FOREIGN TRAVEL TAX

1881-3

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETIETH CONGRESS

SECOND SESSION

ON

H.R. 16241

AN ACT TO EXTEND THE TAX ON THE TRANSPORTATION OF PERSONS BY AIR AND TO REDUCE THE PERSONAL EXEMPTION FROM DUTY IN THE CASE OF RETURNING RESIDENTS

PART 1

JUNE 25 AND 26, 1968

STATEMENT AND RECOMMENDATIONS OF THE SECRETARY OF THE TREASURY

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

95-943 O WASHINGTON : 1968

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[1] Part 1 only.

FOREIGN TRAVEL TAX

TUESDAY, JUNE 25, 1968

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

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

Present: Senators Long, Smathers (presiding), Williams, Carlson, Bennett, and Dirksen.

Senator SMATHERS. All right; the hearing will come to order.

This morning the committee begins taking testimony on the President's program to reduce the tourist gap in our balance of payments. In 1967 American tourists spent nearly $4 billion abroad while foreign tourists to this country spent only $1.8 billion, thus creating a deficit—a gap—of more than $2 billion in the travel portion of our international payments accounts.

H.R. 16241, the bill before us, is a considerably scaled-down version of the legislation submitted to Congress back in January to narrow the tourist gap. It extends the 5 percent tax—presently applicable only to domestic air transportation—to international flights as well. It also cuts back on the customs exemption for returning residents.

The controversial expenditure tax recommendation was rejected by the House Committee on Ways and Means. So was the tax on water transportation. The special 25-percent duty on purchases in excess of the tariff exemption was cut back by that committee to 10 percent. To some, this feature of the bill creates a considerable incentive for tourists to make large purchases of high-tariff articles while they are abroad and bring them in under the special low tariff. This incentive no doubt would offset much of the balance-of-payments savings expected from this bill.

I would like to insert at this point in the record a copy of H.R. 16241, our press releases concerning this hearing, a staff summary of the bill, and agency comments on the bill.

(The material referred to follows:)

90TH CONGRESS
2D SESSION

H. R. 16241

IN THE SENATE OF THE UNITED STATES

APRIL 10, 1968

Read twice and referred to the Committee on Finance

AN ACT

To extend the tax on the transportation of persons by air and to reduce the personal exemption from duty in the case of returning residents.

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

3 TITLE I—AMENDMENT OF INTER-
4 NAL REVENUE CODE

5 SEC. 101. TAX ON TRANSPORTATION OF PERSONS.

6 (a) TAX ON TRANSPORTATION OF PERSONS.—Sub-
7 chapter C of chapter 33 of the Internal Revenue Code of
8 1954 (relating to tax on transportation of persons by air)
9 is amended to read as follows:

II

1 "Subchapter C—Transportation of Persons by Air

"Sec. 4261. Imposition of tax on transportation of persons by air.
"Sec. 4262. Exemptions.
"Sec. 4263. Special rules.

2 "SEC. 4261. IMPOSITION OF TAX ON TRANSPORTATION OF
3 PERSONS BY AIR.

4 "(a) AMOUNTS PAID WITHIN THE UNITED STATES.—
5 There is hereby imposed upon the amount paid within the
6 United States for transportation of any person by air, within
7 or without the United States, a tax equal to 5 percent of the
8 amount so paid.

9 "(b) AMOUNTS PAID OUTSIDE THE UNITED
10 STATES.—There is hereby imposed upon the amount paid
11 outside the United States for transportation of any person
12 by air, but only if such transportation—

13 "(1) begins and ends in the United States, or
14 "(2) is provided pursuant to a ticket or order under
15 which the first transportation by air begins in the United
16 States,

17 a tax equal to 5 percent of the amount so paid. In the case
18 of any transportation by air which is interrupted by a
19 scheduled stopover in the United States of 6 hours or more,
20 paragraph (1) shall be applied separately to the portion of
21 such transportation before the interruption and to the portion
22 of such transportation after the interruption.

1 "(c) SEATS, BERTHS, ETC.—There is hereby imposed
2 upon the amount paid for seating or sleeping accommoda-
3 tions in connection with transportation with respect to which
4 a tax is imposed by subsection (a) or (b), a tax equivalent
5 to 5 percent of the amount so paid.

6 "(d) BY WHOM PAID.—Except as provided in section
7 4263, the taxes imposed by this section shall be paid by the
8 person making the payment subject to the tax.

9 "(e) UNITED STATES DEFINED.—For purposes of this
10 section, the term 'United States' means the States, the Dis-
11 trict of Columbia, the Commonwealth of Puerto Rico, and
12 the possessions of the United States.

13 "SEC. 4262. EXEMPTIONS.

14 "(a) CERTAIN ORGANIZATIONS.—The tax imposed by
15 section 4261 shall not apply to the payment for transporta-
16 tion or facilities furnished to an international organization,
17 or any corporation created by Act of Congress to act in
18 matters of relief under the treaty of Geneva of August 22,
19 1864.

20 "(b) SMALL AIRCRAFT ON NONESTABLISHED
21 LINES.—The tax imposed by section 4261 shall not apply
22 to transportation, beginning and ending within the United
23 States (within the meaning of section 4261(e)), by air-
24 craft having—

1 "(1) a gross takeoff weight (as determined under
2 regulations prescribed by the Secretary or his delegate)
3 of less than 12,500 pounds, and
4 "(2) a passenger seating capacity of less than 10
5 adult passengers, including the pilot,
6 except when such aircraft is operated on an established line.
7 "SEC. 4263. SPECIAL RULES.
8 "(a) PAYMENTS MADE OUTSIDE THE UNITED STATES
9 FOR PREPAID ORDERS.—If the payment upon which tax
10 is imposed by section 4261 is made outside the United
11 States for a prepaid order, exchange order, or similar order,
12 the person furnishing the initial transportation pursuant to
13 such order shall collect the amount of the tax.
14 "(b) TAX DEDUCTED UPON REFUNDS.—Every per-
15 son who refunds any amount with respect to a ticket or order
16 which was purchased without payment of tax imposed by
17 section 4261 shall deduct from the amount refundable, to
18 the extent available, any tax due under section 4261 and
19 shall report to the Secretary or his delegate the amount of
20 any such tax remaining uncollected.
21 "(c) PAYMENT OF TAX.—Where any tax imposed by
22 section 4261 is not paid at the time payment for transporta-
23 tion is made, then, under regulations prescribed by the
24 Secretary or his delegate, to the extent that such tax is not
25 collected under any other provision of this subchapter—

1 "(1) such tax shall be paid by the person paying
2 for the transportation or by the person using the trans-
3 portation;
4 "(2) such tax shall be paid within such time as the
5 Secretary or his delegate shall prescribe by regulations
6 after whichever of the following first occurs:
7 "(A) the rights to the transportation expire;
8 or
9 "(B) the time when the transportation becomes
10 subject to tax; and
11 "(3) payment of such tax shall be made to the Sec-
12 retary or his delegate, to the person to whom the pay-
13 ment for transportation was made, or to any person
14 furnishing any portion of such transportation.
15 "(d) APPLICATION OF TAX.—The tax imposed by sec-
16 tion 4261 shall apply to any amount paid within the United
17 States for transportation of any person by air unless the tax-
18 payer establishes, pursuant to regulations prescribed by the
19 Secretary or his delegate, at the time of payment for the
20 transportation, that the transportation is not transportation
21 in respect of which tax is imposed by section 4261."
22 (b) TERMINATION OF EXEMPTIONS.—Sections 4292
23 (relating to State and local governmental exemptions) and
24 4294 (relating to exemption for nonprofit educational orga-

1 nizations) of the Internal Revenue Code of 1954 are each
2 amended by striking out "or 4261". Section 4293 (relat-
3 ing to exemptions for United States and possessions) of
4 such Code is amended by striking out "subchapters B and
5 C" and inserting in lieu thereof "subchapter B".

6 (c) CONFORMING AMENDMENT.—Section 4291 of such
7 Code is amended by striking out "4264 (a)," and inserting
8 in lieu thereof "4263 (a),".

9 (d) EFFECTIVE DATE.—The amendments made by this
10 section shall apply with respect to amounts paid on or after
11 the 10th day after the date of enactment of this Act for
12 transportation beginning on or after such 10th day.

13 TITLE II—AMENDMENT OF TARIFF
14 SCHEDULES

15 **SEC. 201. REDUCTION OF PERSONAL EXEMPTION OF CER-**
16 **TAIN RETURNING RESIDENTS.**

17 (a) REDUCTION.—The article description for item
18 813.31 of the Tariff Schedules of the United States (19
19 U.S.C. 1202) is amended—

20 (1) by striking out "Articles not over $100 (or
21 $200 in the case of persons arriving directly or indirectly
22 from American Samoa, Guam, or the Virgin Islands of
23 the United States, not more than $100 of which shall
24 have been acquired elsewhere than in such insular pos-
25 sessions)", and

1 (2) by inserting in lieu thereof "Articles not over
2 $10 (or $100 in the case of persons arriving directly
3 from a contiguous country or directly or indirectly from
4 American Samoa, Guam, or the Virgin Islands of the
5 United States, not more than $10 of which shall have
6 been acquired elsewhere than in a contiguous country or
7 in such insular possessions)".

8 (b) $50 PERSONAL EXEMPTION ($200 PERSONAL
9 EXEMPTION IN CASE OF INSULAR POSSESSIONS) AFTER
10 OCTOBER 15, 1969.—Effective with respect to persons arriv-
11 ing in the United States after October 15, 1969, the article
12 description for such item 813.31, as amended by subsection
13 (a), is amended—

14 (1) by striking out the matter inserted by subsec-
15 tion (a) (2), and

16 (2) by inserting in lieu thereof "Articles not over
17 $50 (or $100 in the case of persons arriving directly
18 from a contiguous country, or $200 in the case of
19 persons arriving directly or indirectly from American
20 Samoa, Guam, or the Virgin Islands of the United
21 States, not more than $100 of which shall have been
22 acquired in a contiguous country, except that not more
23 than $50 of such $100 or $200 shall have been acquired
24 elsewhere than in a contiguous country)".

1 SEC. 202. ARTICLES IMPORTED FOR NONCOMMERCIAL
2 USE.

3 (a) RATE OF DUTY.—Part 6 of schedule 8 of the Tariff
4 Schedules of the United States (19 U.S.C. 1202) is amended
5 by inserting before item 870.10 the following:

"			
	Subpart A.—Noncommercial Importations		
	Subpart A headnote: 1. For the purposes of this subpart— (a) The rates of duty for articles provided for in this subpart shall be assessed in lieu of any other rates of duty except free rates of duty on such articles. (b) Any article dutiable under item 869.05 shall be exempt from the payment of any internal-revenue tax imposed upon or by reason of importation.		
	Articles not intended for sale or other commercial use:		
869.00	If accompanying a person arriving in the United States and valued in the aggregate (exclusive of duty-free articles) not over $500	10% of fair retail value	10% of fair retail value
869.05	If imported in the mails in any package containing articles valued in the aggregate (exclusive of duty-free articles) not over $10 fair retail value	$1 per package	$1 per package
869.10	Other articles in any shipment (whether imported in the mails or otherwise but not accompanying a person arriving in the United States) containing articles valued in the aggregate (exclusive of duty-free articles) not over $250	10% of fair retail value	10% of fair retail value
	Subpart B.—Other Provisions		"

6 (b) CONFORMING AMENDMENT.—The headnote for
7 schedule 8 of the Tariff Schedules of the United States is
8 amended by inserting "(other than of subpart A of part 6)"
9 after "schedule" the first place it appears therein.

1 SEC. 203. EFFECTIVE DATE.

2 The amendments made by sections 201 (a) and 202 shall
3 apply with respect to persons and articles arriving in the
4 United States on or after the 10th day after the date of the
5 enactment of this Act.

Passed the House of Representatives April 4, 1968.

Attest: W. PAT JENNINGS,
Clerk.

