

The subscription books will be open only on Monday, October 30. Subscriptions ith the required deposits addressed to a Federal Reserve Bank or Branch, or to e Treasurer of the United States, and placed in the mail before midnight October), 1967, will be considered timely.

F-1064

Subscriptions from commercial banks, for their own account, will be restricted in each case to an amount not exceeding 50 percent of the combined capital (not including capital notes or debentures), surplus and undivided profits of the subscribing bank.

Subscriptions from commercial and other banks for their own account, Federally-insured savings and loan associations, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, Government Investment Accounts, and the Federal Reserve Banks will be received without deposit.

Subscriptions from all others must be accompanied by payment of 2% (in cash, or Treasury securities maturing November 15, 1967, at par) of the amount of notes applied for not subject to withdrawal until after allotment.

The Secretary of the Treasury reserves the right to reject or reduce any subscription, to allot less than the amount of notes applied for, and to make different percentage allotments to various classes of subscribers; and any action he may take in these respects shall be final. The bases of the allotments will be publicly announced, and allotment notices will be sent out promptly upon allotment.

Subject to the reservations in the preceding paragraph, all subscriptions from States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, Government Investment Accounts, and the Federal Reserve Banks, will be allotted in full if a statement is submitted certifying that the amount of the subscription does not exceed the amount of the two maturing securities owned or contracted for purchase for value, at 4 p.m., Eastern daylight saving time, October 25, 1967. Any such subscriber may enter an additional subscription subject to a percentage allotment.

All subscribers are required to agree not to purchase or to sell, or to make any agreements with respect to the purchase or sale or other disposition of any of the notes subscribed for under this offering at a specific rate or price, until after midnight October 30, 1967.

Commercial banks in submitting subscriptions will be required to certify that they have no beneficial interest in any of the subscriptions they enter for the account of their customers, and that their customers have no beneficial interest in the banks' subscriptions for their own account.

Estimated Ownership of November Maturities
as of August 31, 1967

(In millions of dollars)

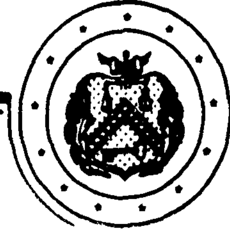
	November 15, 1967		
	3-5/8% Bond	4-7/8% Note	Total
Commercial Banks....................	690	576	1,266
Mutual Savings Banks................	10	32	42
Insurance companies			
Fire..............................	60	31	91
Life..............................	5	*	5
Total, insurance companies........	65	31	96
Savings & Loan Associations.........	50	20	70
Corporations........................	35	15	50
State & Local governments...........	100	155	255
All other private investors.........	457	358	815
Total, privately held...............	1,407	1,187	2,594
Federal Reserve Banks and Government Investment Accts.......	612	6,948	7,560
Total Outstanding...................	2,019	8,135	10,154

Office of the Secretary of the Treasury
Office of Debt Analysis

October 25, 1967

* Less than $500,000.

TREASURY DEPARTMENT



WASHINGTON, D.C.

October 25, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $ 2,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing November 2,1967, in the amount of $ 2,405,296,000, as follows:

91-day bills (to maturity date) to be issued November 2,1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated August 3, 1967, and to mature February 1,1968, originally issued in the amount of $ 1,000,357,000, the additional and original bills to be freely interchangeable.

182 -day bills, for $1,000,000,000, or thereabouts, to be dated November 2,1967, and to mature May 2, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Standard time, Monday, October 30, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

F-1065

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on November 2,1967, in cash or other immediately available funds or in a like face amount of Treasury bills maturing November 2,1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT
Washington

FOR RELEASE: UPON DELIVERY

REMARKS BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
AT THE
HONORS CONVOCATION OF ROANOKE COLLEGE
SALEM, VIRGINIA
SATURDAY, OCTOBER 28, 1967, 10:30 A.M., EDT

As a proud alumnus of Roanoke College, may I congratulate the faculty, Trustees, students, and all those responsible, for the perceptive program marking this 125th Anniversary Celebration of the educational contributions of Roanoke College to the State, the nation and the world.

How fitting -- instead of looking back with satisfaction -- to look forward to a fuller achievement of the ancient dream of the founders.

Today, in this Honors Convocation the college -- this community of intellectuals -- does honor to some of an older and passing generation of its alumni for their performance in this work-a-day world.

But our real concern today is that tomorrow's students have the opportunity and equipment to move boldly into the decades ahead. As the program notes, Roanoke College is concerned with "preparing students for the developing world."

For those of us in the older generation who are privileged to participate in this Honors Convocation, we are grateful.

We treasure this mark of your regard.

But, it is a bittersweet moment.

With it comes the reality to be faced -- our time is rapidly passing. Soon a new generation will take over. What we now on the top-side of fifty think and do will not matter too much for too long. But what this new generation does or does not do will matter terribly for as long as we dare contemplate.

It is my passionate conviction that what the new generation of Americans do and think -- particularly those who are university and college trained -- will determine the future course of world affairs.

Justice Oliver Wendell Holmes once observed that the only people he despised were those who stayed aloof from the passions of their times.

Because of circumstances beyond their control, the new generation of college trained Americans will be unable to remain aloof from the passions of their times at home or in the world at large. They have an inescapable responsibility to become involved. They will be educated men and women and, because of that, they will have a special responsibility to their community. Because they are Americans, they will have an inescapable responsibility to the world community. This becomes clear as we face the facts of life that surround America's position in the world.

Against this background the 125th Anniversary program aptly chooses as its theme "A New Man for a New Age."

I will not discuss today this theme in the context of responsibility to the pressing problems here in the United States which call for a steady flow of extremely capable people into decision-making roles in our domestic society. The agenda at home for the on-coming generation is long and compelling.

To meet these problems, as my colleague, John Gardner, recently remarked, we need our ablest and most capable young people in the dangerous and strenuous positions of leadership. To use his words:

> "We need them as leaders, not just as buttoned-up and buttoned-down professionals living secure and tidy lives. We need them as leaders in business and in education and in every other area of our national life -- but most particularly we need them in public life.
>
> "We are producing the most educated, articulate and brilliant sidewalk superintendents the world has ever seen."

Apathy, cynicism, intolerance, self-deception, and an unwillingness on the part of the individual to lend himself to any worthy common purpose can lead to the decay of any civilization -- even ours here at home.

The aspect of "A New Man for a New Age" to which I will invite your attention is the inescapable responsibility of the educated American to the world community.

We must ask ourselves several questions. The first -- what kind of citizens of the world community are we? This question can be answered. We shall attempt it.

The second question -- what kind of people as citizens of the world community should we become -- cannot be so easily answered. It is not a matter of individual judgment but of collective decision. And only the future will tell whether we as a people are setting our sights and fixing our goals wisely, realistically and with a vision and courage that measure up to the responsibilities our God-given opportunities have brought to us.

I can only give you one man's view based on one man's observation, experience and participation.

In such a moment -- confronted by such a task -- one is reluctant to etch even in broad outline his own personal dream and conception of a new man for a new age. For in so doing he will inevitably take a measure of his country and his fellow countrymen.

In New York there is a play called "Man of La Mancha." It is a new version of an old story of Don Quixote. It is notable for one of the lyrics called "The Impossible Dream."

Dare we in envisaging "A New Man for a New Age" -- the role of the educated American in a developing world -- dare we dream "The Impossible Dream" of an America continuing to lead a community of nations toward peace and security, and toward that development for all men that has been the dream of the poets, the philosophers, and the men of faith down through the ages?

I covet that role for my country and its new generation of educated Americans.

I.

Why is the responsibility of the new generation to become involved in the world community inescapable?

A short answer is that this new generation of educated Americans will be leading a nation which in the greatness of its power and wealth and influence no other nation in the world can equal or, indeed, approach.

Our immense power is combined with a growing dedication to a tradition of individual freedom and equal opportunity, self-determination for nations, and an unparalleled material development that promises the large-scale conquest of poverty, illiteracy and disease for the first time in human history. Given this combination of strength and purpose, we bear upon our shoulders the mantle of Free World leadership.

We have not sought that leadership. Indeed, our earliest tradition was isolationist. Under the circumstances then existing, isolationism was both practical and idealistic. Because our country was relatively small in population and wealth, geographically isolated from the main movements of world politics, the educated American of the era of Washington, Jefferson and Madison could realistically satisfy his idealism by seeking to create in America a splendid and inspiring example to all believers in popular government everywhere.

But by the beginning of this century this nation had grown too great to live alone in a world grown so small. We came to learn that any threat to freedom anywhere is a potential threat to our own freedom. In such a world isolation offers only the illusion of security and strength. In reality, it is the course of greatest weakness and greatest danger.

But, for a while we retreated -- for a while we refused to accept a share in the responsibility that history was beginning to thrust upon us. International power politics -- European style -- brought World War I and in its wake Soviet Communism, a new form of imperialism. In the 1920's after the horror of World War I we washed our hands of a world which was not one of our making and not to our liking -- we withdrew from an international effort to preserve world order. We left the job of peace, security and economic development to others.

Within two decades we found ourselves embroiled in a world-wide depression and in the far greater horror of World War II.

The cost of the world-wide depression was incalculable. One by-product was an Adolph Hitler and a conviction, fed by appeasement, that free democratic societies would not resist aggression -- a view shared by Mussolini and the Japanese war lords. The cost of the resulting war to the world has been estimated at one trillion, one hundred and fifty-four billion dollars -- taking no account whatever of any property damage. In that war nearly one hundred million people had died in the resulting maiming and disease and starvation.

In the wake of that war came a new and serious challenge posed by a Soviet Communist imperialism committed at the outset to world conquest -- by outright aggression and by subversion backed by threat of aggression. Not far behind was an even newer brand of Chinese Communist imperialism -- sometimes competitive and sometimes cooperative with the Russian brand -- but always contemptuous in public utterance and act of competitive coexistence with a non-Communist world.

The unleashing of these new forces coincided with the collapse of the colonial system of the European powers. The weakness of old nations and the emergence of 61 new nations was coupled with growing demands and rising expectations of underprivileged peoples everywhere for full and early deliverance from hunger, disease, ignorance and grinding poverty.

Meanwhile, the world has become increasingly interdependent as communication, missiles and the movement of ideas, goods and people make our globe an ever smaller planet. And the Space Age even promises to bring the other planets closer.

In addition to the facts of history and communication, there are some economic facts that place upon the United States an inescapable responsibility in world affairs.

Consider the mighty productive power of the U.S. economy. With a population of less than nine percent of the total Free World population and less than six percent of the total world population, this country enjoys a Gross National Product that amounts to more than 42 percent of the total Free World production and far exceeds the total output of all the Communist areas combined. Or, expressed in different

terms, our Gross National Product per person exceeds $3,700 per year, more than twice the average $1,660 for European industrial communities, more than seven times an estimate of less than $500 per person for all the Communist world combined, and more than 20 times an estimate of less than $180 per person for the so-called less developed world.

And recent developments in the pace, pattern and policies of the U. S. economy have added incredibly to our power, wealth and strength. Next month the U.S. economy enters the 81st month of an expansion which began in February 1961 and has continued uninterrupted by recession. This will make the current expansion the longest in our history. Moreover, our rate of economic growth has doubled in the last six years over the pace of the previous six. From 1961 through 1966, income per person after taxes and after correction for price changes has risen by 28 percent.

On a global scale the massive dimensions of our current expansion may best be appreciated by some comparisons. In just six and one-half years the U.S. Gross National Product -- that is the value of what we produce each year -- has risen by more than $285 billion. This increase in the value of our production in a short span of six years exceeds the total 1966 Gross National Product of France, West Germany and Italy combined. In other words, it is as though since 1961 we had annexed a national increment to our productive power equal in size to the combined production of these three great countries.

There need be no guilt complex about making responsible use of this power and wealth. Surely, a large country, already quite rich, has little to gain from imperialistically exploiting other nations. Yet, there are those who shrink from the responsibility that comes from this power and wealth. Power, they say, corrupts. And they learnedly quote Lord Acton. But the power and wealth of the United States is also a fact. It must and will be used in the world community for good or evil. That is why the responsibility for its use is inescapable.

This brings us back to the world of reality in which "The New Man for a New Age" in the United States must live.

Some Americans of this new generation, if one is to believe all that one reads about the growing Hippie population and the revolt of some intellectuals on some campuses against American foreign policy, would prefer to be citizens of a small and relatively impotent nation, ignoring what happens in the world and acting as though their nation cannot change it. Those who would have us come home from everywhere and mind only what they consider our own business ignore the different measure of responsibilities that attaches to a large and powerful country in contrast with a small and weak one.

This was well put by a recent commentator in the July issue of "Foreign Affairs". He said: "There are a great many people who appear to think that a great power is only the magnification of a small power, and that the principles governing the actions of the latter are simply transferable -- perhaps with some modification -- to the former. In fact, there is a qualitative difference between the two conditions, and the difference can be summed up as follows: a great power is 'imperial' because what it does not do is just as significant and just as consequential, as what it does. Which is to say, a great power does not have the range of freedom of action -- derived from the freedom of inaction -- that a small power possesses. It is entangled in a web of responsibilities from which there is no hope of escape: and its policy-makers are doomed to a strenuous and unquiet life, with no prospect of ultimate resolution, no hope for an unproblematic existence, no promise of a final contentment. ...It is no accident that all classical political philosophers, and all depicters of utopia, have agreed that, to be truly happy a human community should be relatively small and as isolated as possible from foreign entanglements."

So here we have the first dimensions of the "new man for a new age." He must expect the strenuous and unquiet life with no prospect of ultimate resolution, no hope for an unproblematic existence and no promise of final contentment.

I would suggest that the young Americans in the Armed Forces who come into our homes on television from far-off Vietnam, or are less dramatically engaged in the far-flung operations of the Peace Corps, or who are diligently preparing themselves for a constructive role in society by pursuing their studies in classroom, dormitory and library rather than cultivating the practice of civil disobedience -- these fill out "the new man for a new age" concept. The Hippies and the practitioners of civil disobedience seek an escape from it.

II.

In peering ahead to the all-important future for the oncoming generations of Americans in the world community we must ask ourselves what kind of people we have been in the years just past. Continuity and consistency are important. In these times we cannot lead the world to peace, security and development sporadically.

My own assessment is that the American people have a right to be proud of their performance in the world community since World War II.

Of course, mistakes have been made, and hindsight is always better than foresight. But, by and large, our people -- young and old, rich and poor, business and labor, Democrat, Republican, or nonpartisan, leaders and rank and file -- have met the great and common challenges before us and seized the great and common opportunities.

We have helped mightily in a thousand ways to restore the materially advanced countries which were ravaged by war and did not fall behind the Iron Curtain.

We have sought and struggled for peace within the framework of the United Nations and outside it.

We have lived up to our commitments in providing leadership and standing firm with other like-minded people against Communist aggression and externally supported subversion, supplying with our Allies sufficient force and power to deter such efforts and to demonstrate beyond any doubt that they are far too unrewarding and dangerous to be worth the risk.

We have provided leadership in assisting on a multilateral basis the new nations in their struggle to achieve both essential stability and sufficient progress toward meeting the rising needs and demands of their people.

We have given leadership in promoting the development of an astonishing volume of world trade and investment across international lines and promoted the highest degree of international economic and financial cooperation ever experienced in those countries that make up the Free World, resulting in the greatest era of common prosperity and growth that many have ever enjoyed.

We have helped to counter aggression in many guises -- open or concealed -- on nearly every continent on the globe, involving the freedom and self-determination of countries great and small -- in Iran, in Greece, in Turkey, in Berlin, in Korea, in Lebanon, in Taiwan, in the Congo, in Laos, in India, and now in Vietnam.

But, this has not been a seeking of a "Pax America". We have sought, not to act alone and apart, but to join with other nations in forging effective alliances against aggression -- aggression in the Atlantic Community through the North Atlantic Treaty Organization, aggression in Southeast Asia and the Pacific through the Southeast Asia Treaty Organization, aggression in Latin America through the Organization of American States, and aggression anywhere in the world through the United Nations.

In the two decades since the end of World War II, we have spent vast sums of money to maintain our military security and that of the Free World. Our national defense expenditures add up to over $850 billion in the last twenty years.

More significant, the young people of both the generation past and this generation have borne arms on behalf of all of us and the future peace and security of the world in many countries at many battle stations. Some have sealed the sacrifice in blood. More than 33,000 Americans died on the battlefields of Korea and more than 103,000 were wounded. As of a week ago, more than 14,000 Americans had died in Vietnam and more than 47,000 had been wounded.

We have helped organize and encourage the development of great multilateral organizations for peace and development and their accomplishments reflect, in large measure, our leadership and our support -- the United Nations, the International Monetary Fund, the World Bank, the Marshall Plan, the Inter-American Development Bank, the Alliance for Progress, and now the Asian Development Bank.

Through these multilateral efforts, through bilateral government aid, and through numerous private channels -- such as our private foundations and multinational corporations -- we have devoted a substantial share of our wealth, energy and resources to the mutually agreeable and beneficial task of helping others increase their contribution to Free World abundance. In the postwar decades we have contributed in excess of $100 billion of our national wealth to helping better the lives of others and provide a stable world community of free nations through our major government foreign assistance programs.

Indeed, in meeting the great challenges in the world community the American people have not been found wanting. Never in the memory of man has any nation done so much and at such great cost, not to gain dominion over the lives or the resources or the territory of others, but to help others gain full and free dominion over their own destinies.

We have understood -- and our accomplishments have proclaimed our understanding -- that with might must come maturity, with wealth and riches must come wisdom and responsibility, and with success must come service.

This is more than the history of an era past. It is the living reality of right now. It is a dynamic moving process. The foundations placed by Presidents Truman, Eisenhower and Kennedy are being built upon soundly by President Lyndon Johnson. There is continuity in conception and consistency in achievement.

Look more closely in 1967, which has been a most constructive year for the United States in the world community.

True there is the stubborn refusal of a Ho Chi Minh, abetted by his Soviet and Chinese allies, to accept repeated invitations to unconditional negotiations, looking to a peaceful settlement in Vietnam.

Yet through patient and persistent exchange of views, American diplomacy has achieved agreements and participated in the formulation of meaningful international arrangements that promise much for the future of the world community.

The successful conclusion of the Kennedy Round negotiations to reduce tariffs will -- if we have the courage and wisdom to resist current protectionist moves -- lower trade barriers to many of the goods produced by the United States and other nations, further stimulating the unparalleled growth of world trade in recent years.

The plan for the deliberate creation of a new world monetary reserve asset to supplement inadequate supplies of gold and relieve reserve currencies from additional strains was recently approved by the member nations of the International Monetary Fund after two years of intensive negotiations.

Other agreements encompass more than Free World cooperation.

The treaty for the peaceful exploration of space has been recently ratified. This treaty, and the draft non-proliferation of nuclear weapon's treaty filed jointly with the Soviet Union, constitute giant steps to delimit the threat of nuclear conflict.

The Presidents of the nations of the Western Hemisphere decided this past spring to build a Latin American Common Market during this next decade. The Asian Development Bank became a going institution this year.

Even though there was a sharp and distressing war in the Middle East, the fighting was ended in four days without the great powers being drawn into conflict.

And so, my friends, the old generation does not say to on-coming generations that it has always been successful. But no man and no nation can justly deny what history makes manifest: in the last twenty years we have not been found wanting as citizens of a world community.

My generation has asked certain questions: Is it worthwhile to devote a portion of our human and material resources to the military effort required for the promotion and preservation of peace and freedom in a world in which tyranny cannot be imposed by aggression? Is it worth it to devote a share of our resources to help shape a world that will, year by year, witness nations, new and old, beat back the tides of hunger and disease and illiteracy in an atmosphere of economic and social progress and of political freedom and order? Is it worthwhile to work with other like-minded nations in a wide range of ever-growing economic, financial and cultural cooperation?

For two long decades, under four great Presidents -- Harry Truman, Dwight Eisenhower, John Kennedy, and Lyndon Johnson -- we have answered these questions in a clear and unqualified affirmative, for that has seemed to us to be the only answer that a truly great nation can and should give in an inter-dependent world.

III.

And now we come to the final question which will be answered -- like it or not -- by both the old and the new generation. That question is: What kind of people as citizens of the world community shall we become in the face of adversity, disappointment and frustration?

There is a choice to be made. And, like most choices in a confused and complicated area, the ultimate choice arises out of some concrete decisions in concrete situations. And the usual array of options is retreat, hold fast or go forward. This choice is being presented to you at this very moment in a new and novel form.

Vice President Humphrey said earlier this week:

> "There are growing indications that the coalition of retreat would impose a new isolation -- or maybe it is the same 'old isolation' -- on America in a shrinking, hungry, troubled and dangerous world."

He cited danger signs in foreign policy -- the efforts which would undermine the achievements of the Kennedy Round, the attack on foreign aid which puts in jeopardy our whole constructive postwar work of nation building, and the attack on U. S. policy in Vietnam.

Those who would have America retreat from its world responsibilities point up the difficulties where the going is tough, the problems endless, and the deficiencies of others somehow a moral challenge to quit. Perhaps they have never taken to heart the wordsof Sir Thomas More in his "Utopia" about the obligation of the true intellectual:

> "If evil persons cannot be quite rooted out, and if you cannot correct habitual attitudes as you wish, you must not therefore abandon the Commonwealth ... you must strive to guide policy indirectly, so that you make the best of things, and what you cannot turn to good, you can at least make less bad. For it is impossible to do all things well unless all men are good, and this I do not expect to see for a long time."

So it is important that we maintain our morale, our faith in ourselves, and our role in the world community regardless of the difficulties, frustrations and disappointments.

The single most acute situation in which our morale, our faith in ourselves, and our role in the world community is being tested is Vietnam.

Heretofore, the danger to America's role of responsibility in the world community has come from an unwillingness to become involved, as in the late Thirties -- a withdrawal in the wake of success or victory, as in 1919 -- an indifference or apathy to a threat not fully perceived, as in Cuba in the late Fifties.

But today a new and more terrifying danger signal sounds. It is the rising cacophony of voicesbeing increasingly heard that urge or suggest that in one way or another the United States contrive a withdrawal from its international commitment -- specifically in Vietnam.

Let us be clear about this issue. This is not a debate about whether the United States should enter into a commitment or should have become involved in Vietnam. We are in Vietnam. Our commitment is clear. These are demands, growing increasingly strident, culminating in a disgraceful demonstration last weekend before the Pentagon, that the United States go back on its commitment and, in one way or another, reward aggression by North Vietnam against South Vietnam.

The SEATO Treaty, approved in 1954 with only one dissenting vote by our Senate, declares that:

> "Each party recognizes that aggression by means of armed attack in the treaty area...would endanger its own peace and safety, and agrees that it will in that event act to meet the common danger."

The fidelity of the United States is not subject to the veto of some other signatory -- and five signatories have engaged their forces alongside Korean and South Vietnamese troops.

I wish to join with the eminent and courageous Secretary of State Dean Rusk, who recently told the American people:

> "Let me say, as solemnly as I can, that those who would place in question the credibility of the pledged word of the United States under our mutual security treaties would subject this nation to mortal danger. If any who would be our adversary should suppose that our treaties are a bluff, or will be abandoned if the going gets tough, the result can be catastrophe for all mankind."

What is the objective of our treaty commitments? It is the overriding objective of our foreign policy -- the establishment of a reliable peace. It is to prevent World War III. It is to stop aggression before it becomes a pattern of international conduct.

Our several alliances in the Pacific reflect our profound interest in peace in the Pacific and in Asia, where live two-thirds of the world's people who are no less vital to our national interests than are the people of our own hemisphere or those of the NATO area.

Th so-called "war of national liberation", which is a new phrase for Communist subversion aided and abetted from outside the afflicted country, is not peculiar to South Vietnam. In one form or another it is apparent in Laos and Thailand. There was a major Communist effort in 1965 to take over Indonesia and its more than one hundred million people.

And "wars of national liberation", if successful in achieving Communist domination in Southeast Asia, will not be confined to that area. The spectre of Castro, the adventures of Che Guevara, and recent incidents in other parts of the Western Hemisphere remind us that they can strike nearer home.

The issue on Vietnam is coming into clearer focus as the public debate waxes in the Congress, in the press, on every television set, and on every street corner. It is: shall we fall back, get out, go all out, or stick it out on the course our Commander-in-Chief has chosen?

Eyes and ears all over the world are watching and listening. They are making up their minds about what kind of people we are going to turn out to be.

Of course, Hanoi is listening. They remember that they defeated France in Paris -- not Vietnam. They seem determined to turn down all offers to negotiate while their hopes are being raised by the sounds of dissent in the United States.

And Moscow is listening.

And Peking is listening.

For much of their future plans will hinge on the outcome of this debate and the kind of people we Americans turn out to be in the hot crucible of divided opinions.

After all, as recently as this year, to celebrate the 50th anniversary of the Bolshevik Revolution, a Soviet Communist party document was issued in Moscow which stated:

> "Imperialism, notably U. S. imperialism, was and continues to be the main enemy of the national liberation movement."

Should that "main enemy" cut and run in Vietnam, how many "national liberation movements" will be mounted in the years to come?

And, yes, there are others listening to this debate in many other capitals -- of countries allied to us -- of countries uncommitted.

Prime Minister Lee, of the Republic of Singapore, made a most revealing statement on one of the nationwide television networks last Sunday, saying:

> "I have no doubt that your President has got resolution, and determination and restraint, and I have also no doubt that your Secretary of State and Secretary of Defense have got it, but what, I think, in your kind of open, democratic society you must demonstrate, and which I have really come here to try and understand better, to watch the proceedings in your presidential elections next year is whether you, as a people,

have got that resolution, that stamina, that perseverance and, most important of all, infinite patience and capacity to hold back your desire to settle this quickly and get it over with, because this is a very different kind of war."

A little bit later the Prime Minister made another observation apropos the position of the uncommitted people of Asia, Africa and Latin America. He said:

> "And if you want people to take a stand, you have got to demonstrate that as a people you have got what it takes; that Asia does matter to you and does matter to the Free World, as you call it."

So, my good friends, it is not the President of the United States, our Commander-in-Chief, and his principal aides who are on trial in this ordeal. Ho Chi Minh knows where they stands. So do the leaders of the Asian countries who are fighting by our side in South Vietnam. So do the leaders of the uncommitted people. What they are not sure of is where the American people stand because they are confused by the babel of dissent.

Therefore, for one, I welcome the emergence this week of a new voice which I like to believe is the truly authentic voice of my generation. I refer to the organization announcement of the Citizens Committee for Peace in Vietnam, and its statement that:

> "We strongly support our commitment in Vietnam and the policy of non-compromising, although limited, resistance to aggression ... We believe that, in this, we speak for the great 'silent center' of American life, the understanding, independent and responsible men and women who have consistently opposed rewarding international aggressors from Adolf Hitler to Mao Tse-tung. And we believe that the 'silent center' should now be heard."

Signatories to that statement and members of the new, nonpartisan Committee include former President Truman and former President Eisenhower, and I, for one, have no doubt that the spirit of John F. Kennedy approves and appreciates

the statement of the Committee, and in particular, these further words:

> "We are not supporters of a President or an Administration; we are supporters of the Office of the Presidency."

And so, my friends, in conclusion, my message from an older generation to the "New Man for a New Age" at Roanoke College and its sister institutions concerning his role in the world community is a simple one.

You are inescapably involved in the affairs of the world. Of necessity you will have to be a leader -- a leader in the further advance to durable peace, security for all nations, development and opportunity for all people -- or a leader in a personal and national retreat from a great tradition that started with the Declaration of Independence and the Constitution and has flowered in a United States foreign policy shaped in the last twenty years by four great Presidents.

The path for continued advance on the course set will not be easy; the problems will be endless. Courage, stamina and vision must match training and skill. You will not be loved in the world -- no great power enjoys popularity in world affairs. But upon you falls the duty to be sure the United States is respected.

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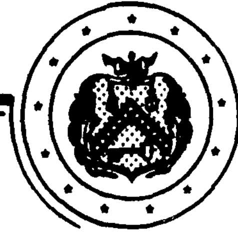
TREASURY DEPARTMENT



WASHINGTON, D.C.

OR RELEASE 6:30 P.M.,
onday, October 30, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury
ills, one series to be an additional issue of the bills dated August 3, 1967, and the
her series to be dated November 2, 1967, which were offered on October 25, 1967, were
ened at the Federal Reserve Banks today. Tenders were invited for $1,500,000,000,
thereabouts, of 91-day bills, and for $1,000,000,000, or thereabouts, of 182-day
lls. The details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	91-day Treasury bills maturing February 1, 1968		:	182-day Treasury bills maturing May 2, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.860	4.510%	:	97.453	5.038%
Low	98.848	4.557%	:	97.442	5.060%
Average	98.852	4.542% 1/	:	97.450	5.044% 1/

33% of the amount of 91-day bills bid for at the low price was accepted
25% of the amount of 182-day bills bid for at the low price was accepted

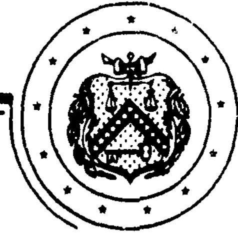
TAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 18,269,000	$ 8,069,000	:	$ 20,155,000	$ 8,930,000
New York	1,673,909,000	1,134,999,000	:	1,432,796,000	754,569,000
Philadelphia	23,585,000	11,585,000	:	13,684,000	5,684,000
Cleveland	35,423,000	18,601,000	:	20,032,000	19,995,000
Richmond	15,645,000	9,645,000	:	11,028,000	6,278,000
Atlanta	44,120,000	28,865,000	:	27,626,000	20,701,000
Chicago	214,053,000	141,973,000	:	180,202,000	77,195,000
St. Louis	65,079,000	54,574,000	:	46,095,000	42,570,000
Minneapolis	22,338,000	13,009,000	:	18,162,000	9,812,000
Kansas City	23,418,000	15,076,000	:	12,547,000	8,916,000
Dallas	22,467,000	12,199,000	:	19,211,000	8,611,000
San Francisco	126,933,000	51,969,000	:	110,066,000	36,743,000
TOTALS	$2,285,239,000	$1,500,564,000 a/		$1,911,604,000	$1,000,004,000 b/

Includes $210,194,000 noncompetitive tenders accepted at the average price of 98.852
Includes $126,128,000 noncompetitive tenders accepted at the average price of 97.450
These rates are on a bank discount basis. The equivalent coupon issue yields are
4.67% for the 91-day bills, and 5.26% for the 182-day bills.

F-1067

TREASURY DEPARTMENT



WASHINGTON, D.C.

October 31, 1967

FOR IMMEDIATE RELEASE

UNITED STATES-CYPRUS INCOME TAX TREATY
TERMINATES DECEMBER 31, 1967

The Treasury today notified taxpayers that the United States income tax convention with Cyprus will terminate as of December 31, 1967. For the purpose of the United States tax, the convention will not apply for taxable years beginning on or after January 1, 1968. Notice of its desire to terminate the treaty has been given to the U.S. by the Government of Cyprus in accordance with the provision of Article XXIV (1) of the treaty.

The convention to avoid double taxation with Cyprus came into effect January 1, 1959 when the treaty between the United Kingdom and the United States was extended to Cyprus and a number of other then dependent territories of the United Kingdom. It remained effective as respects Cyprus after it became independent.

The parties have been considering changes in the convention but were unable to reach agreement. It is expected that discussions will continue in the future, aimed at entering into a convention to replace the one terminated this year.

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F-1068

TREASURY DEPARTMENT
Washington

FOR A.M. RELEASE
THURSDAY, NOVEMBER 2, 1967

REMARKS BY THE HONORABLE STANLEY S. SURREY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
NATIONAL FOREIGN TRADE COUNCIL CONVENTION
THE WALDORF-ASTORIA HOTEL
NEW YORK, NEW YORK
WEDNESDAY, NOVEMBER 1, 1967, 3:00 P.M., EST

THE UNITED STATES TAX SYSTEM AND INTERNATIONAL TAX RELATIONSHIPS -- CURRENT DEVELOPMENTS, 1967

There is always a fascination and a challenge in speaking on the topic of international tax relationships. The subject is superb for exhibiting the difficulties and obstacles, of theory and of practice, that beset the constant task of improving a nation's tax system. It presents at the outset a panoramic view of the mix of factors which shape the changes in a country's tax structure -- the presence of complex policy issues which must be analyzed and for which acceptable solutions must be found, the task of embodying those solutions into acceptable legislation, and the constant effort to maintain a proper day-to-day application of the legislative solution in the context of a tax administration that must be both adversary and non-adversary in character. These aspects can be seen of course in many facets of our tax system.

But in the area of international tax relationships we must go still further. For here we have the added task of developing principles and policies to prevent the international tax anarchy that otherwise would exist if each nation applied its domestic tax structure without regard to the tax structures of other countries. And since we are therefore involved in achieving international tax harmony, the framework of the tax system we must shape goes beyond the unilateral domestic tax structure to cover international tax accommodations through tax treaties and other international agreements. The task of giving shape to the United States tax system in its international relationships is thus as complex as it is endless.

Our international tax relationships must begin with our domestic tax structure and the rules it unilaterally prescribes for those relationships. In recent years legislative activity has established the current framework of our statutory rules for this purpose -- first in 1962 as respects the United States taxation of foreign income and then in 1966 as respects the United States tax treatment of foreigners receiving income from the United States. In both cases, but much more notably in 1962, the legislative patterns were shaped in circumstances where differences of opinion existed on the analysis of the policy issues and the character of the solutions. Of necessity the ultimate legislative result involved compromises at many points, and the need to reduce compromises to legislative language in a technical field is not conducive to a simple set of statutory rules. Undoubtedly experience and further analysis will clarify the perspective in which our unilateral rules must be viewed. Any efforts at change, however, are not likely to come as long as there exist important sectors seeking to turn back to a world in which tax havens are encouraged and hidden incentives are obtained to enlarge capital outflows to other industrialized countries.

There are still those who believe that the path to better tax rules lies in a crossing of the Internal Revenue Code with the National Geographic magazine. But whatever may be the undoubted attractions of many romantic countries or tropical islands -- of which I gather the Cayman Islands is the most recent discovery -- it is hard to conceive of an enduring structure of international tax rules being founded on these vagaries of geography, history, and island jurisprudence. There would be much of the art of the absurb in having imposing edifices of multinational corporations shaped by these vagaries and tied by tax strands to the islands of the Caribbean. We must also recognize the attraction that the intricacies of the present statutory structure hold for those whose talents lie in this fashioning of elaborately structured tiers of corporations carefully spotted in these havens -- indeed the fascinating temptations that exist in the chains and grouping of corporations under the minimum distribution rules combined with the foreign tax credit rules appear irresistible to some. And so the Internal Revenue Service must maintain a constant vigilance in guarding the basic principles and rules of the statutory structure. You may rest assured that this vigilance is being exercised.

Given these unilateral statutory patterns we are continuously directing our efforts to improving international accommodation through tax treaties and to improving the day-to-day administration of our statutory and treaty rules.

INCOME TAX TREATIES

In considering the international tax accommodations we are reaching through tax treaties, we must divide the subject between developed country treaties and those with less developed countries.

Developed Countries

In the past several years the United States has engaged in extensive treaty negotiations with the European countries. The causes are threefold: to accommodate existing treaties to the changes that have occurred in the domestic tax systems of those countries, primarily in their corporation taxes; to adapt our treaty provisions as far as appropriate to those in the Model OECD Convention; and to reach treaties with two European countries outside our treaty network, Spain and Portugal.

As a consequence of these negotiations, our objectives have in large part now been accomplished. We expect in the coming year to sign a treaty with Portugal. We have, through the process of these negotiations, worked out a United States model which represents our accommodations to the OECD Model. This United States model is pretty much represented by our recent treaty with France, and it is thus the basis of our current discussions with other countries. Of course, refinements will develop in future negotiations, but the basic framework that has evolved through our recent negotiations appears to meet our needs. Our next steps are likely to be revisions of treaties concluded some time ago. Thus, we are now negotiating with Finland, and are considering the appropriateness of revisions of our treaties with other European countries.

The negotiations with the United Kingdom, Germany and France illustrate the complexities involved in our efforts to maintain a consistent set of international tax principles to guide our negotiating posture. Each of these countries has a different corporate tax structure: the United Kingdom now has a corporate tax separate from the individual income tax in the pattern of the United States structure; Germany

has a deduction at the corporate level for dividend distributions which lowers its effective rate on distributed profits; France provides the shareholders with a credit for a portion of the corporate tax that goes far to eliminate the shareholder payment of a tax on the dividends he receives.

The United Kingdom treaty negotiations presented primarily the problem of the level of the withholding rates on dividends, since the corporate taxes of the two structures are similar, and the result was a compromise of 15 percent. The German treaty presented the problem of seeing that American firms with direct investments were not denied the benefit of the corporate deduction for distributed profits and at the same time achieving a reciprocal withholding rate. This was accomplished by a 15 percent rate, with a provision to protect Germany from abuse of the corporate deduction.

