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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

December 31, 1968

file

EXECUTIVE

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FB11-3

MEMORANDUM FOR Joseph Califano

Attached is the revised draft of the Post-Vietnam Report to the President. With the approval of the Committee (and, of course, of the President), we would like to publish this along with the President's 1969 Economic Report and the Annual Report of the Council of Economic Advisers.

We must have comments by cob Thursday, January 2. They should take the form of alternative language entered directly on the galley.

Thanks for your help.

Arthur M. Okun
Arthur M. Okun

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CENTRAL FILES

Report to the President of the Cabinet Coordinating Committee on Economic Planning for the End of Vietnam Hostilities

On March 1, 1967 you asked the Secretaries of Defense, Commerce, Labor, Treasury, the Director of the Bureau of the Budget and the Chairman of the Council of Economic Advisers to form a committee to coordinate the economic planning for the end of hostilities in Vietnam.

As initial terms of reference, you instructed the Committee to

- consider possibilities and priorities for tax adjustment;
- prepare, with the Federal Reserve Board, plans for quick adjustments of monetary and financial policies;
- determine which high priority programs can be quickly expanded;
- determine priorities for the longer range expansion of programs to meet the needs of the American people, both through new and existing programs;
- study and evaluate the future direction of Federal financial support to our State and local governments;
- examine ways in which the transition to peace can be smoothed for the workers, companies, and communities now engaged in supplying our defense needs, and for the men released from our armed forces.

Vietnam hostilities first became a significant economic influence in the summer of 1965, at a time when the economy was remarkably vigorous and well-balanced and had achieved the longest peacetime expansion in history. The increase in the military budget required for Vietnam (evident in Chart—) complicated the assignment of fiscal-monetary policies and hence subjected the economy to inflationary strains. Although the American economic system demonstrated the strength and adaptability necessary to carry the extra load without major disruption and without jeopardizing its fundamental health, it is clear that the cost of war has been a load for the economy to carry—not a supporting “prop.” Prosperity has not been dependent on the military budget swollen by a period of hostilities and will not need high military spending to support it in peace. On the contrary, our analysis convinces us that peace will provide the Nation with welcome opportunities to channel into civilian use manpower and material resources now being devoted to the war.

SUMMARY OF ANALYSES

The following is a summary of the findings of the Committee. It is followed by more detailed discussion.

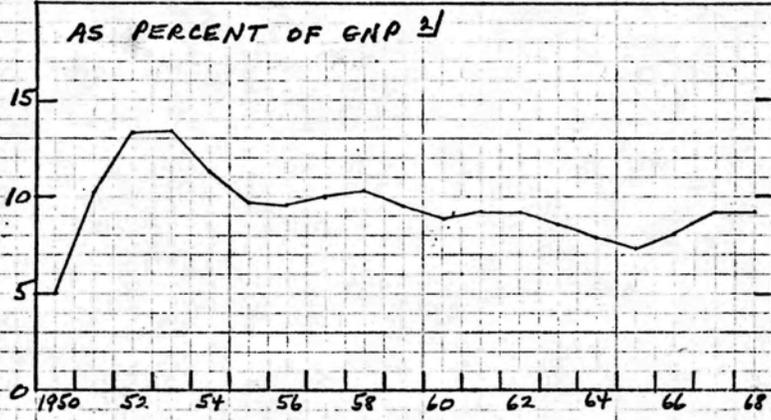
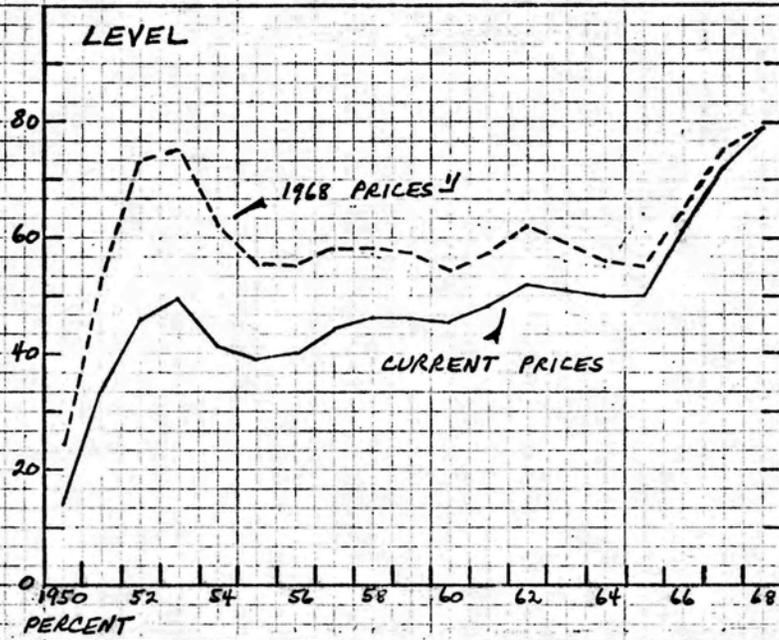
FISCAL AND MONETARY POLICIES DURING DEMOBILIZATION

Sustaining prosperity during the demobilization and seizing the welcome opportunities of peace will depend on careful and forward-looking management of fiscal-monetary policies. If the pattern of demobilization should produce a major and rapid decline in defense spending, and if fiscal and monetary policies were not adjusted to compensate, an abrupt and inappropriate shift to excessive restraint would result. The criteria and the opportunities for an appropriate fiscal-monetary adjustment are set forth in the second major section, below.

12/28/68 ✓
Revised 12/30/68

Federal Purchases for National Defense

BILLIONS OF DOLLARS



1) CURRENT PRICES DIVIDED BY IMPLICIT PRICE DEFLATOR FOR TOTAL FEDERAL PURCHASES
2) BASED ON CURRENT PRICES.

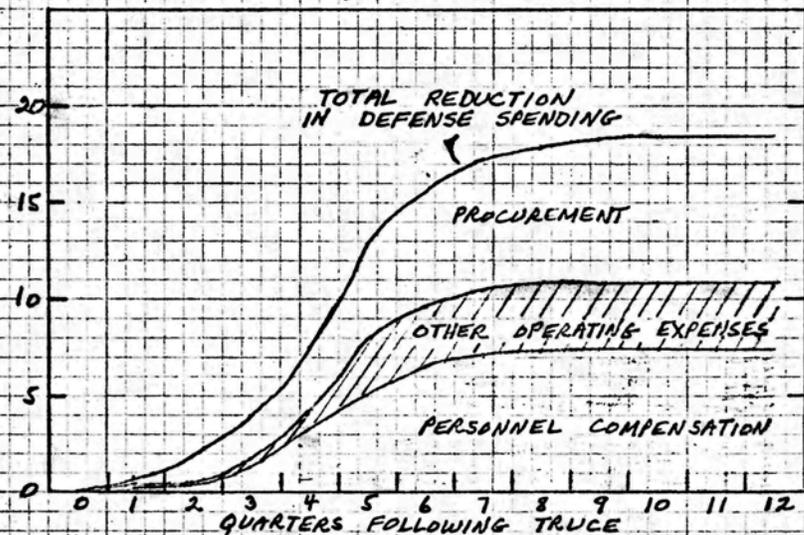
NOTE: DATA RELATE TO PURCHASES OF GOODS AND SERVICES.
SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

Chap. 6

12/30/68 Yna

ILLUSTRATIVE REDUCTION IN DEFENSE SPENDING WITH A VIETNAM DEMOBILIZATION

BILLIONS OF DOLLARS, 1968 PRICES



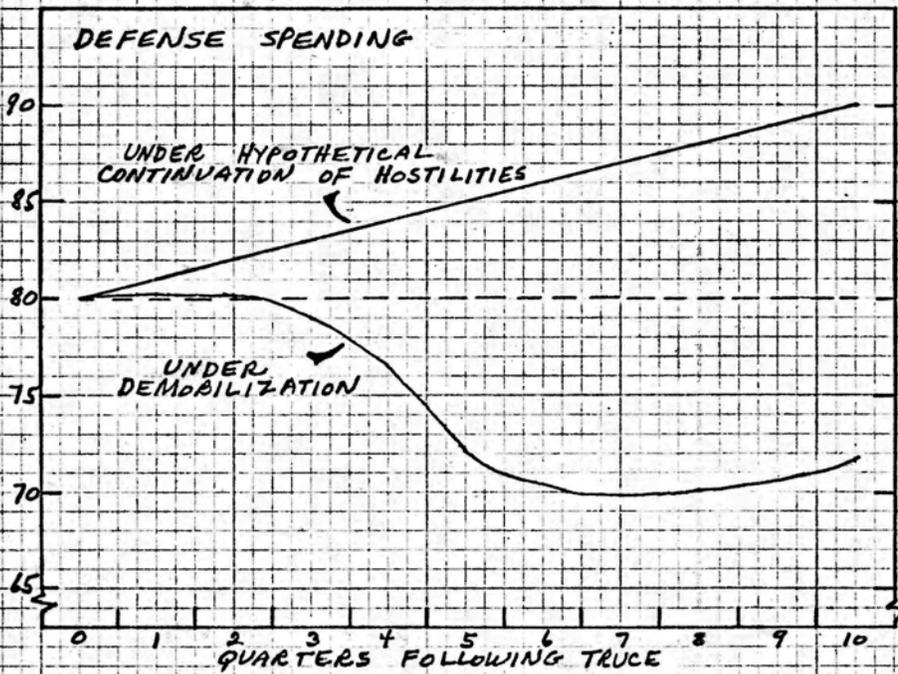
NOTE: DATA RELATE TO FEDERAL PURCHASES OF GOODS AND SERVICES FOR NATIONAL DEFENSE.
SOURCE: COUNCIL OF ECONOMIC ADVISERS BASED ON ESTIMATES OF DEPARTMENT OF DEFENSE.

Chap. 6

12/30/68

ILLUSTRATIVE PATHS OF DEFENSE SPENDING WITH AND WITHOUT A VIETNAM DEMOBILIZATION

BILLIONS OF DOLLARS



NOTE: DATA RELATE TO FEDERAL PURCHASES OF GOODS AND SERVICES FOR NATIONAL DEFENSE.

SOURCE: COUNCIL OF ECONOMIC ADVISERS BASED ON ESTIMATES OF DEPARTMENT OF DEFENSE.

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An illustrative pattern of demobilization is traced on the assumption that, within 6 months after cessation of hostilities, a genuine peace would be secured and a full withdrawal of troops could be initiated. In such a rapid demobilization, the use of real resources for defense purposes would drop by \$16 billion (annual rate in 1968 prices) below the previously planned path over a period of 6 quarters following the truce, and, ultimately, by \$19 billion at the end of 10 quarters. If there were no compensating fiscal-monetary policy actions, the Nation could be threatened with a recession similar to the experience at the end of the Korean War.

Economic policymakers must be prepared to take action. The magnitude and the timing of the policy adjustment best suited to promote steady and healthy economic growth will depend on the strength of private demand at the time peace arrives and on the specific profile of the defense cutback. Careful assessment and economic analysis will be needed to provide the best possible projections of these elements in order to guide fiscal-monetary policy.

A number of possible compensating measures can be foreseen now, however. If the current 10 percent surcharge is still in effect when hostilities end, its early expiration (or phasing out) could provide a major offsetting element to maintain the even keel of fiscal policy and thus support total demand. The Bureau of the Budget should stand ready—as it is now—to offer the President for his consideration a program to speed up expenditures on established high-priority programs, insofar as these actions would be consistent with the efficiency of Federal programs and with the need for economic stimulus. If further stimulus is appropriate, new program initiatives could be launched during the demobilization period. The objectives of the compensating fiscal action should receive the support of monetary policy, but credit conditions probably should not be pushed into a posture of aggressive ease.

Meanwhile, the objectives of price stability and balance-of-payments equilibrium should be pursued intensively during the demobilization. Efforts to overcome structural problems and thus to improve price performance should be emphasized. Administration should be prepared to benefit from opportunities to deal more effectively and more flexibly with the Nation's lingering balance-of-payments problem, in light of the reduction in foreign exchange drains associated with Government expenditures in Southeast Asia.

RESOURCES AND PRIORITIES FOR THE LONGER RUN

The choices among alternative fiscal adjustments during the demobilization period should be guided by longer-run priorities for the Federal Budget. Only by considering such priorities in advance, can society be prepared to take full advantage of opportunities to launch important new programs, to strengthen high-priority existing programs, or to reduce taxes. Estimates of the budgetary resources likely to become available to the Federal Government over the years ahead and some of the considerations bearing on the use of these resources are discussed in the third major section, below.

As revenues expand in a growing peacetime economy, the elbow room in the budget increases. But a substantial part of the growth in revenues is preempted by essentially built-in commitments of existing expenditure programs to meet the needs of a growing population and an expanding economy. These commitments are reflected in the estimated "baseline" budget for both defense and nondefense expenditures in fiscal year 1972. These estimates assume that the transition to peace is essentially completed by 1972.

According to the illustrative calculations, the "peace-and-growth dividend," available for extra Federal spending above the "baseline" and for tax reduction, would amount to \$22 billion in fiscal year 1972 and would

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increase \$7 to \$8 billion a year in succeeding years. The peace-and-growth dividend must be used if healthy economic growth is to be maintained, and it can be used productively.

Some of the possible uses of the dividend are set forth to illustrate the considerable pressures, demands, and opportunities for Federal efforts in the year ahead. Liberalization of social insurance benefits amounting to \$5 billion a year is viewed as a prime claim on the dividend. In addition, the full funding of existing civilian programs to authorized levels would cost another \$6 billion a year.

Beyond that, a variety of major expansions of existing programs and of new programs are highly eligible claimants. A selection of such items, based on proposals which have been made by responsible individuals or groups, adds up to \$39 billion a year. And other more ambitious, new proposals, such as a comprehensive income maintenance program currently receiving widespread public discussion, may also merit consideration. Furthermore, tax reduction is an appealing and effective way to use a share of the dividend.

It is clear that the Nation cannot meet all these goals in the next few years from the peace-and-growth dividend; difficult choices based on a careful determination of priorities will be necessary. But, for those objectives placed at the top of society's priority list, substantial progress can be made in a peaceful environment of prosperity and essential price stability.

These calculations of the peace-and-growth dividend allow for tax reductions through the expiration of the 10 percent tax surcharge and of certain excise taxes. But, in view of the urgent needs of the public sector, we would not recommend further large-scale Federal tax reductions in the years immediately following the end of the Vietnam hostilities.

POLICIES TO ASSIST PARTICULAR COMMUNITIES AND INDIVIDUALS

The economic impact of the war has been broadly diffused among all States and most industries. Only a small number of areas and industries are likely to be especially affected by the demobilization or to encounter significant problems of transition. In the final section below, we recommend some steps by which the Federal Government can assist those areas and industries. These measures include community redevelopment assistance, homeowner assistance, and most importantly, the strengthening of job placement and training.

To provide for efficient planning and timely implementation of assistance programs, we recommend the early establishment of a coordinating group, which might be called the Readjustment Operations Committee. That Committee should assume responsibility for detailed planning of Federal readjustment assistance and should work with State and local authorities responsible for demobilization planning. When peace comes, this Committee would be responsible for coordinating Federal readjustment programs.

The steps we propose for readjustment assistance are limited and relatively inexpensive, reflecting our conviction that the maintenance of an over-all healthy prosperity is far and away the major part of the economic problem of the transition. In our dynamic and flexible free market economy, most areas and industries should be able to make a prompt and healthy adjustment so long as the Federal Government does its job of promoting noninflationary prosperity.

LOOKING FORWARD TO PEACE

We also wish to stress the importance of a responsible and responsive fiscal policy during the remaining period of hostilities. Only in recent months, through the enactment of the 1968 program of fiscal restraint, have our Nation's finances become adequately adjusted to the defense emergency situation. It is absolutely essential to maintain an appropriate fiscal and monetary policy both to preserve prosperity and to minimize the problem of transition to a peacetime economy at the end of hostilities.

FISCAL-MONETARY POLICIES DURING DEMOBILIZATION

Peace may "break out" in any number of ways. For example, there could be a gradual decline in hostilities over time accompanied by reduced expenditures on armament and manpower. Alternatively, there could be a lengthy armed truce which permitted no significant reduction in force strength in Southeast Asia. Different demobilization patterns imply different economic problems for the transition, but the most demanding challenges for Federal policy are presented by a sharp demobilization to a significantly lower level of defense spending in a relatively short time. This possibility was given the closest examination.

DEMOBILIZATION SCENARIO

In the calculations underlying this report, it is assumed that defense activity in Vietnam will continue at essentially present levels until hostilities cease. It is furthermore assumed that, within 6 months after a truce, there will be a genuine assurance of peace and hence the beginning of a full withdrawal of troops from Vietnam with accompanying cutbacks in procurement, operations, and maintenance. This is a rapid demobilization—probably the most rapid that could realistically be assumed. The demobilization may in fact turn out to be smaller or more gradual as a result of any one of at least three developments:

1. a gradual attrition in military activity prior to the truce;
2. a long period of uncertainty between the attainment of the truce and the decision for redeployment; or
3. the need to maintain significant residual forces in Vietnam, even in peacetime.

The rapid pattern of demobilization is assumed because it represents the sharpest test of the Nation's ability to adapt to peace—not because it appears most probable. If the Nation is ready to meet the challenge of a very rapid demobilization, it will surely be able to handle the lesser challenge of a more gradual transition.

The economic impact will depend upon how much defense spending during the demobilization falls below the previously planned path. That is, the reductions in men, materials and outlays described in the illustrative demobilization scenario below are amounts defense spending would fall short of the path it would have taken if hostilities had continued. One planning scenario developed by the staff of the Department of Defense calls for reductions of the following magnitude.

1. The armed services would decline by about 800,000 persons, averaging 200,000 a quarter starting in the third quarter following the truce and terminating after the sixth quarter.
2. Civilian personnel in the Department of Defense would be reduced by 170,000, also declining smoothly between the third and sixth quarter.
3. As a result of the manpower reduction, military and civilian compensation would be reduced by \$7 billion a year at 1968 rates of pay.
4. Other operating expenditures at 1968 prices would decline by \$4 billion a year over a slightly longer time period.
5. Expenditures for procurement would be reduced by \$8 billion over an interval of 10 quarters. This reduction would be stretched out in time because of the need to rebuild inventories held by the Department of Defense.
6. As a total result of the above, the real level of defense spending (at 1968 prices) would be reduced by \$8 billion at the end of 4 quarters, \$16 billion at the end of 6 quarters, and \$19 billion at the end of 10 quarters.

The time profile of the assumed reduction in real expenditures is shown in Chart -----.

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It should be noted that the estimated decline in defense expenditures is significantly less than the \$29 billion a year currently estimated as the cost of the war, because \$10 billion of military resources currently used for Vietnam would be required in other areas or other uses in peacetime.

If hostilities were to continue at an undiminished intensity, the total defense budget would probably continue to rise at least enough to cover increases in military pay scales and gradual advance in prices paid for defense goods. Thus, the reduction in Vietnam outlays during the demobilization will appear as a shortfall from an otherwise increasing path of defense spending.