RUSSELL B. LONG, CHAIRMAN, ANNOUNCES COMMITTEE HEARINGS ON FOREIGN TRAVEL TAX

Senator Russell B. Long (D., La.), Chairman of the Senate Finance Committee, today announced that on *Wednesday, May 22*, the Committee will begin *public hearings on H.R. 16241*, the Administration bill to impose an excise tax on overseas air transportation tickets and to reduce the customs exemptions for returning residents and foreign gifts received through the mails.

The Chairman recalled that this bill was an important part of the President's program to reverse the unfavorable trends in this country's balance of payments. He indicated that the Committee desired to consider this legislation before the 1968 tourist seasons begin so that persons planning to travel abroad would know in advance what Federal tax liabilities their travel might entail, and the extent to which reductions in the customs exemption might affect them on their return.

Senator Long also reported that statements would be received by the Committee with respect to those features of the House passed bill deleting the present exemption (from the domestic air transportation tax) for travel furnished to state or local government units or to nonprofit educational organizations.

Leading off the hearing for the Administration will be the Honorable Henry H. Fowler, Secretary of the Treasury. Public witnesses are expected to be heard beginning Friday, May 24.

Those desiring to participate in this proceeding should make their request to Tom Vail, Chief Counsel, Committee on Finance, 2227 New Senate Office Building, *no later than Monday, May 20*. All statements should include a summary sheet and subject heading. Statements to be presented orally should be sumitted to the Committee the day before the witness is to testify. Chairman Long urged persons desiring to contribute written statements to submit them *no later than Wednesday, June 5, 1968.*

HEARING ON FOREIGN TRAVEL TAX BILL POSTPONED

Senator Russell B. Long (D., La.), Chairman, Senate Committee on Finance, today announced that *public hearings on H.R. 16241*, the Administration bill to impose an excise tax on overseas air transportation tickets and to reduce the customs exemptions for returning residents and foreign gifts received through the mails, originally scheduled to begin on May 22, 1968, *are being postponed.*

The Chairman advised that *these hearings will be held at a later date* and that an announcement of the new schedule would be published as soon as the new dates are determined.

HEARINGS ON FOREIGN TRAVEL TAX BILL RESCHEDULED BY FINANCE COMMITTEE

Senator Russell B. Long (D., La.), Chairman of the Senate Finance Committee, today announced that on *Tuesday, June 25, 1968*, the Committee would begin the *first phase of public hearings on H.R. 16241*, the Administration bill to impose an excise tax on overseas air transportation tickets and to reduce the customs exemptions for returning residents and foreign gifts received through the mails. During this first phase of the hearing, the Honorable Henry H. Fowler, Secretary of the Treasury, will present the case for the legislation.

Public witnesses who will be heard by the Committee *will testify at a later phase of the hearing*, the data of which is to be announced at a subsequent time.

Senator Long urged those desiring to participate in this proceeding who have not already done so to make their request to Tom Vail, Chief Counsel, Committee on Finance, 2227 New Senate Office Building, *no later than Tuesday, June 25, 1968.*

STAFF SUMMARY OF H.R. 16241 AS PASSED BY THE HOUSE OF REPRESENTATIVES—TAX ON FOREIGN AIR TRANSPORTATION AND REDUCTION IN CUSTOMS EXEMPTION FOR RETURNING RESIDENTS

EXCISE TAX CHANGES MADE BY THE BILL

1. *Tax on foreign air transportation.*—At present the 5 percent U.S. excise tax on air transportation applies only to domestic travel. Even with respect to domestic travel, however, special rules exempt the overseas portion of flights to Hawaii and Alaska. Moreover, the tax does not apply with respect to travel between the mainland and Puerto Rico.

Under the House bill, this 5 percent tax would apply to foreign as well as domestic travel and the special rules relating to Alaska, Hawaii, and Puerto Rico would be terminated. Under the bill, the tax would apply (regardless of destination) to all air transportation originating in this country.

2. *State and local government officials.*—The present law includes an exemption from the tax on air transportation for transportation furnished to State and local governments and to nonprofit educational institutions.

The House bill would delete these exemptions.

3. *Other exemptions.*—Present law also contains exemptions from the air transportation tax for,

(*a*) Certain commutation travel.
(*b*) International organizations.
(*c*) The Red Cross.
(*d*) Certain travel by military personnel at rates not more than 2.5 cents per mile.
(*e*) Air taxi service.
(*f*) U.S. Government.

The House bill would retain the special exemption for international organizations, the Red Cross, and air taxi services, but repeals the other exemptions.

4. *Effective date.*—The amendments made by the House bill would apply with respect to amounts paid on or after 10 days after the date of enactment of the bill for transportation beginning on or after 10 days after enactment.

CUSTOMS CHANGES MADE BY THE BILL

1. *Tariff exemption for returning residents.*—Under present law residents returning to this country from abroad are permitted to bring souvenirs, gifts, and other articles free of U.S. tariff if the retail value of these articles does not exceed $100. If they return from the Virgin Islands, the customs exemption is $200, of which at least $100 must have been acquired in the Islands.

The House bill makes the following changes:

(*a*) *U.S. possessions.*—It reduces the $200 customs exemption for residents returning from the U.S. possessions to $100.

(*b*) *Canada and Mexico.*—It retains the $100 exemption for residents returning from Canada and Mexico.

(c) *Elsewhere.*—It reduces the $100 exemption for tourists returning from any other country to $10.

These modifications in the present law would apply until October 15, 1969.

Thereafter, the $200 exemption for residents arriving from the Virgin Islands, Guam, or American Samoa, would be restored. The $100 exemption for those returning from Canada or Mexico would be continued. Finally, the $10 exemption for tourists returning from any other country would be increased to $50. These exemptions would be permanent.

2. *$10 gift exemption.*—Under present administrative practice, gifts from abroad valued at not more than $10 are entered duty-free. In addition, gifts from servicemen serving in a combat zone are duty-free if they are valued at not more than $50.

The bill as passed by the House terminates the $10 gift exemption and provides that gift packages valued not over $10 are to be dutiable at a flat rate of $1 per package. (In addition to this, the Post Office Department will continue to assess a special charge of 50 cents for each package for which it collects a tariff for the customs service.)

3. *Noncommercial importations.*—The bill as passed by the House also adds two new features to the customs law:

(a) *Accompanying the returning resident.*—The first of these changes provides for a tariff of 10 percent to be applied to articles valued not over $500 wholesale ($700 retail value) which accompany the returning resident.

(b) *Not accompanying the returning resident.*—The second of these changes imposes a 10 percent tariff on articles valued up to $250 wholesale ($350 retail value) imported by a returning resident but not accompanying him.

The tariffs would be in lieu of the regular duties to which the imported merchandise would be subject under the tariff schedules. However, they would not apply to duty-free articles. In determining the $500 and $250 ceilings, only the value of articles in excess of the customs exemption would be counted.

4. *Effective date.*—The amendments to the tariff schedules brought about by these changes would take effect on the 10th day after enactment.

Agency Comments

The General Counsel,
Post Office Department,
Washington, D.C., June 24, 1968.

Hon. Russell B. Long,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

Dear Mr. Chairman: This is in response to your request for a report on H.R. 16241 which is now pending before your Committee.

Section 202(a) of the bill would impose upon articles not intended for sale or other commercial use when imported in the mails a duty of $1.00 per package when the fair retail value is not over $10.00 and 10% of the fair retail value for articles valued in the aggregate at not over $250.00.

We endorse the purposes of H.R. 16241.

The provisions cited would result in substantial additional work for the Postal Service. However, this should not present an obstacle to the enactment of this legislation, since it may be assumed that adequate provision for funding this work will be made at a later date.

Due to the urgency of your request we have been unable to secure the views of the Bureau of the Budget on this report.

Sincerely yours,

Timothy J. May.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., June 28, 1968.

B-164701

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

DEAR MR. CHAIRMAN: We are furnishing our comments and views on H.R. 16241 pursuant to your staff's informal request of June 24, 1968.

H.R. 16241, as passed by the House, would amend several sections of the Internal Revenue Code concerning the tax on payments for the transportation of persons by air and would reduce the personal exemption from duty in the case of returning residents. We are primarily interested in Title I of the act, and particularly in paragraphs (b), (c), and (d), the latter beginning at line 22 of page 5 and ending at line 12 of page 6.

As explained in House Report No. 1264, accompanying H.R. 16241, the present law provides a series of exemptions from the five percent tax on payments for the transportation of persons by air, including payments for transportation furnished the United States. The House Committee did not consider it appropriate to continue special exemptions for the United States as well as State and local governmental subdivisions and educational organizations "since the use of the airway facilities in these cases is relatively limited" and "there would appear to be no reason why these governmental and other organizations should not pay for their share of the use of the airway facilities."

It is further explained in House Report No. 1264 that H.R. 16241 extends the existing five percent tax on payments for the transportation of persons by air to all air travel purchased in the United States. Thus, the five percent tax is to apply not only to amounts paid for air travel within the United States, but also to payments for travel between the United States and other countries, including U.S. possessions and Puerto Rico. This would mean that most of the funds used by Government departments and agencies for air transportation, including large sums expended annually by the Military Airlift Command under contract arrangements, would be subject to the five percent tax.

Before the passage of the Revenue Act of 1943, 58 Stat. 21, payments made for transportation services furnished the United States were, by express statutory provision, exempt from the tax. Section 307 of the Revenue Act (58 Stat. 64) terminated this exemption but provided that the Secretary of the Treasury could thereafter authorize exemption in certain circumstances. Pursuant to this authority the Secretary issued a regulation authorizing exemption from the tax when the transportation services were performed for the United States under Government bills of lading or Government transportation requests. 26 CFR, 1956 Supp., page 109, note following section 143.16 correcting 1949 edition. Consistent with these developments was the specific exemption from Federal taxes provided by statutes creating certain agencies or instrumentalities of the United States, such as Home Owners' Loan Corporation, Reconstruction Finance Corporation, and others, which were held to be unaffected by the termination provisions of section 307 of the 1943 act. Miscellaneous Tax Ruling 21, Internal Revenue Bulletin 1944, page 594.

In the absence of an express provision in the statute to the contrary, a Federal tax statute is ordinarily construed as not imposing a tax on the United States for it is presumed that the United States will not tax itself. Under the present language, of the proposed legislation, if Senator Bennett's amendments of June 3, 1968, are not adopted, the presumption would clearly be overcome, and the United States would be required to pay the tax on the payments for passenger transportation services via air carriers.

Senator Wallace F. Bennett's proposed amendments to H.R. 16241 would reinstate references to certain mandatory exemption provisions in 26 U.S.C. 4292 and 4294; it would also reinstate the discretionary authority now given to the Secretary of the Treasury in 26 U.S.C. 4293 as to the granting of exemptions from the transportation tax provisions of 26 U.S.C. 4261.

As indicated above, the exemption authority exercised by the Secretary of the Treasury was first included in section 307 of the Revenue Act of 1943, 58 Stat. 64; such authority has continued to the present day. Public Law 87-508, June 28, 1962, 79 Stat. 114, removed the applicability of the ten percent tax on the transportation of persons by rail, motor vehicle, or water, and reduced the ten percent tax on payments for air transportation of persons to five percent. The termination date of this tax has been extended from year to year. Until the present time, no consideration has been given to termination of the transporta-

95-948 O—68—pt. 1——2

tion tax exemption authority placed in the Secretary of the Treasury as to air carrier services furnished the United States.

While we express no opinion as to the propriety or desirability of discontinuing the transportation tax exemptions provision in favor of State and political subdivisions and nonprofit educational organizations, we are firmly of the view that the transportation tax exemption authority prescribed in 26 U.S.C. 4293 should not be removed insofar as Federal government travel is concerned. We believe strongly that Senator Bennett's proposed amendment would best serve the interests of the United States. Since the transportation tax base would be materially broadened by H.R. 16241, the consequences of the exemption authority cancellation are more disturbing from an administrative and budgetary point of view than they would be under present conditions. If the United States did not presently have the benefit of the exemption allowed upon use of the Government transportation request as the procuring instrument, or under other special exemptions granted by the Secretary of the Treasury in special cases involving payments of appropriated funds, a substantial amount of the procurement cost would be represented by the five percent tax.