The treaty with France presented the problem of dealing with the discrimination against American investors vis-a-vis French investors by reason by the French law not granting to foreign shareholders the benefits of the credit for the French corporate tax. The French denied that in principle a discrimination existed and asserted that the restriction of the credit to shareholders subject to French income tax was proper. The United States felt that if the allowance of the credit means that the French 50 percent corporate tax is in part a shareholder tax, then domestically-owned French companies are paying a lower corporate tax rate than foreign-(including American) owned French companies, which is discriminatory in fact. If, on the other hand, the French corporate tax is a full 50 percent and the credit instead represents a reduction in the shareholder tax on dividends, then since the reduction eliminates such tax for the most part, the French should not claim a withholding tax on foreign shareholders. A withholding tax on foreign shareholders is but a counterpart to a domestic income tax on shareholders, and if that domestic tax does not exist, the assertion of a withholding tax is discriminatory.

The net result of these conflicting views was the French agreement to a 5 percent withholding tax on parent-subsidiary dividends, a reduction from the 15 percent tax under the previous treaty. Since the United States is in favor generally of a 5 percent withholding rate in parent-subsidiary cases, the rate is reciprocal. The United States in effect

reserved its view that the French tax structure could still be regarded as discriminatory and that lower withholding rates on the part of the French on direct and portfolio investment -- which need not be reciprocated on our side -- were appropriate. (The United Kingdom, when it previously had a corporate structure which gave a full shareholder credit, allowed that credit to foreign shareholders.) We were the first country to negotiate with France after the adoption of its new corporate tax structure. We thus have an understanding that if France accedes to this contention advanced by any other country, modifications of its treaty with the United States would be in order. It is interesting to note that France has recently stated it is considering removal of this discrimination against foreign shareholders in connection with its treaty negotiations with the Common Market countries.

The United States also has the view that the denial by France under its new corporate system of a credit to French shareholders for the portion of the French corporate tax levied on income of a French corporation from sources outside France (or for the foreign corporate tax where France, in effect, offsets that foreign corporate tax against the French corporate tax) discriminates against Frenchmen who invest abroad as against Frenchmen who invest in France. This similar denial of a credit, for the foreign corporate tax, to a French shareholder directly holding a portfolio investment in a foreign corporation is also discriminatory. (Here also the United Kingdom had not followed this differentiation.) The French, on the other hand, see this as a matter of French internal tax law even though the results affect international investment. The treaty does not deal with this situation.

As a consequence of the differing views possible on the treatment to be accorded non-residents on income from foreign sources between countries that use the credit-to-shareholder approach and countries that do not, it is evident that more international discussion is needed of the principles that should guide negotiations in these situations. The OECD Model Convention does not deal with this matter. Since other countries beside France use or may turn to the credit-to-shareholder approach, such a discussion has a wider importance.

Less Developed Countries

As the less developed countries of the world seek foreign private capital to hasten their economic development, it is natural that they begin to think of tax treaties to govern their tax relationships with the industrialized countries supplying that capital. This aspect is especially evident in Latin America, and the major countries of that continent are intensively considering treaties with European countries, Japan, and the United States. They are thus commencing the process of country-by-country negotiation from which will evolve the pattern of treaties between the industrialized and these developing countries, just as those industrialized countries have through the negotiations of the past two decades produced the present general pattern governing the treaties among themselves.

In most cases Latin American countries approach this negotiating process with domestic tax systems somewhat ill-adapted to international transactions. As a consequence their unilateral tax rules often produce obstacles to international trade and investment. There is in general the realization in these countries that, through treaties, modifications are in order to conform their unilateral jurisdictional rules to the current international tax standards. The modifications will not necessarily come all at once, for the newness of the whole process and the degree of modification sometimes needed combine to evoke a cautious and hesitant approach. These countries are apparently also willing to reduce their withholding taxes to more appropriate levels in those cases where present rates may constitute a barrier -- though not to the levels of the OECD Convention. But in making these reductions, the Latin American countries want assurance that the reductions will benefit the taxpayer-investors of the industrialized countries and not the Treasuries of those countries. In addition, in making accommodations to international standards and joining in treaties these countries want the industrialized countries to take some step representing an encouragement to investment by their taxpayers in the Latin American countries. Encouraging trade and investment is the objective of tax treaties in general; but for these developing countries, this objective takes on a more urgent meaning.

The United States position is one of recognition of the problems that the Latin American countries face in the somewhat unfamiliar area of international tax treaties. It is also one of accepting the basic lines of approach guiding those countries in their endeavors. This position is based on a consideration of the bilateral tax relationship between the United States and a treaty country and hence is essentially on a "per country" view of the operation of the treaty in the context of our tax system. As to the aspect of encouragement to investment, the United States approach is to offer to extend our domestic 7 percent investment credit to investment, on similar terms, to those countries and thus provide the same treatment as investment in the United States. This approach on our part permits us to maintain an equality of treatment between our investors at home and our investors in those countries while still favoring those countries over the industrialized countries.

In taking this approach, we have had to assume the task of demonstrating to these countries that this investment credit extension is a better contribution on our part to meeting the treaty objective of encouraging investment than a tax-sparing concession would be. A number of industrialized countries are following the tax-sparing approach and some Latin American countries have, we believe uncritically, accepted the view that they benefit more from tax-sparing than from an extension of the credit. Indeed, many of our own taxpayers have the same belief.

It can be shown that the direct cost to a less developed country of entering into a tax-sparing treaty with respect to direct investment is greater than the cost to it of entering into an investment credit treaty. The former often requires a large reduction in the withholding tax of the Latin American country to make the tax-sparing concession of real benefit to the investor from the industrialized country. This is not the situation under an investment credit treaty. On the other hand, the benefit to the United States investor of a tax-sparing credit for a treaty reduction in withholding rates may frequently be small or even nil, as it would require an improbably large reduction in the withholding rate to get significantly below the point where a net United States tax becomes payable under the existing tax credit system. In other words, in many cases the benefit of the rate reduction would accrue to the taxpayer with or without tax-sparing.

The benefits to a firm under the credit treaty, on the other hand, are cumulative, for it receives both the credit and the withholding rate concession of the other country, where the latter brings the Latin American country's effective rate to an approximation of the United States corporate rate. The benefits to the taxpayer-investor under a treaty providing the investment credit and moderate withholding rate reductions are thus greater than the benefits under a treaty providing tax-sparing and drastic withholding rate reductions.[1/]

1/ Suppose a foreign country makes a moderate reduction in its withholding rate on dividends to reach an effective over-all rate of 48 percent in return for the extension of the investment credit. The benefits of this withholding rate reduction go to the U.S. corporate taxpayer, and in addition he receives the benefits of the extension of the investment credit, so that the concessions of the two Governments produce a cumulation of benefits -- as they should to avoid any wastage of the concessions. But if the foreign country reduces its withholding rate still further, this time in exchange for tax-sparing rather than the investment credit, a part of the reduction would still have benefited the U.S. corporate taxpayer even in the absence of tax-sparing, in view of our lack of gross-up under the foreign tax credit (thus producing an effective rate of our tax that is less than 48 percent). The balance of the withholding reduction will only benefit the U.S. corporate taxpayer if tax-sparing is granted. But the full benefit of the withholding rate reduction, achieved in this latter manner, would be distinctly less than the cumulative benefit the U.S. corporate taxpayer would have obtained under the first approach, given the limits of the reductions in withholding rates the Latin American countries are likely to make even under tax-sparing treaties. Hence the U.S. corporate taxpayer does not gain as much, and the foreign country loses more, under the tax-sparing treaty. If the foreign country under an investment credit treaty wants to benefit a U.S. corporate taxpayer still more, it could of course lower its withholding rate to the point where it matches our effective rate in the absence of gross-up -- and this lowered rate would without tax-sparing be of benefit to the taxpayer, cumulative with the investment credit.

Continuation of Footnote 1, page 8.

To illustrate by a numerical example, assume a Latin American country with a corporate tax of 35 percent and a withholding tax of 25 percent. The combined tax on the profits of a U. S. subsidiary remitted to the United States would total 51.25 percent. A reduction in the withholding rate to 20 percent would lower the effective foreign rate to 48 percent. But with a 35 percent foreign corporate rate the combined United States and foreign effective rate on income from the Latin American country is only 43.45 percent. (This is the sum of 35 units foreign corporate tax paid plus the net amount of 8.45 units payable to the United States on the dividend of 65 units, after allowing a credit of 22.75 units for the foreign corporate tax [65(48%) - 65(35%)=8.45].) Thus any reduction in the withholding rate down to 13 percent (65x13%=8.45) would benefit the United States investor. With withholding rates of less than 13 percent the foreign tax credit becomes less than U.S. tax liability and tax-sparing would begin to take effect. But even if the Latin American country agreed to lower its withholding tax from 25 percent to 10 percent, the value of the investment credit would exceed 3 percent of the dividend -- which would be the value of a tax-sparing credit -- over an indefinite period, using moderate assumptions about investment, profits and dividends.

Even in the case of statutory investment incentive concessions involving a reduction in the basic corporate tax of the Latin American country, the investment credit over the typical time period of those concessions will compare favorably with the tax-sparing approach in terms of value to the investor. 2/ In addition, the credit comes at the outset as the investment is made, is increased as additional investment is made, and is thus not dependent as is the tax-sparing mechanism on the success of the enterprise or the distribution of profits.

2/ For example, if a Latin American country assumed to have a 35 percent corporate rate granted full exemption from that rate to new firms in a certain area, it would take about six years for the tax-sparing credit to match the investment credit. Another form of incentive sometimes used is a 50 percent reduction in income tax: in this case, a profitably operating U.S. subsidiary entitled to this benefit should clearly prefer the investment credit to the tax-sparing credit as the latter would not match the investment credit in tax savings until after the tenth year, which is probably the final year of the reduction.

The assumptions used in these examples are: (1) the investment credit is earned on 60 percent of the initial investment for a new company and 75 percent for an operating company. The creditable assets acquired in either case are depreciated on a straight-line basis over an eight-year period with depreciation reserves applied to acquire additional creditable assets; no credit is earned on reinvested profits since these are assumed to total only one-half of current profits; (2) the profit rate is assumed to be 20 percent before tax; for a new company this is approached gradually over the first four years (zero in year 1, then 5 percent, 10 percent, and 20 percent) while for an operating company it prevails throughout; (3) one-half of after-tax profits is distributed; and (4) the discount rate is 15 percent.

Also, under the investment credit approach the United States would apply its tax in the same way to income from the treaty country as to income arising within the United States. As a result, the decision to invest in a treaty country can be made on economic criteria without institutional pressures. In constrast, the tax-sparing approach would undo this basic aspect of United States control over application of its tax system by permitting different rates to apply to income from different countries; it would encourage investment in the treaty countries which provide the largest unilateral tax relief. If tax-sparing were to be generally accepted by the industrialized countries, the result might be a competitive struggle among the developing countries to divert resources to the lagging regions or sectors of their economies by offering the largest tax subsidies. To the extent that such countries choose to try the tax incentive route in their legislation, the benefit of the rate reduction or exemption is available to United States subsidiary firms insofar as they retain the profits in those operations. But a tax-sparing credit on our part is unacceptable on tax policy grounds and less satisfactory in terms of encouraging investment in developing economies than the investment credit extension. The fact that the investment credit approach compares favorably with tax-sparing in quantitative value reinforces our position that the extension of the investment credit is the more efficient and desirable approach.

Our recent treaty with Brazil -- now before the Senate -- is an illustration of the lines of main development that we are following in our approach to Latin American treaties. However, we would hope also to include a provision deferring the taxes of the two countries in the case of transfers of patents and know-how for stock, including a minority interest, in a corporation of the developing country. We are presently engaged in negotiations with Argentina, Jamaica, and Trinidad and Tobago, and in consultations that may develop into negotiations with several other Latin American countries.

For above all, the United States holds the view that these treaties will be of assistance to the economic development of Latin America and in turn that development will be of benefit to the United States, both in material

ways as respects our export trade and in the many intangible values that flow from viable, growing countries in that area. Further, the experience gained by those countries in developing their international tax relationships with the outside world will be of assistance to them when they turn, as their common market concepts grow more tangible, to working out their tax relationships among themselves.

One more word about United States tax treaties with less developed countries. The United States long ago put itself at a distinct handicap in negotiating with these countries when, by statute, it unilaterally extended the foreign tax credit to all the countries of the world, and then more recently when it unilaterally added to the value of that credit through the adoption of the over-all limitation. We unilaterally avoid the adverse consequences to another country of the double taxation of our traders and investors. What is more, through the over-all limitation we even protect a foreign country whose tax rates applied to income from that country achieve levels considerably above international norms. However, when these negotiations turn to talk of who is conceding more and the like, the less developed countries will often dismiss our allowance of the foreign tax credit as any concession at all to be weighed in the negotiations, since it is already in our Internal Revenue Code. The United States thus enters these negotiations with a most valuable card removed from its hand. Other industrialized countries are not so handicapped: Sweden and Germany, for example, do not have fully worked-out unilateral statutory relief against double taxation and hence their treaties are needed to give this benefit fully to the developing country. Few European countries, if any, use the over-all limitation.

We were not so profligate in the Foreign Investors Tax Act of 1966 when we unilaterally reduced the weight of our estate tax and restricted the scope of our income tax as respects foreigners with interests in the United States. For we there provided that the President could return to the former rules with respect to a particular country if he found that the country, when requested to do so by the United States, had not acted to make its taxes no more burdensome on our nationals than those we imposed on its nationals.

As a consequence we might well ponder whether the goals of the United States, and equally the goals of your organization in achieving those international accommodations by other countries that will be of benefit to your members in their investments and trade abroad, would not be further advanced

by some approach under the foreign tax credit that would operate to give the United States a better negotiating position -- that would let us keep in our hand a card representing extension of the foreign tax credit. For example -- and just as an example to spur further thought on this subject rather than a proposal -- using the analogy to the Foreign Investors Tax Act, our Code might perhaps provide that the President could withdraw the benefits of the over-all limitation from a country which, when requested to do so, did not desire to include in a treaty rules compatible with what we regard as generally accepted international standards. While this could have an effect on our investors, and it could therefore be restricted to new investment or maybe new investors in the foreign country, the motivation is clearly not that but rather to obtain a better bargaining position that would assist all of our investors and traders by permitting the United States to more readily achieve proper tax treaties and proper international accommodations. Indeed, once this authority were given to the President, I very much doubt that he would be required to exercise it. There may be other approaches to this problem. I assure you that our negotiators would welcome suggestions that would lessen the handicap they -- and in turn your members -- now bear in achieving appropriate treaties.

ESTATE TAX TREATIES

In the Foreign Investors Tax Act of 1966 the United States provided a unilateral posture for our estate tax that resembles the situation regarding our income tax as respects foreigners with interests in the United States. We now have a reasonably moderate estate tax structure at rates lower than our domestic rates(but without the marital deduction) that in this sense compares with our 30 percent withholding rate and its relationship to our regular income tax rates. We have jurisdictional rules which permit us to tax all United States interests that foreign decedents may own -- land, stock of United States corporations, obligations of United States corporations, bank deposits, and so on -- just as we possess jurisdictional rules under the income tax that enable us to assert our proper claims as a source country.

Under the income tax, through treaties following an international pattern as evidenced in the OECD Model, we have where appropriate reduced the level of our 30 percent withholding tax and limited the assertion of our jurisdiction to tax at source in return for reciprocal treatment. We have, however, confined these steps to countries that possess responsible income tax systems and which grant a credit for any income taxes we might impose. As a consequence, our relinquishment of source jurisdiction does not result in our becoming a tax haven for foreigners. Rather, our concessions either lower our effective rates to an appropriate international level or simplify the tax aspects of trade and investment even where our tax would be fully creditable -- and thus yield revenue to the foreigh Treasury -- in return for similar concessions. Where our concessions at source have turned out in practice to make us into a tax haven, we have moved to eliminate this defect in our treaties -- as in the case of the Netherlands Antilles and Canada.

We now face similar issues under the estate tax. The OECD Model Estate Tax Convention, for example, provides that the country of source shall yield its estate tax on the decedent's investment in its stocks and debt obligations and thereby confines jurisdiction to tax in this situation tothe country of domicile of the decedent. The United States reserved its righs under that provision, however, and has yet to determine the approach it will take. It may well be that, in order to remove needless barriers to investment in the United States, it would be proper to follow the OECD Model where the result would not turn us into a tax haven. This approach could require that the other treaty country have an estate tax at a level resembling our rates at source and enforced that tax on the estates of its decedents with assets abroad. The United States is now entering upon estate tax negotiations -- with Sweden for example -- and the OECD Model will necessarily be considered in these negotiations. We are thus giving thought to the approach that the United States should take as it expands and modernizes its network of estate treaties.

SECTION 482

We may next turn to an aspect of international tax relationships that under our tax system -- and the tax systems of all other countries as far as I know -- is principally dealt with by tax administrators working under a general statutory mandate. This is the aspect of the proper allocation of income and expenses between entities under a common control -- in the international situation typically a parent-subsidiary relationship with the parent corporation in one country and the subsidiary corporation in another. Our Code Section 482 provides that in any case where two or more organizations are owned or controlled by the same interests, the Secretary of the Treasury or his delegate may allocate income and deductions among the organizations if he determines that this action is necessary to prevent evasion of taxes or clearly to reflect the income of any of the organizations. Our tax treaties also have provisions which look to such an allocation.

The mandate is a broad one, and necessarily so, for the provision is vital to the integrity of an income tax. But we must be careful to recognize clearly the reasons for this provision, and more especially the reasons why particular taxpayers may present a situation in which a tax administrator must ask himself whether potentially a Section 482 check is in order. The salient fact is that a taxpayer worry about the section is almost a symbol of status, for a Section 482 worry is generally the price of possessing a tax preference.

As an example, the main corporate worriers about the rules of Section 482 in a totally United States domestic setting are those corporate chains which exploit the preference permitted by multiple surtax

exemptions. Since they live in a tax world where the exploitation of that preference requires as careful an adherence as possible to the mathematics of the $25,000 per corporation exemption, they must constantly seek to distribute income and expenses among the corporate components in keeping with that mathematics. Thus, a parent corporation furnishing goods, services, or funds to the subsidiary components in the chain must hold its charges low to avoid itself obtaining a large amount of surtax income. And so Section 482 becomes a worry for these groups. If we had a rational application of the surtax exemption and did not permit multiple exemptions, then their preference would end -- and so would their worries over Section 482. But since they seem to prefer their Section 482 worries to a yielding of their preference, they can hardly be heard to complain that the Internal Revenue Service considers them proper potential for careful Section 482 scrutiny.

The preference analysis is also applicable to the international scene, for here also most Section 482 allocations come only because the taxpayers have preferences that others do not possess. I am not using "preference" in any deprecatory sense, but rather to describe situations in which there is the ability to reduce the over-all tax compared to those taxpayers without the preference. In general, the international preference comes about because while one componenet, the parent, is subject to our 48 percent corporate rate, the other components, its foreign subsidiaries, are not subject to that rate but to the rates of tax in the foreign countries in which they are located or operate. Where those foreign rates are substantially lower or nonexistent, the preference is quite marked. A similar preference exists where a domestic Western Hemisphere Trade Corporation is used, since its tax rate is 14 percentage points below the regular United States corporate rate.

The mathematics of these tax preferences has a compelling attraction and there is thus the potential for Section 482 application. If corporate treasurers never joined forces with their tax departments to obtain the maximum tax savings that all combinations of rates, source of income, and allocation of expenses might provide under these preferences, then the need for Section 482 application would be greatly reduced. But we have heard no responsible person or group say that the Internal Revenue Service may place Section 482 on the shelf in the international area. On the contrary, Internal Revenue Service settlements, court cases, and the theories of a number of tax advisors all bear witness to the fact that the mathematics of the preferences can for some govern the allocation of income and expenses. And private research studies show that some major companies even have one set of allocations to permit management control of their international business, but another set of allocations to squeeze the tax benefits from the preferences.

The factor of a tax preference in creating the potential for a Section 482 scrutiny is clearly evident in the controversies that do arise. The two major court decisions involving the inter-company pricing of goods, Eli Lilly and Johnson Bronze, both concerned transactions between United States manufacturing companies and their Western Hemisphere Trade Corporation affiliates. Virtually all the pricing cases currently in the National Office of the Internal Revenue Service for technical advice involve either Western Hemisphere Trade Corporations or tax haven subsidiaries. If these cases are representative of the field cases, there has been far more realistic pricing of goods where no tax differential exists and as a consequence no Section 482 controversy.

Certainly the Western Hemisphere Trade Corporation and the tax haven situations are open invitations to temptation: if the manipulation is undetected or if a favorable "compromise price" is worked out on audit, the consequent lowering of price to the subsidiary results in after-tax savings. If the shifting is fully corrected on audit, any adjustment of price will usually simply mean a loss to the taxpayer of 6 percent interest (3 percent after tax) as the United States tax on the parent goes to its proper level -- there is no fear of double taxation through inability to make a correlative adjustment in the Western Hemisphere case (assuming it, itself, is not subject to tax abroad) and no need for one in the tax haven case.

All this being so, the task of the Internal Revenue Service, and indeed of any tax administration, is how to achieve a rational administration of Section 482 where there is a considerable potential area for its application, where some companies sufficiently serious in number take unwarrented advantage of the situation created by the preferences, but where every company cannot and should not be carefully scrutinized and its activities second-guessed just because those who yield to temptation are mixed among the throng. One key to sensible administration in these circumstances is to provide those concerns which seek no unwarranted advantage with the standards that the Service is using to identify the others. Another key is to utilize standards that are sensibly tolerant of the very wide variety of transactions, patterns of business conduct, and investment and trade situations that are clearly present in international activities.

This analysis leads inevitably to the provision of guidelines for the application of Section 482, as well as those sections bearing a relationship to it, such as Sections 861 and 862 involving the allocation of expenses in determining taxable income from foreign sources. But the analysis takes us still further, for it also points to the premises on which those guidelines must be formulated. We believe that the guidelines must adhere as closely as possible to management and accounting standards developed to achieve the same goal -- that of proper allocation of items among the constituent components of a business enterprise.

This adherence has two distinct advantages: First, it will keep tax administration within the mainstream of the developments regarding these management and accounting standards. These standards are constantly being improved by management experts, accountants, and others under the pressure of meeting a variety of needs and concerns affecting these multi-component enterprises. Thus, central management can keep control of the performance of its components -- and evaluate their activities and reward their managers -- only if it has tools that are sufficiently developed to provide proper allocations of items of income and expense among the components. As another example, where one part of an enterprise is subject to Government controls -- because for example it involves public utility regulation or Defense contracts -- not applicable to the other parts, then the same tools of allocation are needed. Developments in accounting for conglomerates will similarly need such tools.

Second, the use of these management and accounting standards will provide the United States with a rational, consistent approach to international transactions which it can use for all the forms those transactions may take. We must not forget there are two sides of the coin. Many groups focus on the side of the coin involving a parent in the United States transferring goods and services to its subsidiaries abroad. But on the other side of the coin are corporations involved in extraction or manufacture abroad and the transfer of materials or goods to the United States -- they may be subsidiaries of United States corporations or they may involve foreign parents and their United States subsidiaries. These two sides of the coin underscore both the need for consistency and the care required in the formulation of appropriate rules. We have our exporters of goods and our importers of goods; we have our manufacturing industries operating at home and abroad; we have our extractive industries obtaining their raw materials at home and abroad; we have service, shipping transportation, financing, and construction industries operating across international borders; and so on. Section 482 guidelines applicable to all these activities, all of which exhibit the two sides of the coin, must be formulated in a non-discriminatory manner that permits the United States to maintain the necessary consistency of position no matter which side of the coin turns up or where it does so. Indeed, the allocation provisions, the competent authority provisions, and the non-discrimination provisions in our treaties all require this objective, even-sided approach to these guidelines.

This matter of allocation is thus not to be viewed as a typical skirmish between taxpayers and the Internal Revenue Service, involving only the typical parochial interests that normally color such skirmishes. On the contrary, its proper resolution is a challenge to the vision and statesmanship of those who speak of the present and coming stature of the "multinational corporation." Their insights have already led them to recognize the importance of this form of business organization in the evolution of the institutions of the modern world. But clearly a part of this institutional role will be an appropriate allocation of the profits of these organizations among the various countries touched by their business activities, and thereby a fair sharing among these countries of the tax revenues to be derived from those profits.

Those who are concerned with shaping the institutional character of these multinational corporations should therefore not shy away from this challenge, for its resolution is crucial to the stability of their business planning and the achievement of maximum freedom from dispute and controversy with sovereign governments. They should not be bemused or diverted from facing the problem by attempts at legal smokescreens, such as the argument that Section 482 does not permit the Service to create income where none exists or the argument that Section 482 does not apply between related foreign corporations.

They should also recognize the constraints that apply in developing tax rules for this allocation. Tax disputes involve concrete cases to which a specific dollars and cents answer must be given at the end of the road. Hence accounting rules and techniques must be rephrased as tax rules in which the specific dollar results do count and in which details as well as principles must be decided by some one. The attempt to provide Section 482 guidelines is thus an effort designed to permit Government and business to think through these principles and details as broadly and thoroughly as possible, foreseeing as far as possible the issues that may arise and their ramifications. The guidelines should be designed to guide -- to represent the solutions to problems achieved after careful thinking at top levels of business, the professions, and Government, rather than leaving the individual Internal Revenue agents to raise and solve problems on their own. This does not mean every detail must be set forth in guidelines, for intelligent discretion at the agent level is an integral part of tax administration. But it does mean a recognition that tax allocation problems do involve many matters of substance and principle and important detail that demand a coherent and thought-through set of answers, rather than a seat-of-the-pants, "let's decide each case on its facts" approach.

We must emphasize that the guidance here sought is guidance both before and after, so to speak. It is, of course,guidance to Internal Revenue agents as to what to look for and what not to look for, and what to decide when issues evolve. But it is also guidance to business on how to minimize possible dispute and controversy over the tax return and how to achieve a stability in business planning and arrangements that will not be upset, maybe years later, when that inevitable Internal Revenue Service audit comes along.

With all this in mind, just where are we in our consideration of the proposed Section 482 Regulations embodying these guidelines? For the past several months a group from the Treasury and the Internal Revenue Service has been concentrating on the comments presented with regard to the proposed Regulations. Every comment submitted by taxpayers has been read and a 200 page summary of the criticisms and alternative approaches has been prepared and carefully analyzed. The process of revision of the proposed Regulations is well underway, with many of the suggestions made at that hearing adopted and already incorporated. We are hopeful of final revision within the next few months.

The comments at the last hearing dealt mainly with the subject of inter-company pricing of goods -- a matter not on the agenda at the first hearing. Part of the concern in this area may stem from the amounts that can be involved in price adjustments, the frequency of transactions involving the transfer of goods between related organizations, and the problems involved in establishing transfer prices. The concern for some companies also stems from the aspect of correlative adjustments in the tax of the foreign country applicable to a related foreign subsidiary, an aspect which I will discuss later. At the risk of appearing negative, let me indicate why we find difficulties in some of the approaches suggested at the hearing.

A typical suggestion is that the Regulations should supply a "mechanical safe haven" in the area of the pricing of goods. Much as this solution appeals as blissful to our tax administration as to the taxpayers who suggest it, we have not taken this route. The reason is that no satisfactory device has yet been suggested or worked out. The variation in profit margins from industry to industry, among companies within an industry and even among product lines within a company is much too great to permit a single percentage, or a series of percentages, as mark-ups or mark-downs in establishing transfer prices. The recognition of this problem has led other taxpayers to urge just as strongly that we do not provide a mechanical safe haven. They realize how unrepresentative that safe haven may be and they fear that in practice all territory outside the safe haven will be heavily mined for taxpayers. The "safe haven" here will therefore have to lie in a sensible, reasonable administration of the Regulations themselves.

Nevertheless, we should not, after the Regulations are adopted, give up the search for more precise standards. Consideration should be given to framing a number of possible approaches and then testing them in a sample of actual cases to see what results they would have achieved compared with the actual adjustments.

Another set of suggestions relates to the point of view that the only appropriate test of transfer pricing should be its "reasonableness." These comments have been phrased in a number of ways, but essentially they suggest that no Section 482 allocation be made where the price is "reasonable," or where the seller makes a "reasonable profit," or where the total profit earned by related entities is divided among them on a "reasonable basis." While the test of reasonableness has its uses in some situations, in this area it is not sufficiently precise to provide guidance -- reasonable by what or by whose standards? Nor is the approach substantively accurate, since the basic arm's length standard underlying the section is not directly related to a reasonable profit figure for the parties involved. The arm's length standard is designed to determine the price or charge that the parties would have arrived at assuming they had dealt with each other as independent unrelated entities -- and this could mean no profit at all or indeed a loss in some cases. In essence, this suggestion for a safe haven of "reasonableness" has the same deceptive attractiveness as a mechanical safe haven. But just as in that case, its superficial appeal does not on analysis withstand its potential for real unfairness among taxpayers.

But there is a place for the concept of "reasonableness" in these Section 482 Regulations -- and it lies in the way the guidelines should and will be applied. We expect these guidelines to be applied in a reasonable manner by taxpayers. They, in turn, have a right to expect a reasonable interpretation and application by the Internal Revenue Service. The Commissioner has several times in recent statements stressed that this will be the approach of the Service. He has said that the guidelines will be administered in an understanding and sensible manner. He has stated that this policy is being emphasized in the agent training seminars and other instructions to Service personnel. This will be our use of "reasonableness."

When we turn to more substantive comments and to the other parts of the guidelines in addition to transfer pricing, we should first note that virtually no criticism was received on a conceptual basis. It is not seriously questioned that the clear reflection of income requires charges to be made for benefits received. Interest for the use of money, rent for the use of property, royalties for the use of intangibles have become such basic concepts that they are no longer seriously questioned. Some aspects of the guidelines have been criticized, however, on the ground that they are ahead of our time and that we are requiring business to meet impossible or unrealistic standards.

This is not our objective and we do not feel that this is basically the case. The guidelines, and the allocation rules they contain, utilize known and accepted applications of accounting principles. We have not been referred to any instance in which the guidelines are in conflict with generally accepted accounting principles. We do, of course, recognize the limitations in these guidelines in terms of furnishing absolute or precise answers. However, as accountancy continues its development and as our management and other analytical tools become more refined, the guidelines will also benefit. Indeed, as stressed earlier, we recognize there is much to be gained by using current accounting concepts and management techniques as the foundation for these guidelines, so that they can share in the progress to come in these areas.

We can look at the relevance of the guidelines to current practices in another way. We hear on many sides that one consequence of the guidelines has been that many companies have begun to look at their foreign operations with a more realistic and objective appraisal. We understand that the results have been quite instructive. Apparently, many corporations in riding the wave of the future in international business and in establishing foreign activities consciously or unconsciously favored their foreign enterprises. As a result these foreign subsidiaries showed a fine profit picture. But now a more careful appraisal, prompted by the stress placed on arm's length concepts in these guidelines and the attention they have called to the management techniques that do exist to that end, has shown that in many cases this profitableness is but the reflection of a considerable generosity on the part of the United States parent. A foreign subsidiary can compile an attractive profit showing if it is not charged for the services it receives or the financing it obtains, or if it receives its goods at cost figures. As the Journal of one accounting firm states, the guidelines may provide an unexpected benefit to some United States companies by

> "exposing to them the true cost of their international operations, which they have not always appreciated. Companies that manage their United States operations very profitably, but are new to the international field, frequently have to pay well for their education in that field. There seems to be a tendency to conceal from oneself the cost of the education, particularly if it is embarrassingly high."

All of this underscores our desire to keep these guidelines within the mainstream of accounting principles and management techniques.

A number of comments at the hearing related to the pricing standards set forth in the guidelines. These comments indicate some misunderstanding as to our intention regarding those standards and also deficiencies in the proposed Regulations in communicating that intention.

The proposed Regulations require taxpayers and revenue agents to test inter-company prices against the arm's length standard of Section 482 by using one of three approaches. The first approach is the comparable uncontrolled price method under which the price charged to a related entity must be similar to the price charged in comparable transactions with or between independent third parties. The second approach, applicable to the situation in which the related purchaser acts as a mere distributor with respect to the goods, computes the transfer price by taking the price which such distributor charges to third parties and reducing it by the appropriate mark-up for a distributor operating under the same circumstances. The third approach is the cost-plus method under which the seller must charge related entities his full cost, plus an appropriate profit margin. There is, in addition, a so-called "fourth method" which is applicable only in situations in which a taxpayer has been using a method different from the three listed above and which the Commissioner finds is clearly more appropriate.

There appears to be a certain amount of confusion with regard to the "priority" of these methods. The priority of application rule, which calls for an application of the methods in the order they are set forth, is not intended to be an arbitrary listing of preferences among methods which might yield varying results. The fundamental arm's length standard involves a determination of the price which would have been arrived at by independent, unrelated entities entering into the same transaction. The priority of application rule simply states the approach for obtaining the most relevant evidence to establish that price. Clearly, a price arrived at in a truly comparable third party sale is the best evidence of such a price -- it is the direct way to meet the arm's length standard. We are therefore examining the feasibility of broadening this method to allow a greater range of adjustments to comparable transactions to permit arriving at a comparable price. The resale price

method and the cost-plus method are indirect ways to approach the arm's length standard, and hence less likely to achieve that end than the direct route. The resale price method is placed ahead of the cost-plus method in the order of priority since it is felt that in the limited distributor situation to which the resale price method is applicable -- where the buyer does not add significant value to the product or employ significant intangibles in its resale -- a distributor profit more clearly reflects the function of the buyer-reseller and, therefore, the income of each of the parties to the transaction.

These priorities thus reflect evidentiary guides. Under the priorities, a taxpayer is protected from an arbitrary choice of method by the examining agent, and has the assurance that the most relevant evidence will be taken into consideration in arriving at an arm's length price. But some taxpayers apparently would like to place their bets on method three or method two and use only that approach. They may have followed that approach in establishing their prices, or they now see it as the appropriate way to support the prices used. In such situations, one would expect the examining agent, as a sensible precaution, to check the result obtained under the methods higher in the priority scale. If the check shows a marked variation from the method chosen by the taxpayer, then an explanation would seem in order; if not, then the taxpayer's price should not be disturbed. This seems to be a sensible way to handle the three methods that are recognized as having the widest application.

There have also been comments directed at the "fourth method." This method has a limited scope under the proposed Regulations, since the method to qualify must be actually used by the taxpayer and the Commissioner must feel that it is "clearly more appropriate." Some companies have requested, in the light of their own pricing practices, that they be allowed to use a variety of methods in setting prices which they feel are not prescribed by the proposed Regulations. Some of the methods are merely variations of the specified approaches; others are based upon different premises. Where such pricing systems will yield results which are substantially the same as the prices which would have been arrived at under

the Regulations, it would seem to be in the interest of both taxpayers and tax administrators to apply prices based on such systems. Of course, if such prices do in fact meet the arm's length standard, the method by which they are derived makes no difference. There is, however, a feeling among some taxpayers that the system that they follow in arriving at a price should be specifically blessed in the Regulations. This can hardly be done without allowing a proliferation of described methods, which in turn reduces the over-all guidance which these Regulations must develop in order to accomplish their avowed purpose; certainly the taxpayer whose method is left out of a long list would wonder where it stands. But, on the other hand, we are aware of the narrow focus in the proposed Regulations, and to the extent feasible will make the "fourth method" broader in its application and clarify its relation to the other three approaches.

Another set of comments -- again resulting, we believe, from some misunderstanding and a lack of clarity in communication -- relates to "marginal pricing." The guidelines are intended to achieve the following results in this area: Under the comparable uncontrolled price method, to the extent that marginal pricing is used to establish or to maintain a market, such pricing is proper under the guidelines if the buyer-reseller engages in additional expenses, such as promotional expenses or if the reduced prices are passed on to a third party. Further, if the parent company uses incremental costing in arriving at the price charged to unrelated parties, such prices may be charged to related parties in comparable circumstances. Thus, to the extent that reductions in price to third parties are based on a marginal or incremental approach, such pricing to a foreign subsidiary is allowed under the comparable uncontrolled price method. Similarly, if a foreign subsidiary of the United States parent could purchase goods at a certain price from third parties, the United States parent manufacturing company could sell at the same price under comparable circumstances.

Some comments seek to clarify the application of the guidelines where the related corporations are engaged in a number of transactions falling under Section 482, such as the transfer of goods to a subsidiary alongside the receipt of royalties from that subsidiary. We do not intend that Section 482 interfere with normal commercial transactions.