The way the net reduction in spending might work out is illustrated in Chart -----. Initially defense purchases are taken to be \$80 billion, and they are shown rising at the rate of \$1 billion per quarter, enough to cover price and pay increases and to provide for a very modest real growth. In the absence of peace, defense purchases would reach \$86 billion (undeflated) after six quarters and \$90 billion after 10 quarters. With the cessation of hostilities, however, purchases will be pulled down by \$16 billion to \$70 billion after 6 quarters (and by \$19 billion to \$71 billion after 10 quarters.) If fiscal policy had been planned with the rising defense budget in view, a policy adjustment would be needed to accommodate a \$16 billion reduction below the previous plan by the end of six quarters, even though the absolute decline from the initial level of \$80 billion would be only \$10 billion.

ECONOMIC IMPACT

The economic impact of the demobilization (and the required fiscal-monetary adjustment) can best be appraised by supposing that the fiscal program had been appropriately designed initially, under the assumption of continuing hostilities, to promote a balance between aggregate demand and the economy's supply capabilities. In such a situation, a major fiscal adjustment would be clearly required if the illustrative demobilization occurred.

The impact of demobilization on the over-all balance between aggregate demand and the economy's productive capacity may be thought of as having three components.

1. The reduced use of resources by the Federal Government, reflected in the decline of defense spending described above.
2. The short-run downward adjustments of inventories by defense suppliers, as defense production falls below deliveries to the Government and production is adjusted to declining levels of defense orders. The impact on the economy would occur before the Federal Budget recorded a reduction in expenditures.
3. An induced increase in the Nation's potential GNP—the total output the economy is capable of producing under high-employment conditions—resulting from the potential additional employment of released military personnel in civilian jobs, where average productivity is substantially greater. The declines of 800,000 in the armed forces and of 170,000 in civilian personnel of the defense agencies will not be matched fully by the resulting increase in the private labor force. About 200,000 women now in the labor force may withdraw when their husbands return to civilian life. And some veterans will return to school before entering the civilian labor force. The cumulative net induced increase in the private labor force is estimated at about 600,000 after 6 quarters.

This shift toward higher productivity employment would add about \$4 to \$5 billion to potential GNP. Policy actions would be, therefore, required to add nearly \$2 billion directly to total demand. The private incomes thereby generated would be expected to add consumption and investment demand and, in combination, to absorb the \$4 to \$5 billion increment in supply.

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With no policy offset whatsoever, the direct shortfall of demand by the sixth quarter following the truce could amount to \$18 billion: \$16 billion for the real decline in military spending and \$2 billion for the direct spending needed to make use of the \$4 to \$5 billion addition to potential output. (The separate inventory impact would be negligible by that time.)

Shifts in the strength of private demand might either reduce or add to this gap, but they would be unlikely to change the picture dramatically. Without compensatory stabilization action, the gap would be multiplied through income losses and induced further cutbacks in demand that spread through the private sector. The total multiplied shortfall below the potential output of the economy could easily reach \$40 billion by the end of the second year of demobilization. Inaction would thus threaten a recession similar to the 1953-54 experience at the end of the Korean War.

The Fiscal-Monetary Adjustment

The instruments of fiscal and monetary policy must be available for prompt and decisive use to promote continued prosperity and economic growth. There is no doubt, in principle, that these instruments are capable of offsetting the restrictive effects of demobilization and reduced military spending. Indeed, an excessive or premature stimulative fiscal-monetary program could overdo the job and generate an inflationary boom. There will be a major challenge to determine and carry out a policy adjustment of proper size and timing in order to promote steady noninflationary growth.

The projections in the scenario suggest the general magnitude of the problem that might face the makers of fiscal and monetary policy during the demobilization. The specific dimensions can only be appraised when peace comes, and much more is known about the prospects for private demand, the budget, and the time-path of the military cutback. Nevertheless, there are important guides which can be set forth now.

1. When peace comes, the President and the Congress will need advice based on detailed projections—prepared by experts—of the gross national product, prices, unemployment, and the balance of international payments. Despite the inherent limitations of projections, prudent reliance on quantitative forecasts—carefully weighed and interpreted—is preferable to any other course. There are far greater dangers in a policy of wait-and-see, a resort to predetermined rules of policy adjustment, or a simple extrapolation of existing economic conditions.

2. Efforts should begin now to strengthen the quality of statistical information about the economy's performance, because such information may be critical in determining the success of policy during the demobilization. Decisions involving billions of dollars may rest on statistical programs costing only a few million dollars—such as those improvements you recommended in your Budget program for fiscal year 1969.

3. For the same reasons, the Department of Defense should continue its intensive efforts to improve projections of its orders and outlays so as to aid economic policy during the demobilization period. There will be important uncertainties in assessing the time path of the military cutback, just as there were great difficulties in appraising the size and extent of the initial defense buildup in Vietnam.

4. Flexibility of fiscal and monetary policy decisions will be important to the success of the adjustment. Even with the best efforts, it will be difficult to gauge either private demand or defense outlays. During the demobilizations, prediction of private spending will be particularly difficult. The end of the war will have substantial psychological impacts on private decision-makers, and, in the present state of knowledge, economists are not able to assess these impacts with accuracy. It is a safe judgment that Americans will be delighted by peace, but it does not follow that they will therefore spend

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more, or alternatively that they will save more. Hence, a successful transition program—marked by steadiness and stability in the growth, employment, and price performance of the Nation—may require continuing adjustments in the budgetary balance and in the behavior of monetary and credit flows.

5. Fiscal-monetary policies for the transition should take into account the initial economic situation. If the economy is advancing too rapidly, when peace comes, the restrictive effort of the demobilization should not be entirely offset. On the other hand, if the economy is initially sluggish, the adjustment of stabilization policy should more than compensate for the impact of the demobilization.

6. In the event of a rapid demobilization, the required fiscal adjustment may be large—as much as \$18 billion in a period of a year and a half. And the extraordinary “peace dividend” would be fully available to provide for “controllable” expenditures or tax reductions, unlike the normal fiscal dividend from growing tax revenues, which must, in part, finance the built-in growth of Federal expenditures. Hence it is important to plan in advance to take full advantage of the opportunity.

7. If the cessation of hostilities occurs while the income tax surcharge is still in effect, its early expiration (or phasing out) could provide a major element in the required fiscal offset. Acceleration of the currently scheduled reductions in excise taxes on automobiles and telephone service could serve as another element in the fiscal adjustment.

8. The Bureau of the Budget should remain prepared in the future, as it is now, to offer the President a program of accelerated expenditures that could be initiated on short notice following the cessation of hostilities. These should remain confined to high-priority public expenditures which, in any event, were going to be made in the near future. According to the staff of the Bureau of the Budget, such a program could add to Federal expenditures (at annual rates) by as much as \$2.9 billion in 6 months and \$7.4 billion in 12 months following its activation.

9. Decisions on Federal expenditures, as part of the program of fiscal adjustment, should be made in light of the promptness with which various types of outlays will add to total demand. For example, according to our staff studies, some—although not all—Federal grant programs to States and localities involve a significant lag between the expenditure of the funds by the Federal Government and their translation into *additional* purchases by the recipients. Such programs with long lags would not be ideal for supporting demand during the transition. On the other hand, certain Federal programs may generate orders or contracts to the private sector which would increase employment and economic activity promptly even before expenditures would be incurred by the Federal Government.

10. While the precise assignment of responsibilities between fiscal and monetary policies should be made in full light of the circumstances associated with peace, monetary policy should be expected to support the expansionary aims of the fiscal adjustment. In particular, it should be designed to accommodate strong and rising demands for new homes. But it probably should not shift toward extreme ease to provide a maximum economic stimulant. For one thing, balance-of-payments considerations are likely to limit, to some degree, the easing of credit. Secondly, the flexibility that monetary policy possesses makes it a useful instrument to hold in reserve as a means of compensating for deficiencies or excesses that may develop in the fiscal program or for unforeseen developments in private demand.

11. During the transition period, efforts should be redoubled to combat the troublesome inflationary tendencies of a high-employment economy. The efforts could include various measures which have been explored recently by the Cabinet Committee on Price Stability—to strengthen manpower pro-

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grams; to improve the price performance of particularly troublesome sectors such as construction and medical care; to increase the efficiency of the private economy generally; to minimize any inflationary effects of the Federal Government's own activities; and to achieve through cooperative efforts, patterns of collective bargaining and of business price determination that are consistent with over-all price stability.

12. Similarly, intensive efforts should be made to take full advantage of the welcome opportunities that peace may bring for improvement in the U.S. balance of payments. The direct foreign exchange costs of our military presence in East Asia is now about \$1.6 billion a year higher than it was in 1965. The relief in this outflow might be reinforced by other measures to yield a more comprehensive solution to the lingering problem of our international payments deficit.

13. In general, fiscal policy adjustments during the transition should advance longer-range objectives and meet the top priorities of the Nation. One basic choice will concern the relative importance of tax reduction and of increased Federal expenditures in the fiscal program. This decision should not be governed primarily by considerations of economic stabilization: various mixes of increased spending and reduced taxes may be equally satisfactory from that standpoint. Rather it should depend on the extent to which the Nation wishes to channel resources from defense uses into the other areas of the public sector. Given the allocation between tax cuts and increased civilian programs, further choices will be required to set priorities among various existing programs and possible new programs. These priorities should be weighed in advance.

14. In the event that the Administration should plan to initiate, during the transition, any new programs which would require major legislation, it would be wise to consider submitting this legislation to the Congress in the near future for discussion and debate and perhaps even for enactment on a standby basis. Thus, they could be ready when needed.

RESOURCES AND PRIORITIES

Many of the choices that will have to be made during the transition period should be guided by a longer range view of the public sector and the tax structure. To build the best bridge to peacetime prosperity, we should know where we are going once we cross the bridge. The projections presented below are intended to provide an indication of the resources that will become available in the next few years, and to serve as an aid in making some of the critical choices about the uses of these resources.

PROJECTIONS OF THE PRIVATE ECONOMY

Underlying our views of the post-demobilization outlook are some fairly detailed economic projections prepared by our staff. While these projections are surely not to be regarded as precise forecasts of economic conditions, they provide useful rough indications of what the economic situation might be on the basis of reasonable assumptions.

The projections were focused on fiscal year 1972. It was assumed that the demobilization process was essentially completed by that time, an assumption that is reasonably consistent with the demobilization scenario above if a truce occurs within calendar 1969.

The economic framework was based on an unemployment rate of 3.8 percent and an over-all rate of price increase of about 2 percent a year. These assumptions represent neither a forecast nor a judgment that these rates will necessarily be feasible or appropriate. Lower unemployment would result in a higher gross national product (GNP) and increased

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budgetary resources. Greater price stability would also be strongly preferred. What combination of price stability and high employment will prove feasible depends on the success of measures to help reconcile these two objectives.

Based on the assumed unemployment rate, the time path of real GNP was estimated using labor force, employment, and productivity projections supplied by the Bureau of Labor Statistics. GNP in current dollars was obtained, after projecting the GNP price deflator.

Next, the various components of private demand were estimated, assuming that the indicated levels of GNP were in fact achieved. In the projection of residential construction activity, allowance was made for the growing impact of the special housing program stemming from the Housing Act of 1968. Estimates were also made of State and local government expenditures.

BASELINE FEDERAL EXPENDITURES

A baseline level of Federal expenditures was then projected for fiscal year 1972.

Defense

The baseline defense budget for fiscal year 1972 assumes that non-Vietnam programs now funded or approved will be carried out on schedule with no stretch-out or cancellation. It does not allow for possible *new* defense programs. Allowance is made for significant increases in military pay scales and in Federal civilian salaries, and for some upcreep in prices paid for items purchased from private business. The resulting estimate of Federal purchases for defense is \$73 billion for fiscal year 1972, compared to \$79 billion in calendar 1968.

In constant prices, the baseline estimate for fiscal year 1972 is nearly 20 percent below the current level of *real* defense outlays. Compared with the pre-Vietnam average level of 1960-64, *real* baseline expenditures for fiscal year 1972 are roughly 15 percent higher. These calculations are necessarily imprecise because the character of defense equipment and programs changes markedly over time, making the estimates of increases in prices and costs particularly difficult. After 1972, the baseline defense budget would continue to move up slowly, mainly to keep pace with higher pay and other elements of rising cost.

Nondefense

The baseline Federal nondefense budget allows for rises from the current level for several reasons. Some gradual increases must be expected in the prices of the things the Government buys, and the pay of civilian Government employees must be raised more or less in pace with wages and salaries in the private sector. More veterans will become eligible for pensions; more Government employees will qualify for retirement benefits with the passage of time; a growing population will increase the workload of many Government agencies, such as the Post Office Department and the National Park Service; and so on. Social security benefits will rise even with an unchanged benefit formula, as more persons become eligible for benefits and as the average past income of applicants rises. As a result of these increases, baseline nondefense expenditures rise about \$7 billion to \$8 billion per year.

The Peace-and-Growth Dividend

The peace-and-growth dividend may be defined as the additional GNP expenditures over and above normal private demand and baseline Federal expenditures that will be needed to achieve the specified GNP targets. For example, GNP is projected to be \$1,100 billion for fiscal year 1972. Total demand—private consumption and investment, net exports, State and local government purchases, and baseline Federal purchases—adds up to \$1,078 billion. The difference of \$22 billion between these expenditures and the GNP projection is the peace-and-growth dividend. It represents the additional amount of expenditures that would have to be forthcoming in order to achieve the GNP target of \$1,100 billion.

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To illustrate the calculations, Table ---- shows the main results for fiscal year 1972, with a peace-and-growth dividend of \$22 billion.

The peace-and-growth dividend is thus a rough measure of the resources available for additional Government spending or for tax reduction. A dollar of this dividend may be "used up" either by a dollar of increase in Federal purchases; or by a dollar of additional private spending such as might be induced by a reduction in taxes, an increase in Federal transfer payments, or an easing of monetary policy.

The peace-and-growth dividend reflects the net effect of possible changes in four areas.

Tax revenues. With our present tax system, the normal gain in Federal revenues under conditions of high-employment and steady economic growth amounts to about 6 to 7 percent per year. The normal revenue growth is augmented in the projections by scheduled increases in social security tax rates in 1969 and 1971, but is reduced by the expiration of the current 10 percent income tax surcharge and of excise taxes on telephone service and automobiles.

Baseline Defense Expenditures. A second component in the peace-and-growth dividend is the decline in baseline defense purchases. In two important respects, the small size of the absolute decline in defense spending shown in Table ---- understates the contribution of peace to the opportunities for other Federal efforts. First, while the dollar decline in defense purchases from fiscal year 1968 to the baseline for fiscal year 1972 is only \$3 billion, rises in pay and prices are significant elements adding to the total in the later year. The reduction in *real* expenditures would be much larger—about \$12 to \$14 billion in 1968 prices. This real decline is the meaningful measure of the reduction in the claim of national defense on the Nation's resources, assuming that outlays hold to the baseline budget. Second, in a growing economy, the mere fact that defense spending would not be rising in parallel with GNP or Federal revenues during peacetime adds to the elbow room in the Federal budget.

Baseline Nondefense Expenditures. A portion of the budgetary resources made available by growing tax revenues and declining defense spending will be absorbed by increases in baseline nondefense spending.

Budget Deficit or Surplus. The appropriate budget deficit or surplus in any given year is determined by the degree of fiscal restraint or stimulus appropriate to the strength of private demand and the posture of monetary policy. In Table ----, surplus of \$4 billion (on a national income accounts basis) in fiscal year 1972 is estimated to be consistent with the achievement of target levels of GNP. The peace-and-growth dividend is reduced wherever a portion of the gain in tax revenues must be used to reduce the deficit or increase the surplus.

The separate effects of these four factors on the peace-and-growth dividend for fiscal year 1972 in using actual values for fiscal year 1968 as a base, are shown in the following Table ----.

For the years following 1972, the annual peace-and-growth dividend may be expected to grow \$7 or \$8 billion a year, as annual Federal revenues expand by roughly \$15 billion and baseline expenditures absorb about half of that growth.

ELEMENTS OF UNCERTAINTY

The estimates above indicate the orders of magnitude of the peace-and-growth dividends that will become available in the years ahead. Quite apart from military developments, several other elements of uncertainty may make the peace-and-growth dividend depart from the estimate. First, private demand may be either weaker or stronger than assumed, thereby calling for

a different budgetary policy from that shown above. If private demand is weaker than assumed, smaller surpluses (or possible deficits) will be needed, and the peace-and-growth dividend will be larger than \$22 billion for fiscal year 1972. Conversely, if private demand is stronger than indicated, larger surpluses will be needed and the dividend will be smaller than \$22 billion.

Second, the projections implicitly assume a certain monetary policy posture on the part of the Federal Reserve and an associated level and structure of interest rates. It may be appropriate for Federal Reserve policy to be either more restrictive or more stimulative than assumed; thus possibly altering the required posture of fiscal policy and the size of the peace-and-growth dividend.

Finally, it should be noted that the peace-and-growth dividend is a measure of the additional expenditures on goods and services required to meet the target levels of GNP. Presumably, the fiscal stimulus would use the dividend dollar-for-dollar to the extent it takes the form of purchases of goods and services. However, an increase in transfer payments or a reduction in taxes of one dollar will generally not increase private spending by a full dollar; hence, to the extent that these instruments are used, the total of expansionary fiscal action can be somewhat greater than the peace-and-growth dividend.

ALTERNATIVE USES OF THE PEACE-AND-GROWTH DIVIDEND

The peace-and-growth dividend *must* be used in some fashion if the growth and employment targets are to be achieved. And it surely can be used productively for strengthening useful Federal programs and enacting attractive tax reductions. Indeed, the problem will be to choose among many worthy alternatives.

There is no limit to the portion of the peace-and-growth dividend that could, in principle, take the form of a lighter tax burden on individuals and businesses. This use of the dividend would contribute effectively to achieving the over-all growth and employment targets. Our national experience from 1962 to 1965 demonstrates the effectiveness of the stimulus from a steadily lightened Federal tax burden. However, the use of the dividend to reduce Federal taxes must compete with compelling needs for strengthened and new public expenditure programs. The ultimate national decisions on priorities must focus on the allocation of the dividend between these two basic routes.

Some of the alternatives among various types of Federal expenditures are spelled out below. There are two areas of expenditure that would appear to have a prime claim on the peace-and-growth dividend. The first is increases in benefits needed to maintain standards under social security and related Federal programs. The second is the full funding of existing programs which are currently operating below their authorized levels. The claim from these two areas may add up to \$11 billion in fiscal year 1972.

Maintaining Standards Under Cash Benefit Programs

The baseline expenditures projections allow for growth in social security and other transfer benefits resulting from an increased *number* of recipients and an increase in the *average income* of recipients under the present benefit formula. But they make no allowance for statutory liberalization of benefit formulas under social security, Federal retirement, railroad retirement, veterans benefits, and welfare programs. Such liberalization would have a high priority claim on the peace-and-growth dividend. Indeed, if there were no legislative liberalization, social insurance trust funds would accumulate unusual surpluses. A legislated increase of \$5 billion for fiscal year 1972 in these benefit formulas would assure that benefits keep pace with increases in the cost-of-living and would make provision for at least a minor improvement in the real levels of benefits.

Full Funding of Existing Programs

Several Federal programs, particularly ones adopted recently, are operating below levels authorized by the Congress. To fund these programs fully, thus making appropriations match authorizations, would cost \$6.1 billion a year as distributed in Table ----- . These programs are already making important contributions to the solution of major social and environmental problems, and increasing their appropriations to authorized levels would probably command high priority. Nevertheless, in establishing priorities, the relative value of each of these programs should be weighed against those of new or expanded programs and of tax reduction.