We do not have any precise figures at this time on the money that would have been paid for taxes if the present law did not include the exemption authority. However, we are able to estimate what additional funds for the five percent tax payments would have been budgeted and appropriated for the air transportation services furnished the United States for the fiscal years 1967 and 1968 in the event provisions of law similar to those now contained in H.R. 16241 were in effect.

For these fiscal years the records available in our audit indicate that the United States spent or will spend about $540,000,000 for air passenger transportation that would have been taxable if the present provisions of H.R. 16241 were effective. Of this amount $325,875,000 represents payments for scheduled and charter flights for which U.S. Government transportation requests are used. The remainder of the total outlay, $214,125,000 is for air passenger transportation furnished under contracts negotiated by the Military Airlift Command. Application of a five percent tax on those payments, totaling $540,000,000 produces a tax liability of $27,000,000 for two years. This is obviously a large amount of money that could be kept in the Treasury or diverted to other projects, rather than appropriated, obligated, paid, and returned to the Treasury in the form of tax payments.

Apart from the advantage of avoiding the need for appropriations to cover the taxes in the amount of $13,500,000 per fiscal year, or some different figure (we understand that the monetary value of Military Airlift Command air passenger contracts recently awarded has increased by $33,558,000 over that contracted for the fiscal year ending June 30, 1968), depending on the transportation procurement programs ahead, retention of the existing exemption authority in 26 U.S.C. 4293 and the preservation of the regulations requiring issuance of the Government transportation request as a condition precedent to exemption, would result in other clear advantages.

While transportation tax collections certainly would distinctly increase if the coverage of the five percent tax were enlarged as proposed, the collections would eventually have to be returned to the Government agencies in the form of equivalent appropriations. Considerable paper work and other administrative detail, in addition to budgetary preparations, would be generated and would add significantly to the cost of Government operations. Accounting procedures would be complicated by the necessity of segregating tax payments from the basic transportation payments.

One incidental feature of Government passenger transportation procurement under present conditions is the need for use of the U.S. Government transportation request as the qualifying instrument for an exemption from the tax. Use of the distinctive standard form enables better control over purchase of air transportation services; it helps insure that services for which Treasury money is expended will be obtained from American flag air carriers. Relaxation of the requirement for use of the Government transportation request might tend to lead to greater use of foreign flag air carriers for Government passenger transportation and thus impair the Government's balance of payments position.

We urge that Senator Bennett's amendments of June 3, 1968, at least insofar as they affect air passenger transportation procurement for the account of the United States, be adopted.

Sincerely yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

Senator SMATHERS. We are pleased to have as our witness this morning the Honorable Henry H. Fowler, the Secretary of the Treasury, who is accompanied by his strong right arm, Assistant Secretary Stanley Surrey.

Mr. Secretary, and Mr. Surrey, I hope you can give us your judgment on those features of the House bill which rescind the exemption from the air transportation tax for State and local officials and officials of nonprofit educational institutions and any other comments which you care to make.

You may proceed.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY

Secretary FOWLER. Mr. Chairman, and members of the committee, I appreciate very much this opportunity to appear before you to discuss the bill, H.R. 16241, a bill containing a portion of the administration's recommendations for dealing with our foreign travel payments deficit.

Now, these recommendations are a part of the overall program set forth by the President in his January 1 message on balance of payments. In view of the statement by the chairman that the House Committee had rejected the feature on travel expenditure taxes I believe I should refer the committee to the report of the House committee in which it said:

> Your committee on this bill takes action on the 1st and 3d of these items closely approximating the recommendations received from the administration. It decided to defer action on the foreign travel tax, however, for further consideration, along with measures related to improving our trade balance to which the President referred in his January 1 announcement.

In the interest of maintaining accurate relationships between this committee and its sister committee on the other side, I merely note that my interpretation of their action is not to reject it but merely to defer action on it.

Senator SMATHERS. Mr. Secretary, it has been our observation on the Finance Committee that when the Ways and Means Committee deferred something, for all practical purposes, so far as we were concerned, it was rejection.

However, in this instance we are happy to have your interpretation and, if I understand it, you are going to recommend the expenditure tax again anyway?

Secretary FOWLER. I have had some recent experiences, Mr. Chairman, which indicated that deferment by the House does not always mean ultimately final rejection; so it is in that spirit that I come before you this morning to bring up not only the elements of the bill that have been approved by the House but also to take note of the elements of the proposals on which there has been a deferment.

I. THE BALANCE-OF-PAYMENTS PROBLEM

I do think, however, before discussing the details of this legislation, and our recommendations in this area, I should try to place this meas-

ure in perspective by reviewing with you our overall balance-of-payments program.

I have had distributed to you in the envelopes up there a copy of the so-called Treasury Blue Book entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy." This book, issued earlier in the year, attempts to develop, in the light of the various sections of the President's January 1 message, what has been done, what is being done, and what should be done to bring our balance of payments into equilibrium and keep it there in all of the various phases of our international accounts that importantly affect our balance of payments.

You are all familiar, I am sure, with the fact that the payments deficit for the year 1967 was almost $3.6 billion, and in the final quarter of the year exceeded $1.8 billion, which would represent a deficit of over $7 billion on an annual basis. These deficits, this one and preceding ones, together with devaluation and difficulties of the British pound, the other reserve currency, have led to intense gold speculation and doubt about the survival of the international monetary system as we know it.

On January 1, President Johnson set forth an action program to deal with our balance-of-payments problem, as a national and international responsibility of the highest priority. This program stressed, as the first order of business, the urgent need for enactment of a tax surcharge which, coupled with expenditure controls, would help to stem the inflationary pressures threatening both our economic prosperity and our trade surplus. This fiscal package, now happily becoming law this week, is the keystone of our program to correct the balance-of-payments problem. I want to say I am very grateful to the members of the committee and Members of the Senate and Congress for the action taken. I think we all feel a good deal better this week than we have for some time about the basis of our financial position.

In any discussion of the balance-of-payments problem we cannot overlook the other features of the President's "first line of defense of the dollar." It is of unquestioned importance that business and labor work together to make effective the voluntary program of wage-price restraint and to prevent work stoppages that will adversely affect our foreign trade.

In addition, the President's program called for a number of both temporary and long-range measures directed at the improvement of specific sectors of our international payments account, and in this blue book there is a separate chapter devoted to each one of the segments of the problem, the so-called five-part program.

These specific measures included a five-part program designed to achieve near equilibrium in our balance-of-payments deficit this year by calling upon each major segment of our economy importantly involved in the balance of payments to make a contribution to this savings target. This program asked:

American business to reduce its outlays for direct investment abroad by $1 billion, under a new mandatory program to be administered by the Commerce Department;

Banks and other financial institutions to reduce foreign lending by $500 million, through a tightening of the voluntary restraint program administered by the Federal Reserve Board;

The American people to reduce their oversea travel expenditures by $500 million, on the basis of the President's request for voluntary deferral of nonessential travel plus legislation to help achieve a reduction in travel expenditures by those who do travel;

Government to reduce or offset its expenditures overseas by $500 million, through specific action programs assigned to the Secretaries of State, Treasury, and Defense and the Director of the Budget; and

For prompt cooperative action through consultations with our trading partners to minimize disadvantages to our trade, or appropriate legislative measures, to realize a $500 million improvement in our trade surplus.

It is the travel portion of this immediate direct action program, which at this time requires legislation. In the other sectors, the measures called for have been instituted and are underway.

Thus, for business, the mandatory restraints on direct investment have been in operation under Commerce Department regulations since January 1 and have, during the first quarter of 1968, already had a sizable favorable impact on our balance of payments.

For banking, the Federal Reserve Board restraints on foreign lending were, similarly, issued and effective on January 1. Major progress has already been made toward achievement of the goal under this program, with a decline of about $350 million (seasonally adjusted) during the first quarter of this year in commercial bank claims on foreigners.

The Government has taken action on each of the three specific steps to reduce expenditures abroad listed by the President in his January 1 message:

Discussions with a number of countries in both Europe and Asia to find various ways to reduce the foreign exchange costs of maintaining our troops abroad are already well underway.

An initial program for a 12-percent reduction of oversea staffs, that is Governemnt employees, by the end of 1969, together with a further tightening of Government travel abroad, was put into effect on March 30; and a second-stage effort to achieve even further reductions, primarily in the larger oversea missions, is underway.

The Department of Defense is examining a series of possible specific measures to reduce further the foreign-exchange impact of personal spending by U.S. military personnel and their dependents in Europe, which are importantly related to civilian tourist travel.

Let me just say here, gentlemen and members of the committee, that the Department of Defense has in mind certain measures that can be instituted in this regard, but it is awfully difficult for them to impose on the families and dependents of our soldiers overseas restrictions when nothing literally is being done about the major part of the problem which involves the civilian tourist population.

In addition, the President, on January 11, directed AID to reduce oversea expenditures in 1968 by a minimum of $100 million below the 1967 level.

For trade, the President's special trade representative, Ambassador Roth, has headed an effort by many of our oversea missions to explore actively with our major trading partners possible immediate as well as longer term cooperative actions to contribute toward improvement in our trade surplus. Ambassador Roth has reported on

these discussions in the current hearings before the House Ways and Means Committee.

A working party in the GATT, the General Agreement on Tariffs and Trade, has now been instituted at U.S. initiative and is now engaged in an examination of existing provisions dealing with border-tax adjustments and their effects on trade, looking to the development of a program designed to remove or minimize any significant disadvantage to U.S. trade that results from the existing GATT provisions and the tax systems of our principal trading partners.

In other words, action on each of these parts of the President's balance-of-payments program is well underway. The one remaining aspect of the program is the travel area where the goal is to reduce the balance-of-payments deficit by $500 million. H.R. 16241 represents a beginning—modest as it may be—of the action required to effect an immediate reduction in the outflow of dollars. A long-range program of a different direction, to increase foreign travel to the United States and thereby offset our expenditures abroad, is already well underway, having as its cornerstone the recommendations of a task force headed by Ambassador McKinney. I should like to file a copy of the report of that task force which undertook this work early this year and submitted its report to the President on February 15, 1968.

There is in the envelope in front of you this document which I hold in my hand which is entitled "Report to the President of the United States from the Industry-Government Special Task Force on Travel."

Let me say here that we all feel that one very important and essential part of dealing with the travel problem is the encouragement of foreign tourism in the United States. I just don't think we are going to be able to cope at all adequately with this problem unless a great deal more is done in both the private and the public sector to make attractive and inviting the spending of tourist dollars from abroad in the United States.

We have made some progress in this area in recent years, and the figures that will be cited later will show it. But there is still a great deal that could be done that is not being done by all of the elements that affect the travel picture, and I believe that the report of this task force, which was constituted by and large from the areas of the private sector that are most familiar with the tourist problem, I believe the discussion of these recommendations by Government and the private sector alike will make a very substantial contribution, and we are all grateful to the task force for undertaking it.

II. CONTINUING NEED FOR FULL IMPLEMENTATION OF THE JANUARY PROGRAM

However, events since the beginning of the year have confirmed that the President's full action program is needed to help bring our balance of payments to equilibrium, to maintain confidence in the dollar, and to stabilize the international monetary system.

Our balance-of-payments deficit, sorely affected by the fall-off in our trade surplus, ran at too high a rate in the first quarter. The first-quarter results released on May 14 show a liquidity deficit of $600 million, seasonally adjusted, equivalent to an annual rate of $2.4 billion.

This does show, I am happy to say, a quick and quite substantial recovery from the extremely high and totally unsustainable rate of deficit which we suffered in the last 3 months of last year.

However, continued effort is necessary to advance us further toward our vital goal of sustainable equilibrium. Although we made notable gains in the first quarter, these were mainly due to a number of factors in our capital accounts as distinct from our current account. These included:

(1) A sharp reduction in bank lending and large sales of special corporate bonds to foreigners, in connection with the Federal Reserve and Commerce programs;

(2) Foreign net purchases of U.S. corporate stocks which amounted to about $275 million, approximately maintaining the same postwar record rate averaged during the last half of 1967; and

(3) One large known transaction, classified as foreign direct investment in the United States, involving an inflow of slightly over $200 million.