That section is designed to assist in policing the United States income tax system, and is not cast as a guardian with universal jurisdiction. Valid business reasons may require that transactions be framed in different forms than the simplest possible accounting technique would dictate. In transactions between unrelated parties a price reduction might often be offset by an increased royalty or other charge. The proposed Regulations recognize this and provide for "set-off" computations in certain situations. This device is circumscribed in the proposed Regulations to prevent audits from becoming interminable. In addition, care must be taken to prevent unwarranted switching of sources of income and to properly account for additional foreign taxes. But we do recognize the need for flexibility in this area, and are examining the Regulations with the aim of making this relief available to taxpayers to the extent feasible on a less restrictive basis.

Other areas of the proposed Regulations are, of course, also being reviewed. Few taxpayers objected to the provisions allowing most services to be charged at cost. There is thus no question that incidental services will not have to be charged at a profit. However, there will have to be some clarification with regard to what services are, in fact, "incidental" and on our own account we are reviewing this matter. Some taxpayers have expressed concern that the "full cost" requirement in the service area would yield inappropriate results. It must be noted that all safe havens, including the service charge at cost, are secondary in order of priority to an arm's length price. If a computer were used at only a fraction of its full capacity, a proportionate share of full cost would, in all probability, result in a very high charge to a related party. However, since many computer users are able, on an arm's length basis, to acquire such services on a share-time or incremental basis, the appropriate arm's length charge would be a charge based on such comparable prices. A safe haven is not binding on the taxpayer in any area and clearly would not be appropriate in a situation such as the one described. We have created safe havens to reduce uncertainty wherever possible. The taxpayer, however, is not confined to the safe havens -- he can always use the arm's length standard to support the amount of the charge.

We recognize that the valuation of intangibles and the determination of an appropriate charge for their use present extremely difficult problems. For this reason, the proposed Regulations developed a "safe haven" cost sharing arrangement in an attempt to eliminate many of the valuations which would otherwise be required. There are refinements which can be made in the comprehensive scheme outlined in the Regulations. For example, one of the principal problems remaining is the requirement that the use of previously developed intangibles be valued. We have discussed various alternatives to this extremely difficult task with industry representatives and members of the legal and accounting professions. We hope that together we can develop a satisfactory alternative which will eliminate this valuation problem. We have discussed cost sharing with representatives of foreign governments, attempting to impress upon them the need for such a system and the fact that in most cases it would result in smaller inter-company charges that would otherwise be required. There were objections to the safe haven formula for tangible property rentals contained in the proposed Regulations. The formula, which was tied to the depreciation method used by the lessor, resulted in undesirable variable rentals in many situations. We are developing a modified formula that will yield level rentals in conformity with normal commercial practices.

So far we have been discussing the substantive content of the Section 482 guidelines, developed under our Internal Revenue Code standard. These guidelines are United States rules intended to minimize controversies arising under United States tax returns and to resolve those disputes that do arise. But these United States rules are being applied to international transactions and we clearly recognize that they affect entities which are under the jurisdiction of other Governments. As a consequence the correlative adjustments which are integral to Section 482 allocations are under the control of those Governments. If those adjustments cannot be made, then Section 482 allocations by the United States can have consequences different from allocations affecting an entirely domestic situation.

This aspect of the application of Section 482 has led to another set of comments that merits careful consideration. This is the suggestion that no Section 482 scrutiny or adjustment need be made if the subsidiary is located in a country where the tax rate is approximately the same as that of the United States. The suggestion has support in actual practice, for as indicated earlier, Section 482 issues presumably are rarely raised by the Internal Revenue Service in inter-company pricing cases where this circumstance exists -- which leads one to conclude that the companies themselves are here more careful to prevent their pricing from being suspect under Section 482. Indeed, tax motivation will here rarely be a controlling factor, for little is to be gained from the standpoint of tax saving by a departure from arm's length pricing. This situation is the exception to the earlier observation that a Section 482 worry is the price paid for a tax preference.

We recognize that even in a situation in which no tax reduction or avoidance motive exists, the possibility of price adjustments may cause apprehension to management. Moreover, we are not unaware of the many difficulties involved in setting prices. We are aware of the fact that the proposed Regulations provide guidelines and not final answers. We understand that it can be difficult for even the best intentioned taxpayer to arrive at a price for a particular product which could not be challenged under any conditions. Under these circumstances, the apprehension for such a taxpayer with respect to a Section 482 allocation -- and hence its care regarding its pricing -- can lie in the fact that if a Section 482 adjustment is made, the company runs the risk of not being able to achieve a correlative adjustment in the other country, with the consequences of double taxation and a considerable tax cost.

We do not intend this result. At the same time, we must remember that the statutory standard of Section 482 is a dual one: to clearly reflect income as well as to prevent the avoidance of tax. The standard is indeed a part of the process of determining the real profitability of foreign activities, a subject mentioned earlier. In the international context the standard of "clearly reflect income" also goes beyond the allocation of income to the right company and really involves the allocation of income to the right

country. It is the standard by which the United States protects its sources of revenue and its tax system from the encroachments and claims of the other countries affected by the transactions. As a consequence, the issue is more than a dispute between taxpayer and the Internal Revenue Service and becomes one of international accommodation. It is thus more important and more complex than domestic Section 482 issues.

But, as stated above, for the taxpayer involved in a Section 482 allocation in a setting where the tax rate in the foreign country is around the level of the United States rate, the focus will be on the double taxation that will result if the correlative adjustment is not made. How can this possibility of double taxation be avoided or minimized?

A part of the approach lies in Revenue Procedures 64-54, which for taxable years through 1964 permits the foreign tax on the allocated item to be credited against the increase in United States tax resulting from the allocation. In effect, the United States itself is making the correlative adjustment. This international generosity can be justified on the ground that taxpayers may not in those years have had an adequate appreciation of the Section 482 rules now being applied. But any such international generosity carried into the future would simply be a complete concession by the United States that other countries may unilaterally assert any jurisdictional rules they desire and the United States will always hold its citizens harmless at the expense of our revenues. For if the United States is to relieve the double taxation that results from a failure of the foreign country to make the appropriate correlative adjustment, then what is to keep foreign countries from simply deciding not to make correlative adjustments? No sovereign country can give this blank check to the rest of the world, and we know of no country that does so. As the size and importance of international business increases, the need for each country affected by a transaction to secure its fair share of the profits produced also increases. The United States should not be called upon to forego its share of the tax on the profits generated by international business.

If, when a Section 482 adjustment is made, the other country will make the correlative adjustment -- in effect agreeing with the allocation -- then the taxpayer is not subject to double taxation. We have asked taxpayers to keep us advised of instances where the correlative adjustment is not made by the foreign country, and have so far been quite encouraged by the absence of negative reports. Moreover, many of our allocation cases, though not many of our pricing cases, concern transactions with Canada, a country with a sophisticated tax administration and a long familiarity with close administrative cooperation between the respective Revenue Services. It is, moreover, a country whose present statutory treatment of foreign income is such that its only real defense to the exploitation of tax havens is the use of tax allocation rules. As a consequence, in a generally successful effort to protect its revenues it has achieved full awareness of the techniques of allocation.

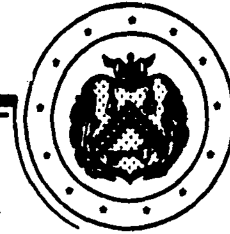
In addition, our recent tax treaties -- for example, the United Kingdom, Germany, France, Netherlands -- contain a provision expressly providing for consultation to achieve agreement in the case of any initial difference between the countries on the allocation. Also, the treaties expressly provide that when the agreement is reached, the correlative adjustment will be made. Moreover, the refund arising from the correlative adjustment will be paid despite any running of the statute of limitations or other procedural barrier to the refund. No country with which we have recently negotiated has refused to include this provision. Finally, we are examining our own "competent authority" procedures and in the OECD Fiscal Committee are consulting with other Governments on these procedures generally, so as to improve the processes of administration under the treaties.

We are thus acting to strengthen international cooperation looking either to the making of the correlative adjustment on the assertion of an allocation by one country or to the modification of that adjustment through mutual agreement in response to the views of the other country. We are also acting to achieve substantive agreement among the countries on the principles and rules that should govern international allocations. As a result of our request, the OECD Fiscal Committee has begun the consideration of this area and has given it a prominent place on its agenda.

I do not want to imply by this discussion of Section 482 in its international setting and the steps being taken to achieve an appropriate response from other countries that we expect many Section 482 adjustments in transactions involving high rate countries. As stated earlier, our impression is that there are very few cases relating to inter-company pricing of goods where the subsidiary is in a high-rate country. Further, with guidelines established and with the effort now being made by most companies to more carefully watch their inter-company transactions, we would not expect many Section 482 adjustments in the remaining areas. Our efforts to obtain proper international accommodation are directed to achieving the proper result and preventing double taxation in the relatively few cases that may occur.

There are thus firm grounds for expecting that governments can achieve international allocations that are both fair to the countries concerned and avoid double taxation consequences to the taxpayers involved. The steps to this end are, of course, not ready-made. We have only to remember the problems and difficulties associated with interstate allocation of taxes within the United States to dispel any such illusion. But we must also remind ourselves that through devices such as foreign tax credits and treaties, countries have probably been more active in achieveing international harmony than is often the case with respect to internal tax matters. The United States Government is thus hopeful that its tax system and those of other countries will continue in their international relationships to produce the harmony that is conducive to the continued development of trade and investment in the world.

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 1, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $2,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing November 9, 1967, in the amount of $2,400,354,000, as follows:

91-day bills (to maturity date) to be issued November 9, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated August 10,1967, and to mature February 8,1968, originally issued in the amount of $1,000,492,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated November 9,1967, and to mature May 9, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Standard time, Monday, November 6, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Treasury Department of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on November 9, 1967, in cash or other immediately available funds or in a like face amount of Treasury bills maturing November 9, 1967. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, does not have any exemption, as such, and loss from the sale or other disposition of Treasury bills does not have any special treatment, as such, under the Internal Revenue Code of 1954. The bills are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States is considered to be interest. Under Sections 454 (b) and 1221 (5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is not considered to accrue until such bills are sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained fr any Federal Reserve Bank or Branch.

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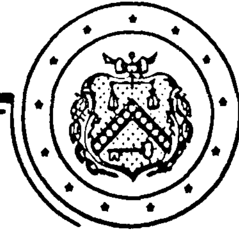
TREASURY DEPARTMENT



WASHINGTON, D.C.

IMMEDIATE RELEASE November 1, 1967

RESULTS OF TREASURY'S CASH OFFERING

Reports from the Federal Reserve Banks show that subscriptions total about $15,640 million for the offering of $10,700 million, or thereabouts, of 5-5/8% Treasury Notes of Series A-1969, due February 15, 1969, and $14,124 million for the offering of $1,500 million, or thereabouts, of 5-3/4% Treasury Notes of Series A-1974, due November 15, 1974. Subscriptions accepted amount to about $10,734 million for the notes of Series A-1969 and $1,636 million for the notes of Series A-1974.

The Treasury will allot in full, as provided in the offering circulars, subscriptions of $7,577 million for the notes of Series A-1969 and $136 million for the notes of Series A-1974, from States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, Government Investment Accounts, and the Federal Reserve Banks where the required certification of ownership of notes maturing November 15, 1967, was made.

On subscriptions for the notes of Series A-1969 received subject to allotment, the Treasury will allot in full those up to $100,000 and other subscriptions will be subject to a 36 percent allotment with a minimum allotment of $100,000 per subscription. These subscriptions total $5,099 million from commercial banks for their own account and $2,964 million from all others.

On subscriptions for the notes of Series A-1974 received subject to allotment, the Treasury will allot in full those up to $100,000 and other subscriptions will be subject to a 7-1/2 percent allotment with a minimum allotment of $100,000 per subscription. These subscriptions total $6,865 million from commercial banks for their own account and $7,123 million from all others.

Details by Federal Reserve District as to subscriptions and allotments will be announced later this month.

F-1071

TREASURY DEPARTMENT
WASHINGTON, D. C.

HOLD FOR RELEASE UPON DELIVERY

EXCERPTS FROM REMARKS
BY THE HONORABLE EVA ADAMS
DIRECTOR OF THE MINT
BEFORE THE
EXECUTIVES CLUB OF CHICAGO
CHICAGO, ILLINOIS

12:30 P. M. CST
FRIDAY, NOVEMBER 3, 1967

Increased Coin Production

We in the Mint always like to feel that we enjoy a very close relationship with the public because our products are so dear to all of you.

And whether you realize it or not, each and everyone of you do play an important role in the minting of United States coins. Our most recent statistics point to the fact that the United States is producing over 40 percent of all the coins made in the free world.

I would like to mention that I have just had the pleasure of visiting the Mints in several European countries, and I can tell you that while I was tremendously impressed with their facilities, I am convinced that ours is the most efficient and economical coin producing industry of all.

Our production figures reflect a two-fold purpose. First of all, we have produced sufficient coin to overcome a nationwide coin shortage. And I don't have to tell any of you the effect a coin shortage has on a nation, because you here in the Chicago area were one of the first to feel the effects when it all began as far back as 1963.

I can promise you that our coin production will and must keep pace with a continually growing and expanding economy. As you know, beginning this month, we are witnessing the longest recession-free expansion of the history of the United States economy. An adequate supply of coin is a prime ingredient necessary for this continued expansion.

Second, our production figures reflect the change-over from the 900 fine silver coins to the cupro-nickel clad coins.

When the Coinage Act of 1965 was passed authorizing the new clad coins, the policy of the Treasury was that the Bureau of the Mint should produce as many of the new coins in fiscal 1966 and fiscal 1967 as possible, with a view to replacing all outstanding subsidiary silver coins that were necessary during a 2-1/2 year period.

Now let's look at what has been done. From July, 1964 to July, 1967, we produced over 24. 9 billion coins. As for clad coins alone, we made over 355 million halves, 3. 5 billion quarters and 4. 6 billion dimes.

While the emphasis was on clad coins, we did not neglect production of minor coin, nickels and cents. Production of cents in calendar 1966 increased about 20 percent over 1965.

All of the extra effort undertaken to achieve record production levels at the Philadelphia and Denver Mints, plus assistance from the San Francisco Assay Office, has let us develop ample coin inventories for all denominations but half dollars.

According to reports reaching my desk, I can now assure you that the coin shortage is over, and despite the heavy demands during the coming holiday season, we have enough coin to go around.

On the basis of coin production and the success of the clad coins in circulation, the Treasury and the Federal Reserve Banks have been able for some time to accumulate circulated coin in inventory, while releasing newly-produced clad into circulation. The Treasury and the Federal Reserve plan to separate this circulated coin, with the clad returning to circulation and the silver going into Mint inventory. As you have probably read, the Treasury is considering melting some of these coins beginning next year.

I would like to add here that without the excellent cooperation from the Federal Reserve System, the Mint could not have produced and circulated the clad coins in sufficient quantities to eliminate the acute shortage in such a short period of time. The Federal Reserve is continuing this cooperation with our coin program.

We are at the present time awaiting delivery of machines to do the separating by using the latest available electronic equipment.

We expect to recover over 250 million ounces of silver from these 900 fine coins by the middle of next year. Added to the estimated amount remaining after the demonetization of silver certificates, the Treasury should have between 350 to 425 million ounces of silver on hand by next June 24.

The President's Joint Commission on the Coinage, of which I am a member, is keeping a close watch on the coinage and silver situation. As you know, this Commission has already made a number of recommendations concerning silver policy which have been put into effect.

Any reference to our clad coins would not be complete without acknowledging the assistance given us by private industry. In fact, many of the steps preliminary to the actual striking of the coin are being done outside of the Mint.

In order to manufacture the clad strip, our contractors separately prepare the cladding and the core from materials supplied them from the Government stockpile.

The processes used in bonding vary from company to company. Perhaps one of the most unique is employed by one of our contractors who joins the core and the two clad strips together through explosion.

After the new Mint in Philadelphia is completed sometime in 1968, we will have our own facilities for the bonding of the clad strip; at the present time, we do not.

The process we will use is known as cold-roll strip bonding. The two strips of cladding and the core will be fed through a cold-rolling mill and bonded together by speed and pressure, eliminating the use of heat.

It is interesting to note that the development of the clad metal composite strip used in the production of the 40 percent silver half dollar has its roots in the practices employed in the manufacture of Sheffield plate. About 1750, British craftsmen had discovered that silver sheets could be bonded to a core of copper, without the use of solder, and subsequently the bonded material could be readily rolled and shaped.

The use of clad materials in this country is not peculiar to United States coinage. For some time, clad materials have been used in thermostats, motor controls and various electrical devices. But the success of our clad coins has given industry the platform it needed to branch out into other areas. In fact, it is estimated that the potential market in this country for clad materials approaches $1 billion a year.

Our use of cladding makes it possible to meet basic coinage requirements. So that the new coins would possess the same electrical resistivity as the former homogeneous silver-copper alloy coins, a vital requirement for vending machine use, it was necessary that clad coins be used. For the half dollars both the cladding and the core is composed of silver-copper alloys, and for the quarter and dime, the cladding is an alloy of copper and nickel, with a pure copper core, to achieve the electrical resistivity factor.

In fiscal year 1967, the Mint made over $834 million in revenue on the production of some 9 billion coins. The revenue derived from the production of coinage is known as seigniorage and it is the difference in the face value and the cost of the metal in the coin. The seigniorage is deposited in the General Fund of the Treasury under miscellaneous receipts. We obtain annual appropriations for operating expenses.

Before I close, I would like to say a few more words about the new Philadelphia Mint. This new Mint has been tagged the "jet-age Mint" and this may be a very appropriate appelation. It will be the most modern, as well as the largest, Mint in the world.

The capacity of this facility, 8 billion coins a year if necessary, should be a joy to behold to all of you who are vitally interested in a large supply of coins. Now, we in the Government are used to talking glibly

about millions and billions, but let me put this figure into a less astronomical context. When the new Mint comes "on stream", we will be able to make 1 million coins an hour, or almost 300 a second.

While we have had some major delays at the new Mint, we do expect to have it in full operation in 1969.

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STATEMENT OF FRED B. SMITH
GENERAL COUNSEL, DEPARTMENT OF THE TREASURY
BEFORE THE HOUSE COMMITTEE ON BANKING AND CURRENCY
ON H.R. 6157
FRIDAY, NOVEMBER 3, 1967, 10:00 A.M., EST

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to testify on H.R. 6157, "to permit Federal employees to purchase shares of Federal or State chartered credit unions through voluntary payroll allotment." This bill would give Federal employees the right to make allotments from their salaries for payment on shares in credit unions. It would also require the credit unions to reimburse the Government for the reasonable costs of providing these special services; and the bill also provides for the Comptroller General to issue necessary regulations.

The Treasury Department is opposed to this legislation and recommends against its enactment. I shall shortly summarize the principal reasons why we think this would be undesirable legislation. But first, let me make it clear that the Government strongly supports the development among Federal employees of the habit of regularly saving a portion of their earnings. In support of the objective, Federal credit unions have been provided with cost-free office space in the principal Government buildings in Washington and in major cities throughout the country. Salaried employees of the Government serve without compensation from the credit unions as directors and on their loan committees. The provision of quarters to which Federal employees have easy access and of these other privileges already afford the credit unions with a preferred status insofar as the savings of Federal employees are concerned. The encouragement of habits

of thrift has been one of the principal objectives of the savings bond program, including the new "Freedom Share" savings note, for which payroll deductions are presently authorized and encouraged. Thus, I think that the Federal Government has already done a great deal to encourage Federal employees to save and to make it easy for them to do so. The question posed by the bill is whether we should go one step further and permit payroll allotment for credit union savings. We think not.

Among several important reasons for our opposition, the strongest one is our conviction that enactment of H.R. 6157, or similar bills, would prove to be a crippling handicap to the successful operation of the Payroll Savings Plan for U.S. Savings Bonds and Freedom Shares in the Federal Government. Federal employees are currently purchasing through payroll allotments savings bonds and "Freedom Shares" at an annual rate of $1 billion. This constitutes 20% of the total purchases throughout the nation of savings bonds and Freedom Shares. While it is difficult to assess the immediate effect of enactment of H.R. 6157, we believe that once established and in full operation it would result in a significant drop in our dollar sales to Federal employees. Part of this would be due to a reduction in the number of participants and the rest to a reduced scale of allotments.

The bases for this estimate are as follows:

(1) Most employees of the Federal Government having a desire to save are already on the Payroll Savings Plan. The current overall participation rate of 66% (74% civilian, 60% military) is the

highest since World War II and is not likely to go much higher. Therefore, this constitutes the lion's share of the market insofar as payroll allotment is concerned for both savings bonds and credit union shares, or other private savings.

(2) We can only assume that present enrollees are saving about all they feel they can afford to save. Of course, some of them have savings by direct deposit for which payroll allotment would be substituted. But, if they elect another savings form through payroll allotment, we believe it would be largely at the expense of savings bonds -- either by dividing their allotments or switching over entirely.

(3) The validity of these assumptions is supported by surveys we have made with respect to payroll savings in private industry. These surveys show that there is a marked disparity in the size of per capita bond allotments between Federal workers and employees of private companies where credit union withholding is also done. Federal civilians average $32 per month, and the total of Federal withholding, both military and civilian, averages $23 per month. By contrast, a spot check of eleven companies which actively promote payroll savings for bonds, but also handle credit union deductions, shows an average monthly allotment for bonds of $8.36.

Thus, there is strong evidence that direct competition with credit unions in the field of payroll deductions would result in a significant dollar loss to the Savings Bond program.

The question might be asked as to why the savings bond program should have the special privilege of Federal Government payroll deduction when other forms of savings do not. I think the answer is that the savings bond program is "special" and it is in the national interest that it should have this type of special assistance. Particularly in these times, it is a way in which Government employees can feel that they are making a contribution toward the efforts of our fighting men in this bitter and frustrating war in Vietnam. If participants today were motivated solely by the rate of return, purchases of savings bonds would be reduced. Of course, there are other attractive aspects such as maximum safety of investment and postponed payment of tax. But, if they had the convenience of payroll allotment, we feel that there would be a high rate of switching to other forms of saving.

As the costs of Government go up in direct relation to the costs of this war, the Treasury has two ways of financing these costs: through increases in taxes and through public debt financing. And we have to guard against the problem of inflation. Taxes are, of course, the most noninflationary method of financing the costs of government. Second to taxes, savings bonds are the most noninflationary way to finance the Government's necessary expenditures. Certainly, borrowing in this form is the best way for the Government to borrow while still keeping a lid on total public and private spending in the economy. In this sense, savings through the purchase of U.S. Savings Bonds is even more noninflationary than would be individual savings in other forms, for those

other types of savings are eventually reflected in additional spending -- however worthwhile that added spending may be -- while in the case of U.S. Savings Bonds we can take Government spending as already given and then it is only a question of how best to finance that given amount of spending.

Let me briefly mention some other reasons why we believe this legislation is undesirable. Put simply, another important reason is that we think the time has come to draw the line and put a stop to the proliferation of payroll allotments. Already payroll systems include deductions for Federal and State income taxes; for Civil Service retirement and, where applicable, for Social Security taxes; for Government life insurance and health insurance; for Combined Federal Campaign charitable contributions and union dues; and for purchase of U.S. savings bonds and notes. The administration of payroll systems, including all of these deductions, has become a tremendous task requiring the services of thousands of employees and a vast amount of expensive equipment. We feel that the Government should be, and is, the most enlightened employer in the country today, and that the allotments which are presently made are in the mutual interest of the Government and its employees. What is now proposed goes beyond the objective of mutual interest and enters into a kind of paternalism on the part of the Federal Government which should be avoided. As I have pointed out, through their credit unions conveniently located in the buildings in which they work, Federal employees already have an easy way in which to save. Also, under existing authority and

Treasury Regulations, a Federal employee today can have his net salary, after all payroll deductions, paid directly to a financial organization of his choice for credit to an account of his choice. In most commercial banks, this same employee can, if he wishes, arrange to have part of this deposit transferred to a savings account, or he can of course draw his own check for deposit to a savings account in any financial organization of his choice.

When I testified on an identical bill before the Senate Banking and Currency Committee, I predicted that the proposed legislation would lead to demands by banks, savings and loan associations, and other financial institutions for like privileges. I said that the end result could be the extension of payroll deductions beyond reasonable limits, with the Federal Government serving as a banker or bookkeeper for many things that are personal affairs of its employees. Little did I realize at the time how accurate a prediction this would be, for the Senate Banking and Currency Committee reported out, and the Senate subsequently passed, S. 1084, which would extend the privilege of payroll allotments for savings not only to credit unions but to any bank, savings bank or savings and loan association. We, of course, are vigorously opposed to enactment of S. 1084, and for the same reasons and for additional reasons relating to its legal and administrative methodology.

We are aware that the bill before this Committee provides that the credit union shall reimburse the United States Government for the reasonable cost of making a payroll allotment. It is exceedingly difficult to

estimate what such costs would be because they vary from agency to agency and are, in part, dependent upon factors which cannot be calculated in advance, such as the frequency of changes in allotments. There are already two Federal payroll allotments for which reimbursement is required. These are the Combined Federal Campaign (for charitable contributions) and deductions for union dues. At the time that the Civil Service Commission was preparing to authorize these allotments, it made a survey to determine what would be a reasonable charge per item. On the basis of this survey which, at best, was an educated guess, the Civil Service Commission arrived at a standard charge of 2 cents per deduction on each payroll, which is the charge presently in effect. It should be pointed out that this charge was fixed some time ago, and costs have risen substantially since that time. Moreover, this charge merely reflected the cost of setting up the allotment in the system and making the bi-weekly payments. It did not, for example, include any estimate of cost for changes in the amount of the allotment. This is because, in the case of the Combined Federal Campaign, an employee decides once a year how much he wishes to have deducted every pay day for this purpose and the amount remains the same throughout the year. Union dues, once allotted, are also relatively static. Therefore, these two allotments are relatively simple and inexpensive to administer.

However, it is predicted that if payroll allotments were authorized for savings, employees would wish to change their allotments frequently and this, along with other operational considerations, would mean that

the reasonable cost to be passed on to the credit union would be considerably higher -- conceivably as much as 10 cents an item. I might add, parenthetically, that doing the same thing for savings banks and savings and loan associations, which S. 1084 would require, would undoubtedly involve even greater reimbursable unit costs. This is because most employees wanting the special service would have a choice of one among many such financial organizations and we would probably be making, within most payrolls, an individual payment for every participating employee to only one financial organization.

I wonder if the credit unions would still be in favor of this additional privilege if they were aware that they might have to pay a charge of this magnitude. Or, to put it another way, would not the credit unions, faced with such a charge, bring pressure to bear for the adoption of a charge of a considerably lesser amount which would amount, in effect, to an additional form of subsidy of their operations. The question arises as to whether the additional amount of savings which the credit unions would get would be worth the cost to them.

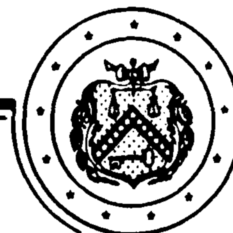
They probably would still be in favor of the bill, but possibly not solely or primarily because of the net gain that they would realize in the form of additional savings. In supporting the bill before the Senate Banking and Currency Committee, the Credit Unions National Association, CUNA, emphasized the much lower loss ratio on loans in private companies where payroll allotments for credit unions were permitted. Once payroll allotments for credit union shares are authorized, the credit union is

then in a position to arrange with individual borrowers to sign a document authorizing each pay day the transfer from his share account to his loan account of the amount required to amortize the loan. Thus, to put the matter in a crude form, enactment of the bill before the Committee could put the Federal Government in the loan-collecting business; and, if the allotment privilege were extended to banks and savings and loans, we would be helping them also to collect on their loans. This would be an especially valuable and cost-saving item for lending institutions. It would eliminate a great deal of paper work and the cost of stationery and postage necessary to send reminders to delinquent borrowers. It would reduce salary costs for those employees needed to handle individual transactions at the teller window on pay days and other peak periods. Without question, it would also be a convenience to the Federal employees concerned. But query: How far should we go in what we might call creeping paternalism in doing a multitude of things for all employees that each one is fully capable of doing for himself? And query further: If the Federal Government is to assist financial institutions in the collection of their loans, what about helping others to collect amounts due -- collection agencies, department stores, etc.?

The possible abuse of this privilege by the financial institutions could result in the use by them of leverage on Federal employees who wish to borrow, in the sense that in order to get approval of a loan, the lending institution might require the borrower to execute a salary allotment and a document authorizing a crediting of a portion of the proceeds of his outstanding loan.

Mr. Chairman, this sums up some of the principal reasons why we are opposed to the enactment of H.R. 6157, but I want to emphasize without minimizing our other points of objection that the most important reason for our opposition is the damage which we feel it will do to our savings bond program. In this period of great competition for savings and high rates of return on some forms of investment, I think the Savings Bonds Division of the Treasury has done a remarkable job in obtaining an increase from $1/2 billion to $1 billion in the amount annually dedicated by Federal employees through the allotment system to the purchase of Savings Bonds and Freedom Shares. It is going to be exceedingly difficult for them in the coming few years to maintain the rate of saving in this form, much less to achieve a substantial increase. We believe that their problem should not be aggravated by providing credit unions or indeed other financial institutions with additional privileges which would result in a loss to the Savings Bond program of a significant percentage of Federal employees' savings.

TREASURY DEPARTMENT



WASHINGTON, D.C.

)R RELEASE 6:30 P.M.,
›nday, November 6, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury lls, one series to be an additional issue of the bills dated August 10, 1967, and the her series to be dated November 9, 1967, which were offered on November 1, 1967, were ened at the Federal Reserve Banks today. Tenders were invited for $1,500,000,000, thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day lls. The details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	91-day Treasury bills maturing February 8, 1968		:	182-day Treasury bills maturing May 9, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.827 a/	4.640%	:	97.406	5.131%
Low	98.814	4.692%	:	97.369	5.204%
Average	98.819	4.672% 1/	:	97.381	5.180% 1/

a/ Excepting 1 tender of $100,000
96% of the amount of 91-day bills bid for at the low price was accepted
77% of the amount of 182-day bills bid for at the low price was accepted

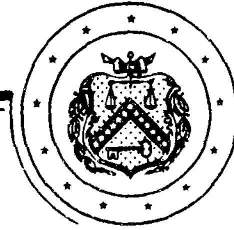
ΓAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 19,126,000	$ 9,076,000	:	$ 13,216,000	$ 3,216,000
New York	1,746,180,000	1,135,580,000	:	1,314,583,000	703,833,000
Philadelphia	24,148,000	12,148,000	:	16,880,000	8,880,000
Cleveland	52,130,000	31,078,000	:	26,476,000	25,326,000
Richmond	21,562,000	12,562,000	:	8,052,000	6,822,000
Atlanta	37,455,000	23,655,000	:	22,010,000	14,010,000
Chicago	203,491,000	118,157,000	:	147,881,000	76,881,000
St. Louis	36,339,000	23,899,000	:	26,691,000	22,691,000
Minneapolis	22,130,000	12,750,000	:	16,797,000	9,797,000
Kansas City	21,073,000	20,573,000	:	13,431,000	13,431,000
Dallas	23,544,000	13,544,000	:	23,693,000	15,693,000
San Francisco	174,101,000	88,121,000	:	126,662,000	99,662,000
TOTALS	$2,381,279,000	$1,501,143,000 b/		$1,756,372,000	$1,000,242,000 c/

Includes $222,007,000 noncompetitive tenders accepted at the average price of 98.819
Includes $132,922,000 noncompetitive tenders accepted at the average price of 97.381
These rates are on a bank discount basis. The equivalent coupon issue yields are 4.81% for the 91-day bills, and 5.41% for the 182-day bills.

F-1072

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 6, 1967

FOR IMMEDIATE RELEASE

PETER D. STERNLIGHT TO SERVE AS TREASURY CONSULTANT
PENDING RETURN TO NEW YORK FEDERAL RESERVE BANK

Peter D. Sternlight has resigned his position as Deputy Under Secretary of the Treasury for Monetary Affairs effective November 11, 1967. Mr. Sternlight came to the Treasury from the Federal Reserve Bank of New York in November, 1965, and will return to the official family of the New York Bank effective November 12, 1967.

Mr. Sternlight graduated from Swarthmore College in 1948 and received his Ph.D. in economics from Harvard in 1960. He joined the staff of the Federal Reserve Bank of New York in 1960. At the time he came to the Treasury as Deputy Under Secretary, he was Assistant Vice President assigned to Open Market Operations and Treasury Issues.

Beginning on November 13, 1967, Mr. Sternlight will return to the Treasury on loan from the Federal Reserve Bank of New York to serve as a Consultant. In that position, he will continue to fulfill most of the functions of his former position as Deputy Under Secretary. His assignment as Consultant will continue until December 22, 1967.

On the occasion of his official resignation as Deputy Under Secretary, Secretary Fowler has presented Mr. Sternlight with the Secretary of the Treasury's Exceptional Service Award. The citation reads in part:

> "... His analytical abilities were coupled with a thorough understanding of the functioning of complex financial markets and a keen sense of the public interest. His early appreciation of the threat posed during 1966 by unbridled competition among financial institutions for a limited pool of savings helped in framing policies which limited the escalation of interest rates. Throughout a difficult period of monetary stringency, his cool judgment was always a valuable asset to the Treasury. His contributions were of especial value in the formulation of Treasury policy on legislation for raising the limit on the national debt and on the tax surcharge proposed in August, 1967."

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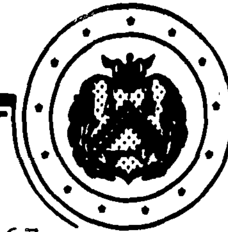
TREASURY DEPARTMENT



WASHINGTON, D.C.

November 8, 1967

ʼOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders or two series of Treasury bills to the aggregate amount of 2,500,000,000, or thereabouts, for cash and in exchange for reasury bills maturing November 16,1967, in the amount of 2,400,412,000, as follows:

91-day bills (to maturity date) to be issued November 16,1967, n the amount of $1,500,000,000, or thereabouts, representing an dditional amount of bills dated August 17,1967, and to ature February 15,1968, originally issued in the amount of 1,000,569,000, the additional and original bills to be freely nterchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated ovember 16,1967, and to mature May 16, 1968.

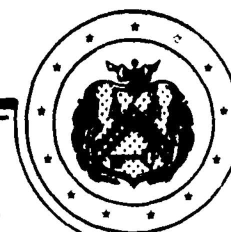
The bills of both series will be issued on a discount basis under ompetitive and noncompetitive bidding as hereinafter provided, and at aturity their face amount will be payable without interest. They .ll be issued in bearer form only, and in denominations of $1,000, ,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 aturity value).

Tenders will be received at Federal Reserve Banks and Branches to the closing hour, one-thirty p.m., Eastern Standard me, Monday, November 13, 1967. Tenders will not be ceived at the Treasury Department, Washington. Each tender must for an even multiple of $1,000, and in the case of competitive nders the price offered must be expressed on the basis of 100, th not more than three decimals, e. g., 99.925. Fractions may not used. It is urged that tenders be made on the printed forms and rwarded in the special envelopes which will be supplied by Federal serve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of stomers provided the names of the customers are set forth in such nders. Others than banking institutions will not be permitted to omit tenders except for their own account. Tenders will be received thout deposit from incorporated banks and trust companies and from sponsible and recognized dealers in investment securities. Tenders om others must be accompanied by payment of 2 percent of the face ount of Treasury bills applied for, unless the tenders are ompanied by an express guaranty of payment by an incorporated bank trust company.

F-1074

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 8, 1967

FOR IMMEDIATE RELEASE

The Treasury Department today released a copy of a letter to the Accounting Principles Board of the American Institute of Certified Public Accountants expressing Treasury's views on the Board's proposed Opinion on accounting for income taxes. The Institute recently solicited views from interested parties on the APB's proposed Opinion, and Stanley S. Surrey, Assistant Secretary for Tax Policy, replied for the Treasury Department.

Attachment

F-1075

TREASURY DEPARTMENT

WASHINGTON, D.C. 20220

SSISTANT SECRETARY

NOV 7 1967

Dear Mr. Lytle:

We submit the following comments in response to your solicitation of views on the Exposure Draft of the proposed APB Opinion on accounting for income taxes.

The Treasury Department has a substantial interest in the manner in which American business concerns report their Federal income tax liabilities. While the statutory corporate income tax rate is 48 percent, it is clear that the effective corporate tax rate on American business as a whole is considerably less than this. The reduction results from conscious decisions on the part of the Congress to achieve this lower effective tax rate on American business in general and on special industries in particular. The accounting approach suggested in the proposed APB Opinion would, however, in the aggregate, substantially overstate the tax liability of American business and present an inaccurate picture of our tax system. Since the tax liability would be substantially overstated in the aggregate, it would obviously also be overstated individually for the vast majority of United States corporations.