New Efforts in Civilian Programs

A variety of new efforts—entirely new programs or major expansions of existing civilian programs—are also highly eligible claimants for a share of the peace-and-growth dividend. A review of recent recommendations of task forces or study groups would indicate potential domestic programs totalling a minimum of some \$60 billion a year in the fields of education, health, job and manpower training, welfare, urban development, crime prevention, air and water pollution, natural resource development, transportation, space technology and science. And even these do not exhaust the possibilities for Federal initiatives. Indeed, they do not include major proposals for negative income tax or revenue sharing with States and municipalities which are currently receiving wide public discussion.

Table ----- contains a list of programs that have been prominently and generally discussed recently as desirable to meet the needs of the Nation during the next several years. For illustrative purposes, the table sets forth quantitative estimates of the expenditures that might take place in each of these programs during fiscal year 1972. In many instances, the dollar amounts shown in the table are considerably below the recommendations of recent task forces or study groups. By many standards, the list is incomplete and inadequate. Yet, it totals \$39 billion—far more than the peace-and-growth dividend, regardless of other decisions that might be made for funding existing programs or for tax reductions. The clear lesson emerging from inspection of this table—and the reason for its inclusion in this report—is that some very difficult choices will have to be made, based on a determination of the highest priorities to the Nation.

New Defense Programs

Depending upon international development affecting our national security and upon technological changes in weapon systems, there could be requirements for added expenditures on new defense programs. If these are essential to our national security, they must be given a top priority claim on the peace-and-growth dividend. At the same time, it is clear that the possibilities of expansion in the defense area are virtually unlimited, and that utmost efficiency will continue to be needed in budgeting for defense. For illustrative purposes, the staff of the Department of Defense has assembled a package of \$6½ billion a year of new programs which may well come up for serious consideration in the next few years. The major elements in the package are \$2 billion for aircraft development and modernization in connection with major new aircraft programs; \$1.8 billion for the construction of defense installations and family housing projects; and \$1.5 billion for shipbuilding to modernize naval forces.

Major New Initiatives

The approach of the proposals listed in Table ----- is essentially piecemeal: expand or build on existing programs. In many cases, more elaborate proposals have been advanced as an alternative to this piecemeal approach.

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There has been wide discussion of a comprehensive income maintenance plan, such as the "negative income tax," as a simple and equitable device to assist those in poverty. Such proposals could be quite expensive—a negative income tax that succeeded in making major inroads on poverty while preserving work incentives might cost \$15 to \$20 billion a year. Such a program would protect people against the ravages of poverty; but it would still need to be reinforced by initiatives in housing, health, education, and job training that aim at the long-run sources and causes of poverty. An alternative major program initiative would provide for guaranteed employment opportunities to those willing and able to work but unable to find jobs. Depending on eligibility criteria and the techniques of implementation, such a program might cost \$3 to \$10 billion a year.

Another area of mounting public concern is the financial pressures on State and local governments. As a means of reducing the more onerous and less equitable State and local taxes, the Federal Government might adopt some general scheme of revenue sharing—such as a return of some personal tax revenues to the States (and/or localities) and a Federal credit on State income taxes. This might cost \$5 to \$10 billion per year. A specific but more limited proposal along these lines would be the establishment of a trust fund to finance a generalized Model Cities program.

Another major proposal that has much support is the establishment of a Community Development Bank, which would be outside the Federal budget, raising its funds in the capital market and lending to State and local governments (and perhaps to private nonprofit organizations concerned with urban and regional development). Such an institution could relieve the excessive pressure on the market for tax-exempt securities and make more funds available to State and local governments at reduced cost. The burden on the Federal Government budget would be minimal, consisting only of interest subsidies to State and local governments, offset at least in part by reduced use of the tax exemption. But the charge against national resources—and therefore against the peace-and-growth dividend—would be substantially greater, perhaps as much as \$5 to \$10 billion a year.

There have also been proposals for replacing the present military draft with a more equitable and efficient method of obtaining the manpower needed for national defense. One such proposal, which might cost \$5 to \$10 billion a year, would be the adoption of a fully volunteer army. Another would be the establishment of a National Service Corps, in which every young person would be expected to give at least 2 years of service to the Nation, either as a member of the Armed Forces or doing civilian work that would contribute to the solution of important national problems.

Conclusion

It is clear that the problems of poverty and human resource development and the pressing needs to improve our physical environment will impose very heavy demands on the Federal budget in the years ahead. The end of the struggle in Vietnam, together with the expansion in tax revenues resulting from economic growth, will make a sizable volume of real resources available to deal with these problems. But, for years and years ahead, the peace-and-growth dividend is dwarfed by the magnitude of the needs. Difficult choices must be made—choices between increased expenditures and tax reductions, between defense spending and nondefense programs, and among competing civilian programs. The calculations set forth above allow for tax reduction from present rate levels through the expiration of the 10 percent surcharge and of certain excise taxes. These funds would permit the private sector to engage in extra private consumption or investment, above the normal growth of private demand. But in view of the vast and urgent needs of the public sector, we would not recommend further large-scale Federal tax reductions in the years immediately following the end of Vietnam hostilities.

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POLICIES TO ASSIST PARTICULAR COMMUNITIES AND
INDIVIDUALS

Demobilization will require some shifts in employment patterns—from the armed forces to civilian jobs; from defense industries to those producing civilian goods and services; and from one community or area to another. But such shifts in the composition of activity will not be new or unusual. Indeed, they are a regular feature of the highly mobile and dynamic U.S. economy. As technology and the pattern of demand evolve over time, the free choices of business, workers and consumers operate through competitive markets to shift resources from one industry to another and one geographic area to another. Generally, these movements are largely self-adjusting and pose no major problems either to workers or communities. When support is needed, however, Federal programs stand ready to cushion and assist with community development activities and manpower information and training. One agency in particular, the Office of Economic Adjustment in the Department of Defense, has been dealing since 1961 with the specific economic impact associated with closings of defense installations and other major changes in military outlays.

The experience of these programs provides a guide for policies to assist the adjustment problems of those communities and individual groups of workers which are likely to be severely affected by demobilization. Measures to assist specific adjustments can complement fiscal-monetary policy in producing a smooth, noninflationary transition for the economy as a whole.

THE MAGNITUDE OF THE READJUSTMENT

Under the particular demobilization scenario assumed above, an estimated 600,000 persons would be added to the private labor force during the 6 quarters following the truce. In addition, as many as 700,000 civilian employees could be required to shift their job as defense purchases from private businesses decline. Altogether, these adjustments suggest that an additional 1.3 million workers will be seeking new civilian employment over a period of 6 quarters. This implies an average of about 70,000 job shifts per month, over and above those normally taking place. But the shifts would be unevenly spaced during the period and might exceed 100,000 in some months.

This is a significant, but not an enormous, addition to the volume of job-shifting which normally takes place in our economy. To give some perspective on these figures, the average number of layoffs per month in manufacturing alone was about 250,000 in 1966-67. Voluntary separation averaged about — a month, while manufacturing workers were hired at an average monthly rate of 729,000 in 1966 and 619,000 in 1967. There are no comparable data for nonmanufacturing sectors. However, manufacturing accounts for only a quarter of the civilian labor force; layoffs and hirings for the total economy must be far larger.

The figures indicate the dynamism and normal adaptations of the labor market. While specific problems of severe dislocation in certain areas will surely occur, the figures do indicate that the magnitude of the demobilization program should be manageable in the environment of over-all prosperity. If fiscal-monetary policy is successful in ensuring that the over-all demand for labor remains strong, the shift of individuals and communities to a peacetime economy should, in general, be readily accomplished.

Particular measures to facilitate the structural transitions of demobilization should include community redevelopment assistance, home owner assistance, and, most importantly, the strengthening of job placement and job training. Efficient planning and implementation of these measures will require the establishment of a coordinating committee.

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READJUSTMENT OPERATIONS COMMITTEE

A Readjustment Operations Committee should be established in the near future to assume responsibility for detailed planning of Federal readjustment assistance and to work closely with State and local authorities responsible for coordinating Federal readjustment programs. The committee should include the Secretaries of Defense, Commerce, and Labor, the Director of the Bureau of the Budget, the Chairman of the Council of Economic Advisers and the Director of the Office of Emergency Planning.

Prior to demobilization, the committee should be responsible for:

1. engaging in continued planning activities in preparation for demobilization, including frequent updating of the estimated budget requirements for adjustment assistance;
2. undertaking and supporting research on characteristics of individual communities likely to require special readjustment assistance and in particular developing an early warning system;
3. providing technical advice and information for State and local government demobilization planning authorities; and
4. coordinating an inventory by the Departments of Defense, Labor, and Commerce of the skills and training of defense industry workers and armed services personnel, and of the skill requirements of potential sources of employment in defense-dependent areas, including the matching of defense contractor and military job classifications with the Dictionary of Occupational Titles.

During the demobilization period, the Readjustment Operations Committee should be responsible for:

1. coordinating Federal assistance programs to communities and individuals with severe readjustment problems,
2. identifying areas experiencing, or likely to experience, high unemployment during demobilization, through advance notification by the Department of Defense of impending contract cancellations and military base closings, and through a careful monitoring of economic developments in key areas by the Departments of Labor and Commerce, and
3. determining, in cooperation with State and local governments, the appropriate size and mix of Federal assistance programs, and recommending specific program actions and budget allocations for dealing with the specific problems of severely disrupted areas.

FUNDING OF READJUSTMENT PROGRAMS

The activities to assist a smooth transition will rely mainly on existing programs originally designed to aid communities in structural adjustments or to help workers gain new skills. How much these programs will have to be expanded will depend upon many factors which cannot be made of the approximate initial size of these programs, as shown in Table -----.

Once hostilities cease or prospects for demobilization appear, supplemental appropriations for readjustment purposes should be sought promptly. All expenditures from special appropriations should be coordinated by the Readjustment Operations Committee.

When demobilization plans are definitely known, more exact program expenditures should be determined by the Readjustment Operations Committee. Initial appropriations, however, should be at the low end of the estimated range, with the understanding of executive and legislative branch that additional funds may be needed. These program supplements should be reserved for uses directly related to the post-Vietnam transition. In addition, funds should be requested to provide returning servicemen with veterans' benefits under existing programs and to assist State unemployment insurance programs in case of high unemployment.

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Even before the demobilization, some important permanent improvements should be made in some existing institutions in order to make them more effective in the transition to peace as well as to improve their effectiveness for the long run. The Unemployment Insurance Program should be improved by increasing coverage, raising benefits, lengthening the possible duration of payments, and improving the financial base of the system. And minimum standards of vesting of private pension plans should be established so that workers can change jobs without losing their benefits, as the economy shifts to a peacetime footing.

ASSISTING DEFENSE-DEPENDENT AREAS

One major measure to be coordinated by the Readjustment Operations Committee is Federal assistance for those communities which will experience a major decline in employment opportunities due to the closing or curtailment of a defense plant or military base. The possible scope of this task is partly revealed by looking at the growth of defense employment during the build-up for Vietnam. From 1965 to 1967, 38 localities experienced increases in defense employment exceeding five percent of their total work force. A few of these localities are moderately large metropolitan areas. But, eight of the areas are predominantly rural counties with no urban center exceeding 12,000 population; they may be especially vulnerable to unemployment during the demobilization.

The Federal Government can assist severely affected communities which have redevelopment potential to reorient their economies to peacetime through programs of the Economic Development Administration and the Small Business Administration. Initial-year funds required for these specific purposes might range from \$20 to \$50 million for the Economic Development Administration, and from \$5 to \$10 million for the Small Business Administration.

These agencies would help defense-dependent communities modernize public facilities, develop industrial sites, convert defense installations to other uses, and otherwise make themselves attractive to new industry.

ASSISTANCE TO DISLOCATED INDIVIDUALS

While most of the individuals who lose defense jobs or who are released from military service will be readily employable, some will not possess the required skills, while others will be geographically isolated from job opportunities. Federal programs should be undertaken to ease the impact of demobilization upon the most seriously affected individuals as follows.

Strengthening the Federal Employment Service

Post-Vietnam demobilization will greatly enlarge demands on the resources of the Employment Service. Prior to demobilization, plans should be made for expanding the staff of the Employment Service offices to assure their capacity for handling veterans and laid-off defense workers; improving the flow of information about job opportunities outside the local labor market area; and temporarily stationing staff at locations convenient to military personnel about to be discharged.

Limited Expansion of Manpower Training

Some individuals dislocated from defense employment will need retraining to help them find good jobs in other industries. The preliminary estimate is that Project Transition will need \$13 million to prepare about 26,000 servicemen for civilian employment, and that other MDTA programs will need \$40 million for about 20,000 other enrollees. These funds should be reserved for exclusive use in connection with demobilization. Further appropriations of up to \$140 million may be required for the two programs.

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Provision of Relocation Assistance

A relocation assistance fund should be established to help low and middle income workers move out of those defense-dependent communities with inadequate reemployment opportunities into areas where there are jobs. The program should be administered by the Department of Labor, which should develop general policy on relocation assistance—including eligibility criteria—in cooperation with the Readjustment Operations Committee. The program should provide full grant assistance for those taking low income jobs, and a mix of loans and grants for those obtaining higher income jobs.

Such relocation assistance should be available only to individuals directly affected by cutbacks in specified defense-dependent communities. The number of individuals so assisted could range between 10,000 and 30,000 families, and require expenditures between \$4 million and \$15 million.

Adequate Funding of Existing Veterans Assistance Programs

Current programs available to veterans are generally adequate to cover the needs of returning servicemen. However, the accelerated separations associated with demobilization will require additional appropriations for these veterans programs, especially employment consultation services and the educational assistance program. Adequate financing of the veterans programs may cost \$30 to \$50 million a year during demobilization.

Provision of Homeowner Assistance

The Federal Government should undertake to prevent a widespread loss of homes in areas suffering temporary unemployment during demobilization. The Department of Housing and Urban Development should establish a program to encourage private lenders to declare moratoria on mortgages on homes owned and occupied by individuals dislocated by a defense cutback. When an extension of mortgage payments cannot be obtained, the Department of Housing and Urban Development should be authorized to lend the homeowner funds to cover up to eighteen months of mortgage payments at a reasonable interest rate. The program would be limited to communities that are specified by the Readjustment Operations Committee as having severe readjustment problems. Expenditures of about \$2 million should be ample for this program.

TABLE 6-1.—*Illustrative projections for 1972 and actual results for 1968*
[Billions of dollars; fiscal years]

Item	1968 actual	1972 projected
Gross national product.....	823	1,100
Federal receipts.....	161	226
Federal expenditures and dividend.....	173	222
Baseline expenditures.....	173	200
Defense purchases.....	76	73
Other expenditures.....	97	127
Peace-and-growth dividend.....	—	22
Federal surplus or deficit (—).....	-12	4

Note.—Federal receipts, expenditures, and surplus or deficit are the concepts used in the Federal Government sector of the national income accounts. Detail will not necessarily add to totals because of rounding.

Sources: Department of Commerce and Council of Economic Advisers.

TABLE 6-2.—*Change in the peace-and-growth dividend, 1968 to 1972*
[Fiscal years]

Item	Change (billions of dollars)
Increase in Federal receipts.....	65
Plus: Decline in baseline Federal defense purchases.....	3
Less: Increase in baseline other Federal expenditures.....	30
Less: Increase in Federal surplus.....	16
Equals: Peace-and-growth dividend.....	22

Note.—Federal receipts, expenditures, and surplus are based on the concepts used in the Federal Government sector of the national income accounts.

Sources: Department of Commerce and Council of Economic Advisers.

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TABLE 6-3.—Estimated full cost of existing programs

Program	Billions of dollars:
Total full cost	6.1
Elementary and secondary education.....	2.0
Higher education.....	1.3
Housing and community development.....	.7
Water and air pollution control.....	.5
Crime control and prevention.....	.2
Area redevelopment.....	.5
Health training and research, etc.....	.4
Agricultural conservation and adjustment.....	.5

Source: Bureau of the Budget.

TABLE 6-4.—New Programs or major expansions of existing Federal civilian programs, fiscal year 1972

Program	Hypothetical expenditures (billions of dollars)
Total expenditures	38.7
Education	7.0
Preschool.....	1.0
Elementary and secondary.....	2.5
Higher.....	3.0
Vocational.....	.5
Health	3.8
Kiddie-care.....	.5
Medicare for disabled.....	1.8
Comprehensive health centers.....	1.0
Hospital construction and modernization.....	.5
Nutrition	1.0
Community service programs8
Jobs and manpower	2.5
Public jobs.....	1.8
MDTA.....	.5
Employment service.....	.2
Cash benefits	9.5
Unemployment insurance.....	2.9
Public assistance.....	4.0
Social security improvements.....	2.6
Veterans3
Economic, area, and other special development programs	2.2
Entrepreneurial aid.....	.5
Area redevelopment.....	.5
Rural development.....	1.0
Indian assistance.....	.2
Crime, delinquency, and riots	1.0
Violence and riot prevention.....	.1
Safe streets programs.....	.3
Rehabilitation of offenders and delinquents.....	.3
Prevention of delinquency and crime by special measures for delinquency-prone youth.....	.3
Quality of environment	1.7
Air pollution prevention and control.....	.1
Public water supply construction programs.....	.3
Water pollution control and sewage treatment.....	1.0
Solid waste disposal.....	.1
Natural beautification, environmental protection, and recreational development.....	.2
Natural resource development and utilization	1.4
Sand and forest conservation.....	.2
Water resources and related.....	.5
Mineral and energy (excluding hydroelectric).....	.2
Natural environmental development.....	.5
Urban development	4.5
New cities.....	.5
Land acquisition and financial planning (suburban).....	.5
Urban mass transportation.....	.5
Model cities.....	2.0
Other urban facilities and renewal.....	1.0
Transportation	1.0
Airway and airport modernization.....	.4
Rapid interurban ground transit.....	.1
Modernization of merchant marine.....	.2
Motor vehicle and transportation safety research and safety grants.....	.3
Science and space exploration	1.0
Post-Apollo space program.....	.5
Scientific research in oceanography, communications, social and behavioral sciences, and natural sciences.....	.5
Foreign economic and financial aid	1.0

NOTES

Education. The preschool program, an extension of Head Start, would provide full-time preschool for about 500,000 children. The elementary and secondary education funds would about double the Federal support in that area. The funds proposed for higher education would more than double current Federal support. The vocational education funds would raise Federal support about halfway toward the recommendation of the 1968 Advisory Council on Vocational Education.

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Health. The "kiddie care" proposal would provide health care for needy mothers and infants. Medicare offered to beneficiaries of social security disability insurance on a contributory basis would potentially reach 2.2 million persons in 1972. About 350 additional comprehensive neighborhood health care centers a year could be built for the amount shown. The added funds for health facilities would enable the Federal Government to double the rate of output of such facilities, in line with estimates of national needs.

Nutrition. Nutritional supplements for needy pregnant women, nursing mothers, and small infants account for about \$200 million, while the remainder would allow a doubling of existing food assistance programs.

Community Service programs. This would provide for expanded daycare centers for children of needy working mothers and for expansion of the OEO Community Action Program.

Jobs and Manpower. The funds for jobs in the public sector would permit expansion of about 500,000 jobs to provide public service employment for the chronically disadvantaged; this program would reinforce expansion in education, health services, and urban and area redevelopment. The increase in MDTA training would reinforce efforts to lower unemployment while improving the Nation's price performance. It would also provide trained manpower for construction. The growth in employment service operations envisions strengthening, decentralizing, and computerizing manpower activities; developing a rural manpower service; and enlarging services to the disadvantaged.