We certainly cannot rely only on improvement in the capital accounts to restore equilibrium in our balance of payments—we must look to the achievement and maintenance of a substantial merchandise trade surplus as an essential cornerstone of our balance of payments. However, during March, in particular, and for the first quarter of this year, as a whole, our performance on trade account has been very poor—reflecting the crucial importance of the tax increase expenditure reduction measure to curb domestic inflationary pressures and the excessive increase in imports that characteristically accompanies an excessive rate of growth in our economy. Our trade surplus for the first quarter fell to an annual rate, after seasonal adjustment, of only slightly over $400 million—compared with a $1.8 billion annual rate based on the final quarter of 1967, and a $4.2 billion annual rate based on the three preceding quarters of last year.

On other fronts also, events during the interim since January 1, have further underlined the reality of the threat to our dollar which was feared at the beginning of the year. From February 7 to March 20, 1968, we experienced a period of intense speculation in the foreign exchange and gold markets of the world. During this period, the Treasury Department transferred a total of $1½ billion in gold to the exchange stabilization fund in order to replenish its working balances and complete the settlement of the U.S. share of the losses experienced by the gold pool.

These gold losses clearly indicated the concern held by foreigners as to this country's persistent balance-of-payments deficit. The situation threatened to bring about serious difficulties for the world's entire financial structure, with accelerating interest rates and the choking off of credit availabilities beginning to spread from the international money markets into domestic markets.

The impact of this monetary crisis was felt not only by bankers and finance ministries of the world, the American traveler also was directly affected. For example, over the period of March 14 through March 18, many American travelers experienced considerable difficulty spending or converting their dollars at the hotels, restaurants, and banks of Europe. When they were permitted to convert, it was frequent-

ly at a large discount. Thus, some American travelers were getting only—

Ninety-four cents for a dollar in Paris.
Ninety-six cents for a dollar in Italy.
Eighty cents for a dollar in Germany.

I would venture to say that these Americans who experienced the direct effect of a lack of confidence in the dollar, for a very short period, I might say, would welcome, if not insist upon, immediate measures to insure that their dollars are not so threatened again.

Fortunately, as a result of the meeting, on March 16–17, of the gold pool central bank governors in Washington, decisions were made and action was taken to restore order to the financial markets. However, the cost of those 6 weeks of speculative activity in terms of our loss of gold and in terms of the strain on the international monetary system was severe. The steps that have been taken—while representing an effective solution for the immediate problem—will not guarantee against a repeat performance in the future. We can only protect against further attacks on the dollar—and, through it, the world monetary system—by striking at the root of the problem—the persistent imbalance in world payments, with a deficit in the United States and a surplus in Europe.

III. FOREIGN TRAVEL AND THE U.S. BALANCE OF PAYMENTS

Foreign travel expenditures are a major contributor to the balance-of-payments deficit and a comprehensive program to close the deficit would be incomplete and out of balance were travel omitted. In 1967 alone, a record number of Americans traveling outside the United States spent $4¾ billion, an increase of 17 percent over the previous year. These expenditures involved a foreign exchange cost of $4 billion. The difference between the $4 billion and the $4¾ billion is that some of that travel expenditure was on our own carriers, our planes, and whatnot and came back to us.

Senator SMATHERS. May I ask you a simple question, simple in terms that I ought to know the answer, but how are you able to determine exactly what the Americans who traveled overseas spent? You know what they spent for their tickets but how do you know what they spent overseas?

Secretary FOWLER. Those figures come to us from the Department of Commerce. They are based on sample surveys made periodically from returning travelers. They represent a sampling of returning travelers and travel groups and eliciting from them on a questionnaire basis from time to time their approximations of what is spent.

Receipts from foreign visitors to the United States last year came to only $1.9 billion, leaving a deficit of about $2.1 billion.

In fact, for the period 1961 through 1967, the total foreign payments for international travel—about $21 billion—were nearly as great as the total foreign exchange costs—$22.9 billion—of our military expenditures abroad, including the foreign exchange costs of the war in Southeast Asia. In other words, the balance-of-payments costs of our foreign travel have been equivalent to the balance-of-payments costs of our national security to the extent it depends upon the operations or presence of our military forces outside the United States.

We hear a great deal in some quarters about ending the war in Southeast Asia or bringing U.S. military forces home as a means of reducing our balance-of-payments deficit. We also hear a great deal about reducing our forces in Western Europe because of their foreign exchange costs. I am not here today to debate these issues. I am here to say that the Government which adopts a program of doing whatever it can, consistent with national security, to reduce or neutralize the foreign exchange costs of our military operations overseas, must similarly tackle the problem of travel expenditures when our balance of payments is still in a serious state of chronic deficit.

In order that members of the committee can see this problem in the overall perspective, I also had included in the envelopes in front of you a picture of the U.S. balance of payments cumulative 1961 through 1967 showing the debit, credit, and net costs in each of the major elements which go into our balance of payments, and I come to that aspect now as it relates to tourism.

U.S. BALANCE OF PAYMENTS, CUMULATIVE 1961-67

[In billions of dollars]

	Debits	Credits	Net
Merchandise imports and exports	−140.3	173.8	33.5
Military (expenditures and military sales deliveries)	−22.8	5.4	−17.4
Tourism (including fares)	−20.9	9.8	−11.2
Miscellaneous services:			
Transportation (excluding fares)	−12.8	14.8	2.1
U.S. direct investment income		(25.1)	25.9
Other private investment income	−7.9	(8.7)	
U.S. direct investment fees and royalties		5.6	5.6
Other private miscellaneous services	−3.3	7.9	4.6
Government interest payments and receipts	−3.1	3.5	.4
Government miscellaneous services	−3.6	1.8	−1.8
U.S. private remittances	−4.4		−4.4
Government payments of pensions, etc	−2.2		−2.2
Government economic grants and credits:			
Gross outlays and repayments	−31.5	7.6	−23.9
Of which: "untied" outlays (dollar outflow)	−(5.8)		
Private capital flows:			
U.S. direct investment, net outflow	−17.7		−17.7
U.S. purchases of new foreign securities	−7.9		−7.9
Redemptions of foreign securities		1.8	1.8
U.S. net sales outstanding foreign securities		.1	.1
Net U.S. bank credit to foreigners	−5.8		−5.8
Net U.S. nonbank credit to foreigners	−2.5		−2.5
Net inflow of foreign capital (nonliquid)		9.0	9.0
Errors and omissions	−4.5		−4.5
Totals and liquidity deficit	−291.2	274.9	−16.3

ITEMS INFLUENCING THE DIRECTION, DIMENSION AND TECHNIQUES OF U.S. FOREIGN POLICY

1. Total deficit 1961–67=$16.3 billion.

2. Deficit *not* due to *trade*, which shows $33.5 billion surplus (despite recent declining surplus). Surplus barely covers major outflow items of military and tourism ($28.6 billion combined) which are increasing. To close total deficit require major increase in trade surplus or, alternatively, cutting back or holding down some or all of major outflows.

3. *Military*.—Despite intensive efforts since early 1961 to decrease expenditures and increase offsetting sales, net military costs abroad ($17.4 billion over 7 years) represent largest single drain.

Figures shown are on conventional balance-of-payments basis, counting military sales in terms of deliveries rather than cash receipts. Alternative cash calculation (counting in net "advance payments" on military sales during the 7 years) would give gross receipts of $6.6 billion and net military expenditures of $16.2 billion—with an offsetting reduction of the net amount shown as foreign-capital inflow, from $9.0 to $8.1 billion.

4. *Tourism.*—Sheer magnitude of this item—with *gross* payments only $1.8 billion (8 per cent) short of total military payments and $3.2 billion (20 per cent) larger than direct-investment outflows, over the 7 years—warrants action despite political sensitivity.

5. *Direct investment* plus *U.S. purchase of foreign securities* show an outflow of about $25 billion which are offset by direct investment income and other private investment income. Adding income from direct investment fees and royalties of over $5 billion improves this investment picture to a net surplus. However, this *cumulative* picture does not adequately reflect deficit trends which have required governmental action in the *short-term* (IET on purchase of foreign securities and direct investment controls) to achieve this balance and avoid future deterioration.

6. *Aid* outflow from Government grants and credits fortunately took the form of only $5.8 billion in "untied" cash outflow because balance tied to U.S. goods and services. Tied amounts are contained in statistics of trade and services accounts.

The net foreign exchange impact of this level of foreign travel spending can—the figures I have given you up to now have been gross figures—can be measured by offsetting against the spending in the United States by foreign travelers. For the same 1961 through 1967 period, the net deficit in foreign exchange payments arising from tourism amounted to a little over $11 billion, as compared to about a $17.4 billion net foreign exchange deficit for military expenditures abroad after offsetting the foreign purchases of military equipment in the United States. Moreover, unless effective measures are undertaken, the situation with regard to travel can only get worse in the future.

Again referring to this table that I included in your envelopes, it shows that for the years 1961 to 1967 the cumulative payments deficit during those years was $16.3 billion, the travel deficit during those years was $11 billion. The cumulative military deficit during those years, taking into account what was bought in this country by foreign governments, was $17 billion. So in comparing these figures one can hardly escape the conclusion that to really grapple with the balance-of-payments problem, as we face it, not only in an emergency and at this particular time, but over the long pull, we have to come to some decision about the extent to which uninhibited expenditures overseas by our civilian tourists are going to continue.

Now, in this regard the Chase Manhattan Bank recently published in its June 1968 "Business in Brief" which is its monthly publication, a summary review of travel figures in the U.S. balance of payments. A copy of that is also in your envelopes and it presents, in very graphic form, the story I am trying to present to this committee and through this committee to the Congress and the country today.

This summary states: "Travel is a fast-growing element in U.S. international financial accounts. Outlays far exceed receipts, helping to create payments deficits." The bank points out that foreign travel is among the major causes of dollar outflows; the $4 billion of foreign travel payments in 1967 being almost as large as military spending of $4.3 billion.

The bank presentation also calls attention to the fact that expenditures abroad by Americans and expenditures in the United States by foreigners have both been increasing, and, indeed, the latter rate of increase on a much smaller base has been somewhat greater. The important point clearly indicated by these figures, however, is that "if

recent rates of growth in travel persist, the dollar gap between outlays and receipts will continue to widen." Thus the bank summary shows that under a continuation of growth patterns that have been exhibited in the past few years, the $2 billion travel deficit in 1967 will widen to $3 billion by 1975. Other estimates, taking into account the greatly increased travel which will flow from the new huge passenger "air buses" place the travel deficit in 1975 at much higher figures.

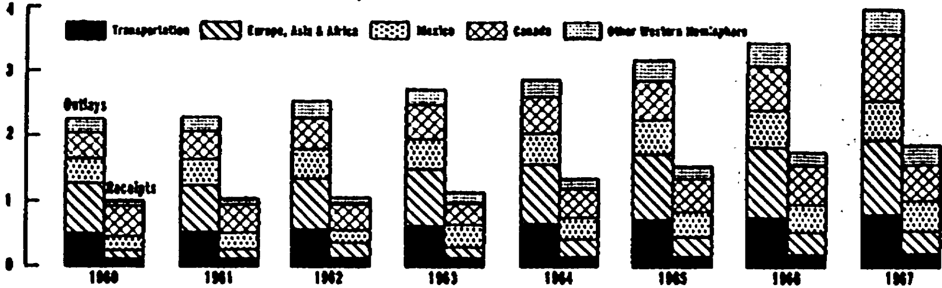
Senator WILLIAMS. Does this report give any indication of the loss as a result of our foreign aid programs over this period of years?

Secretary FOWLER. No, sir; I think it has at other times treated that program, and I can supply a good deal of information on that, which is continued in the appropriate section of the Blue Book here, Senator Williams, and I can note the appropriate pages and tables at this point in the record, if you would like to have me do so.