Congress has achieved this lower effective tax rate by a variety of means -- artificial deductions structured to achieve a rate reduction (e.g., Western Hemisphere trade corporations), expensing of capital costs (e.g., intangible drilling expenses and certain research and development costs), fast tax write-offs (e.g., amortization of emergency facilities), expensing in excess of cost (e.g., depletion), creation of excessive reserves (e.g., financial institutions), capital gains rates (e.g., timber and livestock), special deferrals (e.g., shipping companies and life insurance companies), and credits (e.g., investment credit). The financial accounting treatment for each of these items of tax reduction are all facets of a single problem. Moreover, it appears that the treatment of these items does not readily fall within the framework of traditional accounting concepts. The proposed Opinion recognizes this fact. Thus, paragraph 37 of the Exposure Draft enumerates some of these items as presenting accounting problems still to be resolved.

The effect of the various deductions in these areas still to be resolved, as well as the intention behind their presence in the tax system, is to reduce the effective tax rate on companies in the

particular industries involved (e.g., financial institutions, oil and gas exploration, stock life insurance companies, and certain United States steamship companies). For example, in the case of savings institutions, the tax reduction is achieved by what is recognized to be an unrealistic deduction for additions to reserves for bad debts.

The financial accounting of these institutions does not recognize these additions as charges to income. (While it may be contended that it is always possible that loss experience could utilize the reserve, this is so unlikely that prudent accounting does not take the possibility into account in reflecting current income.) This provision, once devoid of its technical characterization in the Internal Revenue Code, is seen to be simply a preferential tax rate made applicable to these institutions through the device of a bad debt reserve. A substantially identical tax result could have been achieved by a reduction in tax rates applicable to these institutions. Under this approach there would have been no doubt as to the accounting treatment of this reduction -- it would have been recognized immediately.

In many of the preference situations mentioned above, the particular means of achieving tax reduction is less important than the fact that there is a reduction. Most deductions could be structured as credits and, in turn, most deductions and credits could equally well be rate reductions. The financial accounting treatment of the tax reduction arising from the investment credit is a part of this broad problem. In this regard, the investment credit is designed to give a lower effective tax rate to companies modernizing or expanding their machinery and equipment.

When originally proposed the investment credit was to be allowed only on the excess of current investment over current depreciation charges on the theory that new investment equal to annual depreciation was normal investment necessary simply to maintain a company's status quo and would not represent a new level of investment effort. Under this form of the credit it would be difficult to say that the investment credit would be associated with any particular asset. It would represent, rather, a selective tax reduction to those corporations engaged in modernization or expansion. The fact that the provision as finally enacted provided for an investment credit measured by a percentage of gross investment should not be viewed as determinative of the nature and accounting treatment of the credit.

The basic question to be resolved in the case of the investment credit, as well as in the case of the other preferences, is whether the financial accounting treatment of a tax reduction should depend on the mechanical method by which the reduction is measured or implemented in the statute. To seek a solution to the accounting treatment by following the manner in which these reductions are characterized within the Internal Revenue Code will surely lead to accounting inconsistencies because of the variation in the legislative approaches used in achieving these reductions. For example, the tax benefits enjoyed by Western Hemisphere trade corporations, certain cattle and timber sales, dividends received by corporations, etc., are also tax reduction measures. Yet, the benefits arising from these particular measures are recognized immediately for accounting purposes, because the technique by which they are implemented in the statute is regarded as relating more closely to a tax rate reduction. It appears basically inconsistent to recognize immediately the benefits of these tax reduction measures but then to defer the benefits of certain other tax reduction measures because they are artificially associated with assets or because it is possible under some circumstances they may "turn-around" in a later period. In many of these situations the "turn-around" was not viewed by the legislature as a real possibility. While we recognize that under traditional accounting concepts the future prospects of a particular corporation should be viewed with a degree of caution, given the present dynamic economy of this country and the commitment of our society to continued economic growth, such a view is not cautious, but unrealistically pessimistic.

In total, the preferences incorporated within the tax law clearly result in an effective corporate tax rate that is less than 48 percent. We believe that financial accounting should recognize this -- both because it is the fact and because the stimulative effects resulting from the tax reduction should not be obscured.

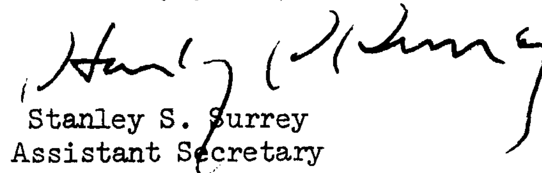
The essential question is whether the characterization of a tax reduction in the Internal Revenue Code should control the accounting treatment of that reduction, when following such a ritualistic approach has these unfortunate consequences. It appears to us that an accounting approach must be developed that is capable of dealing appropriately and consistently with each item of tax reduction regardless of how it is implemented in the statute.

Special care must be exercised with respect to the investment credit because of its magnitude and because most companies would have to change their existing practice in response to the position taken

in the APB Exposure Draft. Presumably, this will result in a massive restatement of earnings whose effects on the economy, while difficult to measure, could be serious. Furthermore, a mandate to defer the benefit arising from the investment credit could well blunt its effectiveness as an incentive to modernization and expansion.

The Treasury Department has said many times that it would like to look to the accounting profession for leadership in the computation of income for tax purposes, for these problems are essentially and historically accountants' problems. Obviously, there are areas where the tax law differs, and indeed must differ, from the accounting approach but in each such case there should be a compelling nonaccounting reason for this. We would view it as an unfortunate reversal for the accounting profession to be bound in its determination of income for financial reporting by the ad hoc characterizations and structures of tax benefits adopted in the Internal Revenue Code for the purpose of achieving selective tax reductions.

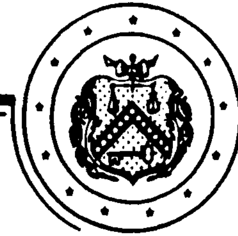
Sincerely yours,



Stanley S. Surrey
Assistant Secretary

Mr. Richard C. Lytle
Administrative Director
Accounting Principles Board
666 Fifth Avenue
New York, New York 10019

TREASURY DEPARTMENT



WASHINGTON, D.C.

)R RELEASE 6:30 P. M.,
›nday, November 13, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury .lls, one series to be an additional issue of the bills dated August 17, 1967, and the .her series to be dated November 16, 1967, which were offered on November 8, 1967, were ›ened at the Federal Reserve Banks today. Tenders were invited for $1,500,000,000, ' thereabouts, of 91-day bills and for $1,000,000,000, or thereabouts, of 182-day lls. The details of the two series are as follows:

NGE OF ACCEPTED MPETITIVE BIDS:	91-day Treasury bills maturing February 15, 1968		:	182-day Treasury bills maturing May 16, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.834	4.613%	:	97.411	5.121%
Low	98.822	4.660%	:	97.382	5.178%
Average	98.825	4.648% 1/	:	97.394	5.155% 1/

56% of the amount of 91-day bills bid for at the low price was accepted
98% of the amount of 182-day bills bid for at the low price was accepted

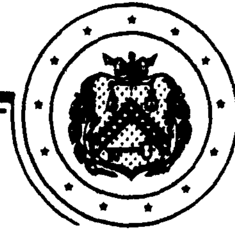
TAL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

District	Applied For	Accepted	:	Applied For	Accepted
Boston	$ 18,073,000	$ 8,073,000	:	$ 17,445,000	$ 7,445,000
New York	1,907,904,000	1,018,684,000	:	1,163,190,000	613,825,000
Philadelphia	27,481,000	13,403,000	:	16,326,000	8,326,000
Cleveland	34,743,000	25,279,000	:	32,820,000	27,820,000
Richmond	21,446,000	10,446,000	:	12,938,000	12,938,000
Atlanta	35,931,000	23,699,000	:	35,797,000	30,781,000
Chicago	272,835,000	228,285,000	:	163,851,000	131,751,000
St. Louis	40,495,000	31,675,000	:	26,713,000	25,209,000
Minneapolis	29,823,000	19,023,000	:	19,522,000	13,022,000
Kansas City	30,844,000	25,971,000	:	13,275,000	13,271,000
Dallas	24,058,000	14,618,000	:	19,173,000	11,173,000
San Francisco	184,654,000	81,574,000	:	130,561,000	104,461,000
TOTALS	$2,628,287,000	$1,500,730,000a/		$1,651,611,000	$1,000,022,000b/

Includes $227,990,000 noncompetitive tenders accepted at the average price of 98.825
Includes $148,574,000 noncompetitive tenders accepted at the average price of 97.394
These rates are on a bank discount basis. The equivalent coupon issue yields are 4.78% for the 91-day bills, and 5.38% for the 182-day bills.

F-1076

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 13, 1967

FOR IMMEDIATE RELEASE

TREASURY MARKET TRANSACTIONS IN OCTOBER

During October 1967, market transactions in direct and guaranteed securities of the government for Government investment accounts resulted in net purchases by the Treasury Department of $60,533,100.00.

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F-1077

TREASURY DEPARTMENT
Washington

FOR RELEASE ON DELIVERY

REMARKS BY THE HONORABLE FREDERICK L. DEMING,
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS,
AT THE 1967 LEGISLATIVE CONFERENCE
OF THE ENLARGED REALTORS WASHINGTON COMMITTEE,
THE NATIONAL ASSOCIATION OF REAL ESTATE BOARDS,
IN THE INTERNATIONAL BALLROOM EAST, THE WASHINGTON HILTON HOTEL,
WASHINGTON, D. C.,
ON SATURDAY, NOVEMBER 11, 1967, AT 4:00 PM (EST)

My thesis today is a simple one -- a tax surcharge, as recommended by the President, is needed badly and is needed now. The real estate industry has a direct interest in this matter and should support the recommended tax action. That, in essence, is my message. Now let me develop it more fully.

There are two fundamental points to keep in mind. One, the housing and real estate sectors of the economy do better under conditions of balanced economic growth than they do under conditions of inflation or deflation. The problems of feast or famine in the housing and real estate industries are too well known to you to require me to discuss them further. You, who work in these fields, know them at first hand.

Two, tight money hits hard and disproportionately at these segments of the economy. This point I do want to develop much more fully -- although you have had recent and, I expect, convincing experience of this fact -- in the Summer and Fall of 1966.

F-1078

Let me turn first and briefly to the state of the economy. Most of the forecasts for 1968 see an economy rising rather strongly but in reasonable balance -- assuming a tax increase. They see quarterly gains in gross national product averaging just short of $15 billion. This would produce close to a $60 billion increase over four quarters -- a gain right at the upper limit of what most economists believe the economy can tolerate without undue strain.

In this setting, prices will be increasing faster than we would like. While much of the upward pressure will be coming from the cost increases of 1965 and 1966, GNP growth of the magnitude expected will hardly contribute to price weakness. But, with reasonable balance in the economy, we would have a chance for better price performance, which would make it easier to continue healthy real growth in 1969.

I want to underline the point that this fairly optimistic outlook has a tax increase built into it. Without that tax increase, there would be more expansion -- too much more for any comfort. That overexuberance would require restraint -- and that restraint, almost inevitably, would mean tight money.

If there were no additional restraint, prices would rise more strongly. Inflation is a tax in itself -- the cruelest tax of all, since it bears most heavily on those who can least protect themselves from it. The recommended temporary 10 per-cent surcharge really means a tax -- on the average -- of about

1 percent of income, and those least able to pay escape the surcharge entirely. If prices rise 1 percent, unless money incomes also rise, average real income is reduced by the same amount as through a 1 percent tax increase. The impact on different income levels varies.

Now, some may say -- then I'll gamble that prices won't rise enough more without a tax increase to make me as badly off as a tax increase would. After all, if the higher prices, without a tax increase, come out less than 1 percent higher then they would with a tax increase, I'll win. And, anyway, I'll have higher income. That kind of a gamble usually has not been a good one -- certainly not a good one for the little fellow, for the retired, for the saver who finances housing. Anyone who is thinking about that kind of a gamble needs to keep in mind (a) that high prices tend to be sticky -- and they stay around and build bases, through cost increases, for future higher prices; (b) there obviously is no guarantee that the price rise can be held to even a good temporary trade-off level, and (c) it's hard to repeal inflation -- but taxes can be repealed and the surcharge is a temporary one.

I'd sum up the broad economic picture this way. Some people see the inflation wolf slipping through the woods; some hear him scratching at the front door; some find him already in grandma's bed.

Wherever he is, this Red Riding Hood economy needs a little wolfbane in the form of a tax increase. It is too plump and tempting for the inflation wolf.

Now I want to turn to the financial picture -- both because it is of more direct concern to you and because there is no question of where the high interest rate wolf is -- he's in grandma's bed, grandma's in his stomach, his jaws are wide open, and Red Riding Hood hasn't got a chance without the tax increase wolfbane.

Interest rates for intermediate and long-term securities in the United States today are higher than they have been since the very early 1920's. Less than two weeks ago, the Treasury issued a 7-year note at 5-3/4 percent -- the highest coupon on a Treasury issue since June, 1921, and it is trading slightly below par. Except for short-term securities, most interest rates today are higher than they were in the money crunch of August - September, 1966 -- long-term Governments and corporates are more than 1/2 percent higher, municipals just a bit higher.

I am sure none of you like to remember the August - September, 1966, period. The crunch that occurred then was broken by a series of actions. Money became available and interest rates fell. From the highs of the Summer of 1966 to the 1967 lows in the early and late Spring, Treasury bill rates dropped 2-1/4 percent, one-year Treasury notes and agency

securities declined about 2 percent, 5- and 10-year Governments dropped 1 to 1-1/2 percent, corporates more than 1 percent, and municipals 7/8ths percent.

But since the lows of last Spring, rates have moved up again quite sharply. We will get to the reasons for this movement later. Meanwhile, the figures are as follows. As of yesterday, Treasury bill rates were up 1-1/4 to 1-1/2 percent from their Spring lows; short-term Governments and agencies and long-term corporates were up 1-1/2 percent, longer-term Governments up 1-1/4 to 1-1/2 percent, and municipals up 9 percent. Much of the increase -- between one-third and one-half -- has occurred since the President's Tax Message went to the Congress on August 3. And all of these increases have taken place against the background of an easy monetary climate.

While I'm talking about interest rates, let me note that they have effects on both the domestic and international economies. And let me note further that these effects concern countries other than the United States.

In January, 1967, the finance ministers of five countries -- the United States, the United Kingdom, Germany, France, and Italy -- met at Chequers in England in what became a widely-publicized effort to de-escalate the so-called interest rate war. The Communique issued after that meeting said, in part:

"The Ministers agreed that they would all make it their objective within the limits of their respective responsibilities to cooperate in such a way as to enable interest rates in their respective countries to be lower than they otherwise would be."

The whole point of the Chequers meeting was that all felt that undue dependence in the past had been placed on monetary policy, that, while this had produced needed restrictions on their economies, it had also produced distortions in their economies.

By and large, monetary cooperation proved successful through the Spring of 1967. And, even since then, despite the sharp upward rise of interest rates in the United States, most of the European countries have continued to follow relatively easy monetary policies. The German rediscount rate has been reduced from 5 to 3 percent in a series of moves. Belgium has cut its bank rate five times -- from 5-1/4 to 4 percent, the latest move coming at the end of October. In the Netherlands, bank rate has been reduced from 5 to 4-1/2 percent. France and Italy have continued their bank rates at 3-1/2 percent; Austria reduced its rate again at the close of October.

All of these moves were in full keeping with proper domestic economic policy -- they were not done out of altruism.

The point is that the moves were taken in the face of rising rates in the United States, and there may be real question whether these policies can be continued as rates rise here.

We already have seen recent upward bank rate movements in the United Kingdom and Canada that were clearly defensive and reflective not of their domestic situations but developments in the international money markets, which are strongly influenced by U. S. interest rates. Early in 1967, the Bank of England cut its bank rate from 7 to 5-1/2 percent in three steps. In the past three weeks, it has done back up again to 6-1/2 percent in two moves. The Bank of Canada cut its rate 3/4 percent in two moves earlier this year; in late September, it went back up 1/2 percent.

More than a year ago, President Blessing, of the Bundesbank, said publicly that high interest rates abroad hamper the German Federal Bank's efforts to bring down rates at home. At about the same time, in a speech here in Washington, Governor Carli, of the Bank of Italy, said:

> "...if one deludes oneself into thinking that a more elaborate policy mix can be successful without the operational techniques and sufficient forcefulness to put them into effect quickly, then it will, sooner or later, still become necessary to employ the credit restrictions which are characteristic of a cruder approach.

In the end effect, their belated application leads the economy into more serious stagnation, the external deficit persists, confidence is lost, speculative pressures grow, and, ultimately, unemployment ensues."

On October 9, 1967, the French Minister of Economy and Finance told a group of French businessmen that "a rise in interest rates in the United States, with the risk of spreading to other countries, and the corresponding risk of a slowdown in economic development" was a negative factor in evaluating worldwide economic growth prospects.

I need not go on with this part of my story. The point I think is quite clear. Tight money and high interest rates in the United States are disturbing influences not only in the United States but also abroad.

Now let me return to the domestic scene and come down harder on the supply-demand picture in our capital and credit markets. While economists were debating the economic outlook earlier this year, and members of Congress were expressing concern over the economy, participants in the credit markets seem to have had few doubts about the basic trend of economic activity. Even though capital needs for financing inventories were lessening and needs to finance current fixed investment outlays held about steady, corporations have racked up record amounts of borrowing in the capital markets this year.

New long-term corporate issues in 1966 totalled $17.6 billion. Based on what has been done and is in prospect, that total will be beat by $7 billion, or 40 percent, this year. New state and municipal securities in 1966 totalled $11.3 billion. It looks as though they will be $2.5 billion higher, or up 22 percent, in 1967. And in neither case was 1966 a slack year -- in fact, it was the record year before 1967.

What has caused this heavy volume of borrowing through the capital markets? Underlying the demand was a combination of conviction and fear -- conviction that liquidity positions run down in 1966 should be restored and dependence upon short-term borrowing from banks reduced, and fear that failure to tie up some available funds while they are available might mean inability to get funds later on when they are needed.

A special source of concern for corporate, state and municipal financial officers has been the possibility of an oversized Federal Government deficit. They, too, remember the tight markets of the Summer of 1966. But, at that time, the Federal Government's demands were quite modest. Now they contemplate a period of heavy private demand augmented by an overgrown Federal deficit. That makes for sleepless nights.

Let me put the picture in simple and stark form by contrasting fiscal year 1967 and fiscal year 1968.

In fiscal 1967, net Federal demands on the private credit markets, as measured by the increase in outstanding Treasury issues, agency issues, and participation certificates, less the increase in the holdings of these obligations by the Government Investment Accounts and the Federal Reserve, was actually negative by $6 billion. Even after adjusting for the decline of $5 billion in the Treasury cash balance, it is clear that there was no net demand from the Federal sector in fiscal 1967 -- instead, there was net supply.

Contrast this with fiscal 1968. Assume the tax program and expenditure control, as recommended by the President, produces an administrative budget deficit of $14 to $18 billion. This will be financed by direct Treasury borrowing. Add to this sales of participation certificates and agency securities. Subtract prospective purchases of the Government Investment Accounts and the Federal Reserve. We estimate the net take from the private markets to be $10 to $12 billion, in contrast to a net supply of $6 billion last year. Without a tax increase, the fiscal 1968 figure becomes $17.5 to $19.5 billion net demand.

We believe we can manage -- with difficulty, of course, but manage -- a net demand of $10 to $12 billion. But another $7.5 billion would put great strain on the markets.

Put the picture in this perspective. Last fiscal year, the total demand for funds flowing through the markets was about $60 billion.

The Federal sector put in about $5 to $6 billion, so private satisfied demand was $65 billion. This fiscal year, total supply should be higher -- perhaps $70 - $75 billion -- maybe more, depending on bank credit expansion. But Federal net demand of $10 - $12 billion would use up the increase. And net Federal demand of $20 billion would use twice the prospective increase. And, incidentally, these are the figures which show pressure on the markets and on interest rates. It is not just $7.5 billion more borrowing against a GNP of $800 billion. The relevant figures are $16 billion more net Federal credit in fiscal 1968 as against fiscal 1967 demand, or $26 billion more relative to a total supply of, say, $75 billion.

Now, let me finish the story of Federal credit demand in fiscal 1968. Direct Treasury borrowings, gross of new money, in the markets in the last half of calendar 1967 will total a bit more than $16 billion. All of this has been done or announced; there will be no more market borrowing by the Treasury in 1967. Yesterday, we announced a $1 billion participation certificate sale -- the only one so far in this half year -- and we will do no more in 1967. There will be some more agency issues, but they are essentially rollovers -- no new money. So we are finished for 1967.

Because of seasonal factors relating to revenues, most Treasury new money borrowing comes in the second half of a calendar year.

Remember I said that, in fiscal 1967, net Federal credit demand -- direct Treasuries, agencies, and participation certificates -- was a minus $6 billion. But we took $5 billion out in the last half of calendar 1966 and put back $11 billion in the first half of this year.

With a tax increase and expenditure control, we would expect to put back net about $2.5 billion in the first half of 1968. With expenditure control and no tax increase, we would take out net about $5 billion. So the swing from the first half of this year would be $16 billion more net demand.

The process through which the market would allocate a limited supply of credit among an excess of would-be borrowers can be described, ahead of time, only in qualitative terms and generalities. The particulars might work out differently under slight variations in circumstances. In general, though, it may be predicted that the Federal Government's credit needs would be met, one way or another, as would also the credit needs of larger business firms. The cost might be high -- even in comparison to the high rates prevailing today -- but the supply probably would be there because some other borrowers would be "pushed off the end of the bench" and unable to find money, except at rates that were considered exorbitantly and prohibitively high.

Consumers might fare unevenly in the scramble for available credit. Funds for installment purchases, and other short-term credit, would probably be available -- but money for home mortgages would quite likely be a major victim. Business might also fare unevenly, with large firms getting their needs filled, and small ones having to make do with less -- drawing on every last ounce of spare liquidity in the system, leaning on trade credit, and cutting corners wherever possible in cash management. State and local governments would also feel the pinch, especially if bank credit expansion potential was under some restraint. In the Summer months of 1966, this was one of the areas where we seemed closest to the stark possibility of non-functioning credit markets in which funds were unavailable at virtually any price.

Let us look more specifically at housing and real estate. Any threat of serious imbalance in the pattern of funds supplied and demanded in the credit markets is necessarily a matter of special concern to those associated with the housing industry. When interest rates are bid sharply higher in a scramble for funds, someone is sure to be the loser. And, if our earlier bouts with tight money are any guide, the housing and real estate industries will feel the first and hardest blows. Certainly, that was the case last year.

In the span of a very few months, the housing industry moved last year from relative prosperity to severe adjustment. Suddenly deprived of a steady inflow of new savings, the mortgage and real estate markets were caught in a tightening squeeze. The main financial causes were clear enough. Total demands for credit, swelled by a rising tide of business borrowing for plant and equipment outlays, far outran potential supplies. Interest rates were drive up and a balanced pattern of financial flows was badly distorted. Thrift institutions lost out to commercial banks in a hectic race for a limited pool of savings, and neither could match the lure of the higher yields that soon appeared on market instruments. As a result, the home financing, residential construction, and real estate sector experienced a period of extreme financial stringency, and the effects fanned out to material suppliers, the construction trades, specialized financial institutions, and the general public.

Loan commitments were cut back sharply as mortgage lenders were hit by heavy withdrawals of funds moving to obtain higher yields. New housing starts plummeted from a rate of 1,430,000 units in March to 845,000 units in October -- a decline of more than 40 percent.As you know all too well, the problem was not limited to the financing of new homes.

In a typical year, the share of the real estate market accounted for by the purchase and sale of existing homes may be nearly twice that of new homes, with some 2-1/2 million existing homes changing hands. According to your own figures, transfers of existing houses in September, 1966, was 23 percent smaller than in September, 1965. The markets for new and existing homes are linked and interrelated with the purchase of a new home frequently dependent upon the availability of financing for the sale of an old home. And, last year, with mortgage money uncommonly scarce, the financing of both new and existing homes was difficult, expensive, and, at times, in some regions, nearly impossible. None of us wants to see those conditions again.

So far the story this year has been one of solid recovery. From some standpoints, the pace of the recovery has even exceeded expectations. In September, the seasonally adjusted annual rate of new private housing starts reached 1,457,000 units, the highest since December, 1965. Third quarter housing starts were 17 percent above the second quarter and more than 50 percent above the fourth quarter, 1966. Savings inflows at thrift institutions and commercial banks have continued in record volume. In the first 9 months, this savings inflow totalled a massive $31.5 billion, in contrast to a mere $14.6 billion in 1966 and an average $21.4 billion in 1963 through 1965. New home sales have been running at high levels.

The inventory of unsold new homes is only about 170,000 units, about 100,000 fewer than at the 1964 peak. In the face of rising incomes and favorable demographic factors, all this suggests a solid basis for a continuing revival in home construction and the real estate business _if_ financial factors permit.

That, I hasten to add, is a mighty big "if." Already, the mortgage market is feeling the impact of high and rising long-term interest rates. Mortgage rates are sluggish, but they have been moving up. On the basis of historical relationships with other long-term interest rates, they could go still higher. Discounts in the FHA market are larger than we like to see for the smooth functioning of that market. But, to this point, financial factors have not arrested the housing recovery. While possibly less than ideal, the financial environment for housing and real estate this year has been one of credit availability, although that availability has been at a high price.

As we look to the future, the problem is whether we can assure the continued availability of credit that real estate markets require. Over the longer pull, the money will be there. But, in this difficult period, while net Federal credit demands are swinging from net supply to sizeable net demand, there is a real risk that total credit demands will again outpace supply -- as they did in 1966, although for different reasons.

If an over-all imbalance were allowed to develop, there is little doubt in my mind -- or, I am sure, in yours -- as to where the heaviest burden of adjustment would come to rest. Once again the residential construction, home financing, and real estate sectors would be near the end of the line when the credit windows were closed.

Some financial problems are complex. This one is essentially very simple. The problem is simply to insure that total credit demands are scaled down into reasonable correspondence with probable supplies. This can be accomplished through the President's fiscal recommendations -- a 10 percent surcharge on personal and corporate taxes, coupled with reductions in Federal expenditure. The effect would be to reduce the net Federal credit demand from an intolerable $20 billion or more to the $10 to $12 billion range, and also to trim down slightly the net private demand for credit.

Credit demands <u>will</u> be cut back to available supplies by the operation of the market, make no mistake about that. The choice lies between the exercise of fiscal responsibility or letting nature take its course. And we saw last year the course that nature takes. Without fiscal restraint, interest rates and the market processes will equate the total demand and supply for credit -- they always do. But that cutting back of demands will surely hit the housing sector with special force.

The course of wisdom, in my opinion, is to apply a badly needed degree of fiscal restraint, so that over-all demands and supplies will be brought into reasonable balance. In that way, the markets will achieve a more even and equitable distribution of credit supplies, and the 1966 experience can remain only as an object lesson of what we are determined to continue to avoid.

The tax increase is needed and is needed now. The question is a right now question -- not one for the indefinite future. Markets don't wait, as is evidenced by the interest rate rise that has taken place so far -- particularly the increase since August 3. To put off taking action is far too big a gamble -- and a gamble that is almost sure to produce some -- perhaps many -- losers -- and housing and real estate are likely to be among those losers.

Again, I say -- the tax question is a right now question -- and we need your support to get it answered right now.

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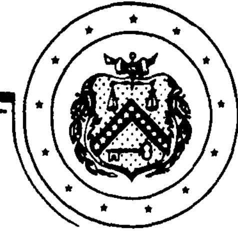
TREASURY DEPARTMENT



WASHINGTON, D.C.

November 14, 1967

FOR IMMEDIATE RELEASE

TREASURY DEPARTMENT OUTLINES EQUAL EMPLOYMENT REQUIREMENTS FOR SAVINGS AND LOAN ASSOCIATIONS, SAVINGS BANKS AND OTHERS WHO HANDLE U. S. SAVINGS BONDS

Assistant Treasury Secretary Robert A. Wallace, the Department's Equal Opportunity Officer, today announced that letters are being sent to some 6,000 savings and loan associations, savings banks and other organizations which issue and redeem U. S. Savings Bonds and Savings Notes, providing detailed information on requirements for compliance with the Treasury Department's new Equal Employment regulations affecting all organizations handling these securities.

Some 12,000 commercial banks with federal deposits which issue and pay savings bonds are already covered by Treasury Equal Employment requirements. The new regulations affect about 6,000 other organizations -- commercial banks which are not already covered, savings and loan associations, savings banks, and a small number of other organizations which have been authorized to issue and pay U. S. savings bonds and savings notes.

These regulations prohibit discrimination in hiring, promotion, training and other personnel activities on the part of these organizations.

Issuing and paying agents which issue or pay savings bonds or savings notes on or after December 1, 1967 will be required to:

1. Establish positive equal employment policies and programs.

2. Include in all solicitations for employees through employment agencies or advertisements a statement that all qualified applicants will receive consideration without regard to race, creed, color or national origin.

3. Post in conspicuous places a standard poster entitled DISCRIMINATION IS PROHIBITED, which has been furnished all issuing and paying agents by the Treasury.

F-1079

Complaints that issuing and paying agents are not pursuing Equal Employment policies will be reviewed by the Treasury and efforts made to resolve such complaints by conciliation. Any agent found to be following discriminatory practices and refusing to end them will have withdrawn authority to issue or pay savings bonds and savings notes.

All issuing and paying agents who did not file a compliance report (Standard Form 100, EEO-1) during 1967 will be required to do so by January 1, 1968. These forms are to be mailed to the Equal Employment Opportunity Officer, U.S. Treasury Department, Washington, D. C. 20220. Subsequent reporting will include only those agents having 50 or more employees and they will be required to file by March 31 of each year.

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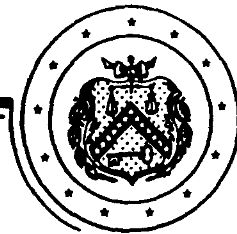
TREASURY DEPARTMENT



WASHINGTON, D.C.
November 14, 1967

FOR IMMEDIATE RELEASE

SUBSCRIPTION AND ALLOTMENT FIGURES FOR TREASURY'S CURRENT CASH OFFERING

The Treasury Department today announced the subscription and allotment figures with respect to the current offering of 5-5/8% Treasury Notes of Series A-1969, due February 15, 1969, and 5-3/4% Treasury Notes of Series A-1974, due November 15, 1974.

Subscriptions and allotments were divided among the several Federal Reserve Districts and the Treasury as follows:

	5-5/8% NOTES OF SERIES A-1969		5-3/4% NOTES OF SERIES A-1974	
Federal Reserve District	Total Subscriptions Received	Total Allotments	Total Subscriptions Received	Total Allotments
Boston	$ 380,031,000	$ 150,544,000	$ 793,719,000	$ 77,509,000
New York	11,062,263,000	8,831,472,000	7,034,635,000	685,715,000
Philadelphia	312,137,000	124,624,000	232,700,000	35,336,000
Cleveland	508,777,000	200,893,000	545,695,000	65,761,000
Richmond	248,782,000	103,425,000	299,944,000	45,369,000
Atlanta	334,666,000	144,412,000	292,448,000	79,479,000
Chicago	922,115,000	387,856,000	1,774,521,000	210,921,000
St. Louis	334,644,000	155,692,000	436,643,000	77,110,000
Minneapolis	189,191,000	87,446,000	205,953,000	44,006,000
Kansas City	253,865,000	120,539,000	342,863,000	95,215,000
Dallas	267,964,000	116,458,000	348,183,000	46,986,000
San Francisco	792,554,000	298,521,000	1,804,084,000	184,980,000
Treasury	37,799,000	15,699,000	20,789,000	3,321,000
TOTALS	$15,644,788,000	$10,737,581,000	$14,132,177,000	$1,651,708,000

Subscriptions by investor classes:	5-5/8% NOTES A-1969	5-3/4% NOTES A-1974
States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States which submitted certification and received full allotment	$ 89,716,000	$ 73,700,000
Commercial banks (own account)	5,108,061,000	6,866,815,000
All others	2,959,919,000	7,091,662,000
TOTAL	$8,157,696,000	$14,032,177,000
Federal Reserve Banks and Government Investment Accounts	7,487,092,000	100,000,000
GRAND TOTAL	$15,644,788,000	$14,132,177,000

F-1080

TREASURY DEPARTMENT
Washington

FOR A.M. RELEASE
THURSDAY, NOVEMBER 16, 1967

REMARKS BY THE HONORABLE STANLEY S. SURREY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
MONEY MARKETEERS
AT
OSCAR'S DELMONICO RESTAURANT, NEW YORK, NEW YORK
NOVEMBER 15, 1967 - 7:00 P.M., EST

THE UNITED STATES INCOME TAX SYSTEM -- THE NEED FOR A FULL ACCOUNTING

The United States income tax system is a powerful factor in our society, in our businesses and in our households. Viewed in the aggregate, its importance for fiscal policy purposes has been demonstrated in recent years, notably in the 1964 revenue reduction -- and we hope again this year through the tax surcharge. American business is intimately aware of its importance in the particular, and tax planning is an integral part of business planning. About 90 percent of our adult population is involved in filing an income tax return and 75 percent in paying an income tax -- a coverage broader than in any other country.

An income tax system of such strength and breadth of application warrants a full accounting. It would seem but obvious that we should be fully aware of its content and scope, so that we could intelligently pass judgment on its effects. This being so, it is all the more surprising that there are gaps in the accounting that now obtains. These gaps exist both at the Governmental level, in the way our Budget reflects the income tax, and at the level of the individual business, in the way financial accounting handles the impact of the tax. These gaps have serious implications for our understanding of the tax system.

F-1081

We may start with the way our income tax is reflected in the Federal Budget in aggregate terms. The Administrative Budget and the Cash Budget both treat tax receipts on a cash basis. This being so, the degree to which changes in income tax or other rates are currently reflected in the Budget depends upon the timing of tax payments. Recent changes in that timing, notably graduated withholding, estimated tax payments for corporations, and currency of deposit for withheld taxes and excise taxes, have considerably narrowed the gap between legislative changes in rates and the impact of the changes on the Administrative and Cash Budgets. The National Income Accounts Budget reflects taxes on an accrual basis, except for non-withheld individual income taxes which are on a cash basis. These variances in the Federal Budget statements of revenues have made it difficult for the general public to readily comprehend the aggregate economic effect of the tax system. The problem is heightened by the fact that the Administrative Budget does not cover the taxes earmarked for various trust funds, such as Social Security taxes and highway taxes, while the other two Budgets do include these revenue sources.

Each of the Budgets conveys some information and a thorough analysis would make use of all of them. Many people, however, think of "the Budget" in terms of one set of figures; this one set of figures is usually that in the Administrative Budget, which is probably the least useful for general economic analysis.

The recent Report of the President's Commission on Budget Concepts seeks to develop one comprehensive measure to reflect aggregate revenues. Its recommendation for the revenue and expenditures part of the Budget would include all revenue sources -- both general revenues and trust fund revenues -- and would place reporting of the income tax revenues on an accrual basis. The Commission states that the use of an accrual basis for the corporate tax and other taxes could be done at this time, while its application to the individual income tax requires further study. These changes in Budget reporting will permit a better public understanding of the economic weight of our taxes. The changes will thereby contribute to a more informed consideration of what will be our major fiscal policy issue in the Post-Vietnam period -- how the revenues released by the reduction in military expenditures should be distributed between tax reduction and aggregate civilian expenditures.

The President's Commission on Budget Concepts also made recommendations regarding the Budget treatment of expenditures, but one aspect was not considered. The aspect not considered -- and this is reflected in all discussions of expenditures -- concerns the Government expenditures made through the tax system. At first blush, such a phrase -- Government expenditures through a tax system -- seems almost meaningless. A tax system presumably concerns itself with raising revenues rather than spending funds. But a closer analysis of our present tax system would reveal real substance to the phrase. Through deliberate departures from accepted concepts of net income and through various special exemptions, deductions and credits, our tax system does operate to affect the private economy in ways that are usually accomplished by expenditures -- in effect to produce an expenditure system described in tax language.

Let us take a simple example: The Federal budget for the Department of Health, Education and Welfare has line items detailing expenditures, including trust fund expenditures, for old age assistance. But that budget contains no line item for the $2.3 billion expended through the tax system to aid the elderly -- under the special $600 exemption, the retirement income credit, the exclusion of Social Security retirement benefits, and so on. The HEW budget also has line items for medical assistance expenditures, but no line item for $100 million expended through the tax system by reason of the special exemption for sick pay paid to employees.

The budgets of the Commerce Department and the Transportation Department contain line items for expenditures under Federal programs for aiding business. But there are no line items for the very large amounts, reaching over $1 billion, expended through the tax system either as tax relief, incentives, or assistance for a variety of business activities: for example, financial institutions, through special deductions for reserves; Western Hemisphere Trade Corporations, through special rate reductions; shipping companies and life insurance companies, through special deferrals.