Cash benefits. The unemployment insurance funds would provide for higher benefits, extended benefits during recessions, and aid to the unemployed through retraining and mobility assistance. The public assistance funds could permit revision of benefit standards and extended coverage, or the adoption of a modest new program of income aid with objective standards. The added expenditure could fill as much as 40 percent of the current poverty income gap. The social security expenditure could provide a higher minimum benefit for those dependent on social insurance benefits as the main source of income, and liberalization of eligibility requirements for disability insurance, as well as some general improvement in benefit levels.

Veterans. The higher priority recommendations made by the Veterans' Advisory Commission in March 1968 could be instituted with these funds.

Economic, area, and other special development programs. The entrepreneurial assistance program could help minority groups—so-called "black capitalism." Area redevelopment programs would assist growth centers in less populated areas, while rural redevelopment programs would concentrate on small communities, providing community facility development, special housing, and family farm assistance.

Crime, delinquency, and riots. Federal aid to State and local governments could be provided to help prevent violence and riots and permit a higher degree of Federal readiness to cope with such emergencies. The Safe Streets program funds would be used to work towards the objectives of the National Crime Commission with respect to strengthening the police and courts. Rehabilitation of offenders and delinquents would be pursued by intensive retraining and other services.

Quality of environment. Federal funds for pollution abatement may be required to enforce standards, investigate claims, or abate pollution caused by government or not readily attributable to particular private individuals. Assistance in expanding the Nation's water supply system would provide a small fraction of the \$2.5 billion annual requirement over the next ten years. Provision of more recreational areas near population centers would be made possible.

Natural resource development and utilization. Department of the Interior, Corps of Engineers, and Department of Agriculture programs relating to land, mineral, energy, forest, recreational and other fields have large backlogs of useful projects, many already planned and authorized but held back for budgetary reasons.

Urban development. Metropolitan development assistance would support improved planning and coordinated advance land acquisition. Each of these programs emphasizes these requirements, whether in new communities, suburbs, or older central cities. The allowances represent only a fractional contribution to the reconstruction and development of the cities.

Transportation. Such expanded investments in the improvement of the principal elements of the Nation's transportation system would serve the objectives of economic development, safety, and national defense.

Science and space exploration. The allowances would permit the science and space agencies to fund some of the research opportunities not covered in the stringent budgets of recent years.

Foreign economic and financial aid. This additional amount would help to meet growth targets in Southeast Asia and under the Alliance for Progress as well as to cover other aid requirements. Even this increase would leave our foreign assistance program below levels of a few years back.

Source: Bureau of the Budget.

TABLE 6-5.—Estimated first year cost of readjustment programs

[Millions of dollars]

Program	Estimated first-year cost	
	Low	High
Total cost.....	120	288
EDA community development assistance.....	20	50
SBA loans.....	5	10
HUD homeowner emergency loans.....	1	3
MDTA training.....	53	140
Employment service.....	7	20
Relocation assistance.....	4	15
Veterans assistance.....	30	50

Note.—Abbreviations used in this table represent the following: EDA (Economic Development Administration), SBA (Small Business Administration), HUD (Department of Housing and Urban Development), and MDTA (Manpower Development and Training Act).

Source: Bureau of the Budget.

FILE MEMO
ELM
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FG 11-8-1/Califano, Joseph
PL 2
BE 5-7
PR 18
LA 8
BE 3
ND 19/CO 312
HU 2/ST 5
HU 2/ST 22
LG/Detroit
PU 2-2
LE
FG 1

Box No. #1758 sent to Central Files by Mr. Joseph Califano's Office on the above date contains the following folders.

1. Political Process
2. Post Vietnam Planning
3. Press Contacts
4. Wage-Price Guideposts
5. Vietnam
6. Watts
7. Detroit - Chronology - Aug. 1.
8. Detroit - Chronology - July 23 - 31
9. Notebook - Favorable Editorials for President Johnson's Legislative Program
10. Notebook - Programs of the Administration

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EXECUTIVE

BE 5-7
7G 11-1
7G 11-3

December 16, 1968

FOR Art Okun

FROM Joe Califano

Attached is Peter Lewis' memorandum. As I indicated, I agree generally with the paragraph as written. I would in addition turn the laundry list into an appendix, much as it is written in the current draft, with the following introduction:

This appendix contains a list of programs that have been more prominently and generally discussed in the public policy arena to meet the needs of the nation during the next _____ years. Many will think the list is incomplete or inadequate. Yet, it should be obvious to any reader that even among this list some very difficult choices must be made based on a determination of the priorities that the nation desires to follow.

Attachment

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EX-100-100

EXECUTIVE OFFICE OF THE PRESIDENT
BUREAU OF THE BUDGET
WASHINGTON, D.C. 20503

OFFICE OF
THE DIRECTOR

DEC 13 1968

MEMORANDUM FOR: MR. JOSEPH A. CALIFANO

SUBJECT: Post Vietnam Planning

There are three ways to handle the problem arising from the laundry list of Federal programs.

One, merge individual programs into broad categories with a dollar figure for each category. This has the same disadvantage as a detailed listing, namely that it implies a setting of priority (which we haven't done) with the additional disadvantage of looking extravagant to boot.

Two, relegate the laundry list to an appendix. This would tend to downplay the importance of the laundry list which would be helpful.

Three, condense the laundry list to one paragraph something like the following:

60

SOME

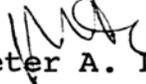
"In addition to the expansion of existing programs, a variety of new--or major expansion of existing programs are highly eligible claimants against the fiscal dividend. A review of recent recommendations of task forces or study groups would indicate potential domestic programs totalling a minimum of \$40 million a year in the fields of education, health, job and manpower training, welfare, urban development, crime prevention, air and water pollution, natural resource development, transportation in all its forms, space technology and science. This listing by no means exhausts the possibilities for Federal initiatives. Indeed, it does not include major proposals for negative income tax or revenue sharing with States and municipalities which have already reached the stage of public debate. Rather,

this listing represents the cost of moderate steps that have been advanced in recent years to deal with important domestic problems."

Such a paragraph, of course, could also be tied to a detailed appendix. However, my personal feeling is that it would not be necessary.

The danger with individual listing of programs is not only that it sounds like the Administration's unfinished agenda (and this may not be the best document for such an agenda), but it distracts from the key issues of the Vietnam study: One, do we have an economic problem in demobilization, and two, to the extent that we do, how do we go about meeting the problem?

The questions of tax reduction, increased military spending, or increased civilian spending can and should be discussed in broad terms, but we ought not get into an argument over whether we ought to spend more on welfare than on health, or more on education than on jobs, and the composition of those programs within each category.


Peter A. Lewis

emj

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From the desk of . . .

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Council of Economic Advisers

12/13/68

To: Joe Califano

Attached is the revised version of the Post-Vietnam report. The revision of section IV, beginning on page 75, is not yet ready, so that section is the same as in the November 26 draft.

WLS

Warren Smith

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REPORT TO THE PRESIDENT
OF THE CABINET COORDINATING COMMITTEE
ON ECONOMIC PLANNING FOR
THE END OF VIETNAM HOSTILITIES

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I. Introduction

On March 1, 1967, you established the Cabinet Coordinating

Committee on Economic Planning for the End of Vietnam Hostilities. At

that time, you instructed us to do the following:

- "consider possibilities and priorities for tax adjustment;
- "prepare, with the Federal Reserve Board, plans for quick adjustments of monetary and financial policies;
- "determine which high priority programs can be quickly expanded;
- "determine priorities for the longer range expansion of programs to meet the needs of the American people, both through new and existing programs;

- "study and evaluate the future direction of Federal financial support to our State and local governments;
- "examine ways in which the transition to peace can be smoothed for the workers, companies, and communities now engaged in supplying our defense needs, and for the men released from our armed forces."

This report summarizes our studies of the past 21 months.

Fundamentally, our analysis convinces us that peace will provide the Nation with welcome opportunities to channel into civilian use manpower and material resources now being devoted to the war.

Vietnam hostilities first became a significant economic influence in the summer of 1965, at a time when the Nation's prosperity was remarkably vigorous and well-balanced. The increase in the military budget required for Vietnam complicated the assignment of fiscal-

monetary policies and hence subjected the economy to inflationary strains.

The American economic system has demonstrated the strength and

adaptability necessary to carry the extra load without disruption. But

the cost of war has been a load for the economy to carry -- certainly not

a "prop" supporting prosperity. Our prosperity clearly does not depend

on the continuation of a military budget swollen by a period of hostilities.

Sustaining that prosperity during the demobilization and seizing the

welcome opportunities of peace will depend on careful and forward-looking

management of fiscal-monetary policies. If the pattern of demobilization

produced a major and rapid decline in defense spending, and if fiscal and

monetary policies were not adjusted to compensate, an abrupt and inappro-

priate shift to excessive restraint would result. This could clearly jeopardize

the Nation's prosperity. The criteria and the opportunities for an

appropriate fiscal-monetary adjustment are set forth in section II below.

The pattern of demobilization is traced on the assumption that, within 6 months after cessation of hostilities, a genuine peace would be secured and a full withdrawal of troops could be initiated. In such a rapid demobilization, the real use of resources for defense purposes would be reduced by \$16 billion (in 1968 prices) over a period of 6 quarters following the truce, and ultimately by \$20 billion at the end of 10 quarters. If there were no compensating fiscal-monetary policy actions, the Nation could be threatened with a recession similar to the 1953-54 experience at the end of the Korean war.

Thus, economic policymakers must be prepared to take action. The magnitude and the timing of the policy adjustment best suited to promote steady and healthy economic growth will depend on the strength of private demand when peace arrives and on the specific profile of the defense cut-back. Careful assessment and economic analysis will be needed to provide the best possible projections of these elements in order to guide fiscal-monetary policy. If the current 10 percent surcharge is still in effect when

hostilities end, its early expiration (or phasing out) could provide a major offsetting element to maintain the even keel of fiscal policy and thus support total demand. In addition, the Bureau of the Budget should stand ready -- as it is now -- to offer the President for his consideration a program to speed up expenditures on established high-priority programs, insofar as these actions would be consistent with the efficiency of Federal programs and with the need for economic stimulus. If further opportunities exist, new program initiatives could be launched during the demobilization period. Meanwhile, it seems most likely that monetary policy should be used to support the objectives of the compensating fiscal action, but should not be pushed into a posture of aggressive ease.

Structural efforts to improve the price performance of the economy should continue during the demobilization to aid in the solution of the Nation's major unsolved over-all economic problem of combining price stability with high employment.

The reduced foreign exchange drains associated with Government expenditures in Southeast Asia should provide opportunities to deal more effectively and more flexibly with the Nation's lingering balance-of-payments problem.

The choices among alternative fiscal adjustments during the demobilization period should be guided by longer run priorities for the Federal Budget. Only by considering such priorities in advance, can society be prepared to take full advantage of opportunities to launch important new programs, to strengthen high-priority existing programs, or to reduce taxes. Some of the considerations bearing on these key choices are discussed in section III below.

That section includes estimates of the budgetary resources likely to become available to the Federal Government over the years ahead.

As revenues expand in a growing peacetime economy, the elbow room in the budget increases. But a substantial part of the growth in revenues is preempted by essentially built-in commitments to raise Federal

expenditures -- in order to provide for higher pay scales and costs and to meet the increased work loads on many Government agencies associated with a growing population and a growing economy. These commitments are reflected in a calculation of "baseline" budgetary expenditures. The level of defense expenditures included in the baseline assumes an ultimate return to the real level of defense outlays maintained prior to the Vietnam emergency.

Allowing for a moderate surplus appropriate to noninflationary economic growth, the calculations suggest that the excess of revenues over baseline expenditures -- the peace-and-growth dividend-- may amount to as much as \$29 billion in FY 1972 and \$36 billion in FY 1973. These amounts would be available for extra Federal spending and tax reduction. Indeed, the peace-and-growth dividend must be used in these ways if healthy economic growth is to be maintained.

Some of the claims on the peace-and-growth dividend are set forth in section III to illustrate the considerable pressures, demands, and opportunities for Federal efforts in the year ahead. Additional defense programs amounting to \$6 billion a year and liberalization of social insurance benefits amounting to \$5 billion a year are viewed as prime claims on the dividend. In addition, the full funding of existing civilian programs to authorized levels would cost another \$6 billion a year.

Beyond that, a variety of new -- or major expansions of existing -- programs are highly eligible claimants. A selection of such items, based on proposals which have been made by responsible individuals or groups, is spelled out; this list adds up to \$46 billion a year. And even beyond that, more ambitious new proposals, such as a comprehensive income maintenance program, are receiving widespread public discussion and deserve consideration.

It is clear that the Nation cannot meet all these goals in the next few years; it will need to make hard choices based on a careful determination of priorities. For those objectives placed at the top of society's priority list, we believe that substantial progress can be made in a peaceful environment of prosperity and essential price stability. Our calculation of the peace-and-growth dividend allows for tax reduction from present rate levels through the expiration of the 10 percent tax surcharge and of certain excise taxes. These funds would become available to the private sector to be spent for additional private consumption or investment. But, in view of the urgent needs of the public sector, we do not recommend further large-scale Federal tax reductions in the years immediately following the end of Vietnam hostilities.

The economic impact of the war has been broadly diffused among our States and our industries. Nevertheless, a limited number of areas

and industries will be especially affected by the demobilization and could encounter significant problems of transition. In our final section, IV, we recommend some steps that the Federal Government can and should take to assist those areas and industries.

These measures include community redevelopment assistance, homeowner assistance, and most importantly, the strengthening of employment-related programs such as job placement, job training, and unemployment compensation. To provide for efficient planning and implementation of these measures, we recommend the prompt establishment of a coordinating group, the Readjustment Operations Committee. That Committee should assume responsibility for detailed planning of Federal readjustment assistance and should work with State and local authorities responsible for demobilization planning. When peace comes, this Committee would be responsible for coordinating Federal readjustment programs.

The steps we propose for readjustment assistance are limited and relatively inexpensive, reflecting our conviction that the maintenance of an over-all healthy prosperity is far and away the major part of the economic problem of the transition. In our dynamic and flexible free market economy, most areas and industries should be able to make a prompt and healthy adjustment so long as the Federal government does its job of promoting an atmosphere of general prosperity .

In looking forward to peace, we also wish to stress the importance of a responsible and responsive fiscal policy during the remaining period of hostilities. Only in recent months, through the enactment of the 1968 program of fiscal restraint, have our Nation's finances become adequately adjusted to the defense emergency situation. It is absolutely essential that fiscal policy be kept appropriately geared to the needs of sustainable noninflationary economic growth.

In looking forward to peace, we also wish to stress the importance of a responsible and responsive fiscal policy during the remaining period of hostilities. Only in recent months, through the enactment of the 1968 tax package, have our Nation's finances become adequately adjusted to the defense emergency situation. Current fiscal policy is adjusted to the needs of sound and sustainable economic growth under present conditions, and it is absolutely essential that the fiscal program be kept consistent with this objective.

II. Fiscal and Monetary Policies During the Demobilization

A. The Demobilization Scenario

Peace may "break out" in any number of ways. For example, there could be a gradual decline in hostilities over time accompanied by reduced expenditures on armament and manpower. Alternatively, there could initially be a lengthy armed truce which permitted no significant reduction in force strength in Southeast Asia.

The calculations underlying this report assume that the transition from war to full peace will be quite rapid. Specifically, it is assumed that, within six months after cessation of hostilities, there will be a genuine assurance of peace that permits the start of a full withdrawal of troops from Vietnam and accompanying cutbacks in procurement, operation, and maintenance.

This is the most rapid demobilization that could realistically be assumed. We used it because it represents the sharpest test of the Nation's ability to adapt to peace -- not because it appears most probable. If the Nation is ready to meet the challenge of a very rapid demobilization, it will certainly be able to handle the lesser challenge of a more gradual transition.

The truce is assumed to take place at a time when the defense budget has leveled off in real terms, thus increasing modestly in dollar

terms to keep up with rising costs of goods and pay increases. The subsequent reductions in men, materials, and outlays are measured from that initial level. One planning scenario developed by the staff of the

Department of Defense calls for reductions of the following magnitude

(expenditures at annual rates):

1. The armed services would decline by about 1 million persons, averaging 250,000 per quarter between the second and sixth quarters after the cessation of hostilities.
2. Civilian personnel in DOD would decline 170,000 on the same time path.
3. The impact on military and civilian compensation associated with the manpower reductions would amount to \$5 billion at 1968 rates of pay.
4. Other operating expenditures, at 1968 prices, would decline by \$8 billion.

5. Expenditures for procurement would be reduced by \$7 billion. This reduction would be delayed as a result of the need to rebuild DOD inventory stocks following the truce date.

6. As the total result of the above, the rate of defense spending (at 1968 prices) would be below the path it would have followed in the absence of demobilization by \$11 billion at the end of 4 quarters, \$16 billion at the end of 6 quarters, and \$20 billion at the end of 10 quarters. It should be noted that the total expenditure reduction associated with the demobilization is significantly less than the \$29 billion a year estimated as the cost of the war. Some of the resources now employed to support the hostilities would have to be retained in other military uses.

7. After 24 months, inventories would be restored to desired levels and demobilization would be essentially completed.

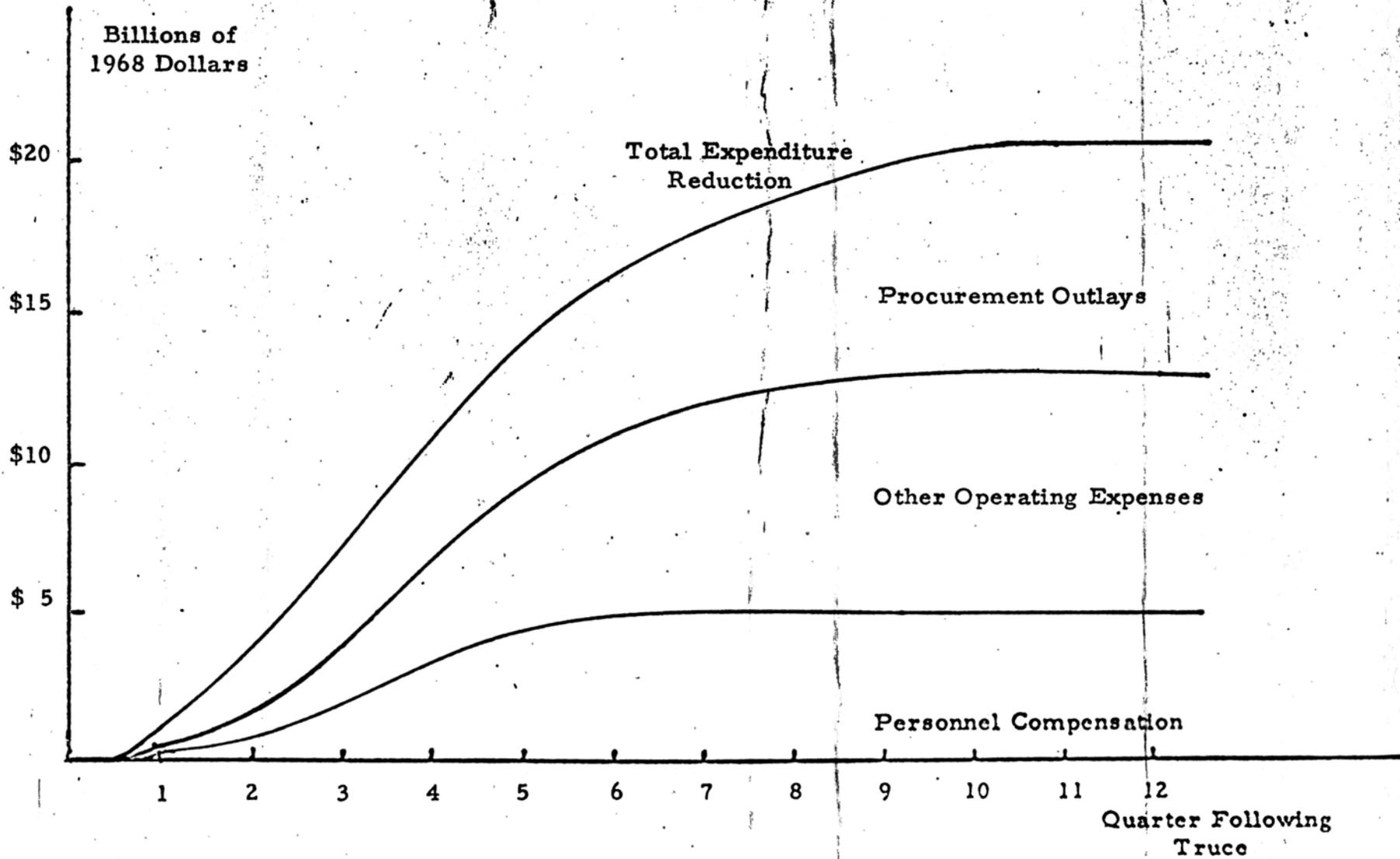
The time profile of the assumed expenditure reduction is shown in Figure I.