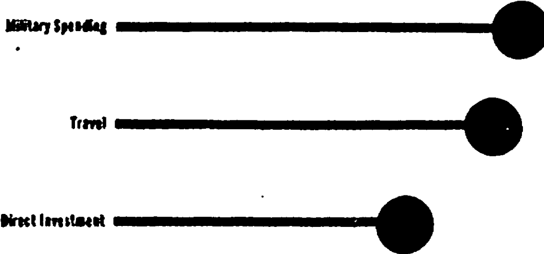
(The information referred to follows:)

HOW TRAVEL FIGURES IN THE U.S. BALANCE OF PAYMENTS

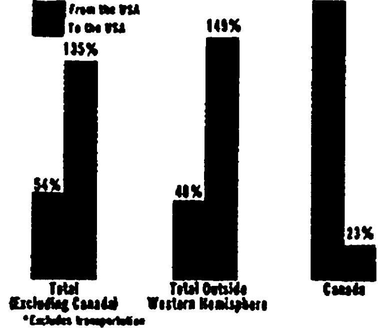
TRAVEL IS A FAST GROWING ELEMENT IN U.S. INTERNATIONAL FINANCIAL ACCOUNTS. OUTLAYS FAR EXCEED RECEIPTS, HELPING TO CREATE PAYMENTS DEFICITS...



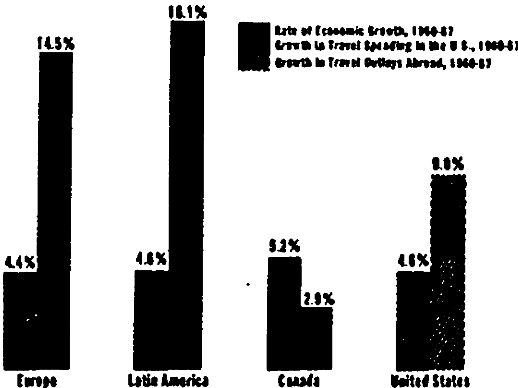
AND TRAVEL EXPENDITURES ARE AMONG MAJOR DOLLAR OUTFLOWS...



BUT U.S. TRAVEL RECEIPTS HAVE BEEN GROWING FASTER THAN OUTLAYS, DRAMATICALLY SO IF THE SPECIAL IMPACT OF CANADA'S "EXPO 67" IS EXCLUDED...

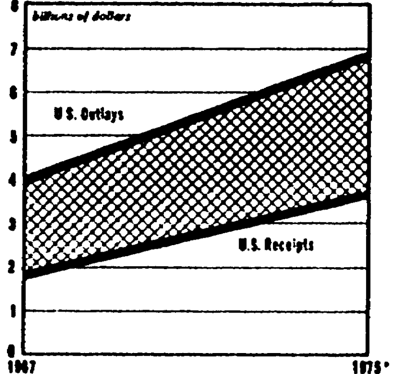


BECAUSE RISING INCOMES GENERALLY ARE HAVING A SHARPER IMPACT ON TRAVEL TO THE U.S. THAN ON U.S. TRAVEL ABROAD...



Data: U.S. Department of Commerce, Agency for International Development, OMB

YET, IF RECENT RATES OF GROWTH IN TRAVEL PERSIST, THE DOLLAR GAP BETWEEN OUTLAYS AND RECEIPTS WILL CONTINUE TO WIDEN.*



*Not a forecast. Chart indicates total receipts and outlays based on continuation of growth patterns for 1960-66.

[Excerpts From January 1968 Treasury Publication "Maintaining the Strength of the Dollar in a Strong Free World Economy"]

V. An Intensified Program to Moderate the Foreign Exchange Costs of Government Expenditures Abroad for Security, Development, and Other Activities

A. Introductory Comments

We are faced now, and will be in the future, with Government expenditures overseas to meet the costs:

—of our commitments abroad, on which America's security and survival depend,

—of our regular overseas establishments, and

—of contractual obligations overseas that arise in the operation of our Government.

We have pressed in all areas of the Government to achieve balance of payments savings, in our *military* expenditures, in *economic* assistance, and in our *regular Government* operations.

We must move ahead in all these areas even more intensively to achieve further balance of payments savings.

The President's program sets as *our new target a $500 million improvement over the present balance of payments costs of our defense, AID, and other Government expenditures abroad.* The President has announced three steps to this end:

"*First*, I have directed the Secretary of State to initiate prompt negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Europe. Our allies can help in a number of ways, including:

—The purchase in the U.S. of more of their defense needs.

—Investments in long-term United States securities.

"I have also directed the Secretaries of State, Treasury and Defense to find similar ways of dealing with this problem in other parts of the world.

"*Second*, I have instructed the Director of the Budget to find ways of reducing the numbers of American civilians working overseas.

"*Third*, I have instructed the Secertary of Defense to find ways to reduce further the foreign exchange impact of personal spending by U.S. forces and their dependents in Europe."

Table 10 shows the net costs of the Government transactions to our over-all balance of payments. (More detail is shown in Tables 11 and 12.) The table shows that between 1960 and 1965 there was a $1.1 billion

drop in the net balance of payments cost of Government activities. Nevertheless, in 1965, the Government sector still showed a substantial deficit ($2.6 billion). In 1966 (and again in 1967), the Government deficit increased significantly as a result of Vietnam expenditures. (Investments in long-term U.S. bank certificates of deposit made largely by foreign central banks as a result of the effort by the United States Treasury described earlier are not included in these figures.)

TABLE 10.—*Net balance-of-payments cost of Government transactions*

[Billions of dollars]

1960	1961	1962	1963	1964	1965	1966	1967 [1]
−3.7	−3.0	−2.0	−2.5	−2.5	−2.6	−3.2	−2.6

[1] January–September only.

Source: See table 12.

The foreign exchange costs of Government will not disappear when hostilities end in Southeast Asia. They will drop, but much of the opportunity to reduce the net cost to the U.S. balance of payments could be lost unless we exercise self-discipline and insist that other nations do their fair share in meeting joint responsibilities in the military and economic assistance fields.

Ways must be found to neutralize the foreign exchange costs of military expenditures in the common defense.

We must find ways to work constructively with our allies on bilateral and possibly multilateral arrangements designed to neutralize the foreign exchange consequences of the locations of our military forces and those of our allies.

The determination of the share a nation should bear in helping to meet *the economic assistance requirements* of the less-developed world and the security requirements of our community of nations requires difficult and continuous decisions on a host of issues. These issues cannot be resolved solely on the basis of domestic resources or budgetary considerations.

In the process of providing bilateral aid and contributions to multilateral financial institutions, we must constantly ask ourselves:

—What are other donor countries contributing?

—How aggressively have the institutions in question attempted to borrow in the capital markets of other donor countries?

—What are the recipients doing, through self-help efforts, to utilize the money efficiently and effectively?

—What safeguards are the institutions providing for donor countries that may from time to time be in balance of payments difficulty themselves?

B. Military

1. *General Measures To Reduce External Military Expenditures.* A detailed report by the Department of Defense on its efforts to reduce expenditures and increase receipts abroad is contained in Tab B.

Our efforts to hold down the foreign exchange costs of military programs have been substantial. Between calendar 1960 and calendar 1965 net military foreign exchange expenditures[1] were reduced from $2.8 billion to $1.6 billion despite rising overseas costs and despite such events as the Berlin crisis build-up. The gap widened again in 1966 and in 1967 because of essential outlays for maintaining the shield of freedom in Vietnam. The net balance of payments costs of our defense expenditures for other purposes, although substantial, have been held strictly in check as the Secretary of Defense carried out the President's prior directives to intensify his program:

—to shift defense buying from sources abroad to sources in the United States;
—to reduce the staffs in overseas headquarters;
—to streamline overseas support operations;
—to work with our defense partners to increase their offset purchases of military equipment in the United States.

These and other measures described in Tab B have been taken while fully protecting our security interests and discharging our responsibilities. Military personnel levels outside Southeast Asia have been reduced. Employment of foreign nationals for support or service activities, setting Southeast Asia aside, has dropped. Military Post Exchanges emphasize U.S. goods in their display, pricing, and purchasing practices. Non-Vietnam overseas construction costs entering the balance of payments have been curtailed. On the individual level, a massive education effort has been undertaken to restrain foreign expenditures and increase savings in the United States.

These are general measures that have been taken and which should continue to be vigorously pursued. But they are not enough. Over the past six calendar years (1961–66), our military expenditures outside the United States have averaged $3.1 billion. Even after taking account of receipts under the military offset arrangements with Germany and other sales of military equipment, the net foreign exchange costs of military outlays averaged $2.0 billion.

These military outlays are rising. They were less than $3.4 billion in fiscal year 1966 and $4.1 billion in fiscal year 1967. The rising trend in our net military deficit is outlined by region in Table 11.

Vietnam may be viewed as temporary, and the extraordinary foreign exchange drains from it should decline in time. But other signifi-

[1] The figures in this section (B) and those in Tab B are Defense Department data which have some technical differences in classification from the data published in the balance of payments accounts which are used in Table 12 in this Chapter and Table 6 in Chapter III.

cant declines in balance of payments consequences of military deployments outside the United States will depend upon the neutralization of their balance of payments effect.

Two possible ways to neutralize these military expenditures, both involving action by the recipient countries, are:

—purchase of additional U.S. goods and services.

—long-term investments in the United States by central banks or governments.

We must successfully negotiate—bilaterally or multilaterally—long-term arrangements of this sort which offset our large remaining balance of payments costs on military account. No other course is consistent with the adjustment process, or fair and equitable.

2. *European Area.* Our commitments for the common defense are vital to U.S. security and cannot be put in question. The balance of payments cost to the U.S. of these commitments is substantial. Gross expenditures for the stationing of U.S. forces in Europe currently amount to about $1.5 billion annually (a part of which has been offset by European purchases in the U.S.). We are now engaged in a renewed effort to find financially viable ways and means of meeting the security needs of the alliance while engaging with our allies in a continuing re-examination of the needs.

TABLE 11.—*U.S. defense expenditures and receipts entering the international balance of payments*

[In millions of U.S. dollars]

	Fiscal years								
	Expenditures			Receipts [2]			Net		
	1965	1966	1967	1965	1966	1967	1965	1966	1967
Southeast Asia [1]	350	711	1,206	10	13	68	−340	−698	−1,138
Japan	328	392	635	32	28	35	−296	−364	−500
Korea	80	123	171	5	3	3	−75	−120	−168
Western Europe	1,442	1,631	1,645	1,033	761	1,226	−409	−770	−319
Canada	208	181	220	62	73	41	−146	−108	−179
Other/undistributed	392	414	432	180	321	397	−212	−93	−35
Total	2,800	3,352	4,100	1,322	1,190	1,770	−1,478	−2,163	−2,339

[1] Republic of China, Philippine Islands, Ryukyu Islands, Thailand, and South Vietnam.

[2] Receipts include primarily (1) cash receipts from sales of goods and services through the Department of Defense and (2) barter. Data exclude receipts for military equipment procured through commercial U.S. sources except where covered by government-to-government agreements and data are curently available.

Source: Department of Defense.

After consultation in NATO, the U.S. has made arrangements for redeploying about 35,000 U.S. military personnel from *Germany in 1968.* These forces will be based in the U.S. but will remain earmarked for use in Germany and will return there at regular intervals for training. This plan will also permit a reduction in the number of the Defense Department's foreign employees in Germany.

The Defense Department report contained in Tab B describes the U.S. military sales program, which was primarily responsible for

increasing our receipts worldwide from $300 million in FY 1961 to $1.6 billion in FY 1967. *Most of those sales were to our NATO allies.* For six years, until last June, we had a series of "military offset agreements" with Germany under which the German Government undertook to buy from the U.S. military equipment and services costing an amount which offset the bulk of our defense expenditures in Germany. The German Government did not renew the agreements for the period after June 1967 but expects to continue major purchases in the U.S., although advance payments under the offset agreements (of which substantial amounts remain on deposit as of year-end 1967) will reduce our new receipts over the near term. During FY 1968 the German Bundesbank agreed to invest $500 million in nonmarketable U.S. Treasury securities. This investment counts as a long-term capital inflow, reducing our payments deficit. It does not fully offset our expenditures in Germany.

Despite our offset agreement with Germany, the EEC countries gained an average of over $300 million annually over the 1961–65 period from military transactions with the United States. In the absence of any neutralization arrangements, this figure will jump to nearly $1 billion annually, beginning in July 1968.