The budget of the Interior Department has line items for natural resources programs, but no line items for the large amounts, also over a billion dollars, expended under the tax system to assist our natural resources industries, including timber, through expensing of certain capital costs, expensing in excess of cost under the treatment of depletion, and special capital gain treatment. The budget for the Agriculture Department has line items representing programs to assist agricultural activities, but no line items for amounts, over a

half-billion, expended under the tax system through the expensing of certain capital costs, the availability of the cash method of accounting even if inventories are used, and special capital gains treatment of livestock.

The absence of line items in the Budget for these tax expenditures -- this lack of a full accounting for our tax system -- has many facets. To begin with, it lessens public understanding of significant segments of our tax policies. For the most part there are no line items in the Internal Revenue Service Statistics of Income delineating these items, so that in the absence of special studies the amounts involved are simply unobtainable. Indeed, many of these "tax expenditure" programs cannot be found in the Internal Revenue Code, so that unlike direct expenditure programs where the budget trails are relatively well posted, the "tax expenditure" trails are very often obscurely marked.

A large part of the tax benefits for the elderly rests on a very brief and cryptic administrative ruling of the Internal Revenue Service excluding Social Security retirement benefits from income, without citation of any authority for the result; much of the benefits for financial institutions rests on administrative rulings stating how the reserves against debts owed to banks shall be computed; a large part of the benefits to agriculture and natural resources also find their origin and even some of their current expression in administrative rulings and regulations.

When Congressional talk and public opinion turn to reduction and control of Federal expenditures, these tax expenditures are never mentioned. Yet it is clear that if these tax amounts were treated as line items on the expenditure side of the Budget, they would automatically come under the close scrutiny of the Congress and the Budget Bureau. But the tax expenditures are not so listed, and they are thus automatically excluded from that scrutiny. Instead, since they are

phrased in tax language and placed in the Internal Revenue Code, any examination to be given to them must fall in the classification of "tax reform" and not "expenditure control". There is a vast difference between the two classifications.

It can be suggested therefore that we need a full accounting for these effects of the tax system. The approach would be to explore the possibility of describing in the Federal Budget the expenditure equivalents of tax benefit provisions. We should not, of course, overlook the difficulties of interpretation or measurement involved here. Thus, just which tax measures can be said to fall in this category -- in other words, which tax rules are integral to a tax system in order to provide a balanced tax structure and a proper measurement of net income, and which tax rules represent departures from that net income concept and balanced structure to provide relief, assistance, incentive or what you will for a particular group or activity. Also, once a tax item can be identified as falling in this second category, we must then compute its expenditure equivalent. Presumably this would be the amount of revenue lost, i.e., "spent," under the special tax treatment, and in a number of situations revenue statistics would have to be improved to give us this information.

This discussion is not to be taken as saying that all tax relief measures are bad -- or that all are good -- just as it is not intended to state that all Federal expenditure programs are bad or all good. This is not a qualitative discussion of tax preferences or, as some say, tax loopholes.

I might here digress to note that one reason tax reform is so difficult may be the hard, unfeeling way we go about it. The very word "loophole" has a jarring ring. I commend

to your attention the delicacy of the following paragraph from a recent Canadian Budget speech of last year:

> "In recent months there has been evidence of increasing abuse of the section of the Act providing special tax treatment for deferred profit sharing plans. In 1960 and 1961 my predecessor, then the Hon. Member for Eglinton, with the worthiest of motives, introduced a section in the Act to provide for these plans, which he described as an important piece of social legislation. Since then various businessmen and their professional advisers have exploited this well-intended but vulnerable section in various ways."

Nor is my discussion intended to say that tax relief deliberately programmed as a direct expenditure item would look the same. Indeed, a possible consequence of describing tax preferences as expenditure equivalents is that more efficient ways to achieve the objective may be developed. I cannot think of any responsible HEW or Budget Bureau official who would put together an expenditure program of assistance to the elderly that would in any way resemble the crazy-quilt pattern of our tax treatment of the elderly. Under that treatment half of the tax revenues spent go to people over age 65 on retirement whose annual income is over $10,000 and hardly any goes to people in that age group who continue to work for their maintenance and whose incomes are far lower. Nor can I think of an agricultural expert who would put together a farm program under which the benefits would become greater the wealthier the owner and the less he relied on his farm activity as the source of his income. Indeed, I suspect that cost-benefit experts assigned to measure the efficiency of tax expenditure programs would have a fascinating time. Appropriate budgetary recognition of these tax expenditures would facilitate such cost-benefit studies.

At this point a word on the investment credit may be helpful to illustrate a different kind of tax device. This credit is a feature of our tax law designed to improve rates of return and to increase investment. We believe it is a sound provision which serves to achieve a better balance in a tax system which would otherwise impinge too heavily on the level of private savings and investment.

Perhaps it could be cast as a direct government expenditure, and the English have recently taken this approach. But there are very definite advantages in handling the sums involved through the tax system. The computation of the credit depends entirely on tax concepts, such as the basis for depreciation and depreciable lives, and being in the tax system its effect is limited to firms which, at least over the long run, expect to make profits. Also, by being in the tax system it remains quite neutral with regard to the investment to which it is applied; it does not involve extensive government decisions as to which investments are particularly meritorious. It is spread very broadly over all business, agriculture, finance, the professions and so on -- the whole gamut of American enterprise.

Let us turn from the accounting at the Federal Budget level for aspects of our tax system and consider the accounting at the taxpayer level. We must, of course, recognize that American accounting practices, the requirements of the Securities and Exchange Commission, and above all the integrity and experience of our accounting profession, have combined to give the American public a very considerable amount of reliable data regarding the operations of our business concerns. This is a long cry from an accountant's statement recently submitted to our Internal Revenue Service representative in one of our European Embassies with respect to the balance sheet of a concern in that foreign country. The statement said that the balance sheet was:

> "Prepared from the official books (of the economy) together with data made available (to the accountant) with regard to secret surplus reserves originating from profits that were not disclosed to the ... Government. These secret reserves consist of cash balances at two local banks; marketable securities held by these same two banks as guaranties to overdraft accounts, and an overstatement of the liability regarding commissions payable to the London agent."

It is not this situation that I am now discussing, for fortunately we do not face in the United States this kind of lack of full accounting regarding the profits picture of a corporation, and hence its tax picture. Rather, I would like to consider the question of how a properly, and of course honestly, prepared financial statement should account for these special tax expenditure programs I have been discussing.

The Accounting Principles Board of the American Institute of Certified Public Accountants has recently issued an Exposure Draft of a proposed Opinion on financial accounting for income taxes. One aspect of that Opinion relates to how business firms should, in their financial reports, handle the 7 percent investment credit. The present accepted accounting for the credit affords an option: the company may, in computing after-tax profits, simply treat the tax reduction provided by the credit as a reduction in the current year's tax expense, or it may amortize that reduction over the life of the asset giving rise to the credit. Apparently about 80 percent of the firms use the first option, that of direct reduction (sometimes called the "flow-through" approach). The proposed Accounting Principles Board Opinion would eliminate the optional approach and require the second method, that of amortization or the "deferred method." The result of the deferred approach would be to show lower after-tax profits, since the tax reduction resulting from the credit is spread over future years. The Opinion also considers the accounting for various other tax reduction provisions, and here also applies "deferred accounting."

The Treasury Department has a substantial interest in the manner in which business concerns report their Federal income tax liabilities on financial statements. The proposed Accounting Principles Board Opinion raises a crucial issue whose resolution is of vital significance to the public understanding of our tax system. Just as it is important to know at the level of the Federal Budget what is happening with respect to the aggregates under our tax system with its many special tax provisions, it is equally important to delineate as clearly as possible the effects of those provisions on individual firms.

The Treasury's concern with respect to the proposed Opinion has nothing to do with income tax collections -- the corporations affected will pay the same amount of tax annually whichever approach is adopted. Rather, our concern is with the proper representation in the financial statements of these corporations of the effect of the tax system.

While the statutory corporate income tax rate is 48 percent, it is clear that the effective corporate tax rate on American business as a whole is considerably less than this. The reduction results from decisions on the part of the Congress to achieve this lower effective tax rate on American business in general and on special industries in particular. The accounting approach suggested in the proposed APB Opinion would, however, in the aggregate, substantially overstate the current tax liability of American business and present an inaccurate picture of our tax system. Since the tax liability would be substantially overstated in the aggregate, it would obviously also be overstated individually for the vast majority of United States corporations.

The preferences incorporated within the tax law clearly result in an effective corporate tax rate for many taxpayers that is less than 48 percent. Financial accounting should recognize this -- both because it is the fact, and because the stimulative effects resulting from the tax reduction should not be obscured.

Special care must be exercised with respect to the investment credit because of its magnitude and because most companies would have to change their existing practice in

response to the position taken in the Accounting Principles Board Exposure Draft. Presumably, this would result in a massive restatement of earnings whose effects on the economy, while difficult to measure, could be serious. Furthermore, a mandate to defer the benefit arising from the investment credit could well blunt its effectiveness in promoting modernization and expansion.

For these reasons the Treasury Department responded to the request of the Accounting Principles Board for comment on its Exposure Draft with a letter expressing its serious concern over the approach taken by the APB in its proposed change in the method of accounting for the 7 percent investment credit. We believe our comment underscores the need for further study of the financial accounting for income tax liabilities at the level of the individual firm.

There are thus considerable gaps in the present accounting for our income tax system. It may be helpful to relate this description of these gaps to a current matter -- the use of tax incentives to meet our social problems.

America faces many social problems that desperately require solution. A major part of these problems centers around the plight of our cities and their disadvantaged residents. One aspect of suggested solutions involves an increase in moderate and low income housing, with special emphasis on housing located in these areas. Another involves providing jobs for the disadvantaged, through manpower training programs and greater employment in business activity within these areas or the aided movement of the inhabitants to jobs outside the areas. Participation by private enterprise, especially large concerns, is considered helpful to achievement of these goals. But it is said that the likely rate of return from business activity involving that participation may not be adequate to enlist that participation. Hence it is proposed in some quarters that the rate of return be increased by some form of tax reduction in exchange for the participation desired. The tax reduction suggested generally involves a large credit against tax or special deductions.

This is one illustration of the tax incentive approach in the setting of social reform. Other illustrations may be found in other social objectives -- pollution control, aid to education, assistance to rural areas, and so on.

Certainly no one can quarrel with these social objectives. In the past tax incentives were generally sought -- and at times obtained -- on the ground that a particular industry needed support. The crucial question of why that support was in the public interest was barely spelled out, if at all, and the details of proof were held to a minimum. But today the public interest objective is in the forefront, and needs no proving. And it is generally taken for granted that private enterprise participation will always be helpful. What is not shown is why the tax route is to be preferred over other means of inducing the desired participation of private enterprise.

The immediate leap to the tax solution serves only to stultify thinking about these social problems. Once the leap is made there is no opportunity to explore the details of the problems. Yet a great many useful questions can be asked: For example, as to low income housing in urban areas and jobs for the urban disadvantaged, just why has private enterprise not undertaken these tasks in the past? Is it that the immediate return is insufficient, or is it that the participation has been seen as only sporadic? What forms of private enterprise are best suited to the tasks? Is it a large industrial concern or a small indigenous business locally owned; is it manufacturing activity or service activity; is it an experienced builder or a concern new to the building field but with management know-how in other business fields? More crucial, what measures are needed to induce the participation -- what rate of profit, what assistance in financing, what guarantees against loss, what assurance of a continued market, what other forms of protection against the risks that have hitherto restrained participation, and so on?

With these questions answered as best we can, the task is then imaginatively to search the arsenal of possible Governmental action -- if Government assistance is needed -- to see which forms of Governmental action can be most responsive, effective and efficient. Here also the immediate leap to the tax route can only prove stultifying, for it tends to foreclose consideration of all other avenues of assistance. And yet experience has taught us that with respect to Governmental assistance to a particular group or activity, the non-tax route is far more liekly to yield the better answer at a lesser cost. Moreover, the tax answer once enacted may well inhibit further useful thought about the problem. It would seem far better to let HUD or Commerce or Labor or HEW gain experience and flexibility through non-tax solutions that can be varied and tested, than turn much of the task over to the Internal Revenue Service, which has no background of experience to use and for whom an increase in experience in the social area will not yield the productive return that it would in the other Departments.

Our progress in space exploration is not built on tax incentives, but on direct relations between Government and business that bring forth the required participation by private enterprise. Our capsules are not propelled into space by the Internal Revenue Code.

In large part those who leap to the tax route recognize all this. But they assume that the non-tax solutions will involve large Government expenditures and they fear that the appropriation door is shut or will not open very wide. Whatever may be the validity of those assumptions and fears as to any particular program, there is no reason to conclude that because the front door of appropriations is closed or narrow, the back door of tax reduction will open wide.

Those who are concerned with the level of government expenditures are cognizant of the two doors to the Federal budget. They readily understand that a decrease in revenues through a tax expenditure has the same impact on the Budget deficit as a direct increase in expenditures. Chairman Mills of the House Ways and Means Committee, for example, has said he considers such tax incentives as "a form of back door spending." He thus fully recognizes it is the door of his Committee that is being knocked on as the entrance to the Budget through tax incentives, rather than the direct route of government assistance. And he can also recognize if that door opens for one or two tax incentives, it must inevitably stay permanently ajar for the wave of tax incentives that would follow.

Chairman Mills is on sound ground. For here also we reach the aspect of full and proper accounting. Our experience with the tax incentives of the past should give us pause before we add a new tax-route expenditure and then keep it buried in the Code away from public scrutiny. We have learned that the tax incentive of the moment becomes the tax reform target of many tomorrows. What can be said about tax incentives for these urban problems can also be said about tax incentives for our other social problems -- pollution control, college education within the reach of all who are qualified, development of rural areas and new towns, assistance to depressed areas, and so on. It is almost demeaning to our collective wisdom to say that every one of these problems will yield and yield only to the universal solvent of a tax incentive. And if they did, how would we solve the loss of our tax system that this maze of tax incentives would mean?

All of this is not to be taken -- and this must be underscored -- as saying the Treasury Department stands aloof from society and its problems. The Treasury clearly recognizes that a negative answer as respects the tax route equally does not solve a problem. It therefore has joined -- and continually will join -- the other Departments and agencies in the active search for constructive solutions involving other forms of governmental assistance or action.

Indeed, the Treasury has found that the way to obtain imaginative and broad thinking about these social problems -- to obtain real brainstorming -- is to tell the groups concerned to forget their stereotype, first impulse solution of a tax incentive, to close the Internal Revenue Code, to bar their tax lawyers from the meeting -- and then get down to the real task of analyzing the problems and thinking about the possible solutions. The results are always positive. Once the blinders of a proposed tax incentive solution are removed and the whole horizon of approaches is opened to exploration, we begin to appreciate that there are many constructive measures that can be taken outside of the tax system.

Our social problems are causing very large demands to be made upon the Federal Government. We are a wealthy nation and we certainly should be able to solve these problems. But even with our great wealth the solutions for all these problems will come more readily if our planning is efficient and sound. There are limits to the ways in which we can use our resources and those limits require careful expenditure control. Such control in the planning of a particular program, even one with a high priority, means other useful programs will not have to be starved.

We must therefore recognize that our tax system should not be used as a back door through which the dollars are to flow free from this careful planning. We need a much higher degree of accounting for the dollars that the tax expenditure programs which grew up in the past are now absorbing. We also should be careful not to leap to a new set of uncontrolled tax expenditure programs through a new set of tax incentives. This is especially so when there are adequate non-tax measures at hand with which to attack these social problems. As a consequence, closing the back door of tax incentives does not mean that no solution will be provided. Rather, it means that the doors and windows are opened for constructive thinking about these other measures. This is the way to both social progress and a sound tax system.

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STATEMENT OF THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
ON PRIVATE FOUNDATIONS
BEFORE SUBCOMMITTEE NUMBER 1, SELECT COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES
WEDNESDAY, NOVEMBER 15, 1967, 10:00 A.M.

Mr. Chairman and Members of the Subcommittee:

I should like to take this opportunity to state, as succinctly and directly as I can, both the record and the position of the Treasury Department on legislative reform relating to private foundations. If you or your staff have any questions concerning the administration and application of existing laws in various individual cases and situations, I shall refer all questions and leave the discussion to the Commissioner of Internal Revenue in whom I repose the highest confidence. He is in charge of the administration of tax laws.

In his appearance before your Committee in the summer of 1964, Secretary Douglas Dillon stated:

"As a matter of personal practice, I do not associate myself, and have disassociated myself ever since I was in the Treasury, with individual tax cases and tax questions, so that to the extent it is an individual case dealing with an individual taxpayer or an individual foundation which is not a taxpayer, but has to file information returns, I would not have

any action. This has been left entirely to the Internal Revenue Service."

I, too, have followed that practice.

On detailed questions as to the various choices of remedy through modification of the laws applying to foundations, I shall call upon Assistant Secretary of the Treasury for Tax Policy Stanley Surrey, who was in charge of the study which resulted in the submission of the Treasury Report on Foundations which contained the Treasury Department's recommendations for new legislation concerning foundations. I resigned from the Treasury as Under Secretary in April 1964 and returned as Secretary in April 1965. In that interval, the Treasury completed its Report and Secretary Dillon submitted it to the appropriate committees of Congress for implementation. While I am not familiar in detail with all of the choices open at that time and the reasons for the selection of those which are included in the Treasury Report, by reason of not being in the Treasury Department then, I endorse the principal recommendations and will support them if called before the House Ways and Means Committee and the Senate Finance Committee.

From 1961 through 1964 the Department conducted an extensive study of the activities of private foundations and the operation of the present laws governing them. It analyzed the relevant administrative

and litigation experience of the Internal Revenue Service and the Department of Justice. It made a special survey of a selected sample of about 1300 foundations to secure new data about their characteristics and performance. Department representatives discussed the facts of the foundation world with lawyers, accountants, critics, administrators, and others familiar with foundation operations. Careful attention was given to the work of other investigators, including this Subcommittee.

Drawing upon the information produced by this study, the Treasury Department concluded that six major problems exist among private foundations. The Department found, also, the presence of several additional problems of less general significance. In its Report on Private Foundations, submitted to the House Ways and Means Committee and the Senate Finance Committee early in 1965, the Department described these problems in considerable detail, provided a series of illustrations of each of them, and recommended quite specific revisions of existing Federal laws to deal with them.

That study did not conclude that the abuses outweighed the benefits to society of private foundations. Rather the Report concluded, and I firmly believe, that private foundations fulfill a vital need of our society; the need for the pioneer, and the vision of the experimenter. In this role, they both complement and supplement the services provided by government and by other non-profit activities in general.

Thus, our recommendations were conceived within the framework of preserving this vital philanthropic activity. Our objective is the elimination of abuses engaged in by some and thereby to strengthen the institution itself.

We should not be misled or diverted from this goal by those who operate on the fringes of philanthropy or with the cloak of philanthropy but without philanthropic motive. The aberrations which they produce can be readily curbed either under existing law or if necessary by specific and selective legislative changes. It is a disservice to confuse those who pervert the law for private gain with those foundations which operate to sustain and advance philanthropy.

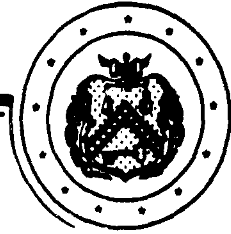
The Senate Finance Committee published the Treasury Report at once. Later in the year the House Ways and Means Committee solicited written comments on the Report from the general public. It published those comments in November and December of 1965.

In his 1966 Economic Report to the Congress, the President urged the Congress "to deal with abuses of tax-exempt foundations." In his Economic Report of 1967, the President again directed Congressional attention to the need for reforms in this area. However, the Ways and Means Committee--its time during the past several years almost steadily occupied by other major tax and Social Security legislation--has not yet taken further action on the Treasury Report.

An examination of the record, then, makes the Treasury Department position on foundation reform quite clear. Having studied the field thoroughly, the Department reported its findings to the Congress, made specific and detailed recommendations for legislative action, and has strongly urged adoption of those recommendations. The President has twice recommended action. The Department presently awaits the attention of the tax writing Committees to this important matter and stands ready to work on this important phase of tax reform with those Committees in the customary manner and procedure when they are ready to proceed.

Thank you.

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 15, 1967

'OR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders 'or two series of Treasury bills to the aggregate amount of $2,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing November 24, 1967, in the amount of $2,401,985,000, as follows:

91-day bills (to maturity date) to be issued November 24, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated August 24, 1967, and to mature February 23, 1968, originally issued in the amount of $1,001,494,000, the additional and original bills to be freely interchangeable.

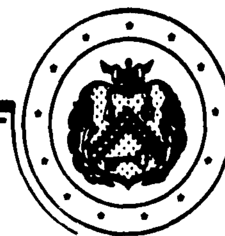
181-day bills, for $1,000,000,000, or thereabouts, to be dated November 24, 1967, and to mature May 23, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Standard time, Monday, November 20, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 16, 1967

FOR IMMEDIATE RELEASE

TREASURY'S MONTHLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $1,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing November 30,1967, in the amount of $3,801,885,000, as follows:

275-day bills (to maturity date) to be issued November 30, 1967 in the amount of $500,000,000, or thereabouts, representing an additional amount of bills dated August 31,1967, and to mature August 31,1968, originally issued in the amount of $1,000,336,000, the additional and original bills to be freely interchangeable.

366-day bills, for $1,000,000,000, or thereabouts, to be dated November 30,1967, and to mature November 30,1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Standard time, Wednesday, November 22, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. (Notwithstanding the fact that the one-year bills will run for 366 days, the discount rate will be computed on a bank discount basis of 360 days, as is currently the practice on all issues of Treasury bills.) It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefore.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from

F-1084

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE

STATEMENT BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
AT A NEWS CONFERENCE
ON THE
THIRD-QUARTER, 1967, BALANCE-OF-PAYMENTS RESULTS
AND VOLUNTARY COOPERATION PROGRAMS FOR 1968,
NOVEMBER 16, 1967 AT 2:00 P.M.
ROOM 4121, MAIN TREASURY

I am here today primarily for four purposes:

-- to make our usual announcement of preliminary balance-of-payments results for the third quarter;

-- to present, jointly with Secretary Trowbridge and Governor Robertson, the Commerce and Federal Reserve guidelines for the Voluntary Cooperation Programs in 1968;

-- to call attention to the announcement by the President this morning of the Industry-Government Special Travel Task Force which has as its aim the development of new programs to increase foreign travel to the United States; and finally

F-1085

-- to emphasize that the enactment of the President's tax increase program at this session of Congress is the single most important and indispensable step this nation can take now to improve our balance of trade and payments and protect the dollar and the international monetary system.

THIRD-QUARTER RESULTS

The main features of the balance-of-payments results for the third quarter are:

-- A deficit of $670 million on the "liquidity" basis. This is $120 million larger than in the previous quarter. At the end of nine months the liquidity deficit totalled $1,750 million compared with $938 million a year earlier.

-- An "official settlements" surplus of $462 million. This represents an improvement of $1,292 million from the large deficit of the preceding quarter. At the end of nine months we had a total deficit of $2,181 million on this basis compared with a surplus of $243 million a year earlier.

-- A decline in our gold stock of $92 million, compared with a loss of $15 million in the second quarter. At the end of nine months the total gold loss was $157 million compared with $450 million a year earlier.

Merchandise Trade

A major favorable factor in our balance-of-payments situation through the third quarter is the continuing recovery in our trade surplus. Using seasonally adjusted balance-of-payments (as opposed to Census) figures:

-- The third-quarter trade surplus was at an annual rate of $4.5 billion, down slightly ($100 million annual rate) from the second quarter.

-- For the first three quarters our trade surplus -- again on a seasonally adjusted basis -- ran at a $4.39 billion annual rate, representing an improvement of $473 million over the same period of last year.

-- Particularly noteworthy is the sharp drop in the growth rate of our imports. In the year 1966, imports increased more than 18-1/2 percent over 1965. For the first nine months of 1967, they increased not quite 5 percent compared with the

same period last year. In the third quarter, there was a small absolute decline in total imports from the seasonally adjusted level in the preceding two quarters.

-- Our export total for the first three quarters of this year increased about 6 percent from a year earlier. However, exports during the past nine months have remained almost flat at the $7.7 billion quarterly rate achieved in the first quarter. This undoubtedly reflects the continued slow pace of business expansion in several of our major markets abroad.

While our trade position has improved in 1967, the improvement is clearly inadequate. For the first three quarters, and in the quarter just concluded, our trade surplus was still running at an annual rate more than $2 billion below the all time high of $6.7 billion reached in 1964. I will comment on this in more detail a bit later in my statement today.

Other Items

New issues of foreign securities in the third quarter showed a $170 million increase (seasonally adjusted) over the second quarter. Nearly half of this increase was accounted

for by extraordinary sales of Israeli bonds following the Middle East war and an increase between the two quarters in IBRD issues, These outflows, however, were accompanied by some offsetting purchases of U. S. agency bonds.

While redemptions were substantially unchanged from the previous quarter, the preliminary figures on other transactions in outstanding foreign securities show a net outflow of around $50 million.

Total bank loans to foreigners showed a seasonablly adjusted ncrease of almost $400 million in the third quarter, a $170 illion increase over the second quarter. This increase re- lected:

-- a $100 million reduction in the outflow of short-term bank funds (from a second quarter level of about $390 million to $291 million in the third), coupled with

-- an adverse shift of $270 million on long-term bank credits. The second quarter inflow of $163 million changed to an outflow of $107 million in the third quarter.

: the end of the third quarter, the outstanding level of such reign credits was still about $530 million below the suggested

:eiling of $10.1 billion under the 1967 Federal Reserve voluntary
›rogram.

Inflows of foreign capital through transactions in U.S.
ıon-Treasury securities and in long-term CD's and deposits
'ith U. S. banks were down roughly $500 million in the third
uarter, compared with the second, but still about $170 million
arger than in the corresponding quarter of last year.

Receipts from advance payments on U. S. Government credits
ere negligible in the third quarter ($5 million) compared with
bout $225 million in the same quarter last year.

The $125 million purchase by Germany of a special medium-
erm Treasury bond in the third quarter was more than double
ıe payments which they made to us during the third quarter
f 1966 for military purchases under our previous offset agree-
ent -- but was also less than half the second-quarter level of
ıese military-purchase payments this year, preceding the mid-
ear expiration of the old agreement.

As you know, these preliminary quarterly balance of pay-
ts releases always include a large residual item, covering
number of accounts in our balance of payments for which the
test quarterly data are not yet available. These include,
ong others, the tourism, investment-income, and other
ervices" accounts; Government grants and capital; a number

f categories of private capital transactions, including U. S.
irect investment abroad; and our military expenditures.

The net third-quarter outflow on this residual item was
own $800 million from the second quarter this year, but that
or the first three quarters combined was about $800 million
arger than the corresponding period last year.

Without attempting any guesses at this stage as to what
ty have happened to the many different accounts which are
umped together in this item, we do know:

-- that our Vietnam costs, and over-all military expenditures abroad, have been running moderately higher;

-- that the travel deficit has been adversely affected by Expo; and

-- that private remittances to Israel increased sharply, at least in the second quarter, due to the Middle East conflict.

e "Official Settlements" Balance

As I have indicated previously, this balance is likely to
ow quite erratic movements. In particular, during the period

from mid-1966 on (due in large part to the appearance, and subsequent easing, of very tight money and credit conditions here along with some pressure on sterling in international exchange markets) our balance on this basis swung:

-- first to a surplus of nearly $850 million for the second half of last year, and

-- then back to a very large deficit (about $2,650 million) in the first half of this year.

These previous wide swings in the "official settlements" balance were also, as you know, accompanied by very large shifts in net borrowing of Euro-dollars by U. S. banks through their branches abroad. Our third-quarter return to a surplus on this basis has again shown this pattern of a parallel shift in such Euro-dollar borrowing by U. S. banks. As measured by the liabilities of U. S. banks to their branches abroad, such borrowing began to turn up again late in the second quarter of this year and increased during the third quarter by roughly $900 million.

BALANCE OF PAYMENTS PROGRAM

Our over-all balance of payments program has both short-term and long-term elements.

Short-term

The Interest Equalization Tax

As you know, the Congress, acting on the recommendation of the President, has voted to extend the life of the IET for two years and also change the law to make it a more flexible policy instrument by granting the President discretionary authority to vary the rate of tax within a range equivalent to an added cost of zero to 1-1/2% per annum of added cost to foreign borrowers. After being raised temporarily to the 1-1/2% level during the period of Congressional consideration, this was reduced, following enactment, to 1-1/4%, a moderate increase from the original 1% level.

The New Voluntary Programs

Supplementing that action, we are today announcing an

extension, and new guidelines, for the Commerce and Federal Reserve voluntary programs for 1968.

President Johnson has approved the recommendation which I made to him -- in my capacity as Chairman of the Cabinet Committee on Balance of Payments and on the basis of an intensive review in that Committee both of the current balance of payments situation and outlook and of the overall U. S. balance of payments program -- for continuation and strengthening of the Voluntary Cooperation Program.

Details of the new guidelines for 1968 under this program are contained in the releases by the Commerce Department and the Federal Reserve Board already distributed to you. Secretary Trowbridge and Governor Robertson are prepared to deal with any questions about them you may have.

Lc. g Term

Exports

I have already commented on the importance of our merchandise trade and the disappointingly limited improvement we have had on this account so far this year.

-- This re-emphasizes the need for sound fiscal and monetary policy -- including a prompt tax increase, which is needed badly and needed now.

-- It re-emphasizes the foolhardiness of recent protectionist proposals, which can only cripple our trade position over the long run; and

-- It re-emphasizes the need for selective measures to encourage Americans industry to cultivate foreign markets more aggressively. Such measures are under active consideration.

Travel Task Force. In another very important area, I also want to call special attention to the announcement by the President this morning of the Industry-Government Special Task Force, chaired by former Ambassodor to Switzerland Robert McKinney. Its aim will be to develop new programs to increase foreign travel to the United States -- which can be an important part of our long-term effort to balance our international payments by increasing our receipts.

The group includes distinguished representatives of a broad cross section of American business -- with emphasis on the travel and communications industries. These men will study what other governments are doing in the travel field; what foreign business does; and what our government and travel industry are and should be doing to promote more foreign travel to this country.

The government effort in this area has been a limited one -- the $3 million a year this government spends in promoting travel by foreigners in the United States is only a fraction of what is utilized by a number of other countries. We are looking to the new Task Force to make recommendations on how the federal government, states

and the private sector can work together, shoulder to shoulder, to increase travel receipts and reduce the travel gap. This will require a long term effort on the part of all of us but I am confident it can be done.

Encouragement of Foreign Investment. I also wish to congratulate the private financial community on their intensified efforts to encourage increased investments by foreigners in the United States. This has recently been exemplified by the formation of the Council of the United States Investment Community abd its sponsorship of a trip to the United States by a large group of foreign bankers and investment managers.

This is just the kind of private initiative we need, and we in the Government pledge our continued cooperation in making such initiative as fruitful as possible.

Gold Budget

An intensified review of government expenditures abroad is underway. While for most departments these are a very minor portion of their total expenditures, they are, nevertheless, being subjected to careful scrutiny with the objective of achieving balance-of-payments savings

The Government is engaged in the most strenuous and extensive effort it has ever undertaken to minimize the impact on our balance of payments of the foreign exchange expenditures made for the common defense and in connection with our bilateral and multilateral aid program.

We shall have more to say about that later.

Conclusion

Thus, in concluding, I want to make it clear that the programs that Secretary Trowbridge and Governor Robertson will describe today represent only a part of our overall balance of payments effort. They are essentially short-term in nature. While they have been extended more often than we would like, this is a consequence of the large foreign exchange costs of Vietnam. We are working hard to develop a broader and more intensive long-range program to increase our foreign exchange receipts and to keep government foreign exchange costs under tight control. It is upon the success of these programs, as well as the termination of hostilities in South East Asia, that ultimate phasing out of these voluntary programs depends.

But, in the final analysis all of these efforts, short-term or long-term, to improve our balance of payments position are threatened with failure unless we return to relative price stability and cost competitiveness in the U. S. economy -- unless we resist and avert the threat of excessive demand which damages our trade balance -- unless we play a responsible role in assuring a sound international monetary system that enables our markets to prosper.

As I said at the outset, the enactment of the President's tax increase program at this session of Congress is the single most important and indispensable step this nation can take now to improve our balance of trade and payments and protect the dollar and the international monetary system.

It is unthinkable to me to allow this session of Congress to conclude without an all-out effort by all responsible forces to put the President's tax proposals into law.

This is a legislative matter which cannot be delayed without undue and unacceptable risk of serious damage to the nation's economic and financial structure and the international situation.

This is a "right now" matter -- it can't wait.

It is indispensable to any early arrest of interest rate escalation and movement toward a credit crunch at home, with all of the dangers to our domestic economy,,short and long term, of a credit shortage due to Government borrowing to meet a deficit that cannot be reduced to manageable proportions without a tax increase.

But the continued rise in our interest rates has serious international consequences as well.

The delay in acting on the tax increase, with the resulting upward movement of interest rates here, has already caused the central banks of Canada and the United Kingdom to raise their rates in defensive action.

In January 1967 the finance ministers of five countries -- the United States, the United Kingdom, Germany, France, and Italy -- met at Chequers in England in an effort to de-escalate the so-called international interest rate race. The Communique issued after that meeting said, in part:

> "The Ministers agreed that they would all make it their objective within the limits of their respective responsibilities to copperate

in such a way as to enable interest rates in
their respective countries to be lower than
they otherwise would be."

The whole point of the Chequers meeting was that all felt that undue dependence in the past had been placed on monetary policy, that, while this had produced needed restrictions on their economies, it had also produced distortions in their economies.

By and large, monetary cooperation proved successful in the ensuing months. And, even since then, despite the sharp upward rise of interest rates in the United States, most of the European countries have continued to follow relatively easy monetary policies. The German rediscount rate has been reduced from 5 to 3 percent in a serious of moves. Belgium has cut its bank rate five times -- from 5-1/4 to 4 percent. In the Netherlands, the bank rate has been reduced from 5 to 4-1/4 percent. France and Italy have continued their bank rates at 3-1/2 percent; Austria reduced its rate again at the close of October.

All of these moves were in full keeping with proper domestic economic policy.

However, there may be real question whether these monetary policies can be continued in the face of rising rates in the United States.

About a year ago the distinguished Governor of the Central Bank of Italy, Guido Carli, said this:

> ".... if one deludes oneself into thinking that a more elaborate policy mix can be successful without the operational techniques and sufficient forcefulness to put them into effect quickly, then it will, sooner or later, still become necessary to employ the credit restrictions which are characteristic of a cruder approach. In the end effect, their belated application leads the economy into more serious stagnation, the external deficit persists, confidence is lost, speculative pressures grow, and ultimately, ultimately, unemployment ensues."

On October 9, 1967, the French Minister of Economy and Finance told a group of French businessmen that "a rise in interest rates in the United States, with the risk of spreading

to other countries, and the corresponding risk of in economic development" was a negative factor in evaluating worldwide economic growth prospects.

The point I am making is, I believe, quite clear. High interest rates in the United States due to excessive borrowing by government are disturbing influences not only in our own country but also abroad. The more that rates rise in the United States, and the more that we seem inclined to rely on monetary rather than fiscal policy to restrain them, the greater the likelihood that we will again face international interest rate escalation.

Confidence in the dollar and the gold exchange standard which is the basis of our international monetary system depends on the ability of the United States Government to act responsibly. There is a general, widely-held feeling in financial circles here and abroad that a tax increase in the United States is an essential element of responsible financial policy under existing circumstances.

There is inflation already in fact and in prospect which will surely lead to another disruptive inventory cycle, a deterioration in our balance of payments, and a grave risk of "boom and bust", in addition to all its other undesirable consequences.

No course of ameliorative or preventive action can be effective without tax action now.

Because the consequences of a failure by Congress to act affirmatively this year could prove so damaging to the country and our international situation, every effort must be exerted by all in a responsible position to have the President's tax proposals acted upon promptly in the broad daylight with the full glare of national and international attention focussed on the issues.

TREASURY DEPARTMENT
Washington

November 16, 1967

STATEMENT BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
IN ANSWER TO QUESTIONS ON CREDITS
TO THE
UNITED KINGDOM

It is clearly inappropriate for me to comment in any way on the various stories which have been circulating concerning various financial packages and other matters relating to the United Kingdom.

The Prime Minister and Chancellor of the Exchequer have repeatedly made very strong statements on the subject of sterling, and have currently reaffirmed them in both word and deed. They have faced the issue with great determination and I have no doubt as to their success.

Against this background, in answer to any question concerning additional credits to the United Kingdom, I can only repeat what is already known to be established United States policy: this country has a consistent record of multilateral financial cooperation, a record which we intend to maintain.