B. Economic Impact

The economic impact (and the required fiscal-monetary adjustment) of the demobilization can best be appraised by supposing that the Federal Budget had previously been planned on the assumption that hostilities would continue and that the fiscal program was appropriately designed to promote a balance between aggregate demand and the economy's supply capabilities. If there were no scheduled or proposed changes in tax laws, this could mean that revenues would be growing at a rate of 6 to 7 percent per year as a result of increases in incomes and economic activity. On this assumption, total Federal expenditures would be scheduled to grow at the rate necessary, in view of the anticipated strength of private demand, to keep the economy moving along a high-employment growth path.

Figure I

ILLUSTRATIVE POST-VIETNAM DEMOBILIZATION



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If the demobilization occurs in such an assumed situation of an initially appropriate fiscal policy and healthy economic growth, there is a clear need for a major fiscal adjustment. ~~The impact of demobilization~~ on the over-all balance between aggregate demand and the economy's productive capacity may be thought of as having two components:

1. The reduced use of resources by the Federal Government reflected in the decline of defense spending described above.
2. The upward impact on the Nation's potential GNP -- the total output the economy is capable of producing under high employment conditions -- resulting from the potential employment of manpower released from the armed forces in the civilian economy. This occurs because average productivity in civilian jobs is substantially greater than the measured productivity of members of the armed forces.

There would be an additional temporary deflationary effect resulting from downward adjustments of inventories by defense suppliers.

In part, this inventory adjustment would cause the economic impact of the declines in defense spending to be felt before they showed up in the Federal budget as reduced expenditures, because defense production would fall behind deliveries as production was adjusted to declining levels of defense orders. This inventory adjustment could be significant in the short-run, requiring carefully timed adjustments in fiscal policy if the deflationary effects of the cutbacks in defense spending were to be entirely avoided.

The declines of 750,000 in the armed forces and of 170,000 in civilian personnel in DOD will not be matched fully by the resulting increase in the civilian labor force. It is estimated that 250,000 women now in the labor force will withdraw when their husbands return to civilian life. Moreover, the entry of some veterans into the civilian labor force will be delayed as they initially return to school to seek further training.

Taking account of all of these factors, the net induced increase in the private labor force builds up to 920,000 after 10 quarters. Given the current productivity differentials among workers in civilian jobs, members of the armed forces and Federal civilian personnel, this shift would add about \$6 billion to potential GNP. In order to adapt to this increase of supply, policy actions would be required to add about \$2 billion directly to total demand. Once that was accomplished, the resulting private incomes could be expected to generate about \$4 billion of further additions to private consumption and investment demand, thereby matching the \$6 billion increment in supply.

With no policy offset whatsoever to the impacts noted above, the direct shortfall of demand could amount to \$18 billion by the sixth quarter following the truce. This would be the result of a decline of \$16 billion in military spending below the level that would have prevailed in the absence of a truce plus an additional \$2 billion of direct spending needed to utilize the additional productive capacity resulting from the shift of manpower

from Federal employment to more productive private jobs. Shifts in the strength of private demand might either reduce or add to this gap, but they would be unlikely to change the picture dramatically. Without compensatory stabilization action, the gap would be multiplied through income losses and induced further cutbacks in demand that spread through the private sector. Assuming a multiplier of $2-1/2$, the total shortfall below potential could easily reach \$40 billion. Inaction would thus threaten a recession similar to the 1953-54 experience at the end of the Korean War.

C. The Fiscal-Monetary Adjustment

It is thus clear that the instruments of fiscal and monetary policy must be used promptly and decisively to promote continued prosperity and economic growth. There is no doubt, in principle, that the instruments of budget policy, with the assistance of flexible monetary policy, are capable of offsetting the restrictive effects of demobilization and reduced military spending. Indeed, an overly large or premature stimulative fiscal-monetary program could overdo the job and generate an inflationary boom.

The problem is that of determining and executing the magnitude and timing of the policy adjustment best suited to promote steady and smooth growth. The projections we have developed are merely illustrative, designed to give an idea of the order of magnitude of the problem that might face the makers of fiscal and monetary policy during the period of transition from war to peace. The specific dimensions can be appraised far more accurately when peace comes than they can be today. More will then be known about the situation and prospects for private demand, the outlook for the budget, and the time-path of the military cutback. But there are important guides which we can set forth now:

1. When peace comes, the President and the Congress will need advice based on the best possible quantitative forecasting of the gross national product and its components, prices,

unemployment rates, and the balance of international payments, as a basis for formulating policies to maintain a healthy economy.

Despite the inherent limitations of such quantitative projections, prudent reliance on them -- carefully weighed and interpreted -- is preferable to any other course. There are far greater dangers in a policy of wait-and-see or a resort to predetermined rules of policy adjustment.

2. The quality of statistical information about the economy's performance should be strengthened, since such information may be critical in determining the success of policy during the demobilization. Decisions involving billions of dollars may rest on statistical programs costing only a few million dollars -- such as those innovations you recommended in your Budget program for FY 1969.

3. For the same reasons, the Department of Defense should continue its intensive efforts to improve projections of its orders and outlays in an effort to provide the best possible input for economic policy during the transition to peace.

There will be important uncertainties in gauging the time path of the military cutback, just as there were extreme difficulties in appraising the size and extent of the defense buildup in Vietnam.

4. Even with the best efforts, there will be difficulties in gauging private demand as well as defense outlays during the transition; these underline the importance of flexibility in fiscal and monetary policy decisions.

During the demobilization, prediction of private demand will be particularly difficult. The end of the war will have substantial psychological impacts on the economy, and

economists are not yet able to gauge and assess these with accuracy. It is easy to judge that businessmen and consumers will be delighted by peace, but it does not follow, by any means, that they will therefore spend more, or alternatively that they will save more.

Keeping the economy on a smooth path may require continuing adjustments of the budget and of the stance of monetary policy.

A successful transition program -- marked by steadiness and stability in the growth, employment, and price performance of the Nation -- may require successive alterations in the budgetary balance over time and in the behavior of monetary and credit flows.

5. The illustrative calculations associated with the scenario of rapid demobilization show ^{that,} in addition to the usual adjustment to the fiscal dividend from economic growth, a very

substantial fiscal adjustment may be required to offset the decline in defense spending below the path it would have followed

in the absence of a truce and to utilize the additional productive capacity resulting from the shift of labor from Federal employment to more productive civilian jobs. This fiscal adjustment could amount to as much as \$18 billion in a period of a year and a half.

And this extraordinary "peace dividend" would be fully available to provide for "controllable" expenditures or tax reductions, unlike the normal fiscal dividend from growing tax revenues, which must, in part, finance the built-in growth of Federal expenditures and prior commitments. Hence, it is important to plan in advance to make optimal use of the opportunity.

6. If the cessation of hostilities occurs while the tax surcharge is still in effect, its early expiration (or phasing out) could provide a major element in the required fiscal offset. Acceleration of the currently scheduled reductions in excise taxes on
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automobiles and telephone service could serve as another element in the fiscal adjustment.

7. The Bureau of the Budget should remain prepared in the future, as it is now, to offer the President a program of accelerated expenditures that could be initiated on short notice following the cessation of hostilities. These should remain confined to high priority public expenditures which would be made in the near future in any event. According to staff estimates of the Bureau of the Budget, such a program could add to Federal expenditures (at annual rates) by as much as \$2.9 billion in 6 months and \$7.4 billion in 12 months following the activation of the program.

8. Decisions on expansion of Federal expenditures, as part of the program of fiscal adjustment, should be made in light of the promptness with which various types of outlays will add

to total demand. For example, according to our staff studies, some -- although not all -- Federal grant programs to States and localities involve a significant lag between the expenditure of the funds by the Federal Government and their translation into additional purchases by the recipient States and localities. Programs involving long lags would not be ideal as an instrument for supporting total demand during the transition. On the other hand, certain types of Federal activities may involve orders or contracts to the private sector which would increase employment and economic activity before any expenditures would be incurred by the Federal Government.

9. While the precise assignment of responsibilities between fiscal and monetary policies should be made in full light of the circumstances associated with peace, monetary policy

should probably play a supporting role, rather than shifting toward extreme ease to provide a maximum stimulant. For one thing, balance-of-payments considerations are likely to limit to some degree the flexibility of monetary policy in the direction of easing. Secondly, the flexibility that monetary policy possesses makes it a useful instrument to hold in reserve as a means of correcting errors in fiscal policy or in the forecasting of private demand.

10. The transition period is not the time to relax our efforts through structural measures to combat the troublesome tendency for prices to rise at an unacceptable rate when the economy is operating under conditions of reasonably full employment. Thus, we should continue to emphasize actions of the kind

being explored by the Cabinet Committee on Price Stability to improve the price performance of sectors such as construction and medical care, which have experienced especially rapid increases in wages and prices; to increase the efficiency of the private economy generally; to minimize the inflationary effects of the Federal Government's own activities; and to achieve patterns of collective bargaining and of business price determination that are consistent with over-all price stability. Manpower programs should also be strengthened, both to permit a reduction of unemployment and, by increasing the efficiency of the labor force, to help reduce inflationary pressures.

Inflationary tendencies may be strengthened during the transition period as shifts in the composition of demand drive up prices in those sectors of the economy experiencing increasing demand without corresponding declines elsewhere. While it is likely to be impossible to avoid such tendencies

entirely, the Federal Government should pay some attention

to specific resource availabilities in deciding what policy

actions to take. For example, an effort to stimulate the

demand for housing at a rate exceeding the expansion of the

supplies of labor and other resources in the homebuilding

industry would contribute unnecessarily to inflation.

11. In general, fiscal policy adjustments during the transition

should advance longer-range objectives and meet the top

priorities of the public sector. Particularly if tax reduction

is not a large element in the fiscal adjustment program, there

could be important opportunities to launch new Federal programs

to achieve some of the Nation's top-priority objectives. These

priorities should be weighed in advance in order to determine

whether new programs should be initiated under likely circum-

stances, and, if so, which would stand at the top of the list.

12. In the event that the Administration should wish to initiate programs during the transition which would require any major legislation, it would be wise to consider submitting this legislation to the Congress in the near future for discussion and debate and perhaps even for enactment on a stand-by basis. Planning ahead in this way could avoid unnecessary delays in implementing the desired programs for the demobilization.

III. A Further Look Ahead

Many of the choices that will have to be made during the transition period should be guided by a longer range view of where the public sector and the tax structure should be headed after the transition. To build the best bridge to peacetime prosperity, we should know where we are going once we cross the bridge. As a partial basis for making some of these critical choices, the projections presented below are intended to provide an indication of the resources that will become available in the next few years to meet urgent national needs, and to consider alternative ways in which these resources might be used.

A. Economic Projections

In order to assess the outlook in the years ahead, it is necessary to make fairly detailed economic projections. These projections should not be viewed as precise forecasts of economic conditions but rather as rough indications of what the economic situation might be on the basis of reasonable assumptions.

In making the projections underlying this presentation, it was assumed that once the current inflationary tendencies are brought under control it will be possible for the economy to operate at an unemployment rate of 3.8 percent while maintaining reasonable price stability. Starting from this assumption, the time path of real GNP was estimated on the basis of labor force, employment, and productivity projections supplied by the Bureau of Labor Statistics. The behavior of the GNP price deflator was then projected, and the time path of current dollar GNP was obtained. It should be emphasized that the 3.8 percent unemployment rate represents neither a forecast nor a judgment that this will necessarily be the most appropriate rate. A lower unemployment rate would result in a higher GNP and an increased fiscal dividend. The Cabinet Committee on Price Stability is considering possible measures to enable the Nation to achieve a reduction in unemployment while maintaining reasonable price stability.

The next step was to estimate the various components of private demand that could be expected if the indicated levels of GNP were in fact achieved.

In the projections, allowance was made for the gradual phasing in of the special housing program stemming from the Housing Act of 1968. Estimates were also made of the anticipated levels of State and local government expenditures.

B. Federal Expenditures

For purposes of this study, projected Federal expenditures are divided into two categories: baseline expenditures and the peace-and-growth dividend.

Baseline expenditures.

Baseline expenditures include allowance for growth in Federal spending under established existing programs to allow for rising prices, increases in salaries of Federal employees, and increasing workloads. The baseline defense budget is based on the assumption that, when the struggle in Vietnam ends, the Nation's defense posture will be cut back ultimately to the level of FY 1965, before the extensive build-up in Vietnam began. (Actually, in real terms, Federal defense outlays remained essentially on a plateau between FY 1959 and FY 1965.) This assumption yields a projection of defense expenditures of about \$66 billion in FY 1972 and a gradual rise

thereafter as costs increase.

The baseline Federal nondefense budget allows for some increases ~~from the current level. Some increases must be expected in the prices of~~ the things the Government buys, and the pay of civilian Government employees must be raised more or less in pace with wages and salaries in the private sector. More veterans will become eligible for pensions; more Government employees will qualify for retirement benefits with the passage of time; a growing population will increase the workloads of many Government agencies, such as the Post Office Department and the National Park Service; and so on. Social security benefits will rise even with an unchanged benefit formula, as more persons become eligible for benefits and as the average past income of applicants rises. As a result of such increases in prices, pay, and workloads, baseline nondefense expenditures rise at a rate of about \$7 billion to \$8 billion per year. In addition, an estimate of the Federal Government's share of the cost of the special housing program has been included in baseline Federal expenditures. This share is forecast to rise to about \$1.1 billion by FY 1972. Total expenditures under the special housing program are

projected to be \$ 6.0 billion in that year -- the remaining \$ 4.9 billion is counted as private expenditures.

The method of handling social security is worthy of special note.

The revenue projections include the proceeds from increases in social security taxes that have already been enacted and are scheduled to go into effect in 1969 and 1971. However, benefit payments included in baseline expenditures are estimated on the basis of the existing statutory formula.

That is, allowance is made in baseline expenditures for increased social security benefits resulting from an increased number of recipients and an increase in the average income of recipients under the present benefit formula, but not for a liberalization of the formula itself. Some liberalization is likely to be enacted, in part to keep pace with past and future increases in the cost of living. But since the amount and timing remain an open issue, benefit liberalization is not included in the baseline expenditure total.

The peace-and-growth dividend

The peace-and-growth dividend may be defined as the additional GNP expenditures over and above normal private demand and baseline Federal

expenditures

that, according to the projections, will be needed if the economy is to

achieve the specified GNP targets. For example, GNP is projected

to be \$1,104 billion in FY 1972. Non-Federal expenditures (private

consumption and investment, net exports, State and local government

purchases, and the special housing program), together with baseline

Federal purchases, add up to \$1,075 billion. The difference of \$29

billion between these expenditures and the GNP projection is the peace-and-growth

dividend. It represents the additional amount of expenditures that would

have to be forthcoming in order to achieve the GNP target of \$1,104 billion.

The \$29 billion could take the form of additional Federal purchases of

goods and services, or alternatively of additional private expenditures.

To illustrate the calculations, Table I shows the main results for

FY 1972 and FY 1973. These calculations assume that the demobilization

process has been completed, an assumption that is reasonably consistent

with the demobilization scenario above if a truce occurs within calendar

Table 1

Illustrative Projections for Fiscal Years 1969 and 1972-73
(Amounts in billions of dollars)

	Projections		
	1969	1972	1973
GNP in current dollars	893	1,104	1,182
GNP in 1958 dollars	721	818	855
Baseline Federal expenditures	185	193	202
Defense	78	66	67
Nondefense	107	127	135
Peace-and-growth dividend.....	--	29	36
Total Federal expenditures including fiscal dividend...	185	222	238
Federal revenues	<u>184</u>	<u>226</u>	<u>242</u>
Federal surplus or deficit (-), N.I.A. basis...	-1	4	4

Note: Details may not add to totals due to rounding

1969. The peace-and-growth dividends shown in Table I are \$29 billion for FY 1972 and \$36 billion for FY 1973.

~~The peace-and-growth dividend is thus a rough measure of the~~
resources available for additional Government spending or for tax reduction. It should especially be noted that a dollar of peace-and-growth dividend may be "used up" either by a dollar of increase in Federal purchases; or by a dollar of additional private spending such as might be induced by a reduction in taxes, an increase in Federal transfer payments, or an easing of monetary policy.

The peace-and-growth dividend may be regarded as a resultant of the operation of four factors:

1. Tax revenues. With our present tax system, the normal gain in Federal revenues under conditions of high-employment and steady economic growth amounts to about 6 to 7 percent per year. The normal revenue growth is augmented in the projections by scheduled increases in social security tax rates in 1969 and 1971, but is reduced by the expiration of

the current 10 percent income tax surcharge and of excise taxes on telephone service and automobiles. Between FY 1972 and FY 1973, revenues are estimated to increase by \$16 billion.

2. Decline in baseline defense expenditures. The second component in the peace-and-growth dividend is the decline in defense expenditures associated with the ending of the Vietnam conflict. On a fiscal year basis, baseline defense spending falls from an estimated \$78 billion in FY 1969 to \$66 billion in FY 1972. At that point it begins to rise gradually due to continuing increases in prices and pay rates.

3. Increase in baseline nondefense expenditures. A portion of the budgetary resources made available by growing tax revenues and declining defense spending will be absorbed by increases in baseline nondefense spending. These increases are estimated to be \$7 billion in FY 1972 and \$8 billion in FY 1973.

4. Change in budget deficit or surplus. What needs to happen to the budget deficit or surplus (on a national income accounts basis) in any given year is determined by the growth of target GNP in relation to the growth of private demand. In the particular exercise presented in Table I, surpluses of \$4 billion in FY 1972 and FY 1973 are estimated to be consistent with the achievement of target levels of GNP. The peace-and-growth dividend is reduced whenever a portion of the gain in tax revenues must be used to reduce the deficit or increase the surplus.