The importance of neutralizing these costs was stressed by Secretary of State Rusk and Deputy Secretary of Defense Nitze at the NATO Ministerial Meeting on December 12, 1967. In a formal statement in behalf of Secretary of Defense McNamara, the latter said:

> "We will, therefore, continue to maintain forces in Europe for as long as they are desired. In saying this, however, I must also point out an anomaly in European attitudes which cannot persist. This is that on the one hand there should be no diminution of U.S. forces, but that on the other hand the responsibility for meeting the balance of payments deficit caused by such large-scale continuing U.S. deployments in Europe is none of Europe's affair. It is essential that deficits suffered by countries as a result of their stationing troops abroad in the common effort should be treated and solved by their allies on a cooperative basis. We would welcome suggestions from our allies on how to meet this pressing problem, since its solution cannot be further postponed."

The United States intends to renew negotiations promptly with Germany and with other European countries where the U.S. has large military expenditures. We propose to explore ways and means of broadening our bilateral neutralization agreements into multilateral arrangements of a long-lasting character.

The economies we have made as a result of the move from France and those which will follow the redeployment of about 35,000 additional military personnel from Europe in 1968 are together expected to reduce our balance of payments costs on military account in Europe

by over $125 million a year. Nevertheless, the remaining balance of payments costs incurred as a result of large-scale deployments of U.S. forces in Europe are still substantial. We have made it clear to our allies that we consider it essential that deficits suffered by countries as a result of stationing troops abroad in the common effort should be treated and solved by the allies on a cooperative basis.

In addition to the other steps being taken to reduce the balance of payments costs of our military effort, the *Secretary of Defense has been instructed to find ways to reduce further the foreign exchange impact of personal spending in Europe by Defense personnel and dependents.*

3. *East Asia.* The mounting foreign exchange costs of our vital military actions in Vietnam have brought to the front the question of dynamic and viable financial relationships in that area of the world—both currently and when the fighting stops. The direct balance of payments costs attributable to our security efforts in Southeast Asia began to increase in 1965. By calendar year 1967 the increase totaled $1.5 billion per annum (excluding indirect effects). But even before Vietnam, U.S. military costs in Asia were not insignificant.

We must intensify our efforts to reduce the impact of the foreign exchange costs of security operations in Asia—both now and after the fighting ends. We have already begun, in a number of countries, to encourage investment of official reserves—climbing dramatically in many instances because of U.S. military spending—in longer-term investments in the United States. This is mutually beneficial—helpful to the developing countries in putting aside a reserve for the future and helpful to the United States, which is now bearing heavy foreign exchange costs in the area. As experience in Europe has taught us, this is but one of a number of possible neutralization techniques. Very clearly, more needs to be done in Asia to neutralize U.S. balance of payments costs incurred in the common defense. More is being done, and can be done without detriment to economic development of the countries of East Asia.

The joint communique by President Johnson and His Excellency Prime Minister Sato of Japan on November 15, 1967, included an agreement:

> "* * * to enhance the usefulness of the joint United States-Japan Committee on Trade and Economic Affairs by establishing at an early date a subcommittee. This subcommittee will be a forum for consultation on economic and financial matters of importance to both countries, including the short- and longer-range balance of payments problems of the two countries."

The first meeting of the subcommittee is scheduled for late January 1968.

C. Aid

1. *Bilateral.* We cannot expect to strengthen our balance of payments at the expense of the less-developed world. It is in our economic interest and in the world's economic interest to assist this vast group of nations with its vast potential for expanded world trade, output and employment, or world insecurity, hopeless poverty and frustration.

We seek to assist the less-developed nations toward a better life, but we seek to do it in a way that transfers primarily *real resources when we are in balance of payments difficulties and emphasize both real and financial resources when we are in balance of payments surplus.*

Our efforts in the past have been directed to two main areas:

—increasingly to tie bilateral foreign assistance to the financing of United States goods and services; and

—to have the other financially powerful countries of the Free World increase their assistance to the less-developed countries.

The fact that our agricultural sales program and the operations of the Export-Import Bank involve U.S. exports is well recognized. The AID story is less well recognized—its role of assisting others while on an increasing scale supplying U.S. goods in ways that minimize any adverse balance of payments impact.

In most of the 1950's, U.S. bilateral assistance was open to international competitive bidding. Increasingly, this resulted in U.S. financing of procurement in other industrial countries which have recovered from the war and become increasingly competitive. While we were seeking to help the economically "have-not" nations, our help was hurting the dollar and adding to potential calls on our gold. This was inconsistent with our own and the world's balance of payments situation. By 1959 only 40 percent of our bilateral aid dollars were being spent on U.S. goods and services. At that time moves were started to place tighter limitations on the U.S. policy of worldwide procurement. Tying procedures have been strengthened over time.

Today, AID funds are spent primarily in the United States for goods and services procured in this country. Ninety-two percent of total AID expenditures will be spent in the United States. Of AID's total expenditures for commodity assistance, 96 percent will be for procurement of U.S. goods. Successive tightening of AID activities as part of our balance of payments program leaves only a few elements not specifically tied to U.S. goods and services—salaries and payments to AID overseas personnel and contractors, only a part of which is spent abroad, strictly limited offshore procurement, and AID's contribution to the multilateral Foreign Exchange Operations Fund in Laos and parts of some grants to overseas educational institutions.

On a balance of payments accounting basis AID's offshore expenditures were over $900 million in FY 1961 and $800 million in 1963.

The balance of payments directive was to reduce its offshore expenditures to not more than $500 million by FY 1965. The target was more than met. Despite a greatly expanded economic aid program for Vietnam, offshore expenditures were held to the target in FY 1966. As a result of AID's further tightening of tied procurement regulations, offshore expenditures are estimated at $290 million in FY 1967 and at $200 million in FY 1968. These figures do not take into account the repayments on loans made by AID and its predecessors.

The President, on January 11, 1968, directed that the foreign exchange costs of AID's activities be reduced by at least $100 million in calendar year 1968 below the calendar 1967 level. The Agency will attempt to reduce its overseas expenditures to less than $170 million by further restricting dollar payments for staff and services abroad and confining virtually all financial and commodity assistance to tied or barter-type procurement.

Now that our bilateral assistance program is almost completely tied, *we are working to make sure that this assistance results in truly additional transfers of U.S. goods and services* to the developing countries. This new effort to assure "*additionality*"—to assure that these exports are additional and that this assistance does not substitute for sales that the U.S. would have made on a commercial basis—has important long-range potential for our balance of payments. When an aid-receiving country buys U.S. goods financed by AID under a tying arrangement, it may be buying goods that it would otherwise have bought with dollars it already owns. Such dollars—free foreign exchange—can be used for purchases and payments either in the U.S. or elsewhere. *Tying procurement to U.S. sources may not itself be enough to reduce to the extent necessary the impact of the AID program on the balance of payments.*

To meet this potential balance of payments problem, a special task force of the Cabinet Committee on Balance of Payments has been formed to work with AID in a program to assure "additionality" of exports in our aid program. "Additionality Teams" have now visited a number of major aid-receiving countries. AID has begun to explore measures to ensure that AID-financed exports will be additional. This is an ongoing effort that must be pursued diligently. As part of this effort, AID has included U.S. export promotion as a factor—although necessarily not the dominant one—in selecting capital projects. Attention is being paid to the selection of projects and goods that have a greater potential for "follow on" orders. U.S. Embassy commercial staffs in the more important aid-receiving countries are being strengthened with this purpose in mind.

This new program cannot succeed by Government efforts alone. U.S. industry and trade must play their role. In too many cases in too many developing countries our businessmen have not actively sought to

establish the trade ties so essential in the international competition for new markets. *The export expansion program of the Department of Commerce outlined earlier has an important role to play here* and *must be coordinated* with the effort for "additionality."

2. *Multilateral.* In the field of the multilateral development finance institutions, new efforts have been made to assure the compatibility of our participation with our balance of payments policies. While these efforts have balance of payments improvement as an objective, they also seek to strengthen these institutions and fully preserve their multilateral character. The principles involve:

—improve burden-sharing, by capital exporting countries in their contributions and by developing countries in their self-help efforts.

—improved access of the development finance institutions to wider and more diversified world capital markets.

—mitigating the impact on our balance of payments when access to our own capital market is necessary.

—providing safeguards not only for receiving countries, but for contributing countries that may, from time to time, be in balance of payments difficulties themselves when long-term advance pledges are turned into requirements for payments.

—emphasizing contributions that take the form of goods and services when contributing countries find themselves in balance of payments difficulties and in the form of finance when countries are in surplus.

—more generally, seeking to insure that development finance more actively contributes to the international payments adjustment process while the aggregrate level of development assistance, which for too long has been on an international plateau, is significantly increased.

As stated earlier, the determination of a nation's "fair share" of economic—or military—assistance is no simple matter. Years ago, as the other industrial countries regained economic strength, it became clear that the time had come to decrease reliance on a single country. This issue can no longer be resolved solely by relating the size of a given country's contribution to the size of its gross national product. The form in which a donor provides aid, the terms of its aid and its international liquidity position must be taken into account.

The overall effect of the *World Bank* operations has been a substantial positive factor to the U.S. balance of payments. In its own interest as a multilateral institution and with some urging by the U.S., it has energetically sought to raise capital on other markets. More than half of its funded debt is now held outside the United States. Nevertheless, in the face of its increased requirements for capital and still relatively underdeveloped capital markets abroad, access to the U.S. bond

market has from time to time been approved. In each of these instances in recent years the proceeds of these bond issues were reinvested in the United States in a manner that neutralized, at least for a time, any impact on our balance of payments.

The *Inter-American Development Bank* has acted in the same fashion. It has raised substantial money abroad even under the handicap of going to nonmember country markets, and it has invested the proceeds of its U.S. borrowings in ways compatible with our balance of payments policies. It has recently taken further measures to attract nonmember capital by limiting procurement under its loans in accord with the financing that nonmembers make available on appropriate terms.

The *International Development Association*, affiliated with the World Bank, is in urgent need of replenishment. Other nations have shared with us to the extent of about $1.50 for every $1 we have contributed in meeting this need. Pursuant to President Johnson's directive, the Secretary of the Treasury has indicated our readiness to participate in a substantial replenishment which must include adequate balance of payments safeguards.

The newly-established *Asian Development Bank* has been characterized by burden-sharing in the fullest sense. Here 20 percent of the capital was provided by the United States and the rest by Japan, other regional donors, Canada, and Western Europe. The President has responded to a further Asian initiative with a request to the Congress to join with others in supplying special funds for concessionary lending by the Bank. In this case the balance of payments will be protected and the U.S. funds will be used only for procurement in the United States. It is in these ways—ways compatible with the realities of international finance—that the U.S. hopes to join with others in meeting the urgent needs of development of those economically less fortunate.

D. Other Departments and Agencies

In order to assure that all activities—not only the key military and aid activities—are brought into balance of payments focus, the overseas disbursements of all departments of Government have been brought under special review and control by the Director of the Bureau of the Budget. The review and control mechanism is called the Gold Budget. Increasingly vigorous screening of expenditures abroad by these other Federal departments and agencies must be continued if the Government is to play its full role in moderating the exchange costs of its own expenditures abroad.

The financial scope of the Gold Budget is large, roughly $10 billion, taking receipts and expenditures together. The range of activ-

itics covered is very wide, from defense outlays to Post Office receipts and expenditures on international mail activities, from overseas payments on the public debt to the cost of operating overseas tracking stations by NASA for space flight missions.

The figures for any agency do not necessarily reveal the scope of the effort to achieve foreign exchange savings. Real foreign exchange savings in some cases have been offset by rising prices abroad which have raised the cost of ongoing programs.

The State Department, whose Gold Budget expenditures in FY 1967 totaled $265 million compared with $280 million in FY 1963, has undertaken a variety of actions to cut foreign exchange outlays, including:

—purchase of goods in the U.S. for use overseas, at costs up to 50 percent greater than those abroad;

—use of U.S. flag carriers to the largest extent possible for travel by Department personnel;

—consolidation of overseas posts, elimination of overseas positions, maximal use of U.S. postage for diplomatic pouch mail, and relocation of some courier operations in the U.S.