TREASURY DEPARTMENT
WASHINGTON

November 19, 1967

FOR IMMEDIATE RELEASE

STATEMENT BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY

Events of the twenty-four hours following announcement of the new parity rate of $2.40 for the pound have demonstrated the strength of the international monetary arrangements and the spirit of monetary cooperation created in the Free World since World War II. This cooperation began with Bretton Woods, was strengthened and implemented through various successful arrangements over the past twenty years, showed up fully in the agreement reached at Rio de Janeiro in September in plans for new international liquidity, and has been expressed since the U. K. devaluation as:

-- The International Monetary Fund has indicated that it is giving prompt attention to the U. K. request for a $1.4 billion standby "with the expectation of reaching a favorable decision in a few days."

-- President Johnson has reiterated the firm commitment of the United States to buy and sell gold at the existing price of $35 an ounce.

-- An overwhelming majority of the major financial and trading nations of the Free World have announced decisions to maintain their currencies at present rates. It is clear now that adjustments will be confined to a few countries where fundamental disequilibrium also exists.

-- Chancellor Callaghan has indicated that very substantial additional financial support has already been pledged by a number of important central banks. Together with the $1.4 billion International Monetary Fund standby, this will bring total new support to approximately $3 billion.

To emphasize her determination to reach equilibrium, the U.K. Government has announced a series of new domestic measures designed to resolve her balance of payments problem.

The United States is confident that with this broad understanding and the actions cited above the United Kingdom will achieve its objectives. As the President said yesterday:

> "I believe the United Kingdom will -- at the new parity -- achieve the needed improvement in its ability to compete in world markets. The attainment of equilibrium by the United Kingdom will be a healthy and constructive development in international financial markets."

Thus the nations of the Free World have demonstrated again that they have the will and the means to work together, in the framework of the International Monetary Fund and other international cooperative arrangements, to assure the continued healthy functioning of the international monetary system.

The United States, with all of its productive strength, stands firmly committed to joining with others in the international task of maintaining a sound world monetary system.

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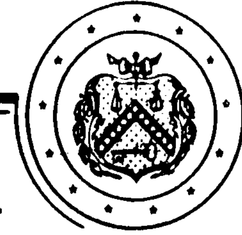
TREASURY DEPARTMENT



WASHINGTON, D.C.

RELEASE 6:30 P.M.,
day, November 20, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury ls, one series to be an additional issue of the bills dated August 24, 1967, and other series to be dated November 24, 1967, which were offered on November 15, 7, were opened at the Federal Reserve Banks today. Tenders were invited for 500,000,000, or thereabouts, of 91-day bills and for $1,000,000,000, or there- uts, of 181-day bills. The details of the two series are as follows:

GE OF ACCEPTED PETITIVE BIDS:	91-day Treasury bills maturing February 23, 1968		181-day Treasury bills maturing May 23, 1968	
	Price	Approx. Equiv. Annual Rate	Price	Approx. Equiv. Annual Rate
High	98.751	4.941%	97.255 a/	5.460%
Low	98.735	5.004%	97.204	5.561%
Average	98.739	4.989% 1/	97.226	5.517% 1/

a/ Excepting 1 tender of $6,000
15% of the amount of 91-day bills bid for at the low price was accepted
49% of the amount of 181-day bills bid for at the low price was accepted

AL TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

istrict	Applied For	Accepted	Applied For	Accepted
oston	$ 17,641,000	$ 7,641,000	$ 16,707,000	$ 16,707,000
ew York	2,237,449,000	1,095,881,000	1,685,899,000	708,459,000
iladelphia	35,021,000	13,021,000	15,604,000	5,804,000
leveland	57,992,000	15,992,000	34,308,000	32,308,000
ichmond	19,918,000	12,068,000	13,019,000	6,019,000
lanta	32,781,000	22,518,000	21,710,000	21,410,000
icago	265,963,000	63,626,000	213,142,000	49,842,000
. Louis	41,213,000	29,313,000	22,018,000	21,318,000
nneapolis	22,997,000	11,197,000	17,112,000	8,592,000
nsas City	17,330,000	17,330,000	10,821,000	10,721,000
llas	24,054,000	14,054,000	18,146,000	10,636,000
n Francisco	265,554,000	197,754,000	220,944,000	108,194,000
TOTALS	$3,037,913,000	$1,500,395,000 b/	$2,289,430,000	$1,000,010,000 c/

Includes $199,417,000 noncompetitive tenders accepted at the average price of 98.739
Includes $122,083,000 noncompetitive tenders accepted at the average price of 97.226
These rates are on a bank discount basis. The equivalent coupon issue yields are 5.14% for the 91-day bills, and 5.77% for the 181-day bills.

TREASURY DEPARTMENT
Washington

FOR RELEASE UPON DELIVERY

REMARKS OF THE HONORABLE JOSEPH W. BARR
THE UNDER SECRETARY OF THE TREASURY
BEFORE THE
1967 CONVENTION OF THE
SOCIETY OF AMERICAN REGISTERED ARCHITECTS
MARRIOTT TWIN BRIDGES MOTEL, WASHINGTON, D. C.
MONDAY, NOVEMBER 20, 1967, 1:00 P. M., EST

THE FINANCIAL ENVIRONMENT FOR ARCHITECTURAL DESIGN

F-1088

It is a pleasure to be with you today on the occasion of your annual convention. As I traveled the relatively short distance across the Potomac from the Treasury building, I was struck by the contrast of old and new and the changes time has brought. To come from that ornate and dignified Treasury building -- more than 30 years in the construction -- to today's modern and functional surroundings is to come quite a distance from the standpoint of architecture and construction technique.

Certainly, site selection was simpler then. According to the legend handed down through the years and still preserved in our Treasury publications, the cornerstone location for the present Treasury building was determined by President Andrew Jackson in characteristically forthright fashion. One morning back in 1836, displeased by what he felt was undue delay in committee action -- a sentiment later Presidents may sometimes have shared -- he strode over from the White House, planted his cane into the ground near the northeast corner, and announced that the cornerstone would be set right there.

Later that year, actually on July 4, 1836, Congress authorized the construction of a "fireproof building of such dimensions as may be required for the present and future accommodations"

of the Treasury Department. We may assume that the Congress was acting on sound architectural advice in commissioning a fireproof building, or was it perhaps merely the lessons of bitter experience? The first Treasury building in Washington, completed in 1799 and occupied in 1800 by 69 Treasury employees, the full 7-man complement of the State Department, and some personnel of the Navy Department, was partially destroyed by fire just one year later in 1801. Rebuilt, the building was again destroyed by fire in 1814 under circumstances too painful to repeat, but familiar to you, I know. Once again, there was a rebuilding. But, within two decades, the Treasury building met a similar fate, being destroyed by fire in the early morning of March 31, 1833, although this time fortunately not by foreign hands. But the circumstances were scarcely more pleasant. Subsequent investigation suggested strongly that the fire had been set to destroy certain papers which would prove fraudulent conduct by persons engaged as Treasury agents.

With this record of misfortune, the outlook for the new building could hardly have been regarded as a promising one in 1836. But, perseverance finally had its reward in the form of

the present stately structure. Successive additions and enlargements -- interrupted by the Civil War -- were finally completed by 1869. After more than a third of a century, the Treasury building became the magnificent structure originally intended. But in the process, one of the results of site selection and expansion was the violation of what some consider to have been a vital feature of L'Enfant's master plan for the Federal City -- to leave unobstructed the view from the White House to the Capitol.

If the Treasury building's past has lessons for us even today in the fields of site selection, fireproofing, and respect for an architect's original vision, it certainly has something to say on the subject of construction costs as well. This massive structure was constructed at an estimated total cost of only $8 million. We need search no further for a graphic example of the difference between historical and replacement cost.

As Under Secretary of the Treasury, I take pride in our building's rich architectural past, bound up so closely with the history of this city and our nation. But, I came to speak

with you this noon on other matters of more immediate concern to us, and to you as well. I think it can fairly be said that success in your profession requires a unique blend of the creative and the practical. My remarks today will be directed more to your practical side. For I want to discuss with you the stake that architects and the public they serve have in the preservation of a sound financial environment, free from chronic inflationary strains and wide swings in the cost and availability of credit. Within such a sound financial environment, both nationally and internationally, your efforts to build and to create are much more likely to receive the continuing financial support they deserve. In the absence of overall financial stability and dependable sources of finance, your creative activities and those of many others may feel the blight of a hard financial reality.

Certainly, the architectural profession has special reason for concern about the financial conditions that affect commercial and residential construction. One possibility is that expensive financing may lead developers and builders to "economize" on architectural design. At best, the result would be a duplication of an existing and satisfactory design but no progress. And, at the worst, our urban landscape would feature more ghastly examples of "do-it-yourself" architecture.

If expensive financing of residential and commercial construction sometimes takes its toll in the form of false economy, an even more serious consequence of tight money may be the temporary unavailability of financing on almost any terms. This can lead to periods of an inadequate volume of construction which may then be followed by bursts of over-hasty construction, riding the tide of speculation and easy credit. Dependable and regular flows of credit and a building expansion closely geared to developing commercial and private needs can avoid the waste and inefficiencies inherent in a "stop-go" approach to construction.

Yet, I think it is perfectly clear to all of us that there are no panaceas in this area. Our institutional framework for the financing of construction is basically sound and improvements and refinements are constantly being sought, both within and without government. But, a steady flow of finance into construction is going to be possible only in a balanced economic and financial environment. When total demands for finance far outpace the volume of privately generated savings in a full employment economy, rising interest rates and credit imbalances are the more or less inevitable consequence.

And, all too frequently in the past, periods of heavy pressure in the financial markets have been followed by periods of retrenchment and slack business activity. An adequate and dependable flow of funds into construction and other sectors requires a certain degree of moderation and balance in the economy generally.

There really are two interrelated features of the adequacy of financing for construction activity. One is longer-run in nature and concerns the terms on which long-term debt financing will be available over, say, the next quarter century. This is a complex problem, and I will content myself today simply with raising what seem to be some of the key questions. The second part of the problem is the avoidance of sharp and disruptive contractions and expansions in the short-term availability of financing in the construction field. Last year's experience should be a constant reminder that overloaded financial markets and sharply rising interest rates can deal the construction industry some sharp blows. In this year's situation, with construction activity making a strong recovery, the clear need is for more fiscal restraint to prevent a return to last year's conditions. As I will argue more fully in a few minutes, a tax increase and reductions in government expenditures now can fend off the threat of another "credit crunch"

and insure continuing expansion in the construction field. Whether that necessary fiscal action will be taken is the prime issue of economic and financial policy. The outcome will be of crucial importance for residential and commercial construction.

Before I comment in more detail on the immediate need for fiscal restraint, let me raise just a few questions concerning the longer-run outlook for construction financing, and debt financing in general.

By its nature, investment in land and building is inherently a type of capital investment that rests in large part upon debt financing -- and relatively long-term debt financing at that. Therefore, those who are concerned with construction activity are inevitably concerned with the future developments that will be influencing the cost and availability of long-term debt financing.

Many in the financial community contend that there is a fundamental movement away from fixed-return investments toward investments which provide some opportunity to share in equity profits. They cite such developments as:

-- the increasing popularity in recent years of convertible debentures;

-- the decreasing ratio of debt to equity in the portfolios of such major institutional investors as pension funds and insurance companies;

-- the movement toward variable rate annuities;

-- proposals for increased use of variable rate mortgages.

It is not easy to assess the full implications of these developments or even whether some of them are necessarily of much lasting significance. It is true that over the past decade and a half, there has been some apparent shift in investor preferences toward equities. This is reflected in a rising interest yield on high-grade corporate bonds and declining dividend yields on common stocks.

In 1950 the interest yield on outstanding high-grade corporate bonds (Moody's AAA) was about 2-5/8 percent while the dividend yield on 500 common stocks (Standard & Poor's Index) was about 6-1/2 percent. Since then, that relationship has almost exactly reversed itself. By the late 1950's, rising bond yields and falling dividend yields on stocks brought these two rates into approximate equality. The decline in dividend yields on common stocks has continued -- with some interruptions -- and averages near 3 percent at the present time. On the other hand, high-grade bond yields have accelerated

their rise, particularly since 1965, and the average yield on outstanding issues is near 5-3/4 percent, with yields on top quality new issues as much as 3/4 percent higher.

Surely, one factor in the reversal of the earlier relationship between bond and stock yields has been the alteration in investor expectations. In the immediate post-war period, memories of the depression decade were still fresh and the longer-term business outlook was uncertain. During the period that followed, investors came gradually to the view that the economy would be operating near capacity, with only minor lapses. The fact that the current expansion is now the longest in our history has done much to strengthen that view. In a prosperous and growing economy, many investors have wanted an equity share in that growth and have driven dividend yields down in the process.

Another factor has been the development of a view that inflationary pressures were likely to predominate. In the minds of some investors, common stocks became a "hedge against inflation" and some prospective investors in bonds may even have tended to discount their nominal return for an expected degree of inflation.

What will the future hold in terms of the cost and availability of the long-term debt financing so important to construction as well as other sectors? On the one hand, it could be argued that the worldwide need for, and ability to utilize capital, are at the moment increasing more rapidly than the required amount of savings can be mobilized. This fundamental capital scarcity leads to pressures on capital markets and rising interest yields. The tendency toward high rates is reinforced from the monetary side to the extent that more reliance is placed on monetary policy than on fiscal policy to restrain demand and contain inflation. And, in countries where inflation is chronic investors may demand and receive a premium, either in terms of an even higher interest rate or an equity "kicker", if they are to provide long-term funds.

It is clear that some of these pressures for higher interest rates do exist. But there is no warrant for a fatalistic attitude toward them. We must work toward increasing the rate of capital formation and improving capital markets throughout the world. Particularly in Western Europe there is a need for much better capital markets to mobilize that region's savings and enable it to assume its proper and historic role as an exporter of long-term capital to capital-scarce regions.

Intelligent financial management in the United States -- which has so great an influence in world economic affairs -- can facilitate greater progress along these lines in other countries.

It is conceivable that the world is entering, or has entered, an era of relative capital scarcity and that the average of long-term interest rates may edge still higher. But I would not be so sure. Certainly in this country there are factors operating in the other direction. The United States economy generates a tremendous volume of savings each year and channels them to productive use through an adaptable and efficient market mechanism. When we read that this bond issue or that carries the highest yield since 1921, or the Civil War, or some other remote date, it should remind us just how far from accustomed levels interest rates are at the present time. And it is worth recalling the fact that the bulk of this sharp rise in rates has occurred within the last two years under the pressures of a rapid defense buildup, now apparently reaching its late stages. On the longer view, which as architects and builders you are accustomed to take, the present upsurge in long-term rates may well turn out to be a peak rather than a plateau.

Only time will tell whether the cost of long-term debt financing will soon return to the much lower levels characteristic of most of our own and Western European experience in the past century or so. Much will depend on how flexibly and how effectively fiscal and monetary policies are employed in this and other major countries. In both the short and long range, we must avoid excessive inflation, but do so without undue reliance upon restrictive credit policies. This will require the active use of fiscal policy to help keep the economy on a steady course of sustainable growth and price stability.

That brings me to the present and to the crucial issue facing us at the present time. Right now the need is for this country to apply a measure of fiscal restraint -- through control of government expenditures and enactment of the President's tax proposals -- in order to forestall excessive expansion in the near future without forcing a turnaround in Federal Reserve monetary policy.

Some have questioned the ground for expecting an excessive rate of economic expansion. Bemused by the appearance of a statistic or two reflecting effects of the Ford strike, they

have ignored the overwhelming consensus of informed economic and financial opinion on the economic outlook. Economic forecasts are fallible. But the following is fact, not forecast. It is a fact that our most comprehensive measure of overall economic activity, Gross National Product, has risen by the following quarterly increments this year: first quarter, $4.2 billion; second quarter, $8.8 billion; third quarter, $16.1 billion. Consider further that quarterly gains of $15 billion are at, or beyond, the upper range of the increases the economy can safely tolerate; consider that the actual third quarter gain of $16.1 billion was beyond the noninflationary range and would have been even some $2 billion higher had it not been for the Ford strike; and finally consider that nearly half of that third quarter GNP gain was illusory in the sense of being due to sharply rising prices. What clearer signs could we have of the need to ease off on the accelerator and start applying the brakes?

In terms of financial markets and the Federal deficit the need for prompt fiscal action is equally clear and compelling. In fiscal 1967 -- the year ending last June 30 -- net Federal demands on the private credit markets were

actually negative. Net Federal credit demands (or supply when negative) is measured by the change in outstanding Treasury issues, agency issues, and participation certificates, less the increase in the holdings of these obligations by the Government Investment Accounts and the Federal Reserve. In fiscal 1967, there was a net Federal supply of funds of some $6 billion as debt in private hands was reduced. But this fiscal year, in the absence of tax and expenditure action, there would be a call of as much as $20 billion on private credit markets in the form of net sales of all types of Federal securities above and beyond the normal takings of the Government Investment Accounts and the Federal Reserve. In a total credit market flow of some $70 to $75 billion there would be a net increase of possibly $25 billion in Federal impact. This is simply too much. We know what would happen. The Government would get its money but some private borrowers would not. And, if previous experience is any guide, the construction sector would bear a heavy burden in terms of reduced availability of credit.

Nor can there be any expectation that the Federal Reserve will pump out enough bank credit to fill the gap and tide us over. A failure to accept either fiscal or monetary restraint

would produce an unacceptable degree of inflation. The choice is rapidly coming down to fiscal restraint and a transition back to stable prices and moderate interest rates, or a turn to restrictive monetary policy and a credit crunch that would hurt housing and other construction most severely. There is still time to put our finances in good order and to avoid sharply higher interest rates and restricted credit availability. But there is not an unlimited amount of time. I remain confident that the Congress will see the need for fiscal restraint and take this necessary, if seemingly unpopular, action in the national interest.

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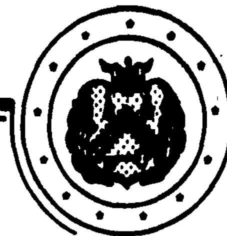
TREASURY DEPARTMENT



WASHINGTON, D.C.

November 22, 1967

'OR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders 'or two series of Treasury bills to the aggregate amount of 2,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing November 30,1967, in the amount of 3,801,885,000, as follows:

91-day bills (to maturity date) to be issued November 30, 1967, in the amount of $1,500,000,000, or thereabouts, representing an additional amount of bills dated February 28, 1967, and to mature February 29, 1968, originally issued in the amount of $901,029,000 (additional amounts of $500,040,000 and $1,001,441,000 were issued May 31, 1967, and August 31, 1967, respectively), the additional and original bills to be freely interchangeable.

183-day bills (to maturity date) to be issued November 30, 1967, in the amount of $1,000,000,000, or thereabouts, representing an additional amount of bills dated May 31, 1967, and to mature May 31, 1968, originally issued in the amount of $900,146,000 (an additional $500,686,000 was issued August 31, 1967), the additional and original bills to be freely interchangeable.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Standard time, Monday, November 27, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received

F-1089

TREASURY DEPARTMENT

WASHINGTON, D.C.

'ELEASE 6:30 P.M.,
sday, November 22, 1967.

RESULTS OF TREASURY'S MONTHLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury , one series to be an additional issue of the bills dated August 31, 1967, and ther series to be dated November 30, 1967, which were offered on November 16, 1967, opened at the Federal Reserve Banks today. Tenders were invited for $500,000,000, ereabouts, of 275-day bills and for $1,000,000,000, or thereabouts, of 366-day . The details of the two series are as follows:

OF ACCEPTED TITIVE BIDS:	275-day Treasury bills maturing August 31, 1968		:	366-day Treasury bills maturing November 30, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	95.883	5.390%	:	94.525	5.385%
Low	95.838	5.448%	:	94.429	5.480%
Average	95.858	5.422% 1/	:	94.479	5.430 1/

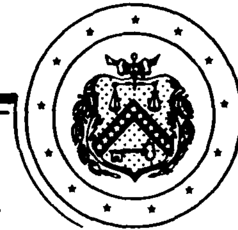
37% of the amount of 275-day bills bid for at the low price was accepted
5% of the amount of 366-day bills bid for at the low price was accepted

TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

strict	Applied For	Accepted	:	Applied For	Accepted
ston	$ 145,000	$ 145,000	:	$ 30,544,000	$ 10,544,000
w York	984,514,000	423,254,000	:	1,347,619,000	803,469,000
iladelphia	4,411,000	411,000	:	10,416,000	2,416,000
eveland	1,194,000	1,194,000	:	16,416,000	4,416,000
chmond	3,975,000	1,975,000	:	5,991,000	3,991,000
lanta	11,926,000	4,666,000	:	17,599,000	13,599,000
icago	98,465,000	19,465,000	:	114,113,000	54,163,000
. Louis	17,685,000	16,425,000	:	23,423,000	23,423,000
nneapolis	6,281,000	981,000	:	6,258,000	3,308,000
nsas City	3,529,000	1,529,000	:	7,466,000	5,466,000
llas	10,934,000	2,934,000	:	15,546,000	10,546,000
n Francisco	120,546,000	27,096,000	:	171,463,000	64,788,000
TOTALS	$1,263,605,000	$ 500,075,000 a/		$1,766,854,000	$1,000,129,000 b/

Includes $16,137,000 noncompetitive tenders accepted at the average price of 95.858
Includes $34,272,000 noncompetitive tenders accepted at the average price of 94.479
These rates are on a bank discount basis. The equivalent coupon issue yields are 5.70 % for the 275-day bills, and 5.76% for the 366-day bills.

TREASURY DEPARTMENT



WASHINGTON, D.C.

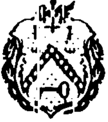
November 22, 1967

FOR IMMEDIATE RELEASE

Secretary of the Treasury Henry H. Fowler today sent the attached letter to Senator John J. Williams.

Attachment

F-1091



THE SECRETARY OF THE TREASURY
WASHINGTON

NOV 22 1967

Dear Senator Williams:

Thank you for your letter of November 7th, concerning the Administration's tax surcharge proposal. I know of no subject which demands more urgent attention among those concerned with the future of the American economy.

Because of your key position in the Senate and because of the many areas of mutual agreement between us, I would like to respond in full.

History of the Proposal

The Administration's proposal for a surcharge was made last January, almost eleven months ago.

Early in August it was revised due to the changed conditions in the economy. In the face of an unacceptable deficit, of rising interest rates and heavy inflationary pressures, the President on August 3 recommended a balanced fiscal program:

-- "rigorously controlling expenditures"

-- "raising as much money as possible through increased taxes" and

-- "borrowing the difference."

Following his message, the President met with the leadership of both Houses and the ranking majority and minority members of the tax writing and appropriations committees. He invited every Democrat in the House of Representatives, and at least fifty Republicans to discussions in which he described the vital importance of a tax increase and the need to reduce less essential expenditures. He outlined the dangers of inaction to the American people.

The top fiscal officials of the Administration and the Chairman of the Federal Reserve Board (speaking for the entire Board) made detailed presentations in hearings before the House

Ways and Means Committee from August 14 through September 14. Representatives of major business, financial and labor organizations, and leaders in the field of business and finance also testified.

The need for a tax increase was supported virtually unanimously. Many of those supporting a tax increase also spoke of another major element in the President's program: the need to reduce federal expenditures.

At the time of the President's August 3 message, eleven of the fourteen appropriation bills for Fiscal 1968 had not been enacted. The President urged "the Congress to exercise the utmost restraint and responsibility in the legislative decisions which are to come and to make every effort not to exceed the January Budget estimates."

For his part, the President pledged to make every possible expenditure reduction -- civilian and military -- short of jeopardizing the Nation's security and well-being.

Since January, the Congress has been working its will on expenditures by acting on appropriation bills and on the Federal employee pay increase. As of today the Congress has passed 12 of the 14 appropriation bills for Fiscal 1968. Both the House and Senate therefore, have taken, in your words "legislative action prior to a tax increase dealing with expenditures."

The Chairman of the House Appropriations Committee has stated that Congressional action taken and anticipated is likely to reduce new spending authority proposed in the Budget by up to $6 billion.

As a result of these appropriation actions, fiscal 1968 expenditures will be reduced by about $1.5 billion.

The "indecision" over the tax increase to which you refer does not rest with the Administration. The uncertainty is whether the Congress will act on the President's recommendations. Consistently the President, the Council of Economic Advisers, members of the Federal Reserve Board, and senior officials of the Treasury have urged prompt enactment of the tax increase.

But on October 3, the House Ways and Means Committee adopted a motion, stating that:

> "The Committee lay this matter on the table and that further consideration of the tax increase be deferred until such time as the President and the Congress reach an understanding on a means of implementing more effective expenditure reduction and controls as an essential corollary to further consideration of a tax increase, and that at such time this matter will again be given priority in the Committee's order of business."

Two days after the House Committee action, President Johnson stated in his news conference:

> "The Secretary of the Treasury was at the Committee session representing the Administration. He had certain proposals that he desired to make along the lines of my tax message and along the lines of what I have said in this statement -- that we will try to have the Administration and the Congress agree on the restraints that the Congress desires to put into effect.
>
> "We were ready that day, and we have been ready every day since -- the Secretary of the Treasury and each department head -- to appear before the Appropriations Committee or the Ways and Means Committee to express our views and to go as far as we can in carrying out the decision of the Congress."

The President restated his view in the strongest terms last week.

Since October 3 the House Ways and Means Committee has been in recess. Nonetheless, Budget Director Schultze and I have had a number of conferences with the Chairmen of the House Ways and Means and Appropriations Committees. We have tried to work out a solution to the problem of combining expenditure reduction and control with a tax increase in a manner that would be satisfactory to both Committees and some chance of being acceptable to the Senate as well.

Let us be clear, Senator Williams, that the Administration has made its willingness known "to get together" with the appropriate committees of Congress to help them "make a decision as to whether they will or will not approve a tax increase in 1968."

Action on a tax bill is a legislative matter which cannot be delayed without undue and unacceptable risk to the Nation's economic and financial structure. We should not wait any longer.

This is a "right now" matter.

Consequences of Inaction

A tax increase is necessary to prevent skyrocketing of interest rates. This necessity goes beyond damage to our domestic economy such as, for example, putting a pistol to the head of our housing industry now in process of a needed recovery.

A continued failure by Congress to act decisively may reverse the trend towards lower interest rates in Europe, a trend which began so successfully earlier this year. If those rates begin to rise sharply, they will surely threaten the healthy growth of the free world economy.

Confidence in the dollar and the gold exchange standard -- the basis of our international monetary system -- depends on the ability of the United States Government to act responsibly. There is a widely-held feeling in financial circles at home and abroad that a reduction in our budget deficit by reducing expenditures and a tax increase in the United States are essential elements of responsible financial policy. I do not need to remind you of the most recent signs of disturbance in international financial conditions. The British devaluation puts the dollar in the front line. It calls for responsible action that will maintain full confidence in the stability and strength of the dollar and of the U.S. economy.

But there is another important reason to move ahead with the tax proposal -- the grave risk of mounting inflation, another disruptive inventory cycle, a deterioration in our balance of payments, and of a return to the old pattern of "boom and bust."

No course of preventive action can be effective without tax action -- now.

I have been encouraged by recent public statements on the tax question by the two Senate leaders, Senator Mansfield and Senator Dirksen. For that reason I welcome your statement on October 24 and an earlier one by your colleague on the Finance Committee, Senator Smathers.

A New Proposal

Upon careful reflection it appears that once again it is up to the Administration to make another effort to break the deadlock between the spending and taxing powers of the Congress.

Accordingly, we have prepared a plan which combines the President's tax proposals with a statutory provision embodying a program of realistic expenditure reductions.

This package would result in a reduction of the administrative budget deficit in Fiscal 1968 by about $11 billion and would relieve the credit markets of that much anticipated demand over the next seven months.

There has been much misunderstanding about a key element in the program -- the tax surcharge on both individual and corporate incomes. Its impact on the individual taxpayer is modest -- about one penny on a dollar of income. For those in the lower brackets, no tax increase at all.

In short, this bill would bring our deficit into manageable proportions. It would take much of the pressure off the credit markets and interest rates. It would enable the Federal Government to put money into the credit market in the first half of Calendar 1968 instead of taking it out. It would give additional confidence in financial markets here and abroad in the dollar and the U.S. economy.

I believe this proposal can be readily considered and processed by Congress in the normal course of business during this session.

As you know, the President in his meeting Monday with the bipartisan leadership of the Congress and the appropriate Committees appealed for favorable action on this legislative package of expenditure reduction and tax increase.

I have requested Chairman Mills to convene the House Ways and Means Committee to consider this legislative plan and he has called a meeting for Wednesday, November 29, at 10 a.m.

Of course, action by that Committee and the House Appropriations Committee on these two key elements in the package must be the first step in the legislative process. However, the Director of the Budget and I stand ready to appear before the Senate Finance Committee and the Senate Appropriations Committees to explain these proposals on the necessity for prompt and favorable action.

I appreciate your letter. I am grateful for your thoughtful approach to a problem of great importance to our country, a problem which, as you say, transcends the "political aspects" of the decision.

Sincerely yours,

Henry H. Fowler

Henry H. Fowler

The Honorable
John J. Williams
United States Senate
Washington, D.C.

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE

November 26, 1967

The Secretary of the Treasury and the Chairman of the Federal Reserve Board made available a communiqué issued in Frankfurt, Germany, today which reads as follows:

"The Governors of the Central Banks of Belgium, Germany, Italy, Netherlands, Switzerland, United Kingdom and the United States convened in Frankfurt on November 26, 1967.

"They noted that the President of the United States has stated:

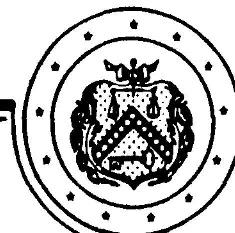
"'I reaffirm unequivocally the commitment of the United States to buy and sell gold at the existing price of $35 per ounce.'

"They took decisions on specific measures to ensure by coordinated action orderly conditions in the exchange markets and to support the present pattern of exchange rates based on the fixed price of $35 per ounce of gold.

"They concluded that the volume of gold and foreign exchange reserves at their disposal guarantees the success of these actions; at the same time they indicated that they would welcome the participation of other central banks."

oOo

TREASURY DEPARTMENT



WASHINGTON, D.C.

RELEASE 6:30 P.M.,
ay, November 27, 1967.

RESULTS OF TREASURY'S WEEKLY BILL OFFERING

The Treasury Department announced that the tenders for two series of Treasury s, one series to be an additional issue of the bills dated February 28, 1967, and other series to be an additional issue of the bills dated May 31, 1967, which offered on November 22, 1967, were opened at the Federal Reserve Banks today. ers were invited for $1,500,000,000, or thereabouts, of the 91-day bills and for 00,000,000, or thereabouts, of the 183-day bills. The details of the two series as follows:

E OF ACCEPTED ETITIVE BIDS:	91-day Treasury bills maturing February 29, 1968		:	183-day Treasury bills maturing May 31, 1968	
	Price	Approx. Equiv. Annual Rate	:	Price	Approx. Equiv. Annual Rate
High	98.752	4.937%	:	97.206	5.496%
Low	98.743	4.973%	:	97.182	5.544%
Average	98.747	4.957% 1/	:	97.186	5.536% 1/

47% of the amount of 91-day bills bid for at the low price was accepted
94% of the amount of 183-day bills bid for at the low price was accepted

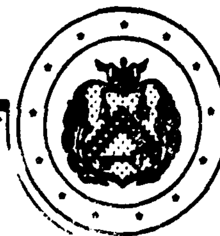
L TENDERS APPLIED FOR AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

strict	Applied For	Accepted	:	Applied For	Accepted
ston	$ 20,190,000	$ 9,019,000	:	$ 24,448,000	$ 13,348,000
v York	1,996,290,000	1,159,600,000	:	1,533,423,000	720,814,000
iladelphia	39,333,000	12,333,000	:	24,526,000	10,926,000
eveland	28,444,000	20,791,000	:	49,796,000	47,696,000
hmond	21,846,000	10,746,000	:	14,473,000	7,473,000
lanta	38,178,000	20,873,000	:	33,105,000	16,175,000
icago	239,203,000	165,603,000	:	237,067,000	100,458,000
. Louis	49,092,000	31,614,000	:	36,482,000	27,602,000
neapolis	24,663,000	15,033,000	:	16,804,000	9,804,000
nsas City	26,313,000	18,535,000	:	13,923,000	11,373,000
las	22,261,000	13,731,000	:	16,467,000	6,467,000
n Francisco	198,082,000	22,712,000	:	144,495,000	28,995,000
TOTALS	$2,703,895,000	$1,500,590,000 a/		$2,145,009,000	$1,001,131,000 b/

ncludes $217,486,000 noncompetitive tenders accepted at the average price of 98.747
ncludes $128,198,000 noncompetitive tenders accepted at the average price of 97.186
hese rates are on a bank discount basis. The equivalent coupon issue yields are .10% for the 91-day bills, and 5.79% for the 183-day bills.

1092

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 29, 1967

FOR IMMEDIATE RELEASE

TREASURY'S WEEKLY BILL OFFERING

The Treasury Department, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $2,500,000,000, or thereabouts, for cash and in exchange for Treasury bills maturing December 7, 1967, in the amount of $2,401,536,000, as follows:

91-day bills (to maturity date) to be issued December 7, 1967, in the amount of $ 1,500,000,000, or thereabouts, representing an additional amount of bills dated September 7, 1967, and to mature March 7, 1968, originally issued in the amount of $1,001,208,000, the additional and original bills to be freely interchangeable.

182-day bills, for $1,000,000,000, or thereabouts, to be dated December 7, 1967, and to mature June 6, 1968.

The bills of both series will be issued on a discount basis under competitive and noncompetitive bidding as hereinafter provided, and at maturity their face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, one-thirty p.m., Eastern Standard time, Monday, December 4, 1967. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others than banking institutions will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

F-1098

STATEMENT BY THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
WEDNESDAY, NOVEMBER 29, 1967, 10:00 A.M., EST

I am here today to present the Administration's specific recommendations, in the words of your resolution of October 3, for "an understanding between the President and the Congress on a means of implementing more effective expenditure reduction and controls" as a corollary to the President's tax increase proposals.

Permit me to appeal to you on both an official and personal basis to report promptly and favorably a bill to the House embodying these recommendations.

I have appeared before this Committee many times in the last six years. We have faced many situations together. I am proud of the record of fiscal initiative, flexibility and responsibility we have built together with beneficial results to the nation's economy.

Never have we been confronted by a fiscal problem which, in my judgment, was more decisive for our country and the Free World. Never have I been more convinced of the appropriate course of action to meet the problem.

F-1094

It is my deep-seated, personal conviction, which I wish to stress with all of the earnestness at my command, that favorable action by the Congress on the proposals to be placed before you cannot be further deferred without undue and unacceptable risk to the nation's economic and financial structure and the international monetary system. We should not wait any longer. Delay can be as damaging as defeat. It is unthinkable to me to allow this session of Congress to conclude without an all-out effort by all responsible forces to enact into law the proposals to be presented today.

To be specific, I am submitting our recommendations in the form of a bill. This bill has two titles -- one embodying the President's tax increase proposals; the second presenting a specific statutory plan and provision for expenditure reduction and control for the Fiscal Year 1968.

<u>The prompt enactment of this proposal at this session</u> of Congress would:

-- Reduce the deficit in the Administrative budget by more than $11 billion.

-- Bring the currently estimated deficit from a range upwards of $25 billion to below $14 billion.

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

-- Take a giant step in providing the confidence and stability in financial markets here and abroad which is based on the strength of the dollar and the U. S. economy.

-- Reduce appreciably the most important source of pressure on our credit markets: the huge overhang of federal borrowing which steadily moves up interest despite an easy monetary policy.

-- Remove the threat to our housing industry which is in the process of a needed recovery.

-- Remove the risk of a credit crunch that will deprive States and local governments and small business of ready access to credits.

-- Reverse the trend from a creeping to an accelerating inflation and turn the economy back toward price stability and wage changes more closely related to increased productivity.

-- Halt movement toward another disruptive inventory cycle.

-- Prevent our returning to the old pattern of "boom and bust."

-- Protect, maintain and expand our trade surplus which is the mainstay of our balance of payments position and which is vitally important to the preservation of international confidence in the dollar.

When I appeared before this Committee on August 14, I presented these basic over-all reasons which had led us to the conclusion that the prompt enactment of the President's fiscal program -- tax increases joined with expenditure reductions -- was the "sound, fair and fiscally responsible choice of the alternatives open to this Committee, the Congress, and the American people."

Developments since August 14 serve to confirm those overall reasons advanced on that day and underscore the urgency of the Administration's request for action. (A Supplementary Statement summarizing the intervening economic and financial developments supporting these overall reasons is submitted for the convenience of the Committee.)