The effects of these four factors on the peace-and-growth dividend for FY 1972 and FY 1973, using estimated values for FY 1969 as a base, are shown in the following table (amounts in billions of dollars).

	Change from FY 1969 to	
	<u>FY 1972</u>	<u>FY 1973</u>
Increase in revenues	42	58
Plus: Decline in baseline defense spending	12	11
Less: Increase in baseline non-defense spending	20	28
Increase in Federal surplus, N.I.A. basis	<u>5</u>	<u>5</u>
Equals: Peace-and-growth dividend	29	36

To illustrate, in FY 1972, Federal revenues exceed FY 1969 by \$42

billion, while baseline defense expenditures are \$12 billion below FY 1969.

This provides a total of \$54 billion of budgetary resources. Of this, \$20

billion is absorbed by an increase in baseline nondefense expenditures

above the FY 1969 level. In addition, the N.I.A. budget shifts from a deficit

of \$1 billion in FY 1969 to a surplus of \$4 billion in FY 1972, using up \$5

billion of budgetary resources. This leaves a peace-and-growth dividend of

\$29 billion for FY 1972. That is, there will be room for an additional \$29

billion of expenditures in FY 1972 over the estimated cost of current program

commitments -- indeed, this amount of extra demand will have to be forthcoming if the GNP and employment targets are to be achieved in FY 1972.

C. Elements of Uncertainty

The estimates presented above should be taken as indicating the orders of magnitude of the peace-and-growth dividends that will become available in FY 1972 and FY 1973. Several elements of uncertainty should be recognized which may make the peace-and-growth dividends depart from the estimates presented. First, the demands emanating from sectors of the economy other than the Federal Government may be either weaker or stronger than we have assumed, thereby requiring either more or less economic stimulus through the budget. The estimates of private demand incorporated in the above projections suggest that it will be possible to keep the economy operating at capacity in FY 1972 and FY 1973 with small surpluses (\$4 billion) in the Federal NIA budget. If private demand is not strong enough to permit this, smaller surpluses (or

possibly deficits) will be needed, and the peace-and-growth dividends will be larger than those shown above. Conversely, if private demand is stronger than indicated, larger surpluses will be needed and the peace-

and-growth dividends will be smaller than shown above. Second, the projections imply a certain monetary policy posture on the part of the Federal Reserve and an associated level and structure of interest rates, although this posture is not specified in detail. If Federal Reserve policy is more restrictive or easier than is implicitly assumed, offsetting fiscal action will be required which will increase or decrease the peace-and-growth dividend.

Finally, it should be noted that the peace-and-growth dividend is a measure of the additional fiscal stimulus the Federal Government can provide over and above the expenditures included in the baseline budget only on the assumption that all of this added stimulus takes the form of purchases of goods and services. To the extent that adjustments in

demand is not strong enough to permit this

transfer payments or taxes are used to provide the needed stimulus,

the increase in transfer payments or the reduction in taxes can be some-

what greater than the peace-and-growth dividend. This is because an

increase in transfer payments or a reduction in taxes of one dollar

will generally not increase private spending by a full dollar, since some

of the impact will fall on saving.

D. Uses of the Peace-and-Growth Dividend

The projections presented above provide rough estimates of the fiscal resources that can be expected to become available in the period after the transition from war to peace in Vietnam. By FY 1972 and FY 1973, the peace-and-growth dividends can be expected to reach magnitudes in the neighborhood of \$29 billion and \$36 billion, respectively.

In succeeding years, the dividend should expand at a rate of about \$8 billion a year as tax revenues rise more rapidly than increases in baseline Federal expenditures.

The peace-and-growth dividend must be used in some fashion if the growth and employment targets are to be achieved. And it surely can be used -- through strengthened Federal programs and for tax reduction. There is no shortage of useful Federal programs on which the peace-and-growth dividend can be spent. Indeed, with given tax rates, the problem will be to choose among many worthy alternatives.

A broad classification of the possible uses of the fiscal dividend

developed by the Bureau of the Budget and the Council of Economic

Advisers is presented in Table II, listing annual expenditure require-

ments for full operation of programs by FY1972. Taken together, the

list of programs is sufficiently flexible to permit a gradual buildup

as funds become available. The \$52 billion total of the list far exceeds

the estimated fiscal dividend and makes clear the need for careful

choices. The various categories shown in Table II are discussed in

the following pages.

Additional defense activities

The baseline level of defense expenditures used above in calculating the fiscal dividend was \$66 billion for FY 1972. This was meant to mark a return to the pre-1965 level of defense outlays in real terms.

Estimating the cost of the pre-1965 defense program in terms of current and projected pay scales and prices is extremely difficult primarily because defense equipment, programs, and deployment, other than for Vietnam, have changed markedly since 1965 and will continue to change

Table II

Programs for Using the
Peace-and-Growth Dividend, FY 1972
(annual rates of expenditure in
billions of dollars)

Additional defense activities	6.2
Increases needed to maintain standards under cash benefit programs as general living costs rise.....	4.8
Expansion of existing programs to authorized levels	6.1
<hr/>	
Selected new or expanded programs to meet major national needs	<u>46.2</u>
Total	63.3

in the future. The estimate above implies that it would cost about one-third more in FY 1972 than it did in FY 1965 to provide the same level of real resources for defense. In addition, there is approximately \$6 to \$6-1/2 billion of regular defense programs over and above the \$66 billion which are currently funded or approved. In order not to exceed the \$66 billion level for defense, approved program levels would have to be cut back or markedly stretched out. Consequently, these additional defense costs may be a prime claim against the fiscal dividend. The \$6 to \$6-1/2 billion additional expenditure does not provide funds for new defense programs currently under consideration.

Increases needed to maintain standards under cash benefit programs

To cover anticipated increases in living costs, cash benefit expenditures (social security, Federal retirement, railroad retirement, veterans' benefits, and welfare programs) must increase by nearly 10 percent, or \$4.8 billion, between fiscal 1969 and 1972. The baseline expenditure

estimates make no allowance for liberalization of benefits to compensate for rising prices or for other reasons except to the extent that such

adjustments are provided for in existing legislation. Presumably, liberalization of benefits would have a high priority claim on the fiscal dividend.

Indeed, if there were no legislated liberalization, social insurance trust funds would accumulate unusual surpluses.

Expansion of existing programs

Several Federal programs adopted in the past few years are not yet operating at authorized levels. To bring appropriations for these programs up to authorizations would cost \$6.1 billion per year, distributed as follows (in billions of dollars):

Education:

Elementary and secondary	2.0
Higher	1.3
<hr/>	
Housing and community development	0.7
Water and air pollution control	0.5
Crime control and prevention	0.2
<hr/>	
Area redevelopment	0.5
Health training and research, etc.	0.4
Agricultural conservation and adjustment	<u>0.5</u>
Total - expansion of existing programs	6.1

Since these programs are already making important contributions to the solution of major social and environmental problems, increasing their appropriations to authorized levels presumably commands high priority.

Nevertheless, in establishing priorities, the relative value of each of these programs should be weighed against the new or expanded programs

in the following section, which may be of equal or greater value.

New programs

A variety of new -- or major expansions of existing -- programs are highly eligible claimants against the peace-and-growth dividend. Expenditures for these programs, which are shown by major areas in Table III, total \$46.2 billion. In many instances, the amounts fall well below the recommendations of relevant recent task forces or study groups. Thus, they by no means exhaust the possibilities for Federal initiatives; rather they represent moderate steps that would help significantly in dealing with important problems. Some of the details for the individual program areas are set forth in the following paragraphs.

Education

\$7.0 billion

Preschool	\$1.0 billion
Elementary and secondary	2.5
Higher	3.0
Vocational	0.5

Table III

New Programs or Major
Expansions in Existing
Programs
(annual rates of expenditures
in billions of dollars)

Education	7.0
Health	3.8
Nutrition	1.0
Community service programs	0.8
Jobs and manpower	2.5
Cash benefits	9.5
Veterans	0.3
Economic, area, and other special development programs	2.2
Crime, delinquency, and riots	1.0
Quality of environment	1.7
Natural resource development and utilization	1.4
Urban development	5.5
Transportation	1.0
National defense	6.5
Science and space exploration	1.0
Foreign economic and financial aid	<u>1.0</u>
Total	46.2

The preschool program, an extension of Head Start, would provide full-time preschool for about 500,000 children. The elementary and secondary education funds would about double the Federal support in that area, raising to one-sixth the Federal share in the costs of public education by 1972. The funds proposed for higher education would more than double the Federal support of FY 1969, making the FY 1972 Federal contribution to higher education 20 percent of projected expenditures.

The vocational education funds would raise Federal support about half-way toward the recommendation of the 1968 Advisory Council on Vocational Education.

Health

\$3.7 billion

Kiddie-care	\$0.5 billion
Medicare for disabled and coverage of high- use drugs	1.8
Comprehensive health centers	1.0
Hospital construction and modernization	0.5

The so-called "kiddie care" proposal would provide health care for

mothers and infants under one year of age. Medicare on a contributory basis for beneficiaries of social security disability insurance would potentially reach 2.2 million persons in 1972. About 350 additional comprehensive neighborhood health care centers a year could be built for the \$1 billion listed above. The add-on for health facilities would enable the Federal Government to double the rate of output of such facilities, as indicated by estimates of national needs.

Nutrition

\$1.0 billion

Nutritional supplements for pregnant women, nursing mothers, and small infants account for about \$200 million, while the remainder would allow a doubling of existing food assistance programs. Considerably more could also be done in expanding nutritional programs for the elderly.

Community service programs

\$0.8 billion

This category includes \$0.5 billion for expanded daycare centers for children of working AFDC mothers and \$0.3 billion for expansion of the OEO Community Action Program.

Jobs and manpower

\$2.5 billion

Public jobs

\$1.8 billion

MDTA

0.5

Employment service

0.2

Most of the current efforts in public jobs is for summer jobs for youth and for work-training programs for youth and adults. The proposed expansion of about 500,000 jobs, including public service employment for the chronically disadvantaged, is related to the proposed expansion in education, health services, urban and area redevelopment, etc. The increase in MDTA training is necessary to hold down levels of unemployment in accordance with goals in Section II and also to provide trained manpower for proposed expansion in the construction of public facilities in the new programs cited in this section. The growth in employment service operations envisions strengthening, decentralizing, and computerizing manpower activities, development on a viable basis of a rural manpower service, and greatly enlarging services to the disadvantaged.

Cash benefits

\$9.5 billion

Unemployment insurance	\$2.0 billion
Public assistance	4.0
Social security improvements	3.5

The unemployment insurance funds would provide for higher unemployment insurance benefits, extended benefits during recessions, and aid to the unemployed through retraining, increasing mobility, and so on. The allowance for income protection for the poor could permit revision of public assistance standards and extend coverage, or the adoption of a modest new income aid program with objective standards, possibly with emphasis on families with children. The added expenditure listed above about could fill 1/40 percent of the poverty income gap for the poor. The social security allowance would permit a 10 percent improvement. This could include a higher minimum benefit for those dependent on social insurance benefits as the main source of income, permit liberalization of eligibility requirements for disability insurance, and some general improvement in benefit levels.

Veterans

\$0.3 billion

The higher priority recommendations made by the Veterans' Advisory

Commission in March 1968 could be instituted with these funds.

Economic, area, and other special development programs \$2.2 billion

Entrepreneurial aid \$0.5 billion

Area redevelopment 0.5

Rural development 1.0

Indian assistance 0.2

The entrepreneurial assistance program could help in the development of areas populated by minority groups -- so-called "black capitalism."

Area redevelopment programs assist growth centers in less populated areas, while rural redevelopment programs concentrate on small communities, providing community facility development, special housing, and family farm assistance. The Indian assistance would provide expanded programs in education, health, housing, employment, and economic and community development.

Crime, delinquency, and riots

\$1.0 billion

Violence and riot prevention

\$0.1 billion

Safe Streets program

0.3

Rehabilitation of offenders and delinquents

0.3

Prevention of delinquency and crime by special measures for delinquency-prone youth

0.3

Federal aid to State and local governments could be provided to help

prevent violence and riots and permit a higher degree of Federal readiness

to cope with such emergencies, in line with the Kerner Commission

recommendations. The Safe Streets program funds would be used to work

towards the objectives of the National Crime Commission with respect

to strengthening the police and courts. Rehabilitation of offenders and

delinquents would be achieved by intensive retraining and other

services.

Quality of environment

\$1.7 billion

Air pollution prevention and control	\$0.1 billion
Public water supply construction programs	0.3
Water pollution control and sewage treatment	1.0
Solid waste disposal	0.1
Natural beautification, environmental protection, and recreational development	0.2

Most of the costs of pollution abatement should be borne by the private sector; however, some Federal funds may be required to enforce standards, investigate claims, or abate pollution caused by government or inallocable among private individuals. Assistance in expanding the Nation's water supply system will be limited to a small fraction of the \$2.5 billion annual requirements over the next ten years. Nevertheless, this assistance is particularly important in low income areas seeking to develop. Provision of more recreational areas near population centers would be made possible.

Natural resource development and utilization

\$1.4 billion

Sand and forest conservation	.2
Water resources and related	.5
Mineral and energy (ex. hydro.)	.2
Natural environmental development	.5

Department of Interior, Corps of Engineers, and Department of Agriculture programs relating to land, mineral, energy, forest, recreational and other fields have large backlogs of useful projects, many already planned and authorized but held back for budgetary reasons.

Urban development

\$4.5 billion

New cities	\$0.5 billion
Land acquisition and financial planning (suburban)	0.5
Urban mass transportation	0.5
Model cities	2.0
Other urban facilities and renewal	1.0

Metropolitan development assistance arises from recognition that orderly development requires improved planning and coordinated advanced land

acquisition. Each of these programs emphasizes these requirements,

whether in new communities, suburbs, or older central cities. The

allowances represent on a fractional contribution to the reconstruction

and development of the cities.

Transportation

\$1.0 billion

Airway and airport modernization \$0.4 billion

Rapid interurban ground transit 0.1

Modernization of merchant marine 0.2

Motor vehicle and transportation
safety research and safety grants 0.3

Economic development, safety, and national defense concerns all points

to the need for expansion of investments in the improvement of the prin-

cipal elements of the Nation's transportation system.

National defense

\$6.5 billion

Military construction \$1.7 billion

Family housing 0.1

Aircraft development and
modernization 2.0

Shipbuilding 1.5

Production base modernization	0.5
Meeting inventory objectives	<u>0.7</u>

The programs would permit the construction of defense installations and family housing projects which have been held back by the war in South-east Asia; would provide funds for research, procurement, and operations in connection with aircraft development programs, such as the VFX, AX, and FX; would permit modernization development of naval forces; would allow for renovation and modernization of munitions plants, shipyards, etc; and would make allowance for inventory adjustments that might not be taken care of in the period of Vietnam phasedown.

Science and space exploration \$1.0 billion

Post-Apollo space program \$0.5 billion

Scientific research in oceanography, communications, social and behavioral sciences, and natural sciences 0.5

The allowances would permit the science and space agencies to fund some of the research opportunities not covered in the stringent budgets of recent years.

Foreign economic and financial aid

\$1.0 billion

This additional amount would help to meet growth targets in Southeast Asia and under the Alliance for Progress as well as to cover other aid requirements; however, even this increase would not return our foreign assistance program to levels of a few years back.

Possible major new initiatives

The programs included in Table III and discussed above, represent, for the most part, expansions of initiatives that are already under way, in many instances on a relatively small scale. The proposals are new in the sense that legislation would be required to implement them, but in most instances they do not represent entirely new approaches to our problems.

The major domestic issues facing the Nation in the next few years are the problems of poverty and of urban development. Both of these problems are extremely complex (one-third of the population and one-third of the poor live in the central cities of metropolitan areas). Many

of the programs listed above are designed to alleviate poverty or revitalize urban areas. Indeed, out of the total of \$63.3 billion of expenditures included in Table II, roughly \$18 billion would be directed toward the poor and another \$7 billion would go toward urban development.

The approach reflected above is essentially piecemeal: expand or build on existing programs. For poverty, this means increasing aid for children, improving the diet of poor families, manpower training, social security, unemployment insurance, and welfare. For cities, the approach emphasizes a modest piecemeal expansion of air and water pollution abatement, urban transportation, Model Cities, crime prevention and public facilities programs.

In place of such a piecemeal approach, other more elaborate proposals could be directed at the poverty and urban problems. These proposals would not eliminate the need for all of the special programs mentioned above, but they do represent substitutes, in each case, for some of these programs.

Since the draft raises major issues of equity and has important social implications, two proposals for major reforms in the system of recruiting military manpower are also included below.

Comprehensive income maintenance

\$15 to \$20 billion

There have been widespread discussions of the "negative income tax" as a simple and equitable device to assist those in poverty. To make a major contribution, the negative income tax would have to be quite expensive. If it set a minimum income standard close to the poverty line and sought to preserve work incentives by keeping the "tax rate" moderate, it would necessarily involve providing substantial assistance to families above the poverty line. For example, a plan which set a minimum of \$3,000 for a family of 4 and which taxed the earnings of negative tax recipients 50 percent would pay some benefits up to a \$6,000 family income. It would cost about \$16 billion more than the current welfare system, and only about half of this increase would go to those below the poverty line. A somewhat more modest plan, added to the present income maintenance system for all groups not now covered, and involving a minimum payment of \$1,000 to a family of 4 and a marginal tax rate

There are proposals for major reforms in the

of 50 percent⁴, would increase income maintenance costs \$5 billion, all of which would go to the poor. Any of a variety of plans, including children's allowances, would represent a major step toward a general income maintenance system. The amounts shown above are intended to give a general range for the cost of a major new initiative in this direction.

Another possible initiative would be federalization of welfare costs, either through a new general program or Federal assumption of present programs. It would save State and local governments about \$4.0 billion annually by 1972.

Adoption of a major initiative in income maintenance would eliminate the need for some -- but not very many -- others whose benefits go mainly to the poor. Income maintenance would serve as a means of protecting people in the short run against the ravages of poverty. At the same time, initiatives in housing, health, education, and job training would still be necessary.

Revenue sharing

\$5 to \$10 billion

Grants-in-aid by the Federal Government to State and local governments amounted to about \$18.4 billion in FY 1968. A number of the programs listed above would involve additional categorical grants. As a means of relieving the mounting financial pressures on State and local governments and possibly reducing more onerous and less equitable State and local taxes, the Federal Government might adopt some general scheme of revenue sharing. A number of varieties have been proposed -- including a return of some personal tax revenues to the States (and/or localities) and a Federal credit on State income taxes.

Model Cities Trust Fund

\$4 billion

A variant of revenue sharing worthy of consideration would be the establishment of a trust fund to finance a generalized Model Cities program. The capital cost requirements of rebuilding the Nation's cities, though not the greatest expenditure problem of local governments, are quite impressive. The Model Cities program is a first step towards a

a general assistance program for the cities, oriented towards rebuilding.

The Federal Government could pay a certain amount (perhaps \$4 billion)

into a Trust Fund each year. All cities would be eligible for the Trust Fund

program, with their share in the funds proportionate to their low income

population. Cities would become eligible by submitting and having approved a

comprehensive development plan (encompassing metropolitan planning agen-

cies in large urban areas). As under the highway trust fund, cities could

then proceed to build whatever portion of their planned activity they chose,

governed by the funds available to them in any given year.