Despite the narrow margin for reductions, and the continually increasing costs of operation, overseas costs are now below the 1963 levels. The search for additional savings continues.

The United States Information Agency has striven for savings by centralizing operations and procurement where possible in countries where the U.S. Government holds local currencies in excess or near-excess of its needs and by increasing procurement of other goods in the U.S. Consolidation of some overseas operations and their removal to the U.S. are now under consideration.

The Atomic Energy Commission's expenditures abroad reflect purchases of uranium. Such purchases are being phased out entirely.

The Department of Agriculture spends money abroad for development of foreign markets for American foodstuffs, research activities, and payments to foreign-flag vessels to ship agricultural exports. Expenditures for foreign vessels reflected the shortage of U.S. shipping because of Vietnam supply needs. To the maximum extent possible, Agriculture uses excess U.S. holdings of foreign currencies to minimize the balance of payments costs of its activities.

As is well-known, the United States owns amounts of local currency in excess of its needs in a handful of less-developed countries. These holdings have resulted from sales, for local currency, of surplus agricultural products. While the use of these local currencies *has helped us save dollars in a number of instances*—where we could use the currencies in question in lieu of dollars—we have not been

able to utilize all of the currencies acquired. The accumulation of large holdings of other countries' currencies clearly presents a variety of problems. Under the Food for Freedom Act of 1967, we are moving away from agricultural sales for local currency. The act calls for a transition to *dollar* sales over a five-year period, except to the extent that the United States needs local currencies for its own uses, for mutual defense, or for "Cooley" loans.

Table 12 summarizes on the basis of our published overall balance of payments accounts, the identifiable impact of all of the foregoing Government transactions. Comparing the results for calendar year 1966 with 1960 levels:

—Net military expenditures had by 1964 been reduced by $850 million; and, despite the subsequent increase of nearly $1 billion in Southeast Asia related expenditures, net expenditures worldwide for 1966 did not exceed the 1960 level. In other words, apart from the Southeast Asia increase, net military expenditures in 1966 were down nearly $1 billion, or more than one-third, from the 1960 rate.

—Net dollar outflows from all types of U.S. Government grants and credits (excluding, that is, the "tied" outlays serving to finance U.S. exports and other receipts from foreigners) had also been reduced by more than one-third, from $1.1 billion to about $700 million per year.

—The balance of all other Government transactions appearing in the overall balance of payments accounts, while fluctuating widely from one year to another due largely to variations in special capital receipts, has generally shown some surplus. In 1966 this surplus was a little over $200 million, up slightly from that in 1960.

The performance in holding down the foreign exchange costs of all our Government programs during the decade of the 1960's has been good, particularly when the burden of Vietnam is taken into account.

Nevertheless, we should make sure that further savings are obtained. We cannot let up on our efforts in this important area, for unless we can demonstrate conclusively that we are doing everything in our power to limit Government balance of payments costs, we cannot expect continuation of the fine cooperation received to date from the private sector in its efforts to help us solve our balance of payments problem. The Gold Budget will be a key instrument to insure that no stone is left unturned in finding areas where further savings can be made on Government account—both now and after the end of hostilities in Vietnam.

TABLE 12.—*U.S. Government transactions which appear in balance of payments accounts*

[Billions of dollars; by calendar years]

	1960	1961	1962	1963	1964	1965	1966
Military expenditures [1]	−3.1	−3.0	−3.1	−2.9	−2.9	−2.9	−3.7
Military cash receipts [1]	0.3	0.4	1.1	1.0	1.0	1.1	0.9
Net military	−2.7	−2.6	−1.9	−2.0	−1.9	−1.8	−2.7
Excluding increased expenditures related to Southeast Asia [2]	....	....	....	....	....	(−1.6)	(−1.8)
Gross grant & capital outlays not retained within Government sector [3]	−3.2	−3.8	−3.9	−4.1	−3.9	−4.0	−4.3
Excluding "tied" outlays to finance U.S. exports & other private-sector receipts	(−1.1)	(−1.1)	(−1.0)	(−0.8)	(−0.7)	(−0.7)	(−0.7)
Net operational costs and receipts of other Government programs and activities [4]	−0.2	−0.3	−0.3	−0.3	−0.4	−0.4	−0.5
Net "operational" costs	−6.2	−6.7	−6.2	−6.4	−6.2	−6.2	−7.6
Excluding "tied" grants and capital & Southeast Asia military increases	(−4.1)	(−4.0)	(−3.8)	(−3.1)	(−3.0)	(−2.7)	(−3.0)
Government payments of interest and pensions	−0.5	−0.5	−0.6	−0.7	−0.7	−0.9	−0.9
Receipts of interest and cash amortization on Government credits [5]	0.9	0.9	1.0	1.0	0.9	1.0	1.2
Special Government capital receipts, net [6]	0.1	0.7	0.9	0.3	0.3	0.2	0.0
Net Government sector	−5.8	−5.6	−4.9	−5.9	−5.8	−5.9	−6.9
Excluding "tied" grants and capital	(−3.7)	(−3.0)	(−2.0)	(−2.5)	(−2.5)	(−2.6)	(−3.2)
Excluding also Southeast Asia military-expenditure increases	....	....	....	....	....	(−2.3)	(−2.3)

[1] Expenditure and cash receipts data are as published by Commerce Department in balance-of-payments accounts. They differ from Defense Department data by excluding (i.e., shifting from military to other entries): (1) on payments side, small amounts of retired pay, claims, grants, and net changes in foreign-currency balances purchased with dollars; and (2) on receipts side, certain military sales through commercial channels and barter sales.

[2] Measured from calendar year 1964 level.

[3] Differs from gross outlays shown in Table 6 by excluding that part of "tied" outlays used to finance military-sales contracts and other Government-sector receipts.

[4] Represents total Government payments for miscellaneous services, less estimated one-half of government sales of such services not financed by "tied" grant and capital outlays.

[5] Excludes non-scheduled repayments and those financed by new Government credits.

[6] Includes non-scheduled repayments on Government credits plus Government nonliquid liabilities not associated with military-sales contracts or grant and capital outlays.

NOTE.—Detail may not add to totals due to rounding.

Source: Derived from Department of Commerce data.

TAB C

AID and the Balance of Payments

During the Marshall Plan and most of the 1950's, aid appropriations were generally spent wherever prices were lowest. For the first few years after the war, the United States was the only major source of most of the goods needed by aid recipients. Consequently, most aid dollars were spent in this country even though they were not tied to U.S. procurement.

This situation changed as the revived European economies became increasingly effective competitors for U.S. aid purchases. By 1959 only 40% of our aid dollars were being spent on U.S. goods and services.

Beginning in 1959, in order to improve the U.S. balance of payments we began to limit our policy of worldwide procurement. Today, funds are spent primarily in the United States for goods and services procured in this country. The only significant elements in the A.I.D. program not specifically tied to U.S. goods and services are salaries and payments to A.I.D. overseas personnel and contractors (only part of which is spent abroad) and limited offshore procurement for A.I.D. administrative purposes.

In FY 1968, the U.S. share of total A.I.D. expenditures is expected to reach 92%, with 96% of commodity expenditures being made in the United States. The net impact of the A.I.D. program on the balance of payments in FY 1968, after allowing for repayments of principal and interest, is estimated at close to zero, as compared to $934 million in FY 1961.

This change has been brought about by the aggressive steps which A.I.D. has taken in recent years to minimize the balance of payments costs of its programs. These steps fall into three general categories—(a) expansion of A.I.D.'s tied procurement regulations; (b) measures to improve U.S. export additionality, both in the context of A.I.D. programs and generally; and (c) use of local currencies.

Tightening of Tied Procurement Regulations

Loan Financing. To assure that A.I.D. funds are used for the purchase of goods and services in the United States, A.I.D. has progressively tied *all* loans to U.S. procurement. Exceptions are possible only if waivers are approved by interagency committees and signed by the A.I.D. Administrator. There are no current exceptions.

Grant Financing. Virtually all grant procurement is also tied to U.S. goods and services—procurement is limited to the United States and eight Asian and African less-developed countries. These commodities are paid for in local currencies. But arrangements are made to purchase in the United States a dollar-equivalent amount of U.S. goods under Special Letters of Credit. These arrangements are used almost exclusively for security-related foreign procurement for Vietnam and are estimated at about $70 million in FY 1967.

Local Cost Financing. In some instances, A.I.D. pays part of the local costs of A.I.D.-financed projects. In countries where the United States does not already have available local currency in excess of U.S. requirements, dollars must be used to obtain the local currency to cover any project costs which A.I.D. may finance. Since 1963, A.I.D. has moved progressively to tie these dollars to U.S. procurement by using Special Letters of Credit good only in payment of goods and services originating in the United States.

There are only three elements of the A.I.D. program, then, which still have a significant impact on our balance of payments:

1. *Salaries and other payments to A.I.D. overseas direct-hire personnel and contractors.* A.I.D. direct-hire personnel and contractors working overseas have to spend money for living expenses and other local costs. Their salaries and payments cannot, of course, be tied to U.S. procurement, but only part of these funds is spent abroad. The estimate for the FY 1968 program is about $99 million. Little can be done to reduce this amount materially, although A.I.D. is continuing efforts to increase the use of local currencies where they are available.

2. *Minimum foreign procurement for A.I.D. administrative expenses.* A very small amount of A.I.D. funds ($7 million of FY 1968 funds) is used to make local purchases of items necessary for administration of the program which cannot be imported from the United States. Here again, available local currencies are used whenever possible.

3. *Cash grants.* These are still being made in situations where it has been difficult to substitute U.S. goods and services. The item has been reduced drastically in recent years until it includes only the multilateral Foreign Exchange Operations Fund in Laos (about $13 million) and parts of some grants to overseas educational institutions.

A.I.D.'s Expenditures as Measured by the "Accounting" Method. One way to measure the impact of A.I.D.'s expenditures on the balance of payments—the way used by the Department of Commerce in preparing its balance of payments figures and which might be called the "Accounting" approach—is to look at the direct result of A.I.D. spending. To what extent are aid dollars spent directly in this country, and to what extent are they spent abroad or paid to an international organization? To what extent are offshore expenditures offset by

repayments to the United States of principal and interest on prior-year loans?

In FY 1963 A.I.D.'s offshore expenditures totaled $799 million, including all contributions to the UN and other international organizations and before making an allowance for offsetting expenditures by these organizations in the United States. In that year the Agency made a commitment as part of the U.S. balance of payments program to reduce its offshore expenditures to not more than $500 million by FY 1965. That goal was reached. In FY 1965 they were about $411 million. Despite the greatly expanded Vietnam program, offshore expenditures were held to $503 million in FY 1966. As a result of A.I.D.'s further tightening of tied procurement regulations, there was a further reduction in offshore expenditures of $100 million between FY 1966 and FY 1967. It also became apparent that A.I.D. and the State Department's contributions to international organizations should not be treated as "offshore" expenditures since they were more than offset by the spending of these same organizations in the U.S.[1]

The currently estimated offshore expenditures in FY 1967, therefore, are $290 million, after allowing for international organization offsets up to the amount of the U.S. contribution. The projected figure for FY 1968 is $201 million.[2]

These offshore figures are on a *gross* basis. They do not take into account the fact that each year the United States receives payments on loans made by A. I. D. and its predecessors. Such payments totaled $173 million in FY 1965 and $184 million in FY 1966, and are estimated at $208 million and $215 million, respectively, in FY 1967 and FY 1968.

In percentage terms, total A.I.D. expenditures for goods and services in the United States rose from 41% in FY 1961 to about 80% in FY 1966. For FY 1967 this percentage was about 84% and for FY 1968 is expected to reach 92%.

Calculated on the basis of expenditures which will result from current commitments, rather than on the basis of current expenditures (made in part as a result of prior-year commitments), total A.I.D. funds recorded as spent in the United States have risen to over 90%, a level which cannot be increased significantly.