TWO NEW REASONS FOR PROMPT ACTION

But two significant reasons, not present then, make the prompt adoption of proposals along the lines of those in the bill before you an inescapable responsibility of the Congress.

The first reason is that the devaluation of the British pound last Saturday a week, with the ensuing disturbances in the gold and financial markets, calls for prompt and special measures to protect the dollar and the international monetary system. Dealing decisively with our budget deficit has the highest priority.

We must recognize that the gold exchange standard which is the basis of the international trade and payments system on which world trade and prosperity has been based since World War II is being tested, and tested very seriously, by those who speculate, by those who are fearful, and by some in official positions who prefer a different system.

We must recognize that this nation's political, military, diplomatic and commercial position outside our borders, and, with it, our national security, depends in large measure on the maintenance of financial stability in the Free World.

We must recognize the need to take steps designed to assure confidence and stability in financial markets here and abroad which depend on a sound dollar and a prosperous, stable U. S. economy.

We must recognize, in short, that the dramatic international financial events of the past two weeks underline more forcefully than could any rhetoric and argumentation on my part the high responsibility that we bear for the maintenance of a stable international economic system.

There are two means by which we can preserve these stakes. _First_, by practicing multilateral financial cooperation with other leading financial nations in the International Monetary Fund and other related multilateral economic and financial institutions. _Second_, by maintaining a strong dollar through positive decisive action to reverse the current trend to increasing deficits in our budget and our balance of payments.

The sterling devaluation -- even though it was felt necessary by the United Kingdom and is being supported by all the major countries of the world -- is a shock to markets, domestic and international. The dollar is basically strong, and by reaffirming our determination to buy and sell gold at $35 an ounce, we are maintaining the system of fixed exchange rates in which world trade has flourished.

But -- even before a sterling devaluation -- delay and inaction on taxes and on diminishing our prospective deficit was weakening confidence in the dollar and the gold exchange standard. These are the foundations of the international monetary system.

The present situation makes it even more imperative that we insure the strength of the dollar by insuring the strength of the U. S. economy.

Make no mistake about it -- confidence in the dollar and the international monetary system depends on the ability and determination of the United States Government to act responsibly.

There is a widely held feeling in financial circles at home and abroad that a meaningful reduction in our budget deficit by reducing expenditures and a tax increase is an essential element of responsible financial policy.

The <u>second</u> new reason for prompt adoption of the proposals presented is the clear and evident truth that <u>only</u> by the passage of this type of measure can the United States Government substantially reduce the budget deficit and keep this nation on the course of fiscal responsibility.

There were some in the Congress in August who would have met the challenge of the deficit by a temporary increase plus some minor economies; there were some who would rely on massive, long-range economies without a tax increase or a minor and belated one; there were some who wanted a specific program of expenditure reduction and controls, balanced with a meaningful but temporary tax increase; and there were some who wanted neither a tax increase nor economies, following a "the sky's the limit" policy as far as deficit financing is concerned.

There is a widely held feeling in financial circles at home and abroad that a meaningful reduction in our budget deficit by reducing expenditures and a tax increase is an essential element of responsible financial policy.

The second new reason for prompt adoption of the proposals presented is the clear and evident truth that only by the passage of this type of measure can the United States Government substantially reduce the budget deficit and keep this nation on the course of fiscal responsibility.

There were some in the Congress in August who would have met the challenge of the deficit by a temporary increase plus some minor economies; there were some who would rely on massive, long-range economies without a tax increase or a minor and belated one; there were some who wanted a specific program of expenditure reduction and controls, balanced with a meaningful but temporary tax increase; and there were some who wanted neither a tax increase nor economies, following a "the sky's the limit" policy as far as deficit financing is concerned.

It seems high time for the first three groups who are in agreement on the need to reduce the deficit to pool their forces to take decisive action, rather than by inaction and delay forfeit the fiscal responsibility of this Congress.

In August when the President reported a prospective deficit of $29 billion only three of the fourteen appropriation bills for Fiscal 1968 had been enacted. The President, in his Message, urged "the Congress to exercise the utmost restraint and responsibility in the legislative decisions which are to come."

As of today, the Congress has passed all but two of the appropriation bills for Fiscal 1968.

Both the House and Senate, therefore, have taken legislative action in the normal fashion dealing with expenditures in the face of this deficit.

The Chairman of the House Appropriations Committee has stated that Congressional action taken and anticipated in the traditional process is likely to reduce new spending authority proposed in the budget by up to

$6 billion -- thereby reducing actual expenditures this year, next year and, in some cases, in years to follow, by that total.

As a result of appropriation actions to date (amounting to appropriation reductions of $4.5 billion) actual expenditures in the form of cash outlays <u>in Fiscal 1968</u> will be reduced by only about $1.5 billion because much of the appropriation action affected spending in future years.

<u>Therefore, it is clear to all who would exercise any realism that the deficit for Fiscal 1968 will not be reduced sufficiently by these actions. Both larger expenditure reductions and a substantial tax increase are required to reduce the deficit to manageable proportions</u>.

It is equally clear that the best way for Congress and the Administration to join together in a combined effort reflecting the will and decision of both branches to reduce meaningfully this deficit is to enact the President's tax proposals, and special legislation that will insure additional expenditure reduction.

That is the plan before you.

BACKGROUND OF PLAN

In January the President recommended that a temporary tax increase in the form of a six percent surcharge be adopted in the summer of this year as a part of the fiscal 1968 budget to help finance the increased costs of the war. The level and timing of that recommendation were based on the anticipated course of the economy as the facts then in hand indicated.

The President reviewed that recommendation last summer in the light of both the outlook for increased expenditures and reduced revenues and the economic and financial situation that then existed and the expectations for the months ahead.

He concluded that the situation called, as it did before, for a tax increase. But in view of the substantial increase in the prospective deficit he concluded that his January tax proposals should be enlarged and a determined effort inaugurated to reduce controllable expenditures in the January Budget. In his Tax Message of August 3, he recommended a ten percent surcharge and continuation of expiring excise taxes. Moreover, that Message contained a fiscal program for reducing the prospective deficit by <u>combining</u> a tax increase and expenditure reduction and control.

As you will recall, in his Tax Message the President declared that to accept the prospective deficit and totally

finance it "by additional borrowing, which itself would drive up interest rates ... would be fiscally and financially irresponsible under present conditions." He posed a second alternative, namely, that "the deficit could be reduced by regularly controlling expenditures, raising as much money as possible through increased taxes, and then borrowing the difference." He declared the second alternative "is the only way to maintain a strong and healthy economy." Accordingly, he presented for "the judgment and action" of the Congress a fiscal program with two essential elements:

-- "Expenditure restraint to which this Administration is committed and which I urge upon the Congress", and

-- "Tax measures to increase our revenues."

With most of the appropriation bills still pending before the Congress, the President urged "The Congress to exercise the utmost restraint and responsibility in the legislative decisions which are to come and to make every effort not to exceed the January Budget estimates."

The President in his Message also noted that the Congress was considering a bill which would raise civilian and military pay by more than $1 billion <u>above</u> the Administration's pay proposal. The Congress acceded to his persistent

urging that proposals for the extra $1 billion pay raise above his Budget not be adopted and, in fact, the pay scale for this fiscal year exceeds the President's Budget by only a small amount.

For his part the President pledged to the country and the Congress that he would make every possible expenditure reduction -- civilian and military -- in the Budget submitted last January, short of jeopardizing the nation's security and well being.

He stated that as Congress completes each appropriation bill affecting Fiscal 1968 expenditures "we will examine at once very, very carefully" the results of those actions and "determine where, how and by how much expenditures under these appropriations can be reduced."

Moreover, following the presentation of his Message the President invited every Democrat in the House of Representatives and at least fifty Republicans to meetings in which he personally described the serious problems presented by the prospective deficit without a tax increase and the reduction of expenditures.

An accurate contemporary picture of the President's program to reduce the prospective $29 billion deficit described in his Message by combining expenditure reduction and control

with a tax increase may be obtained from the following series of excerpts in his press briefing on the Tax Message on August 3:

"What are we going to do about the $29 billion? We hope, first, that we can take $1 billion off here by the pay bill if the Congress will stay with the budget estimates, and we so recommend.

"We hope we can take $2 billion more off by giving us the authority to sell $2 billion in PC's...

"Under that tax bill, that 10 percent surcharge that expires in 1969 or when the Vietnam problem is over with, plus the extension of the excises due to expire next April -- and they will give you the details -- that will raise $7.4 billion, so that will give us $10.4 billion if we get everything that we are asking for,...

"Take the $10.4 billion from your $29 billion. That gives you an $18.6 billion. Then we only have three appropriation bills. We expect to get another 10 or 12, probably 12 more. We will take each one of those 15 and see what we can cut out of there....

"Whatever we can squeeze out will be deducted from the $18 billion. It could be as much as $4 billion. The deficit

will likely be somewhere in the area of $14 billion to $18 billion, depending on the appropriations....."

The need for combining expenditure reduction with a tax increase in order to deal adequately with the budget deficit was stressed in numerous statements by the President and on August 14 before this Committee by me and the Director of the Budget.

Testimony was taken from representatives of a number of interested business, financial and labor organizations, and leading academic economists and experienced leaders in the field of business and finance. A tax increase was opposed by only one economist, a couple of businessmen and only one business organization. The others strongly urged the enactment of a meaningful tax increase. Many of the proponents of a tax increase urged that it be combined with expenditure reduction and control.

Since the hearings concluded, the one business organization that presented testimony in opposition to a tax increase, the U. S. Chamber of Commerce, has reversed its position and announced publicly as of November 2: "Following a commitment by the Administration to a program of expenditure reduction, the Chamber will support an across-the-board temporary tax increase."

In the executive sessions of the Committee, following the conclusion of the public hearings, I expressed the hope that we could find some procedure for dealing in a combined fashion with the two aspects of the proposed fiscal program because I thought it was primarily a procedural problem. The task confronting us was how, in terms of specific commitments, pledges, provisions, statements or procedures, we could achieve the common result most of us wished of combining expenditure reduction and control with a tax increase.

It was against this background that I stressed publicly in my remarks at the National Press Club on September 21 that there were "various provisions in the law or statements in the House Committee Report that could be devised to protect the position of the House in any final insistence its members may require on expenditure policy as a prerequisite to voting a tax increase."

In accordance with that view I prepared four procedural plans and obtained the President's approval to present to the Committee as suggested ways in which to accomplish the desired linkage between expenditure reduction and the tax increase. I had these plans ready to present to the Committee when it decided instead to put aside the tax proposal on October 3.

With the now detailed impact of Congressional appropriation action, the analysis of the appropriations picture that emerges from this action, and the administrative review by Departments and agencies conducted at the President's instructions referred to in his August 3 Message, we have been able to develop a plan which we feel is specific, feasible, and should be acceptable.

THE PLAN

The plan for implementing significant expenditure reductions and obtaining more effective expenditure control as a corollary to the tax increase proposal is specific. It is a statutory plan. Its details are contained in the proposed bill which I am submitting with this statement. That bill has two parts:

Title I contains the proposal for a tax increase. It conforms to the proposals submitted to you on August 15 in the draft bill you requested. It includes the 10 percent surcharge, effective July 1, 1967 for corporations and October 1, 1967 for individuals; an acceleration of the time for payment of corporate estimated taxes; and postponement of the rate reductions in the excise taxes on automobiles and telephone service scheduled for April 1, 1968.

In the case of individuals, the surcharge for 1967 will amount to only 2½ percent of their 1967 tax. Since it will not

be feasible to collect any of this increased 1967 liability through withholding, its effect will be through the final payments made in 1968 on account of 1967 tax liabilities. We estimate that for about two-thirds of individual taxpayers subject to the surcharge, it will be reflected through reduced refunds in 1968 rather than by any requirement for additional payments.

In the case of corporations, the bill includes a provision which will insure that every corporation will have at least the normal 2½ months after the surcharge is enacted in which to file their 1967 tax return and pay their surcharge for 1967. This is essentially the same procedure that was followed with respect to the 1951 tax increase, which was enacted approximately seven months after its effective date.

Title II represents a specific, statutory plan for expenditure reduction for Fiscal Year 1968. It involves a specific formula which would be applicable to each Department and agency of the government. It involves reductions in both nondefense expenditures and in non-Vietnam defense expenditures. It involves reductions in both payroll expenses and in nonpayroll expenses. It not only incorporates the reductions which have already been achieved through the appropriation bills. It goes beyond those reductions.

The plan calls for a reduction in total obligational authority for the Fiscal Year 1968 for each civilian Department or

agency of at least the following combined sum:

-- A two percent reduction in the January budget estimated for personnel compensation and benefits, plus

-- a ten percent reduction in such estimate for controllable programs other than personnel compensation and benefits.

These percentage reductions in obligational authority do not extend to those items described in the Budget as uncontrollable.

For the Defense Department, the reduction is ten percent of the new obligational authority requested in the January Budget, excluding special Vietnam costs.

I have said that the reductions for each Department and agency shall be at least the above amounts. If for any Department or agency Congress in the appropriation bills has reduced the obligational authority below the reduction that would be achieved through the formula, then the lower appropriation for the Department shall prevail.

The application of this plan will apply to the total controllable obligations of each Department and Agency. Each Department and Agency will therefore be required to examine its individual programs and activities and to apply these reductions to the lowest priority items.

Fiscal Impact of the Plan

The Congress has to date reduced the obligational authority requested by the President in January by roughly $4.5 billion. Applying the 2 percent - 10 percent formula in combination with this Congressional action will result in a total combined reduction of obligational authority of over $9 billion for various programs in the January Budget. This reduction in obligational authority will produce an expenditure reduction in Fiscal Year 1968 of over $4 billion. The $4 billion expenditure reduction will be almost equally divided between defense and non-defense expenditures.

Let me sum up how this plan, and the bill, will affect the Fiscal 1968 deficit. The tax proposals will increase Fiscal 1968 revenues by $7.4 billions. The expenditure reduction plan will cut Fiscal 1968 expenditures by $4 billion. The combined total reduction of the deficit is thus $11-1/2 billion.

We said on August 14 that the Fiscal Year 1968 deficit under certain contingencies could amount to about $29 billion and that we were desirous of reducing that presumptive deficit to a range of $14 to $18 billion. Since then we have successfully averted two of these contingencies, the likelihood of a $1 billion higher payroll increase and a $2 billion reduction in authority for sales of Participation Certificates.

Other changes in expenditure estimates have also occurred since our August testimony, which Director Schultze will explain. But taken all together, passage of the proposals before you should keep the deficit close to the lower end of the $14-18 billion range which was our target in August.

The allocation of national resources to Federal programs has always involved a cooperative effort between the Congress and the President -- the President proposes and the Congress disposes. The President is most anxious to cooperate with the Congress in developing a meaningful statutory package of fiscal restraint. The plan that we have before you today is our best answer to resolving the procedural dilemma that has confronted all of us since August 14.

Director Schultze will further describe the operations of this plan.

A TASK FORCE TO STUDY FEDERAL AGENCIES

In addition, the President is prepared to establish a special bipartisan Task Force of outstanding Americans to take a look at long range Federal program priorities. The Task Force would examine:

(1) The effectiveness of each such program or activity in the context of its present and projected costs;

(2) Whether and at what level the program or activity should be continued; and

(3) The relative priority it should be assigned in the allocation of Federal funds.

ACTION ON THE PLAN

Of course, the procedure by which this Committee and the other Committees concerned -- the House Appropriations Committee and the House Rules Committee -- move this legislation to the floor, is not for me to suggest. That is a matter for the leadership of these Committees and the House to determine.

However, the precedent comes to mind of the handling of the Highway legislation which is of joint concern to the House Public Works Committee and the House Ways and Means Committee.

Whatever procedure is chosen, I ask only that Congress act promptly. For the time for action is now.

Undoubtedly each Committee may find it desirable to make changes in the Title of the proposed law which is in its particular jurisdiction. The Administration will be flexible in its reactions to any changes provided they do not thwart the primary objective -- the enactment of a law prescribing a combined package of expenditure reduction and control and a timely and meaningful tax increase that will reduce the budget deficit for Fiscal 1968 to manageable proportions.

For example, Title II is our recommendation on expenditure reduction and control. It is based on all of the discussions the President, the Director of the Budget and I have had with the leadership of both Houses, members of the Appropriations Committee and other informed persons. It represents our best judgment of what is appropriate under all the circumstances.

If there are those who can persuade the House Appropriations Committee or the Senate or the Congress to accept a larger measure of reduced expenditures by changing the percentage figures in Title II of the proposed bill, let them proceed. If a law providing deeper cuts should be passed by the Congress, I can assure you that the President will give it the most sympathetic consideration.

The Director of the Budget and I will be at the disposal of the other Committees ready to make a presentation, answer questions, or supply information on these proposals. We will try to cooperate in every way. And I am sure that Chairman Martin will be available.

CONCLUSION

Virtually every responsible businessman and economist, every fiscal advisor to the President, and the Chairman of the Federal Reserve Board, have again and again stressed the urgent need for a tax increase coupled with a program of expenditure reduction.

The President's proposal has been before this Committee since early August. And today, in the Administration's recommendation, we have tried to go one step further in response to your request. Now, a specific formula for expenditure control is written into the same law providing for increased taxes.

That tax increase, I might add, is modest by every standard. It averages about one penny on the dollar for individuals. And millions of Americans in the lower brackets will not be affected by the surcharge at all.

With the overriding necessity to support our fighting men in Vietnam, to keep our economy prosperous and our dollar sound, we seek only what the situation urgently requires.

We seek only to ask the American taxpayer to return temporarily to his Government less than half of the $24 billion in tax cuts which the President recommended and the Congress approved over the past 4 years.

That, I believe, is a small price to pay and a small burden to bear to help keep our Nation on a sound fiscal course and to provide responsible financing for the arms and equipment American soldiers in Vietnam must have for their missions and to protect their lives.

A higher tax is unpleasant. Reducing or postponing less essential expenditures in an already tight budget is unpleasant. But far worse are the drastic consequences to every American which will flow from inaction and delay -- the higher, crueler, and unrepealable tax of inflation, weakened confidence in the dollar, brutally high interest rates, and the risk of a return to the old cycle of boom and bust.

Time does not stand still. We dare not lose the opportunity -- and the obligation -- to join together in responsible fiscal action. That is what I have proposed here today.

The eyes of the world are on this Congress. There is much at stake. Now the issue is squarely up to you.

SUPPLEMENT TO THE
STATEMENT OF THE HONORABLE HENRY H. FOWLER
SECRETARY OF THE TREASURY
BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
ON THE PRESIDENT'S FISCAL PROGRAM
WEDNESDAY, NOVEMBER 29, 1967, AT 10:00 A.M.

The purpose of this supplementary statement is to review events relating to the general economy, our money and credit markets, and our balance of payments, as they have developed since August 14 when Chairman Ackley, Director Schultze, and I appeared before this Committee.

At that time hard facts and a careful appraisal of the outlook were presented to you, and they strongly supported the conclusion that enactment of the fiscal program recommended by the President was urgently needed. Since that time events have only served to reinforce the necessity for such immediate fiscal action.

The General Economy

First as to the general economy, in his testimony to this Committee on August 14, Chairman Ackley presented a careful appraisal of the outlook which led to "the verdict of a buoyant economy in which the pursuit of a highly stimulative fiscal policy would be inappropriate -- indeed, perilous." He went on: "I have far more confidence in this over-all judgment than in any quantification I can

offer of just how fast the economy is likely to advance and just where the gains will take place."

At the same time, Chairman Ackley outlined in some detail the Council's numerical projections for the period from the second to the fourth quarter of 1967, assuming "no major disruptions from strikes or developments abroad" and no Congressional action on taxes within 1967. After surveying the various components of national expenditures, Chairman Ackley concluded, "Even at the lower end of this range, the increase in GNP [from the second to the fourth quarter] would be $29 billion. At the upper end, the $35 billion advance would nearly match the hectic pace of gain between the third quarter of 1965 and the first quarter of 1966. If unchecked, the pace of advance would accelerate in the first half of 1968...."

Developments in the past three months have validated Mr. Ackley's appraisal. Even though strikes have had a major impact in holding economic activity down, the increase in GNP from the second to the fourth quarters should still lie within the range of $29 to $35 billion that Mr. Ackley specified. In the absence of major strike activity, the rate of advance might well be exceeding the upper end of the range.

In light of the strong $16 billion advance registered in the third quarter and the available evidence on the performance of the economy so far in the fourth quarter, the pattern as well as the total magnitude of the gain is matching closely with Mr. Ackley's earlier assessment. In several areas, the projections of mid-August remain realistic estimates today: this is the case for the $4-1/2 billion increase in spending by State and local governments that Mr. Ackley projected, the range of $3 to $6 billion for the rise in Federal Government outlays, and the $1 billion prospective increase in plant and equipment spending. Needless to say, however, some revisions are in order. The gratifying rebound in homebuilding has exceeded expectations and now seems headed toward a rise of about $4-1/2 billion over the two-quarter interval rather than the $3-1/2 billion that was projected in August. And the earlier assessment that inventory investment would recover by $1 to $2 billion may also turn out to be conservative, even with auto stocks depressed by strikes.

On the other hand, consumer spending has risen somewhat less rapidly than expected. It will most likely fall short of the $16 to $18 billion range that Mr. Ackley outlined -- in large part, but not entirely, because of the strike-induced

shortfall in auto sales. Consumer spending is the one spot that has not firmed up markedly in recent months. If it had, we would already be riding a runaway economy. As it is, the smaller advances in the consumer area have merely kept the over-all pace within safe speed limits. While nobody can predict the consumer's mood with any confidence, it would be most precarious to bet that the saving rate will rise further in the months ahead.

The other major recent development which deserves some comment is the rise in the unemployment rate during September and October to a level of 4.3 percent of the civilian labor force. This movement is clearly associated with the phenomenal labor force growth of recent months rather than with any notable surprises in the course of employment. The behavior of the labor force has been puzzling throughout 1967. In the early months of the year, when employment was stagnant and there was marked softening in key labor market indicators (like insured unemployment, factory layoffs, and help-wanted advertising), the labor force did not grow and hence the over-all unemployment rate held steady. More recently, employment has been performing well and the other indicators have strengthened consistently,

but the labor force has spurted. From May to October, the seasonally adjusted labor force grew by an enormous 1.8 million, largely concentrated among adult females and younger workers. Since the growth of employment could not keep pace, the over-all unemployment rate rose, reflecting marked increases among women and teenagers. The spurt in the labor force does not have significant implications for demand -- output, employment, or spending. It does tell us something about supply, namely that we have some extra margin in the availability of female and teenage workers. But since there is virtually no margin of slack in the availability of adult male workers, we are highly vulnerable to inflationary pressures in the labor market.

The general assessment of economic developments in recent months has been immensely complicated by widespread strike activity. Strikes have dominated the performance of our key measures of manufacturing activity -- industrial production, orders, and shipments. It is impossible precisely to disentangle strike impacts and trace their ramifications forward to retail sales and backward to supplier industries. A few facts and estimates are nevertheless worth noting. In both September and October, major strikes directly held about

300,000 workers off their jobs -- far exceeding any monthly figures in three years. Trade publications in the auto industry estimate that strike activity so far has cut back output by 362,000 cars in the current quarter. This means a dent of more than $4 billion (annual rate) in this quarter's GNP, following a $2 billion loss in the third quarter. The continued rise of over-all backlogs in durable goods manufacturing in September and October also points to the dominance of strikes in curbing both orders and shipments.

If there are no further strikes in the automobile industry, a considerable catch-up of output will be forthcoming early in 1968. The swing reflecting the strike and its aftermath could easily exceed $6 billion (annual rate) from fourth to first quarter. An appraisal of the near-term outlook must also recognize the likelihood that production and accumulation of steel will soon begin to be influenced by the anticipation of next summer's labor negotiations in that industry. One might hope that any enormous rises in sales and output in the opening months of 1968 would be properly interpreted and discounted by the business and financial community as reflecting strike make-ups and anticipations. But most likely that will not be the case.

Just as the recent strikes have temporarily calmed down the boomy atmosphere that was beginning to emerge late this summer, so the aftermath could contribute to a dangerously inflationary fervor early in 1968. If the strikes have given us a little more time on the economic front, they have also made it more urgent than ever that fiscal policy should be moderating the pace of advance right at the beginning of 1968.

This is the season when economists throughout the land are sizing up the economic outlook for the year ahead. Among private forecasters, a consensus view is shaping up; it places the GNP for 1968 at $840 billion or a little higher, assuming a tax increase. It seems significant, in itself, that the overwhelming majority of private forecasters are assuming the prompt enactment of a surcharge on income taxes for 1968. They generally regard fiscal restraint as essential to the health of our economic and financial system and have confidence that this need will be met through our democratic process.

With a tax increase, the standard forecast calls for a rise in GNP of a little more than $55 billion in 1968. Of this gain of 7 percent or more, about 3 percent is typically expected to represent price increase and the remaining

3-1/2 percent to 4-1/2 percent a gain in real output. The unemployment rate is usually projected at between 3-3/4 percent to 4 percent.

All-in-all, this standard private forecast -- assuming a tax increase -- represents a fairly reassuring picture. Our real output would grow in pace with capacity. To be sure, prices would be increasing considerably faster than we like, but primarily because of pressures on costs that were initially generated during late 1965 and 1966, and not because of new demand pressures straining our capacity. If these same forecasters were obliged to reassess the economic outlook assuming no tax increase, they would see potentially serious trouble with respect to prices, interest rates, credit availability, our international trade position, and the health of our homebuilding industry.

There are good reasons to be skeptical about economic forecasts, but there is simply no way to avoid or ignore them. The decisions of this Committee are bound to affect the economy in 1968. Failure to enact the surcharge would be a decision to maintain a highly stimulative fiscal policy with a large deficit at full-employment. This would be appropriate only if private demand could be counted on to be

especially weak next year -- if the recent private surveys pointing to rising business investment are all too high, if housing demand were about to level off abruptly, if the consumer saving rate were going to rise to unprecedented heights. No expert in the world can give Congress a guarantee that any -- or all -- of these things will not happen. But no prudent man would wish to gamble that they will take place.

Mr. Ackley concluded in August: "There is nothing to suggest that a powerful stimulus is called for in order to support healthy economic growth. On the contrary, the maintenance of such stimulus is most likely to undermine our prospects for prosperity." That judgment is every bit as valid today as it was then, and it is shared by the overwhelming majority of informed opinion throughout the land.

Money and Credit

Turning to the money and credit markets, on August 14 we stated our expectations of an undesirable rise in interest rates and an unhealthy condition in those markets if a tax increase were not forthcoming. The facts since August 14 are:

-- Interest rates declined briefly on the announcement of the President's tax proposals, but it was only a short-lived decline because the market soon concluded that the tax proposals would encounter delays; in the meantime, the market appraised quite soberly the mounting evidence of excessive credit demands that would emerge in the absence of prompt and effective action on taxes and expenditures.

-- Thus interest rates moved higher, across-the-board, from early August onward. A particularly steep rise occurred in rates on Treasury securities during October, following the temporary shelving of active consideration of the tax proposals by this Committee.

Since early August the rate on 3-month Treasury bills has risen by three-fourths of one percent. Long-term Treasury bonds are up more than 1/2 percent. Yields on new high-grade corporate issues are up more than 3/4 of 1 percent. Yields on State and local government issues are up nearly 1/2 percent.

These increases have proceeded from a level of interest rates that was already high -- generally approaching the 40-year highs that had been reached in August and September of 1966. By now, because of the further increases, the high points of 1966 have been reached and surpassed, except in the relatively short-term maturities. For example, in the case of high-grade corporate bonds, the latest rate level of 6.99 percent compares with the high of 6.35 percent in August-September 1966.

These increases in interest rates, moreover, have taken place despite continued growth in the money supply and bank credit. The money supply has risen at an annual rate of 6.8 percent thus far in 1967 in contrast to increases of 2.2 percent in all of 1966 and 4.7 percent in 1965. Bank credit has grown at an annual rate of 12.5 percent for the first 10 months in 1967 compared with increases of 5.7 percent in 1966 and 10.2 percent in 1965.

Rather than a stringency on supply, recent interest rate increases reflect very strong demands for credit from virtually every sector of the economy. An over-hanging fear of excessive Federal Government borrowing is a key factor.

Last year corporations borrowed a record $17.6 billion in the capital markets. This year, in just the first 10 months, they have already borrowed $20.3 billion. The 10-month period is running about 35 percent ahead of the comparable months of 1966.

In my presentation to this Committee last August, I cited a similar comparison but at that time the margin of increase of corporate borrowing over a year ago -- applying then to the first 7 months of the year -- was 23 percent rather than 35 percent. That is one measure of the current pressures on the capital markets.

There is a similar story to tell for State and local governments. Last year these governmental units borrowed $11.3 billion in the capital markets -- a record amount up to that time. That figure has already been surpassed in just the first 10 months of this year, with borrowing of $11.9 billion. This is 27 percent ahead of the amount borrowed in the first 10 months of 1966. It maintains about the same margin of increase that I referred to in my statement to this Committee on August 14.

The major change from a year ago, however, is in the area of Federal Government borrowing. Let me shift here to

talk about fiscal years rather than calendar years because this points up the contrast more distinctly. In the fiscal year that ended last June 30, the Federal Government had an Administrative Budget deficit of $9.9 billion. In addition to financing that deficit there were net borrowings by Federal agencies and sales of participation certificates in Federally-owned financial assets, which also exerted a demand on the credit markets. On the other side substantial financing was provided through net purchases of securities by Government investment accounts, purchases by the Federal Reserve System, and a reduction over the year in the Treasury's cash balance. After netting out all of these factors, the Federal sector did not make a net demand on the private credit markets but rather <u>repaid</u> about $6 billion to these markets.

In the current fiscal year the Federal sector will instead be making a significant net demand on the private credit markets. It will be a substantial demand even with the benefit of the proposed tax surcharge and tight restraints on expenditures. Without these fiscal constraints, it will be a clearly excessive demand -- far more than the

credit markets would be able to handle without drastic cuts in the availability of funds to meet private credit demands, which are also substantial.

The rough orders of magnitude run something like this: given the President's program of fiscal restraint, applying to both the tax and expenditure sides, the Federal sector's net credit demands on the private markets in this fiscal year might be held to the neighborhood of $12 or $13 billion. Without the tax rise and spending restraints, the net Federal credit demand could soar above $22 billion.

In the current half year period, which covers the portion of the year when credit demands are seasonally heavy, the Federal sector's net credit demands on the private market are working out to about $16 billion. That compares with net credit demands of roughly $5 billion each in the July-December periods of 1964, 1965 and 1966.

A key question, however, is what the Federal sector's net demands will be in the January-June 1968 period, and beyond. With a program of rigorous fiscal restraint it will be possible to make some seasonal repayments to the market during the January-June period in 1968. It will not be as large as was the $11 billion repayment in January-June

1967, but it could fall somewhere between the $1.9 billion repayment of January-June 1966 and the $4.7 billion repayment of January-June 1965.

Without the proposed tax measures, however, and with only modest success in restraining the level of Federal expenditures, it would be necessary to press an additional credit demand of at least $6 billion on the markets at a time when seasonal repayment is the normal course of events. A $6 billion net demand would contrast very sharply indeed with the $11 billion net repayment achieved in the January-June period of 1967 -- an adverse swing of some $17 billion.

This may not sound like a very large number against the background of an approximately $800 billion annual rate of GNP. The relevant comparison, however, is not with GNP but with the annual flow of credit through our credit markets which has run roughly in the neighborhood of $70 billion a year. In that context, a swing of $17 billion within a half-year period -- would constitute an extraordinary overload that could not be met out of anticipated levels of savings or new credit formation.

In the process of meeting excessive Federal Government demands, many private credit needs would go unmet. Home buyers, small businessmen and farmers would feel a particularly tight pinch.

Nor would it be any better a solution if one attempted to let all the credit demands be met through pumping in unlimited additions to money supply. That might produce some temporary euphoria but also some very serious problems of inflation and economic distortion that would haunt us for many years to come.

Balance of Payments and the Dollar's World Position

Turning to the international aspects, I said in August that tax and expenditure actions are vitally important to the protection of our balance-of-payments position and to the maintenance of confidence in the dollars. This statement bears even greater emphasis now. The devaluation of sterling -- considering its psychological effect of focusing the eyes of the world upon us as keepers of the world's major currency, and also its expected economic effects on world trade and our balance-of-payments accounts -- makes responsible fiscal action in the United States doubly imperative.

All of our efforts to improve our balance-of-payments position may be for naught.

-- Unless we maintain relative price stability and cost competitiveness in the United States economy;

-- Unless we resist and avert the threat of excessive demand which could damage our trade balance;

-- Unless we play a responsible role by assuring the healthy state of our capital markets so important to the balanced workings of the international monetary system.

Statistical evidence of action or inaction by this session of Congress will be read in annals yet to be published. These indicators will reflect in the months and years ahead whether the foreign holder of dollars today is convinced about our capacity to manage our economy effectively and responsibly. Investors traditionally have been as impressed by imponderables as they have been by facts. They have seized upon our handling of the surcharge and the accompanying expenditure restraints as the measure of our capacity and our intention to act responsibly.

In a very real sense, the size of our gold reserves reflects the judgment by those abroad who now hold dollars

of the ability of the United States to exercise fiscal and budgetary responsibility. We must not give them any cause for doubt of our ability or our resolve to act in a responsible and timely manner.

The delay in acting on the tax increase, with the resulting rise in interest rates here, has already caused many foreign central banks to take defensive action. This moves us away from what we were achieving through the Chequers meeting last January in England. High interest rates in the United States, due to excessive borrowing by the Government, are disturbing influences that have implications far beyond our own border.

All of us realize that the international trading game is made more competitive by the British devaluation. Obviously a part of whatever total improvement the British may achieve in their trade balance will probably be reflected in a correspondingly adverse impact on our own trade surplus. Most likely it will become apparent in our reduced exports to various world markets.

This points up the fact that any deterioration in our competitive position due to rising costs in the United States,

or due to abnormally high United States imports because of excessive demand and capacity pressures in our domestic economy, could have the effect of diverting a substantially larger portion of the impact of the British action towards our own country and away from Europe. With Europe in a surplus position as to balance of payments, it is vital that such a shift be avoided.

The facts and trade statistics speak for themselves:

-- During the 1961-64 period of substantial but clearly sound and well-balanced domestic growth, and with high rates of economic advance in Europe, our trade surplus increased almost $2 billion -- from $4.8 billion in 1960 to $6.7 billion in 1964.

-- During the following two years, with accelerating domestic demand and increasing pressure on our productive capacity, and slower growth rates in Europe, the trade surplus fell -- back to $4.8 billion in 1965 and down to only $3.7 billion last year.

or due to abnormally high United States imports because of excessive demand and capacity pressures in our domestic economy, could have the effect of diverting a substantially larger portion of the impact of the British action towards our own country and away from Europe. With Europe in a surplus position as to balance of payments, it is vital that such a shift be avoided.

The facts and trade statistics speak for themselves:

-- During the 1961-64 period of substantial but clearly sound and well-balanced domestic growth, and with high rates of economic advance in Europe, our trade surplus increased almost $2 billion -- from $4.8 billion in 1960 to $6.7 billion in 1964.

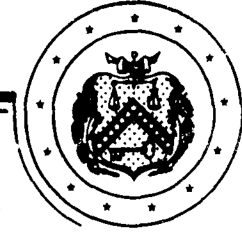
-- During the following two years, with accelerating domestic demand and increasing pressure on our productive capacity, and slower growth rates in Europe, the trade surplus fell -- back to $4.8 billion in 1965 and down to only $3.7 billion last year.

-- With a slower rate of growth again and less inflationary and capacity pressure in our domestic economy so far this year, our trade surplus has, despite the continued slower pace of business activity in Europe, shown significant improvement -- from a last-quarter 1966 low of $2.9 billion (annual rate) to an annual rate of $4.4 billion for the first three quarters of this year.

This offers no cause for complacency: in fact, the developments of the months since August only accentuates the need for tax and budgetary action now.

In summary, then, the import of this review of developments since August 14 is clear: namely whether from the viewpoint of promoting a balanced and healthy domestic economy, or of maintaining stable and orderly conditions in our money and credit markets, or of protecting our balance of payments and the strength of the dollar in the international monetary system -- the case for the recommended program of fiscal restraint becomes even more compelling today than it was last August.

TREASURY DEPARTMENT



WASHINGTON, D.C.

November 29, 1967

FOR IMMEDIATE RELEASE

Attached is a proposed bill and accompanying technical explanation embodying the recommendations contained in Secretary Fowler's statement today before the House Ways and Means Committee.

Attachment

A BILL

To amend the Internal Revenue Code of 1954 to impose a temporary tax surcharge, to provide for expenditure reductions, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) Short Title.--This Act may be cited as the "Tax Surcharge and Expenditure Reduction Act of 1967."