The list of programs presented above includes \$2 billion for the Model

Cities program. The trust fund plan would represent an enlargement

beyond this amount and would make provision for an orderly, more

dependable financial basis for the program.

Community development bank

\$5 to \$10 billion
of resources

The establishment of a community development bank has frequently
been proposed. The usual suggestion is that the bank be set up outside
the budget, raising its funds in the capital market and lending to State and

local governments (and perhaps to private nonprofit organizations concerned with urban and regional development). Bonds issued by the bank could be given a Federal Government guarantee, and interest on them would be subject to Federal income tax. The proposal probably would result in lessened use of tax exempt securities by State and local governments, thereby reducing the excessive load that has been placed on this area of the capital market. The increased Federal revenues obtained as a result of the displacement of tax exempt municipal securities by taxable securities of the bank would be used to subsidize the interest rate charged by the bank, thereby enabling it to lend to State and local governments at interest rates below its borrowing rate in the market.

The net impact of a community development bank on the Federal budget would presumably be minimal, since the cost of the interest subsidies would be wholly or largely offset by the revenue gains from the displacement of tax exempt securities. However, the main purpose

of the enterprise would presumably be to make larger amounts of capital available for urban and regional development. To the extent that this occurred, the bank's own borrowing to finance its lending operations would force up interest rates, causing some cutbacks in private spending. But this rise in interest rates would be unlikely to cause a fully offsetting reduction in credit-financed private spending.

Thus, the establishment of a community development bank which made an expanded supply of funds available to State and local governments would not by itself divert sufficient real resources from other uses to allow a larger volume of development projects. To the extent that the operations of such an institution raised non-Federal spending, correspondingly less room would be left for increases in Federal Government expenditures or tax reductions. The Community Development Bank proposal would absorb a greater amount of the peace-and-growth dividend that the Federal budgetary expense would imply.

All volunteer army

\$5 to \$9 billion

Public discussion of the problems in the current military draft has
available for broad and regional service. The system that has

led to suggestions for substituting volunteers for draftees by increasing
occurred, the bank's own borrowing to finance its operating operations

compensation. Advocates point to major benefits from the elimination of

force to interest rates, causing some to believe that the

compulsion, the improved morale of an army of volunteers, and the greater
more rise in interest rates would be an

equity associated with imposing the burdens of recruitment on all taxpayers --

not just those who are inducted.

Thus, the establishment of a conscription bank would

Finally, proponents claim that an all-volunteer system would improve
made an expanded supply of funds available to

efficiency of the civilian economy. Since individuals could plan their
would not be used for the purpose of

future with more certainty, long-range decisions on schooling, on-the-job
and the value of the service, the government would be able to

training, and employment would be made in the light of economic considera-
operations of such an institution rather

tions, not to escape or delay the draft. Moreover, those who could con-
participating less, because the

tribute most to civilian output would be unlikely to become recruits. Under

the draft, highly skilled individuals are sometimes used as foot soldiers

base. However, if the government could

with a loss to the Nation of the individual's skill.

National Service Corps

This would be an alternative to the Volunteer Army as a solution to the military manpower problem. Every young person would be expected to give at least two years to the service of the Nation, either as a member of the Armed Forces or doing civilian work that would contribute to the solution of important national problems.

Conclusion

It is clear that the problems of poverty and human resource development, together with the pressing needs to improve our physical environment, will impose very heavy demands on our national resources and on the Federal budget in the years ahead. The end of the struggle in Vietnam, together with the expansion in tax revenues resulting from economic growth, will make a sizable volume of resources available to deal with these problems. But the peace-and-growth dividend will not reach the

heroic proportions that are required for several years. In the meantime,

some very hard choices must be made -- choices that involve the balancing

off of defense spending against nondefense programs and the careful

selection of the highest priority programs in the nondefense area. The

calculations set forth above allow for tax reduction from present rate

levels through the expiration of the 10 percent surcharge and of certain

excise taxes. These funds would be turned over to the private sector

to be spent for private consumption or investment. But in view of the

vast and urgent needs of the public sector, further large-scale Federal

tax reductions would not be desirable in the years immediately following

the end of Vietnam hostilities.

IV. Policies to Assist Particular Communities and Individuals

As section II of this report emphasized, the principal weapon for maintaining high employment during the transition period of demobilization and declining defense spending should be monetary and fiscal policy. However, no matter how smoothly and effectively the necessary monetary and fiscal adjustments are made, some communities and some individual workers are bound to experience severe adjustment problems. Accordingly, monetary and fiscal policy must be supplemented by specific adjustment measures to assist such communities and individuals if the transition is to be accomplished in a fully satisfactory way.

The Magnitude of the Post-Vietnam Transition

The magnitude of the demobilization dislocation will vary with the specific demobilization scenario. Under the particular scenario used in this paper, as many as 750,000 civilian employees could be required to shift their jobs as a result of the decline in defense purchases from the private sector. In addition, there would be a reduction in the armed forces of 1,000,000 and a decline of 170,000 in civilian personnel in DOD. This would be partially offset by a decline of 250,000 in the number of women in the labor force. The net result of this would be an increase of 920,000 in the private labor force. Altogether, these adjustments would generate a need for the creation of about 1,670,000 additional new jobs spread over a period of 10 quarters.

To give some perspective to these figures, the average number of layoffs per month in manufacturing alone was 230,000 during the labor shortage of 1966 and 271,000 a month during 1967. Manufacturing employers were hiring workers at the rate of 729,000 a month in 1966 and, in 1967, at the rate of 619,000. There are no comparable data for nonmanufacturing sectors. However, manufacturing accounts for only a quarter of the civilian labor force; layoffs and hirings for the total economy must be far larger.

The figures indicate the dynamism and normal adaptations of the labor market. They do not suggest that specific problems of severe dislocation in certain areas do not or will not occur, nor that defense cutbacks will produce the same mix of frictional and structural unemployment that exist today. The figures do indicate that the magnitude of the demobilization program should be manageable in an environment of over-all prosperity. Federal policies must assure that the job market will be able to absorb an added 100,000 new job seekers a month.

Proper fiscal and monetary policy should ensure that the demand for labor remains strong. If over-all unemployment remains low, the shift of individuals and communities to a peacetime economy should, in general, be relatively easy to accomplish.

The measures proposed below will assist monetary and fiscal

policies to produce a smooth noninflationary transition by increasing the mobility of resources from sectors of the economy experiencing contracting demand to those experiencing expanding demand. In addition, they will ease the transition for specific individuals and communities most severely affected by demobilization.

Summary of Recommendations

The principal immediate order of business is to establish a Readjustment Operations Committee to assume the responsibility for detailed planning of Federal readjustment assistance and to maintain relations with State and local demobilization planning authorities. Later, this committee should be responsible for coordinating Federal readjustment programs.

The magnitude of the programs that will be required to insure a smooth transition during demobilization cannot be determined at this early date. Federal program needs will depend upon the speed of demobilization, the geographical distribution of cutbacks in defense expenditures, the size of the permanent commitment of military forces in Southeast Asia, and a number of other factors which will not be known until either just before or during demobilization. Nevertheless, some tentative limits can be placed on the approximate size of these programs, as shown in the following table.

<u>Program</u>	<u>Estimated First Year Costs</u>	
	<u>Low</u>	<u>High</u>
EDA Community Development Assistance	\$20 million	\$50 million
SBA Loans	5	10
Homeowner Emergency Loans (HUD)	1	3
MDTA Training	53	140
Employment Service	7	20
Relocation Assistance	<u>4</u>	<u>15</u>
	\$90	\$238

The occurrence of international developments that will permit demobilization will be separated by a considerable time period from the date when actual demobilization begins. This interim should be used to seek supplemental appropriations for readjustment. All expenditures from

special appropriations should be coordinated by the Readjustment Operations Committee, thus insuring interagency cooperation in attacking the problems of disproportionately affected communities and individuals.

When demobilization plans are definitely known, more exact program expenditures should be determined by the Readjustment Operations Committee. Initial appropriations, however, should be at the low end of the estimated range, with executive and legislative branch understanding that additional appropriations may be needed if the magnitude of the problem is more severe.

These program supplements would be reserved for users directly related to the post-Vietnam transition. In addition, funds should be requested to provide returning servicemen with veterans' benefits under existing programs and to assist State unemployment insurance programs in case of high unemployment.

Before the beginning of demobilization, permanent improvements should be made in some existing programs to facilitate the successful transition to a post-Vietnam economy. Unemployment compensation should be improved by increasing coverage, raising benefits, lengthening the duration of payments, and improving the financial base of the system. In addition, the Administration proposal to establish minimum standards of vesting of private pension plans should continue to be pursued.

Recommendation No. 1: Establish a Readjustment Operations Committee.

The specific details of the probable size, duration and nature of demobilization will change over time, and consequently the detailed operational planning of program requirements must be continually revised.

Furthermore, the principal policy instruments are in two different executive departments -- Labor, for manpower training and employment services, and Commerce, for community assistance -- so that coordination is required between agencies. Finally, some States such as New York and New Jersey, are actively engaged in their own demobilization planning and require some central point for their communication with the Federal Government.

Accordingly, we recommend:

A Readjustment Operations Committee should be established in the near future by Presidential memorandum or executive order. It should be composed of the Secretaries of Commerce, Defense, and Labor, the Director of the Bureau of the Budget, the Chairman of the Council of Economic Advisers, and the Director of the Office of Emergency Planning.

The organization structure of this committee can follow either of two alternatives.

Alternative A: The Secretaries of Commerce and of Labor could act as co-chairmen. The principal advantage of this organizational structure is that these are the two agencies with the deepest

programmatic involvement in the operations of the committee.

Alternative B: The Director of the Office of Emergency Planning could act as coordinator of committee activities, in the same fashion that the Chairman of the Council of Economic Advisers coordinates the activities of the Cabinet Committee on Price Stability. The principal advantages of this structure are: (1) before demobilization occurs, the principal activities of the committee will be in planning and in maintaining relations with State and local governments, both ~~of which are existing activities of OEP~~; (2) ~~the staff of the committee~~ would be primarily drawn from OEP, at least in the initial planning stages; and (3) the only historical precedent, the Office of War Mobilization and Reconversion, was an agency in the Executive Office which oversaw a number of reconversion activities in executive departments after World War II.

The Readjustment Operations Committee will have both predemobilization and post-demobilization responsibilities.

Prior to demobilization, the Committee should:

- (1) Engage in continued planning activities in preparation for demobilization, including frequent updating of the demobilization contingency budget requirements of those agencies involved in community and individual assistance;

- (2) Undertake and support research on characteristics of individual communities likely to require special readjustment assistance and on other topics pertinent to demobilization policy;
- (3) Act as a source of technical advice and information for State and local government demobilization planning authorities, and coordinate Federal planning activities with those of other levels of government; and
- (4) Coordinate an inventory by the Departments of Defense, Labor, and Commerce of the skills and training of defense industry workers and armed services personnel, and make an assessment of the skill requirements of potential sources of employment in defense-dependent areas. This effort should include matching defense contractor and military job classifications with the Dictionary of Occupational Titles.

During the demobilization period, the Readjustment Operations Committee should be responsible for the coordination of Federal assistance programs to communities and individuals with severe readjustment problems. These responsibilities would include:

- (1) Identifying areas experiencing, or likely to experience, high unemployment during demobilization: performance of this function will require that the Department of Defense give advance

notification to the Readjustment Operations Committee of impending contract cancellations and military base closings, and that the Departments of Labor and Commerce keep the Committee fully informed of economic developments in areas with significant defense-dependent employment;

- (2) Determining, in cooperation with State and local governments, the appropriate size and mix of Federal assistance programs for dealing with the specific problems of areas with severe readjustment dislocation;
- (3) Recommending specific program actions and budget allocations to deal with the problems of severely affected areas. In this connection, the Committee should establish interagency teams, where appropriate, to assist these localities.

Assisting Defense-Dependent Areas

One major measure to be coordinated by the Readjustment Operations Committee is community assistance for those communities which have experienced a rapid increase in employment due to the establishment or growth of a defense plant or military base. Through the defense buildup of 1965-66, twenty-one localities experienced increases in defense employment exceeding five percent of their total work force.^{1/} These localities

1/ In the 1965-67 period, thirty-eight communities had increases in defense employment greater than five percent of their total work force.

ranged in size from moderately large metropolitan areas to small, rural communities. Eight of these areas are predominantly rural counties with no urban center exceeding 12,000 population. The latter communities

depend upon defense-related activity for between eight and 26 percent of their total employment, and are especially likely to experience considerable unemployment if, during the adjustment, their defense plants or military bases are closed.

Other measures of defense dependency show corresponding increases.

The number of areas where defense workers constitute over six percent of the work force increased from 103 to 155 between June 1965 and June 1967, while the number of areas with more than fifteen percent defense dependency rose from 24 to 54 during this two-year period. Many of these communities are particularly vulnerable to curtailments in defense work or closings of military installations at the end of hostilities in Vietnam.

Some of these communities do not have adequate redevelopment potential; in these cases the Federal Government should assist in relocating unemployed individuals, as outlined in Recommendation No. 5. Other areas possess redevelopment potential, but will require Federal assistance to reorient their economies to the peacetime environment.

Recommendation No. 2: Provide Community Redevelopment Assistance.

Among the activities defense-dependent communities must undertake to attract new industry are planning, public relations, modernization of public facilities, industrial site development, and the reconversion of defense installations to other uses. The administrative apparatus for providing assistance for these activities to communities with redevelopment potential already exists in the Federal Government, particularly in the Economic Development Administration (public works and industrial development grants and loans to eligible communities and technical assistance) and in the Small Business Administration (loans to small business enterprises).

The total expenditures required for community development assistance cannot be estimated with exactness at this early date. The President should direct the Readjustment Operations Committee to review periodically the need for community development assistance and make recommendations to the President regarding approximate funding requirements. An appropriation of approximately \$20-\$50 million for the Economic Development Administration and \$5-\$10 million for the Small Business Administration will probably be required, the exact amount depending on the speed and extent of demobilization. Again, however, the initial appropriations should assume the most favorable condition for any demobilization situation, with an indication that these funds be designated an emergency reserve to be

used exclusively for assistance programs to communities experiencing, or expected to experience, a sudden rise in unemployment to at least 150 percent of the national unemployment rate due directly to a cutback in defense expenditures in that community. (This unemployment trigger is currently used to determine the eligibility of communities for EDA assistance.)

Assistance to Dislocated Individuals

While most of the individuals who lose their jobs or who are released from military service will be readily employable in the private sector, some will not possess sufficient skills to obtain a good job, while others will be geographically isolated from job opportunities. Federal programs can be of significant help in matching individuals to jobs. The following programs should be undertaken to ease the impact of demobilization upon these most seriously dislocated individuals. These programs should be in addition to long-run activities undertaken to assist the disadvantaged.

Recommendation No. 3: Strengthen the Federal Employment Service.

Post-Vietnam demobilization will place a significant strain on the resources of the Employment Service. Prior to demobilization, plans should be made for:

- (a) Expanding the staff of the Employment Service offices and adding to their capacity for handling large numbers of veterans and laid-off defense workers;

- (b) Improving the flow of information about job opportunities outside the local labor market area to give workers information about job opportunities in other counties and States;
- (c) Temporarily stationing employment service staff at locations convenient to military personnel about to be discharged.

These improvements would not only ease the readjustment after Vietnam, but would permanently strengthen the Employment Service, and thereby reduce the normal amount of frictional unemployment. The additional financing required for these improvements (between \$7 and \$20 million) should be included in the special supplemental appropriation described above.

Recommendation No. 4: Limited Expansion of Manpower Training.

Some individuals dislocated from defense employment will require retraining before they will be able to find a good job. The cost per trainee in the Project Transition program, which prepares servicemen for civilian employment, is \$500; and the occupational training cost per trainee in other manpower programs, which would apply to some laid-off defense workers and a few returning servicemen, is \$2000. (In addition, Project Transition trainees continue to receive their military pay and other assistance from the Department of Defense.)

As with community development assistance, determination of the necessary increase in expenditures for these programs during demobilization

cannot be made until further information regarding the size of the demobilization and the inventory of defense industry skills is available. The President should direct the Readjustment Operations Committee to submit recommendations for the appropriate funding level for these programs as soon as a definitive decision can be reached. Meanwhile, on the basis of preliminary investigations of the need for manpower programs, a reasonable estimate of initial contingency appropriations requirements is \$13 million for Project Transition and \$40 million for other MDTA programs, with these funds to be reserved for exclusive use in connection with post-Vietnam demobilization dislocation. A \$53 million special fund could provide assistance to 26,000 servicemen through Project Transition and 20,000 regular MDTA enrollees. Further appropriations may be required up to \$140 million for both programs.

Recommendation No. 5: Provision of Relocation Assistance.

Low income individuals dislocated by a defense cutback who live in isolated communities may not have the financial resources necessary to migrate to areas offering greater job opportunities. A relocation assistance fund should be established to help low and middle income workers move from defense-dependent communities with inadequate reemployment opportunities. The communities eligible for this program should be determined by the Readjustment Operations Committee. The program

should be administered by the Department of Labor in connection with its manpower training and employment service activities. General relocation assistance policy should be worked out by the Department of Labor in cooperation with the Readjustment Operations Committee. The program should recognize that only those taking low income jobs need full grant assistance, while those taking higher income jobs should receive a mix of loans and grants, with the loan portion rising with income.

Such relocation assistance should be available only to individuals ~~dislocated as a result of cutbacks in defense expenditures in specified~~ defense-dependent communities. The number of individuals so assisted should not be large. A rough estimate of numbers would be between 10,000 and 30,000 families. The initial appropriation would be small -- initially about \$4 million dollars, but perhaps as much as \$15 million. As with other programs, an indication would be given that additional funding would be sought if necessary.

Recommendation No. 6: Provision of Homeowner Assistance.

In areas of high unemployment, a homeowner often is unable to meet payments on his mortgage. Foreclosure may follow, perhaps leading to a loss of the homeowner's equity. The Federal Government should undertake to prevent the temporary unemployment in selected areas that arises during demobilization from resulting in a widespread loss of homes. The Department of Housing and Urban Development should establish a program

to encourage private lenders to declare moratoria on mortgages on homes owned and occupied by individuals dislocated by a defense cutback. In cases in which the private lender is unwilling to provide an extension of mortgage payments, the Department of Housing and Urban Development should be authorized to lend the homeowner funds to cover up to eighteen months of mortgage payments at an interest rate equal to the lesser of either the current rate on FHA-insured loans or the rate applicable to his mortgage, and for a term equal to the remaining duration of his mortgage. The program would be limited to communities that are specified by the Readjustment Operations Committee as having severe readjustment problems.

A large-scale expenditure should not be required for this program -- about \$2 million should be ample. These funds should be included in the supplemental appropriation described above.

Recommendation No. 7: Existing Veterans Assistance Programs should have adequate funds.

Current programs available to veterans are generally adequate to cover the needs of returning servicemen. However, the accelerated separations associated with demobilization will require additional appropriations for these veterans programs, especially employment consultation services and the educational assistance program.

Adequate financing of the veterans programs should be included in the supplemental appropriation described above.

Recommendation No. 8: Improvements in Unemployment Insurance.

The importance of an unemployment compensation system is second only to that of monetary and fiscal policy as a weapon against demobilization dislocation. Unemployment insurance not only serves to cushion the impact of unemployment on a family's income, but also acts as a partial "automatic stabilizer" by moderating the fall in consumer demand resulting from unemployment. While an improved unemployment compensation system would be beneficial during any period, it would be especially effective during the temporary dislocations arising from post-Vietnam demobilization.

The Department of Labor has recently proposed legislation to improve the employment insurance system. The recently proposed legislation would increase the adequacy and duration of benefits (with additional benefits provided for Vietnam veterans), extend coverage and improve financing arrangements, including the initiation of some Federal contribution to the costs of the system. The post-Vietnam demobilization attaches a special urgency to these improvements.

In addition to the pending proposals, improvements in the financing of unemployment compensation during recessions should also be made. The "automatic stabilization" aspect of unemployment insurance is limited because the program is now entirely financed through an experience-rated payroll tax. During periods of high unemployment, increases in the payroll

tax to finance rising unemployment insurance claims lead to even higher unemployment and mitigate the beneficial impact of unemployment compensation on total demand. States should not be required to raise taxes to meet the costs of increased unemployment insurance claims when the national unemployment rate exceeds tolerable limits. To this end, in each State the extra costs of unemployment compensation benefits for unemployment above a specified State rate (perhaps five percent) should be borne by the Federal Government, financed from the general revenues.

Recommendation No. 9: Mandatory Vesting of Pension Benefits Should be Established.

One of the continuing inequities of the American economy is that long-term employees who are discharged usually lose their pension rights. This Administration has sponsored legislation establishing vesting standards for private investment plans. As in the case of improvements in unemployment compensation, the readjustments required by demobilization give new urgency to this reform. Defense workers who have to shift to new employment need the assurance that they will receive benefits from the pension plans in which they have participated while in defense industries.



U.S. DEPARTMENT OF COMMERCE
Secretary of Commerce

To : Joseph Califano
By messenger

From: C. R. Smith

In view of our
discussion tomorrow,
on post-Vietnam,
enclose copy
of letter I wrote
to Mr. Owen on
the subject

C.R. Smith

12/17/68

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CENTRAL FILES

EXECUTIVE

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December 2, 1968

Honorable Arthur Okun
Chairman
Council of Economic Advisers
Executive Office Building
Washington, D. C.

Dear Mr. Chairman:

I have read the "Post-War Vietnam" report several times. I will send you comments as soon as I can discuss it with others here.

In the meantime, you may like some preliminary observations:

1. This will be one of the last of the documents on behalf of the Johnson Administration. It is quite important that it be realistic, neither too optimistic nor too pessimistic. The whole of the report is a difficult assignment, because there are so many unknowns. The report, however, should be, to the best of our ability, what we estimate will be the situation during the period; not what it may be.

2. The report, in total, is more optimistic than I had anticipated possible. My especial area of concern is necessary expenditures for national defense which affect, of course, funds available for other purposes.

a. We should not use estimates for defense needs which do not have the concurrence of the Defense Department. I presume you have coordinated the figures with Defense, but there is, I believe, no statement to that effect in the report.

b. On my own, I have these problems about future military expenditures:

(1) The war in Vietnam has been much reduced the military inventory and it will need to be replenished;

(2) In some defense areas, our equipment is either obsolescent or obsolete; not modern by the standards of current technology. Some examples:

(a) The B-52 heavy bomber is relatively obsolete and the inventory has been depleted. We have no current replacement.

(b) The Air Force needs a modern fighter plane, and needs many of them.

(b) The Navy has rejected the F111, with the consent of Congress, which will require the development of a new plane.

(3) The Navy has already, tentatively, outlined its need for surface vessels, calling attention to the growing Soviet Navy.

(4) The events in Czechoslovakia are likely to increase the costs of NATO and our part in NATO.

(5) Further, rising costs, many of them unanticipated, will increase the cost of all military equipment. The recent new estimates for the C 105 and the F 111 reflect these trends.

Because defense expenditures are the largest "lump" in the budget, we must be as sure as we can about future military needs, before we proceed to form other figures.

Many believe that we will find it difficult to fully fund social programs already authorized. They are more concerned about preparing for that than in advocating new and now unauthorized projects. Said in another way, "our job may be to find funds

for the continuation and full support of existing programs, rather than finding new projects on which new funds could be justifiably expended."

I believe it would be well, in the early part of the report, to concentrate on funding presently authorized programs. Get that first under cover and then, in a separate section, deal with potentially new programs.

Frankly, an early reading of the report tends to leave the impression that existing programs are in no danger and we should be looking for new endeavors. I am not sure it has been proven that there will be substantial funds over and above the full requirements of present programs.

Another reaction from an early reading is that the report tends, in ultimate conclusion, to say something like this: "All surplus funds should be added to government expenditures, in the main for social objectives." If so, I believe it is too early to come to that conclusion, because we do not now know what will be the national needs in other areas.

The report presumes that the 10% income tax surcharge will be abandoned as soon as the financial situation permits. But it contemplates no further reductions in income taxes, even potential. The tax question may be answered by a set of figures which make it impossible to advocate income tax reductions. But, isn't it early to conclude that there will be none, or to recommend that there be none?

We must have a strong economy. Otherwise, the necessary programs will be difficult to do. To have best chance for that we should have the enthusiastic support of the productive workers. Many of them, perhaps a majority of them, will have few direct benefits from the social programs now existing or discussed for the future. I hesitate to tell them that they will receive no part of the economies resulting from termination of the war.

Sincerely yours,


C. R. Smith
Secretary of Commerce

CRS:gkt

CC: Signer

Bartlett

EXECUTIVE

FILE MEMO:

DG/dg

October 19, 1968

FG 11-8-1/Nimetz, Matt

WE 9	LE/FI 2	PU 2-4
LG/Pasadena	LG/Chicago	FG 1
HU 4	PL 6-3	FG 100
ND 19/CO 312	FA	LE
FO 3-1	FG 604	HS 2
FG 105	WE 6	LG
SP/FG 440	<u>BE5-7</u>	ED
LE/VA	JL 3	LA 2
HS	FG 11-8-1/Bohen, Fred	FG 170
FI 11	FG 11-8-1/Califano, Joe	FG 804

Box # 1594 sent to Central Files, above date from Matt Nimetz's Office containing the following folder material:

1. Westside Study Center, 1967 (Community Action Program)
2. Weekend of Oct. 21, 1967 (three folders) (secret) re: National Defense Mobilization Committee
3. Water for Peace (President's Memo to Sec. of State) 5/22/67
4. Vice Presiden, Speeches (To Oil Chemical and Atomic Workers re: slums(1967)
5. VA Legislation Program (Recommended Legislative Proposals)
6. Urban Economics (Booklets) 1966-67
7. Taxation, 1967
8. S. 1306, 1968
9. Fifth City: The Ecumenical Institute - Chicago, 1968
10. Romney, George
11. Population
12. Post Viet Nam Planning Committee: Crime Control and Education
13. Program Reporting Data and Statistics (background for Fred Bohem on Federal Aid to Urban Areas)
14. Program Information for Detroit (drafts)
15. New York Times Article, 6/8/67 "Johnson will Use Cabinet to court States' Official
16. Legislative Program Development Procedures
17. Housing for the Poor (Confidential Included)
18. Big Cities - Genral (Booklets and Drafts)
19. Big Cities - Education (Article)
20. Big Cities - Manpower / on-Job Training and Unemployment
21. Committee on Economic Development

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

July 3, 1968

MEMORANDUM FOR JOSEPH A. CALIFANO

Subject: Front or Back Burner?

EXECUTIVE
FC 654
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FC 11-3

✓ Carl Heineman

In three areas of economic policy which are getting lots of attention in the press these days, the Administration has an initiative and a contribution to make, but is silent. I am not sure we should be leaving the field to others, and therefore am asking for your reactions to some possible ways that we could move these items to the front burner publicly.

A. Income Maintenance

You have seen the host of proposals and plans for dealing with the welfare and jobs problems: negative income tax, family allowances, employer of last resort, wage subsidies, etc. The Heineman Commission has been given a mandate to cover this territory but it is not scheduled to report until well into 1969. It has assembled a very able staff but they are working at a snail's pace. Meanwhile, a number of people within the Administration have interesting ideas in this area, but they feel constrained to silence.

In particular, James Duesenberry left behind an ingenious income maintenance program. It is evolutionary and eclectic, and yet it contains one bold innovation: an assumption of Federal responsibility to supply a work opportunity for every family head who wants employment and cannot otherwise get it. (I am planning to summarize and simplify the Duesenberry paper and present the plan to the President for his information.)

If this is to be an action area in the months ahead, we ought to launch an effort now. Among the ways to get started would be the following:

1. Ask Heineman for a progress report this fall.
2. Gear up an interagency staff effort within the Administration; the Duesenberry plan could be one point of departure.
3. Develop speech material outlining the President's philosophy in this area (Doug Cater and Ben Wattenberg are already pursuing this line).

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

July 10, 1968
Wednesday, 7:00 p. m.

EXECUTIVE

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FOR THE PRESIDENT

FROM Joe Galifano *JG*

There are several unfinished items -- legislative and administrative -- which merit your attention for possible release within the near future.

Here is a summary of these items. It would be helpful to have your guidance on whether to proceed to develop them further.

1. The Kappel Commission Report on Postal Reorganization

You previously approved a short statement commending the Commission's work and urging the Congress and the Executive Branch to study the proposals, in view of their fundamental public importance. If you approve, we can release the report later this week, and hold a backgrounder with Kappel on it. To refresh your recollection, I am attaching the noncommittal statement you had previously approved. *Fred*

Approve

Disapprove

2. Post-Vietnam Planning Report

The Council can have this ready in about two weeks. It will deal with (a) actions to smooth the transition for displaced workers and returning servicemen and (b) overall budgetary management to assure prosperity and channel the "Peace Dividend" into top priority domestic areas. I believe it would be useful to meet with Okun shortly to get a preview of the report, and you could then consider whether and how the report should be released.

Approve

Disapprove

EXECUTIVE

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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

May 10, 1968

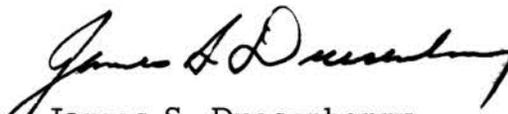
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MEMORANDUM FOR THE PRESIDENT

Subject: Post-Vietnam Planning

Through Joe Califano you asked for a report on Post-Vietnam.

1. The Post-Vietnam planning committee has stepped up its activity in the past few weeks.
 - . Defense is providing us with updated estimates of their plans for redeployment and demobilization of troops and gradual reduction of expenditures.
 - . We are now preparing new estimates of the "peace dividend" -- the amount of expenditure increase or tax reduction required to maintain full employment.
 - . When that job is completed it will be possible to lay out some alternative tax and expenditure programs for adjustment to the new situation.
2. Staff groups are working on a number of special problems including
 - the Post-Vietnam balance of payments outlook
 - manpower training programs for veterans and displaced workers
 - programs to ease the adjustment process for local areas suffering from large defense cutbacks.
3. These groups are well along in their work. We hope to have a detailed progress report for you in about a month.


James S. Duesenberry
Acting Chairman

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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

EXECUTIVE

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May 10, 1967

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PAPANDREOU,
Andreas
BATTUE, Luke

MEMORANDUM FOR THE PRESIDENT

Subject: Matters of Interest

1. Post-Vietnam Planning

The Coordinating Committee you designated on March 1 (Fowler, McNamara, Trowbridge, Reynolds (for Wirtz), Schultze, and Ackley) met on March 11 to get the project under way. Upon my recommendation 9 working groups were established, most of which have met a number of times, and all of which have extensive study programs underway. The Committee met again on May 1 to review the progress of the working groups and to discuss general problems raised by their activities. Governor Robertson of the Fed has been added to the Coordinating Committee, and Fed representatives are participating in a number of the working groups.

The Committee plans to give you a preliminary report by late summer, reviewing our progress, and reaching a number of preliminary conclusions.

At some point we will need to consider what if any information we will provide to the public on this effort.

2. Labor-Management Advisory Committee

It is my feeling that this Committee is not making the contribution it should to resolution of problems in the labor-management area. I believe this reflects two basic weaknesses in the organization of the Committee:

- . The staff work for the Committee is atrocious; and
- . No serious effort is made to enlist the support and to guide the thinking of the one source of potentially constructive initiative -- namely, the Committee's public members.

Staff work for the Committee is provided on a catch-as-catch-can basis by one or two officials of Labor or Commerce (depending on which Secretary currently serves as Chairman). Little or nothing is provided in the way of materials or analysis for the work of the Committee. I have recommended that the Committee have its own staff, selected by and responsible to the Committee. I thought this recommendation had been accepted by the Government side, and was to be proposed to the Committee at its last meeting, but it was not.

The public members of the Committee are its only potential source of constructive initiatives. But, so far as I know, little or no attempt has been made to enlist their support or encourage their leadership. Personally, I think the Committee should be reorganized with one of the public members as Chairman, and with an independent staff reporting to the public Chairman. In any case, I urge that a greater effort should be made to encourage the constructive leadership by the Committee's public members. Someone from the Government should keep in touch with the public members and discuss the issues with them prior to Committee meetings. Given the present organization of the Committee, it has not seemed appropriate for the Council to undertake this.

The Committee has meetings scheduled for May 23, June 13, and July 25.

3. Business Council

I will be attending the Business Council's meetings Thursday PM through Saturday of this week. In discussions with my Liaison Committee, and with all others I talk to, I will urge concentrated concern with the basic question for our future price stability: How do we prevent 5%-a-year (or higher) wage settlements from becoming a habit? What can business and the Government do to prevent it? I hope to generate some sense of responsibility on the part of business in re-establishing what I called in my recent Guidepost speech a new "stabilization compromise."

4. Wage and Price Developments

We will give you shortly an analysis of what happened in the first quarter to wages, prices, costs, profits, and income shares.

Based on replies to my telegrams, and a meeting with Don Burnham of Westinghouse, we think that there will be no across-the-board 3% increase in appliance prices.

5. Business Outlook

The revised March retail sales figures -- and the preliminary figures for April -- are extremely disappointing. Once we have digested their significance -- along with other data we will get in the next week or two -- you may wish to schedule a brief discussion of the over-all economic situation with the Troika or perhaps the Quadriad.

6. Andreas Papandreou

Beginning immediately after the Greek coup, I had numerous calls from Andy's American economist friends, urging U.S. intervention in his behalf. I was in early touch with Luke Battle in this regard. However, I have not been willing to urge special intervention on his behalf, and did not bring the matter to your attention. I did not want to see Andy shot any more than did his other friends. But Andy voluntarily renounced U.S. citizenship, and was willing to play the rough game of Greek politics. I felt we should ask no different treatment for him than for the other political prisoners.



Gardner Ackley

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JOE
SEE THE PRES
ABOUT THESE
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THE WHITE HOUSE
WASHINGTON

11:40 p.m., Tuesday
February 28, 1967

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FOR THE PRESIDENT

FROM Joe Califano *JC*

In this folder are four items for signature if you need any news tomorrow. They are:

1. The formal memorandum setting up the post-Vietnam study announced in your Economic Report to the Congress.
2. The Annual Peace Corps Report.
3. The HEW Report on Protective Payments made in connection with aid to families with dependent children.
4. The HEW Report to Congress on the Community Work and Training Program.

Two of these should be signed for release tomorrow: The memo setting up the post-Vietnam study so that Gardner Ackley can get things underway, and the Report to Congress on the Community Work and Training Program because John Gardner is testifying tomorrow. Both are identified with a red tag.

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MEMORANDUM

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EXECUTIVE

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THE WHITE HOUSE
WASHINGTON

May 8, 1967
8:30 p.m., Monday

FOR THE PRESIDENT

FROM Joe Califano *JC*

Attached is a brief report on the coordinating committee you set up for economic and program planning after Vietnam.

Attachment

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HARVIN WATSON

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MAY 15 1967
CENTRAL FILES

EXECUTIVE OFFICE OF THE PRESIDENT
BUREAU OF THE BUDGET
WASHINGTON, D.C. 20503

May 4, 1967

MEMORANDUM FOR JOE CALIFANO

FROM: Stan Ross *SR*

A meeting was held on Monday, May 1, 1967, of the Coordinating Committee on Economic Planning for the End of Vietnam Hostilities. The major points which emerged are as follows:

1. A preliminary report is scheduled to be made to the President around September 1, describing generally the problems and the kinds of actions that could be taken to solve those problems. The report will probably be an optimistic one since it will show that there are adequate techniques to identify and work through the problems of transition to a peacetime economy.
2. Two major components of the post-Vietnam planning will not be available in detailed form until later this year. One is the scenario for the cutback in defense spending. The Defense Department is building a model to be able to provide this data rapidly when the event occurs.

The second is the long-range goals (three to five years) in the non-defense area. The task forces which will be organized out of your office and the work of BOB in formulating next year's legislative program will be the vehicle to develop these long-range plans. In basic ways, these long-range goals are the most important feature of the post-Vietnam planning since the vital issue will be where the country should be after the transition period. The transition problems can be solved in a variety of ways depending on the ultimate target.

3. There is a virtually unending amount of work that can take place at the technical level on the post-Vietnam planning. The model building, fact gathering, etc., which will be very rough cut at first, can be refined as time and resources permit. Further, decisions as to alternatives cannot really be made until the time at which the problems are actually confronted. The underlying facts are constantly changing and will remain in flux until the Vietnam hostilities terminate. Thus, it seems likely that a conclusion will be reached not to prepare a final report with definitive recommendations, but to continue to upgrade the preliminary report until the time when it is necessary to use it. Intermediate reports could be made available if needed.

RECEIVED
JOE CALIFANO, JR.

1967 MAY 4 PM 12 33

The Coordinating Committee is not scheduled to meet again until there is a draft of the preliminary report to go over. Until then, the work will be carried on through working groups on particular subjects. I intend to follow the work of the Federal-State-Local Relations Group closely since it has responsibility for developing an Executive Branch position on revenue-sharing proposals, a subject which may be important before the end of the Vietnam hostilities.

EXECUTIVE

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76 110

BE 5-7

THE SECRETARY OF THE TREASURY
WASHINGTON

OCT 12 1966

MEMORANDUM FOR THE PRESIDENT

Subject: Your Far Eastern Conference -- Our Long-term
Balance of Payments -- and a Proposal

In planning for reconstruction in war-torn Vietnam and long-range development and security in the Far East, our program must be viable and enduring financially, as well as militarily and politically.

In order to achieve an appropriate financial dimension in the program, we must have ground into it from the beginning objectives, methods and techniques that minimize the burden on our balance of payments.

For example, as of now our projected net overseas defense expenditures in the Far East account for nearly five-sixths of the estimated \$2.6 billion military deficit. This is substantially in excess of our estimated overall deficit for the year.

I do not have a similar computation for the proportion of the burden on our balance of payments deficit in the aid field which is attributable to the Far East. But you can be sure it is a substantial portion and, indeed, comparable in percentage terms to the military if India and Pakistan are included.

We can look back with a certain indulgence on the failure of our predecessors in the late Forties and Fifties to erect NATO and a Marshall Plan in a financial framework that did not take into account the U.S. balance of payments. Then there was no problem and, probably, one was not foreseeable.

This is definitely not the case today as we look into the years that will follow the end of the Vietnam conflict.

Therefore, it seems imperative that our contingency planning for the post-hostilities phase in Asia be carried out on a basis that will forestall a potential sapping of our international