(b) Amendment of 1954 Code.--Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I--TAX PROVISIONS

SEC. 101. IMPOSITION OF TAX SURCHARGE.

(a) In General.--Subchapter A of chapter 1 (relating to determination of tax liability) is amended by inserting at the end thereof the following new part:

"PART V--TAX SURCHARGE
"Sec. 51. Tax surcharge.

"SEC. 51. TAX SURCHARGE.

"(a) Imposition of Tax.--

"(1) Calendar year taxpayers.--In addition to the other taxes imposed by this chapter and except as provided in subsection (b), there is hereby imposed on the income of every

person whose taxable year is the calendar year, a tax equal to the percent of the adjusted tax (as defined in subsection (c)) for the taxable year specified in the following table:

Calendar Year	Percent	
	Individuals	Corporations
1967	2.5	5.0
1968	10.0	10.0
1969	5.0	5.0

"(2) Fiscal year taxpayers.--In addition to the other taxes imposed by this chapter and except as provided in subsection (b), in the case of taxable years ending on or after the effective date of the surcharge and beginning before July 1, 1969, there is hereby imposed on the income of every person whose taxable year is other than the calendar year, a tax equal to--

"(A) Ten percent of the adjusted tax for the taxable year, multiplied by

"(B) A fraction, the numerator of which is the number of days in the taxable year occurring on and after the effective date of the surcharge and before July 1, 1969, and the denominator of which is the number of days in the entire taxable year.

"(3) Effective date defined.--For purposes of paragraph (2), the 'effective date of the surcharge' means--

"(A) July 1, 1967, in the case of a corporation, and

"(B) October 1, 1967, in the case of an individual.

"(b) Low Income Exemption.--Subsection (a) shall not apply if the adjusted tax for the taxable year does not exceed--

"(1) $290, in the case of a joint return of a husband and wife under section 6013,

"(2) $220, in the case of an individual who is a head of household to whom section 1 (b) applies, or

"(3) $145, in the case of any other individual (other than an estate or trust).

"(c) Adjusted Tax Defined.--For purposes of this section, the adjusted tax for a taxable year means the tax imposed by this chapter for such taxable year, determined without regard to--

"(1) the taxes imposed by this section, section 871 (a), and section 881; and

"(2) any increases in tax under section 47 (a)(relating to certain dispositions, etc., of section 38 property) or section 614 (c) (4) (C) (relating to increase in tax for deductions under section 615 (a) prior to aggregation),

and reduced by an amount equal to the amount of any credit which would be allowable under section 37 (relating to retirement income) if no tax were imposed by this section for such taxable year.

"(d) Authority to Prescribe New Optional Tax Tables.-- The Secretary or his delegate shall prescribe regulations setting forth

modified optional tax tables for calendar years 1968 and 1969 computed upon the basis of composite rates incorporating the rate at which tax is imposed by this section. The tax tables so determined may be rounded to the nearest whole dollar. When, pursuant to this subsection, the Secretary or his delegate prescribes regulations setting forth modified optional tax tables for calendar years 1968 and 1969, then, notwithstanding section 144(a), in the case of a taxpayer to whom a credit is allowable for either such year under section 37 the standard deduction may be elected for such year regardless of whether the taxpayer elects to pay the tax imposed by section 3.

"(e) Estimated Tax.--For purposes of applying the provisions of this title with respect to declarations and payments of estimated income tax due more than 45 days (15 days in the case of a corporation) after the enactment of this section--

"(1) In the case of a corporation, so much of any tax imposed by this section as is attributable to the tax imposed by section 11 or 1201 (a) or subchapter L shall be treated as a tax imposed by such section 11 or 1201 (a) or subchapter L;

"(2) The term 'tax shown on the return of the individual for the preceding taxable year', as used in section 6654 (d) (1), and the term 'tax shown on the return of the corporation for the preceding taxable year', as used in section 6655 (d) (1), shall mean the tax which would have been shown on such return if tax had been imposed by this section for such preceding taxable year at the rate applicable to the current taxable year.

"(f) Withholding on Wages.--In the case of wages paid after January 1, 1968, and before July 1, 1969, the tax required to be deducted and withheld under section 3402 shall be determined in accordance with the following tables in lieu of the tables set forth in section 3402 (a) or (c)(1).--

Tables to be Used in Lieu of
Tables in Section 3402 (a)

Tables to be Used in Lieu of
Tables in Section 3402 (c)(1)

"(g) Western Hemisphere Trade Corporations and Dividends on Certain Preferred Stock.--In computing, for a taxable year of a corporation, the fraction described in--

"(1) Section 244 (a)(2), relating to deduction with respect to dividends received on the preferred stock of a public utility,

"(2) Section 247 (a)(2), relating to deduction with respect to certain dividends paid by a public utility, or

"(3) Section 922 (2), relating to special deduction for Western Hemisphere trade corporations,

the denominator shall, under regulations prescribed by the Secretary or his delegate, be increased to reflect the rate at which tax is imposed under subsection (a) for such taxable year.

"(h) Special Rule.--For purposes of this title, except as otherwise expressly provided in this section, to the extent the tax imposed by this section is attributable (under regulations prescribed by the Secretary or his delegate) to a tax imposed by another section of this chapter, such tax shall be deemed to be imposed by such other section.

"(i) Shareholders of Regulated Investment Companies.--In computing the amount of tax deemed paid under section 852 (b)(3)(D)(ii) and the adjustment to basis described in section 852 (b)(3)(D)(iii), the percentage set forth therein shall be adjusted under regulations prescribed by the Secretary or his delegate to reflect the rate at which tax is imposed under subsection (a).

(b) Minimum Distributions.--Section 963 (b) (relating to receipt of minimum distributions by domestic corporations) is amended--

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

"(1) Taxable years beginning in 1963 and taxable years entirely within the surcharge period.--", and

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

"(3) Taxable years beginning after 1964 (except taxable years which include any part of the surcharge period).--", and

(3) by adding after the table in paragraph (3) the following:

"In the case of a taxable year beginning before the surcharge period and ending within the surcharge period, or beginning within the surcharge period and ending after the close of the surcharge period, the required minimum distribution shall be an amount equal to the sum of--

"(A) that portion of the minimum distribution which would be required if the provisions of paragraph (1) were applicable to the taxable year, which the number of days in such taxable year which are within the surcharge period bears to the total number of days in such taxable year, plus

"(B) that portion of the minimum distribution which would be required if the provisions of paragraph (3) were applicable to such taxable year, which the number of days in such taxable year which are not within the surcharge period bears to the total number of days in such taxable year.

As used in this subsection, the term 'surcharge period' means the period beginning on July 1, 1967, and ending at the close of June 30, 1969."

(c) Clerical Amendment.--The table of parts of subchapter A of chapter 1 is amended by adding at the end thereof the following:

"Part V. Tax Surcharge."

(d) Effective Date.--The amendments made by this section shall apply--

(1) Insofar as they relate to individuals, with respect to taxable years ending after September 30, 1967, and beginning before July 1, 1969.

(2) Insofar as they relate to corporations, with respect to taxable years ending after June 30, 1967, and beginning before July 1, 1969.

SEC. 102. RAISING FROM 70 PERCENT TO 80 PERCENT THE ESTIMATED TAX WHICH MUST BE PAID IN INSTALLMENTS BY CORPORATIONS.

(a) In General.--Section 6655 (b)(relating to amount of underpayment), and section 6655 (d)(relating to exception), are amended by striking out "70 percent" each place it appears therein and inserting in lieu thereof "80 percent".

(b) Effective Date.--The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1967.

SEC. 103. PAYMENT OF FIRST $100,000 OF ESTIMATED TAX.

(a) Requirement of Declaration.--Section 6016 (a) (relating to requirement of declaration of estimated tax in case of corporations) is amended by striking out "$100,000" and inserting in lieu thereof "$40".

(b) Reduction of Exclusion from Estimated Tax.--Section 6016 (b) (relating to the definition of estimated tax in the case of a corporation) is amended to read as follows:

"(b) Estimated Tax.--

"(1) Definition.--For purposes of this title, in the case of a corporation, the term 'estimated tax' means the excess of--

"(A) the amount which the corporation estimates as the amount of the income tax imposed by section 11 or 1201 (a), or subchapter L of chapter 1, whichever is applicable, reduced by the amount which the corporation estimates as the sum of any credits against tax provided by part IV of subchapter A of chapter 1, over

"(B) an amount equal to the applicable exclusion percentage (determined under paragraph (2)) multiplied by the lesser of--

"(i) $100,000, or

"(ii) the amount determined under subparagraph (A).

"(2) Exclusion percentage.--The term 'exclusion percentage' means--

If the declaration is for a taxable year beginning in	The exclusion percentage is
1968	80
1969	60
1970	40
1971	20
1972 or later	0"

(c) Exception from Addition to Tax.--Section 6655 (d)(1) is amended by striking out the phrase "reduced by $100,000" and inserting in lieu thereof "reduced by an amount equal to the applicable exclusion percentage, determined under section 6016 (b)(2), multiplied by the lesser of $100,000 or the amount of such tax".

(d) Addition to Tax for Underpayment of Estimated Tax.--Section 6655 (e) (relating to the definition of tax) is amended to read as follows:

"(e) Definition of Tax.--For purposes of subsection(b), (d)(2), and (d)(3), the term 'tax' means the excess of--

"(1) the amount of tax imposed by section 11 or 1201 (a), or subchapter L of chapter 1, whichever is applicable, reduced by the sum of any credits against tax provided by part IV of subchapter A of chapter 1, over

"(2) an amount equal to the applicable exclusion percentage, (determined under section 6016 (b)(2)), multiplied by the lesser of--

"(A) $100,000, or

"(B) the amount determined in paragraph (1)."

(e) Technical Amendment.--Clause (v) of section 243 (b)(3)(C) is amended by striking out "$100,000".

(f) Effective Date.--The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1967.

SEC. 104. POSTPONEMENT OF CERTAIN EXCISE TAX RATE REDUCTIONS.

(a) Passenger Automobiles.--

(1) In general.--Subparagraph (A) of section 4061 (a)(2) (relating to imposition of tax) is amended to read as follows:

"(A) Articles enumerated in subparagraph (B) are taxable at whichever of the following rates is applicable:

"7 percent for the period March 16, 1966, through June 30, 1969.

"2 percent for the period July 1, 1969, through December 31, 1969.

"1 percent for the period after December 31, 1969."

(2) Conforming amendments.--Section 6412 (a)(1) (relating to floor stocks refunds on passenger automobiles, etc.) is amended by striking out "April 1, 1968, or January 1, 1969" and inserting in lieu thereof "July 1, 1969, or January 1, 1970".

(b) Communication Services.--Section 4251 (relating to tax on communications) is amended--

(1) By striking out subsection (a)(2) and inserting in lieu thereof:

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

"Amounts paid pursuant to bills first rendered --	Percent
"Before July 1, 1969	10
"After June 30, 1969, and before January 1, 1970	1"

(2) By striking out subsection (b) and inserting in lieu thereof:

"(b) Termination of Tax.--The tax imposed by subsection (a) shall not apply to amounts paid pursuant to bills first rendered on or after January 1, 1970."

(3) By striking out subsection (c) and inserting in lieu thereof:

"(c) Special Rule.--For purposes of subsection (a), in the case of communications services rendered before May 1, 1969, for which a bill has not been rendered before July 1, 1969, a bill shall be treated as having been first rendered on June 30, 1969. For purposes of subsections (a) and (b), in the case of communications services rendered after April 30, 1969, and before November 1, 1969, for which a bill has not been rendered before January 1, 1970, a bill shall be treated as having been first rendered on December 31, 1969."

(c) Effective Date.--The amendments made by this section shall be effective on the date of enactment of this Act.

SEC. 105. FILING OF CORPORATION RETURNS FOR TAXABLE YEARS ENDING AFTER JUNE 30, 1967, AND BEFORE DECEMBER 1, 1967.

In the case of a corporation subject to a tax imposed by chapter 1 of the Internal Revenue Code for a taxable year ending after June 30, 1967, but prior to December 1, 1967, such corporation shall after the date of the enactment of this Act and on or before March 15, 1967, make a return for such taxable year with respect to the tax imposed by chapter 1 of the Internal Revenue Code for such taxable year. The return required by this section for such taxable year shall constitute the return for such taxable year for all purposes of the Internal Revenue Code; and no return for such taxable year, with respect to any tax imposed by chapter 1 of such Code, filed on or before the date of the enactment of this Act shall be considered for any of such purposes as a return for such year. The taxes imposed by chapter 1 of such Code (determined with the amendments made by this Act) for such taxable year shall be paid on March 15, 1968, in lieu of the time prescribed in section 6151 of such Code. All payments with respect to any tax for such taxable year imposed by chapter 1 of such Code under the law in effect prior to the enactment of this Act, to the extent that such payments have not been credited or refunded, shall be deemed payments made at the time of the filing of the return required by this section on account of the tax for such taxable year under chapter 1 determined with the amendments made by this Act.

SEC. 106. SPECIAL PROVISION WITH RESPECT TO INTEREST AND PENALTIES ON PAYMENTS BY INDIVIDUALS OF SURCHARGE FOR 1967.

Notwithstanding any provision of the Internal Revenue Code, no interest or penalties shall be imposed on account of the late payment by an individual taxpayer of the tax imposed by section 51 for 1967 if such tax is paid within 30 days after a bill therefor has been rendered to the taxpayer by the Secretary or his delegate.

TITLE II -- EXPENDITURE REDUCTIONS

Sec. 201. The Congress hereby finds and determines that it is necessary to reduce budget expenditures for the fiscal year 1968 below the budget estimates therefor, and that the limitations on obligations required by this Title are necessary for that purpose.

Sec. 202. (a) During the fiscal year 1968, no department or agency of the Federal Government, including the Legislative and Judicial branches, shall incur obligations in excess of the lesser of--

(1) the aggregate amount available to each such department or agency as obligational authority in the fiscal year 1968 through appropriation acts or other laws, or

(2) an amount determined by reducing the aggregate budget estimate of obligations for such department or agency in the fiscal year 1968 by--

(i) 2 percent of the amount included in such estimate for personnel compensation and benefits, plus

(ii) 10 percent of the amount included in such estimate for objects other than personnel compensation and benefits.

(b) As used in this section, the terms "obligational authority" and "budget estimate of obligations" include

authority derived from, and estimates of reservations to be made and obligations to be incurred pursuant to, appropriations and authority to enter into contracts in advance of appropriations.

(c) The references in this section to budget estimates of obligations are to such estimates as contained in the Budget Appendix for the fiscal year 1968 (House Document No. 16, 90th Congress, 1st session), as amended during the first session of the 90th Congress.

Sec. 203. (a) This Title shall not apply to obligations for (1) permanent appropriations, (2) trust funds, (3) items (except legislative and judiciary) included under the heading "relatively uncontrollable" in the table appearing on page 14 of the Budget for the fiscal year 1968 (House Document No. 15, Part 1, 90th Congress, 1st session), or (4) programs, projects, or purposes, not exceeding $300,000,000 in the aggregate, determined by the President to be vital to the national interest or security.

(b) This Title shall not be so applied as to require a reduction in obligations for national defense exceeding 10 percent of the new obligational authority (excluding special Vietnam costs) requested in the Budget for the fiscal year 1968 (House Documents Nos. 15, Part 1, and 16), as amended during the first session of the 90th Congress: *Provided*, That the President may exempt from the operation

of this Title any obligations for national defense which he deems to be essential for the purposes of national defense.

Sec. 204. In the administration of any program as to which (1) the amount of obligations is limited by section 202(a) (2) of this Title, and (2) the allocation, grant, apportionment, or other distribution of funds among recipients is required to be determined by application of a formula involving the amount appropriated or otherwise made available for distribution, the amount available for obligation as limited by that section or as determined by the head of the agency concerned pursuant to that section shall be substituted for the amount appropriated or otherwise made available in the application of the formula.

Sec. 205. The amount of any appropriation or authorization which (1) is unused because of the limitation on obligations imposed by section 202(a)(2) of this Title and (2) would not be available for use after June 30, 1968, shall be used only for such purposes and in such manner and amount as may be prescribed by law in the second session of the 90th Congress.

TECHNICAL EXPLANATION
TAX SURCHARGE AND EXPENDITURE
REDUCTION ACT OF 1967

This bill, which is entitled the "Tax Surcharge and Expenditure Reduction Act of 1967", has two titles:

(1) Title I sets forth the tax provisions of the bill in four substantive sections:

(a) Section 101 imposes a temporary surcharge on both individual and corporate income tax liabilities at an annual rate of ten percent.

(b) Section 102 raises from 70 percent to 80 percent, the percent of its estimated tax which a corporation may pay by installments without incurring a penalty.

(c) Section 103 eliminates, over a five-year period, the $100,000 estimated tax exemption presently granted corporations.

(d) Section 104 suspends the schedule for the reduction of the excise taxes on passenger automobiles and telephone service during the period of the temporary surcharge.

(2) Title II provides for expenditure reductions for fiscal year 1968.

There follows a more detailed description of each of these provisions.

TITLE I -- TAX PROVISIONS

SEC. 101. TAX SURCHARGE.

(a) Imposition of tax. Subsection (a) of section 101 adds a new part to subchapter A of chapter 1 of the Internal Revenue Code which consists of a new section 51 imposing a temporary tax surcharge on corporations and individuals.

General Provisions. Subsection (a) of the new section 51 provides for the imposition of the surcharge. The tax is at an annual rate of ten percent of tax liability (adjusted as provided in section 51(c)) and is effective from July 1, 1967, through June 30, 1969, for corporations and from October 1, 1967, through June 30, 1969, for individuals. For taxpayers who report their income on a calendar year basis, the rate of the surcharge for the calendar years involved is as follows:

	Rate of Tax	
Calendar Year	Individuals	Corporations
1967	2.5%	5%
1968	10%	10%
1969	5%	5%

In the case of taxpayers who report their income on a fiscal year basis, the rate will be ten percent for years falling entirely within the effective dates, whereas, in the case of taxable years that straddle either the commencement or termination date, the tax will be prorated depending on the number of days in the taxable year falling within the period the tax is in effect.

Low income exemption. Subsection (b) of the new section 51 provides an exemption from the surcharge for individuals (other

than estates and trusts) whose tax does not exceed that generally applicable to the first two brackets of taxable income. More specifically, the surcharge will not apply to a husband and wife filing a joint return if their tax does not exceed $290. It will not apply to a head of household whose tax does not exceed $220, or to a single individual (or a married individual filing a separate return) whose tax does not exceed $145. In the case of a head of household, the exemption level is determined on the basis of the tax applicable to $1,500 of taxable income which is midway between the first two tax brackets of a single individual and the first two tax brackets of a married couple filing a joint return.

Tax base on which surcharge is computed. Subsection (c) of the new section 51 provides that the surcharge shall be computed as a percentage of the tax otherwise imposed by chapter 1 of the Internal Revenue Code, with the exception that it shall not be imposed (1) with respect to the 30 percent tax under sections 871(a) and 881 on nonresident alien individuals and foreign corporations receiving income not effectively connected with a business in the United States, or (2) with respect to any increases in tax under section 47(a) (relating to certain dispositions of section 38 property) and section 614(c)(4)(C) (relating to deductions taken under section 615(a) prior to aggregation). the case of an elderly person who is eligible for the retirement income credit, the surcharge will be computed as a percentage of his tax liability after subtracting his retirement income credit. Similarly, tax liability shall be reduced by the retirement income credit in determining whether such an individual is eligible for the low income exemption. This treatment is afforded the retirement income credit

in order to give it the same effect on the surcharge as the exclusion for social security benefits. Tax liability would not be reduced by any other credits in computing the amount of the surcharge. On the other hand, once the surcharge has been computed, it may be offset by credits to which the taxpayer is entitled and which are not absorbed by his regular tax liability.

Authority to prescribe new optional tax tables. Subsection (d) of the new section 51 provides that the Secretary of the Treasury or his delegate shall prescribe regulations setting forth modified optional tax tables computed on the basis of composite rates incorporating the surcharge. The tables may be rounded to the nearest whole dollar.

The usual rule that a taxpayer with less than $5,000 of income may take the standard deduction only if he uses the optional tax tables will be waived in the case of a taxpayer who is eligible for the retirement income credit. This special rule is to reflect the fact that the effect of the retirement income credit on the surcharge cannot be accurately incorporated into the optional tax tables, with the result that those claiming the retirement income credit will almost universally use the regular tax

computation. Under these circumstances, without the special rule, most taxpayers claiming the retirement income credit would be precluded from using the standard deduction.

Estimated tax. Subsection (e) of the new section 51 contains provisions conforming the estimated tax provisions to the new surcharge tax. Under present law, corporations are required to pay estimated tax only with respect to taxes imposed by section 11 or 1201 (a) or subchapter L (relating to insurance companies). The new subsection (e) (1) provides that any surcharge that is attributable to a tax imposed under these sections or subchapter shall, for estimated tax purposes, be treated as a tax imposed under these sections or subchapter and, therefore, subject to estimated tax payments. Paragraph (2) of the new subsection (e) provides that, in the case of the option under which individuals and corporations may pay their estimated tax on the basis of their prior year's tax liability, their prior year's liability shall be adjusted to reflect the surcharge tax.

Under the provisions of the new subsection (e), corporations would be required to reflect the surcharge in their first estimated tax payment due more than 15 days after the bill is enacted. For individuals, the surcharge would have to be reflected in the first estimated tax payment due more than 45 days after the enactment of the bill. Thus, individuals will not have to reflect the surcharge on their final estimated tax return for 1967 which is due on January 15, 1968. Hence, no underpayment of estimated taxes for 1967 will result because of the surcharge.

New withholding tables. Subsection (f) of the new section 51 will set forth new tables for computing the amount of income taxes to be withheld from wages paid on or after January 1, 1968, and before July 1, 1969. These tables will reflect an increase in the withholding rates of ten percent.

Western Hemisphere Trade Corporations and dividends on certain preferred stock. The following two provisions of the Internal

Revenue Code provide a special deduction with respect to certain income which has the effect of reducing the corporate tax rate applicable to that income by 14 percentage points. These provisions are:

(1) Section 922, relating to the taxable income of Western Hemisphere Trade Corporations; and

(2) Section 247, relating to dividends paid by a public utility on its preferred stock.

Section 244 provides a reciprocal deduction with respect to amounts received as dividends on certain preferred stock of a public utility. In order to maintain the 14 percentage point differential under these sections, subsection (g) of the new section 51 provides that the computation shall be adjusted, under regulations prescribed by the Secretary of the Treasury or his delegate, to reflect in the regular corporate tax rate the surcharge imposed under the new section 51.

Special rules. Subsections (h) and (i) of the new section 51 insure that, under regulations to be prescribed by the Secretary, the surcharge interacts properly with other tax-imposing sections of the Code. Thus, for example, these subsections insure that the provisions of sections 72(n)(3) and 1378(b) (relating to reduction of taxes by certain credits), sections 815(b)(2)(B) and 815(c)(3)(B) (relating to adjustments to the shareholders and policyholders surplus accounts), sections 535(b)(1), 545(b)(1), and 556(b)(1) (relating to adjustments for taxes of personal holding companies), section 852(b)(3)(D)(ii) and (iii) (relating to treatment of undistributed capital gain by shareholders of regulated investment companies), section 1361(a) and (h) (relating to unincorporated business enterprises electing to be taxed as

domestic corporations), sections 1373(c), 1375(a)(3) and 1378 (relating to subchapter S corporations), and sections 515 and 841 (relating to the credit for foreign taxes) will properly reflect the application of the surcharge. (This list is not intended to be exausted.)

(b) Minimum distributions by foreign subsidiaries. Subsection (b) of section 101 of the bill amends section 963(b) (relating to receipt of minimum distributions by domestic corporations from their foreign subsidiaries) to provide for the use of a minimum distribution table reflecting the surcharge. The table is to be used for taxable years all or part of which fall within the surcharge period. It is the same table that was applicable for taxable years beginning in 1963 when the corporate tax rate was 52 percent (the present corporate tax rate including the additional surcharge is 52.8 percent). In the case of taxpayers with taxable years falling only in part within the surcharge period, the 52 percent minimum distribution table is to be used on a pro rata basis.

(c) Clerical amendment. Subsection (c) of section 101 of the bill makes a clerical amendment to reflect the addition of the new Part V imposing the surcharge.

(d) Effective date. Subsection (d) of section 101 of the bill provides the effective dates for the surcharge. These dates are explained in the discussion under subsection (a) of section 101 of the bill.

SEC. 102. INCREASE FROM 70-80 PERCENT THE AMOUNT OF ESTIMATED TAX WHICH CORPORATIONS MUST PAY IN INSTALLMENTS.

Under present law, a corporation is not penalized for an underpayment of estimated tax if its payments equal or exceed those which would be required on the basis of estimated tax liability of 70 percent of actual tax liability (less $100,000). Section 102 of the bill amends section 6655 to raise the 70 percent figure to 80 percent. This conforms the percentage for corporations to that made applicable to individuals beginning in 1967. This change would be effective for taxable years beginning after December 31, 1967.

SEC. 103. PAYMENT OF FIRST $100,000 OF ESTIMATED TAX.

Under present law, corporations are required to make estimated tax payments only with respect to their estimated tax liability in

excess of $100,000. They are not required to make any estimated tax payments on their first $100,000 of estimated tax liability and, if their annual estimated tax liability is $100,000 or less, they are not required to file a declaration. Under section 103 of the bill, the $100,000 exclusion would be repealed over a five year period.

More specifically, subsection (a) of section 103 of the bill would amend section 6016 (a) to require a corporation to file a declaration of estimated tax for a taxable year if it can reasonably be expected that its tax liability for the year (after taking into account credits) will exceed $40. As indicated above, the present exemption level is $100,000.

Subsection (b) of section 103 of the bill amends section 6016(b) to provide a new definition of "estimated tax" (which is the basic amount subject to payment by installment) reflecting the removal of the existing $100,000 exemption over a five year period. During the transition period, a corporation, in determining the amount of its estimated tax liability, would be permitted to exclude an amount equal to the applicable "exclusion percentage" multiplied by the lesser of (1) $100,000, or (2) the amount which the corporation estimates as its income tax for the year less the estimated amount of its credits. The revised subsection (b) of section 6016 would define the term "exclusion percentage" as follows:

If the declaration is for a year beginning in-	The "exclusion percentage" is-
1968	80
1969	60
1970	40
1971	20

In the case of taxable years beginning after 1971, there would be no special exemption.

As an example of the transition rule, a corporation which estimates its income tax less credits for 1968 to be $80,000 would be entitled to an estimated tax exclusion of $64,000 for 1968; 80 percent (its exclusion percentage) times $80,000. Its estimated tax liability would, therefore, be $16,000. If the corporation estimates its income tax less credits for 1968 to be $120,000, its estimated tax exclusion would be $80,000(80 percent times $100,000) and its estimated tax liability would be $40,000.

Subsection (d) of section 103 of the bill amends section 6655(e) to reflect the repeal of the $100,000 exemption in the provisions for determining whether, and if so, to what extent, an addition to the tax should be imposed for underpayment of estimated tax. The same transitional rules apply. Thus, for example, assume a corporation's tax return for the taxable year ending December 31, 1968, indicates an income tax liability of $150,000. To utilize the exception provided in section 6655 (d)(1) permitting estimated tax payments to be based on the prior year's tax, such corporation would be required to pay for 1969 an estimated tax of $90,000, computed as follows:

1968 Income Tax Liability	$150,000
Less: $60,000; 60 percent (the exclusion percentage for 1969) times $100,000	60,000
	$ 90,000

Subsection (e) of section 103 of the bill amends section 243 (b)(3)(C) (relating to estimated tax exemption for members of an affiliated group) to reflect the repeal of the $100,000 exemption.

Subsection (f) of section 103 of the bill provides that the amendments made by this section shall apply to estimated tax payments for taxable years beginning after December 31, 1967.

SEC. 104. POSTPONEMENT OF CERTAIN EXCISE TAX RATE REDUCTIONS.

(a) Passenger Automobiles. Under present law, an excise tax of 7 percent of the selling price is imposed on the sale by the manufacturer, producer, or importer of passenger automobiles. This rate is scheduled to be reduced to 2 percent on April 1, 1968, then to 1 percent after December 31, 1968.

Subsection (a) of section 104 of the bill suspends this schedule of reductions for the period during which the temporary surcharge will be in effect. Thus, the present 7 percent rate will remain in effect until July 1, 1969. A rate of 2 percent will apply to sales between July 1, 1969 and December 31, 1969, with a 1 percent rate

applying to all sales after December 31, 1969. Conforming amendments are made so that floor stocks refunds will apply on the corresponding date of each reduction.

(b) Communication Services. Under present law, an excise tax of 10 percent is imposed on amounts paid for local and long distance telephone service (including teletypewriter service). A reduction of the rate to 1 percent is scheduled to apply to amounts paid pursuant to bills rendered on or after April 1, 1968, with the tax scheduled to terminate entirely as to bills rendered on or after January 1, 1969.

Subsection (b) of section 104 of the bill suspends this schedule of reductions for the period during which the temporary surcharge will be in effect. Thus, the present 10 percent rate will continue to apply until July 1, 1969, at which time the scheduled reduction to 1 percent will take effect. The tax will terminate on January 1, 1970. A conforming amendment makes corresponding changes in the dates applicable under the special rules established under present law to adjust for billing practices.

(c) Effective Date. Subsection (c) of section 104 of the bill provides that the amendments made by this section shall apply as of the date of enactment of the bill.

SECTION 105. FILING OF CORPORATION RETURNS FOR TAXABLE YEARS ENDING AFTER JUNE 30, 1967 AND BEFORE DECEMBER 1, 1967.

A special rule is provided for corporations whose taxable year ended after June 30, 1967 and before December 1, 1967, to grant such corporations an automatic extension of time within which to file their income tax returns for such taxable year. The return of such corporations will not be due until March 15, 1968. This will give these corporations at least the normal 2 1/2 months to file a return reflecting the surcharge for the appropriate period after June 30, 1967. March 15, 1968 will replace the ordinary due date for returns for such corporations for all purposes, such as the time to begin computing interest, filing claims for refund, computing the statute of limitations, etc. A corporation covered by this special provision that has already filed a return prior to the enactment date will file a new return reflecting the surcharge (the original return will be disregarded for all purposes).

SECTION 106. SPECIAL PROVISION WITH RESPECT TO INTEREST AND PENALTIES ON PAYMENTS BY INDIVIDUALS OF SURCHARGE FOR 1967.

Notwithstanding any provision of the Internal Revenue Code, no interest or penalties shall be imposed on account of late payment by individual taxpayers of the tax imposed by section 51 for 1967 if such tax is paid within 30 days after a bill therefor has been rendered to the taxpayer by the Secretary or his delegate.

TITLE II -- EXPENDITURE REDUCTION PROVISIONS

Section 201 is a declaration of the intent of Congress to reduce budget expenditures for the fiscal year 1968 below the budget estimates. Expenditures result almost automatically from obligations, which consist of contracts awarded, materiel ordered, loan contracts entered into, grants approved, salaries of employees hired, etc. This section recognizes that a reduction in expenditures can be effected only if projected obligations are controlled and reduced.

Section 202 prescribes a formula for establishing a limitation on obligations which may be incurred during the fiscal year 1968. The section is applicable to each department and agency of the executive branch and to the legislative and judicial branches. The limitations are computed in the aggregate in each case--that is, they apply to the sum of the appropriations for each department or agency rather than to individual appropriation accounts.

To apply the formula prescribed by section 202(a), each agency will be required to add the estimated obligations for personnel compensation and benefits (object classes 11, 12, and 13 in the uniform object classification) and multiply the result by 2%. It will then add the estimated obligations for all object classes,

deduct therefrom the estimated obligations for classes 11, 12, and 13, and multiply the remainder by 10%. The sum of the 2% and the 10% is then to be deducted from the budget estimate of obligations, and the remainder is the maximum of obligations which may be incurred under subsection (2) of section 202(a).

In the event that the maximum, determined as described above, exceeds the obligational authority available to an agency--either because Congress has cut the appropriations further below the budget estimates, or because balances brought over from the prior year in continuing appropriations are appreciably less than estimated in the budget--the agency will be limited, under subsection (1) of section 202(a), to the amounts actually made available to it in accordance with appropriation acts and other laws.

The provisions of section 202 are not intended to apply to reimbursable obligations--that is, those financed by reimbursements and therefore not a final charge against the appropriations of the spending agency. In short, the bill is applicable to "net obligations" (the concept used in the Government-wide Budget table on obligations, page 50), which represents gross obligations incurred less reimbursements.

Subsection 202(b) defines the terms "obligational authority" and "budget estimate of obligations" which are employed in subsection 202(a). Under these definitions, "obligational authority" includes authority derived both from appropriations and from authority to enter into contracts in advance of appropriations (often referred to as "contract authority"). "Budget estimate of obligations" includes estimates both of obligations to be entered into and of reservations to be made; this is intended to apply the limitation on obligations to administrative reservations in those instances where such reservations represent a firm commitment even though the funds technically may not be obligated until a later date. (An example of this use of administrative reservations is the program for urban renewal capital grants as set forth on pp. 516-517 of the Budget Appendix.)

Subsection (c) of section 202 adopts the Budget Appendix (the official document of detailed estimates, numbering more than 1,300 pages) as the basic point for figuring the computations required by the bill. However, to the extent that the President has formally amended the Budget during the first session of the 90th Congress, the figures in the Appendix will be replaced by the revision in estimates resulting from the amendments. (Budget

amendments customarily are printed as either House documents or Senate documents promptly upon transmission by the President to the Congress.)

Section 203(a) provides certain classes of exemptions from this Title:

Clause (1) exempts obligations for permanent appropriations; these are appropriations under which new amounts become available in succeeding years without a new action by Congress. They are regularly identified by the use of the word "permanent" in the listing in the Budget and in the schedules in the Budget Appendix.

Clause (2) exempts obligations for trust funds; these funds, considered to be held in a fiduciary capacity, are identified by these words and appear in a separate listing in the Budget and in a separate part in the Budget Appendix.

Clause (3) exempts obligations for certain items described as "relatively uncontrollable" in a table on page 14 of the Budget. In this group are obligations for items such as interest on the public debt, public assistance grants, veterans' pensions, and continuation

of contracts entered into in prior years (a situation which occurs primarily in the water resources field).

Clause (4) provides a degree of flexibility by enabling the President to exempt from the limitations of this Title obligations up to an aggregate of $300 million for specific programs, projects, or purposes which he may determine to be vital to the national interest or security.

Subsection 203(b) provides a special rule relating to national defense. (The term "national defense" in the context of the budget relates to those activities set forth on page 76 of the 1968 Budget; it comprises the military functions of the Department of Defense together with the programs of the Atomic Energy Commission, military assistance, and a very small number of other defense-related activities.) The first part of this subsection indicates that the maximum reduction required by this Title, in the case of national defense, is 10% of the new appropriations and contract authorizations requested in the Budget for the fiscal year 1968, exclusive of "special Vietnam" costs. Nothing in this Title is intended to restrict the amount which would otherwise be available for defense activities pertaining to the conflict in Vietnam.

The second part of subsection 203(b) gives the President authority to exempt from the operation of the Title any obligations for national defense--whether incurred in the Department of Defense or elsewhere--which he deems to be essential for national defense purposes.

Section 204 relates to programs which require the distribution of funds in accordance with a formula set forth in the legislation establishing the programs. In many of these programs (usually for grants-in-aid), the amount appropriated or otherwise made available by law for distribution to a class or classes of recipients is one of the factors which must be considered in the application of the formula. Section 204 would require that, in applying the formula prescribed for any such program, the amount determined to be available for that program by the head of the department concerned, in accordance with the provisions of section 202, would be substituted for the amount appropriated. In any particular program, the amount to be substituted for the appropriated amount in applying the

formula might be smaller or larger than the budget estimate of obligations as affected by the 2%-10% limitation prescribed in section 202.

Section 205 relates to the disposition of the amounts reserved from use under this Title. In the case of those appropriations and contract authorizations which are available without time limitation, or which already extend into fiscal year 1969 or a later specified year, unused balances at the end of the current fiscal year would be carried forward as contemplated by existing law; the forthcoming 1969 budget and the action by Congress on that budget can, of course, take suitable account of the balances thus brought forward in determining the amounts to be appropriated for 1969. However, in the more common type of account in which unobligated balances lapse at the end of the fiscal year and cannot be carried forward, section 205 provides that the amounts which are unused because of the limitation on obligations imposed by section 202 shall be used only as Congress may determine in its next session. If, in the second session of the 90th Congress, there is no specific provision enacted which permits such funds to be used, they will revert to the general fund of the Treasury as provided by existing law (31 U.S.C. 701(a)(2)).