The dramatic rise in the proportion of recorded A.I.D. expenditures in the United States is even more apparent when expenditures for commodities alone are examined. A.I.D. expenditures for commodities

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[1] The classic example was that of the Indus Basin Development Fund. The U.S. was contributing 44% of the foreign exchange needed by the IBRD to finance the construction of the Indus Basin projects. The entire amount of the U.S. contribution, under the old procedures, was being counted as a drain on the U.S. balance of payments, even though 54% of the foreign exchange costs of the contracts under the Indus Basin Fund had been let to U.S. firms for construction or consultant activities.

[2] If international organization contributions were still treated as 100% offshore disbursements, these last two figures would have been $403 million for FY 1967 and $325 million for FY 1968.

purchased domestically rose from 44% in FY 1961 to about 90% in FY 1966. A.I.D. commodity expenditures currently being made in the United States are now above 90% and are expected to rise to about 96% in FY 1968 as tightened A.I.D. procurement measures take effect and remaining expenditures from prior-year commitments are liquidated.

This improvement in aid-tying has not, of course, been achieved without cost. Individual commodities financed by A.I.D. and, therefore, produced in the United States, may cost an aid recipient more—including higher transportation costs—than if they were bought elsewhere at world market prices.

Ensuring Additionality of U.S. Exports

The true economic effect on the balance of payments of the A.I.D. program (or of any other program involving overseas expenditures) cannot be determined as simply as the "accounting" method suggests. There are indirect effects not revealed by the direct accounts.

Many dollars contributed under the A.I.D. program to multilateral agencies, for example, come back through regular commercial channels for purchases of U.S. goods. Also, dollars which go out and enter the economy of a less-developed country may later be used by that country to buy needed goods in the U.S. market. Or, they may go through trade channels to a third country which will use them to purchase goods here.

These are examples of the so-called "feedback" or "re-flow" which comes from overseas spending. They demonstrate that the "accounting" method overstates the effect of aid outflows on the U.S. balance of payments, because the outflows are to a considerable extent soon reflected in increased U.S. export sales.

But there is another indirect effect in the opposite direction. When an aid recipient buys U.S. goods financed by A.I.D. under a tying arrangement, it may be buying goods that it would otherwise have bought with dollars it already owns. The latter dollars—free foreign exchange—can then be used for other purchases either in the United States or elsewhere. When purchases are made elsewhere, the U.S. balance of payments may be adversely affected, although (because of the respending effect) not necessarily by the full amount of third-country purchases.

This is the so-called "substitution" effect, meaning that A.I.D.-financed purchases are sometimes substituted for purchases that would otherwise have been made with "free dollars." To the extent that this takes place, the "accounting" method understates the adverse effect of the A.I.D. program on the balance of payments.

Simply tying procurement to U.S. sources may not, therefore, be fully effective in reducing the impact of the A.I.D. program on the balance of payments. Having already gone about as far as possible in

tying procurement to U.S. goods and services, A.I.D. has undertaken a wide variety of measures to ensure that A.I.D.-financed exports will be additional to, rather than a substitute for, exports that would have occurred without A.I.D. financing. A.I.D. has included U.S. export promotion as an important factor in selecting capital projects and commodities for A.I.D. financing and has stressed in other ways the urgent necessity of minimizing the impact of A.I.D. programs on the U.S. balance of payments. Moreover, U.S. Embassy commercial staffs in the more important aid-recipient countries have been or are being strengthened.

Project and Commodity Selection Criteria. A.I.D. is paying increasingly close attention to balance of payments considerations in selecting projects and commodities which it will or will not finance:

—A.I.D. is placing greater emphasis on projects and products which will ensure not only immediate U.S. exports but also "follow on" orders for such items as spare parts or specialized intermediate materials.

—A.I.D. also has limitations on financing projects which will compete with U.S. exports.

—Another device A.I.D. uses is to refuse to finance items, such as spare parts or goods in which the United States is strongly competitive, which a recipient will buy from the United States in any event since they are available at reasonable cost only in this country.

—Still another method is to limit the list of goods eligible for A.I.D. financing to those in which the United States does not have a price advantage.

Other Measures to Increase Additionality. It has also been possible in a number of cases for host governments to make A.I.D.-financed loans less costly or otherwise more attractive to importers through surcharge reductions or elimination; waiver of prior import deposits; or favorable terms for bank credit. Other more established A.I.D. procedures include general ineligibility of commodities of which the United States is a net importer (*e.g.* POL) for A.I.D. dollar financing and tightened provisions covering the application of 50/50 shipping regulations, commodity import component value rules, and rules concerning contractor services.

In addition, A.I.D. Missions are taking a number of steps to make sure that information about U.S. exports is made available, for example:

—officials responsible for public and private procurement are being brought to the United States to meet U.S. suppliers;

—an Afro-American Purchasing Center has been set up in New York and special arrangements made with the National Institute of

Governmental Purchasing to improve knowledge and availability of U.S. supplies; and

—the availability of unused Special Letter of Credit dollars in certain African countries is being publicized in *International Commerce.*

General Measures to Increase U.S. Exports. Finally, in addition to these and other measures taken by A.I.D. to reduce the impact of its own program on the balance of payments, discussions have been held with aid recipients about the difficulties of maintaining current assistance levels in the face of the U.S. payments deficit and about ways, in light of the deficit, in which U.S. commercial exports, not financed through the A.I.D. program, may be increased. In several instances A.I.D. has obtained agreement from aid recipients on measures, such as liberalization of exchange or trade restrictions, designed to increase their imports from the United States.

Not only can this approach serve to offset any adverse effect that the A.I.D. program in a particular country may have on the U.S. balance of payments, but it can in some cases result in a positive balance of payments effect flowing from the existence of the A.I.D. program in that country.

Research. A.I.D. is also continuing research into the indirect effects of the program on the balance of payments—the effects which the "accounting" method does not measure. With the results of this research not yet available, it remains difficult to estimate the size of the feedback, substitution and other effects of aid spending. Only indirect evidence is available. With respect to the question of how much substitution occurs, for example, an analysis of U.S. trade figures does not indicate that a drop-off in commercial trade occurs when there is an increase in aid. On the contrary, there is evidence that commercial trade with less-developed countries is increasing even where aid may in some cases be increasing.

The less-developed countries do not, as a rule, increase their foreign exchange reserves, although some of the developed countries do. Nevertheless, looking at the world as one large trading community with an infinite number of rounds of respending or feedbacks, there can be little doubt that the great majority of the dollars spent abroad under the A.I.D. program ultimately come back to the United States.

Clearly, more work needs to be done on this score. Meanwhile, it seems fair to conclude that the indirect economic effects of the A.I.D. program on the balance of payments roughly cancel out. Even allowing for some variation from time to time, the true effect of the program on the balance of payments would probably not differ very much from the figures shown by the "accounting" estimates referred to earlier.

Use of Local Currencies

Increasing stress has been laid on using local currencies derived from the sale of commodity imports—including P.L. 480 imports—in place of dollars. In all countries where a supply of local currencies is available, these are used for any U.S.-financed local costs of dollar-assisted projects, local salaries, housing allowances and the like. In the so-called excess currency countries—where U.S. holdings of local currency greatly exceed U.S. needs—local currency is used instead of dollars not only for local procurement, pay and allowances, but also for such items as international air travel of American technicians and foreign participants, meeting international commitments to the Palestine Refugee Program and the Indus Basin Development Fund, and the support of American-sponsored schools and hospitals abroad.

Source: Agency for International Development.

Senator SMATHERS. May I ask you a question right here?

Did this task force which the President appointed to look into the travel deficit recommend what the administration is proposing today?

Secretary FOWLER. No. It contained its study and its recommendations to those measures that are designed to promote foreign travel to the United States, and did not include a consideration of the dealing with the customers problem, dealing with the ticket tax, dealing with the travel expenditure of Americans traveling abroad. It looked at the one side of the coin.

Senator SMATHERS. May I ask you one other question? You say on page 16 that "expenditures abroad by Americans and expenditures in the United States by foreigners have both been increasing, and, indeed, the latter rate of increase," that is, foreigners traveling in the United States, are increasing at a greater rate even though on a much smaller base. Another one of my simple questions is, if expenditures by foreigners in the United States are increasing at a greater percentage even though on a smaller base than are expenditures abroad by Americans, how does that widen the deficit? It would seem to me that would close it.

Secretary FOWLER. It does; but because the base on which their percentage of increase is so much smaller than our own going the other way, in absolute terms there would be a widening of the deficit.

This is indicated very graphically by the two charts at the bottom of the Chase study. For example, the left-hand chart shows that the growth in travel spending in the United States from Europe has been going at 14 percent whereas the growth in travel outlays abroad from the United States has been 9 percent. But, because of the much smaller base on which the foreign percentage is applied, if you look at this chart over on the lower right hand side of the page, you will see that merely by projecting what has happened in previous years into the future that the deficit continues to widen because the 9 percent of growth, of travel growth fom the United States during this period, is on a much bigger base than travel to the United States.

Senator WILLIAMS. That would be true for a number of years but eventually over a number of years it would narrow the gap.

Secretary FOWLER. I think that would depend on the topic I come to now, Senator Williams.

All the economic and social forces at play within our economy will inevitably lead to more Americans traveling abroad in the future and spending more. First, it is anticipated that disposable income, which is the type of income that one uses for a summer trip abroad, if one is wise, will increase year by year. Thus, even if the percentage of disposable income which is spent on foreign travel remains constant, the year-by-year increase in disposable income will automatically lead to a year-by-year increase in amounts spent on foreign travel.

In fact, however, it is reasonable to expect that the percentage of disposable income spent on foreign travel will also increase, thereby further increasing the foreign travel payments. One factor which leads to this conclusion is the rising level of education in this country which should lead to more and more people wanting to travel to foreign countries for its educational value. Second, as per capita income rises, a larger percentage is available for less essential spending which would undoubtedly include travel. Furthermore, the antici-

pated introduction of airplanes with much larger capacities brings the prospect of lower air fares which should encourage more people to travel abroad.

In other words, the economic and social trends in this country can lead to no other conclusion than that our foreign travel payments will increase year by year. This situation, present and future, presents a problem that cannot be dismissed or laughed off or put under the rug.

The long-term solution to moderating our travel deficit lies in a strong program to encourage travel by foreigners to the United States.

Senator SMATHERS. Mr. Secretary, before you get into that, may I just ask you another question here? What has been the result of the disorders in France with respect to the travel of our citizens to Europe this year? Are they traveling as much this year as they have in previous years?

Secretary FOWLER. The recent disorders in France have been really to recent to make any judgment about their ultimate impact. I have seen press dispatches indicating that there is a sharp fall off currently in travel in Paris and it is clearly being felt. This undoubtedly includes, and it has been noted in the press dispatches that there is, a real perceptible dropoff in the travel by Americans in this country.

I think it is too early to tell what the ultimate outcome would be, but there has been a perceptible impact.

Looking at the year as a whole we frankly get something of a conflicting picture about transatlantic travel in the direction of Europe this year. From some of the figures that are submitted to the International Air Transport Association several of the American-flag carriers have shown some diminution in travel to Europe this year which, I think, can be ascribed to in part the unsettled conditions, and in part to the pleas that have been made and to the general concern about our balance-of-payments problem. There have been some cancellations of air charters originating in the United States. There is some expectation of a decrease in travel this summer as compared to last summer due to these unsettled conditions.

What that will show by the yearend would just be on my part at least a very, very random guess.

I think we should look at this problem not only in current terms but also in longer term consequences, because looking at last year, for example, the increase in our travel expenditures was 17 percent as against the average of 9 percent over the past 6 or 7 years. So, I don't think it would be wise to assume that because of the momentary flurry in difficulties in Western Europe that travel is going to fall off from here to there. One also must take into account that we have had our own difficulties here and that may have some impact on foreigners traveling in the United States.

Senator SMATHERS. I was going to ask you that question, whether or not the riots here and the publicity given to that may not actually result in a decrease of foreign travel here in the United States?

Secretary FOWLER. Yes, sir; for the same reasons that I indicated the other way.

Senator CARLSON. Mr. Chairman, the Secretary has just mentioned the Air Transport Association. This morning they issued a release dated Washington, June 25, on travel, and I shall ask unanimous consent that it be placed in the record, but I want to read two or three

paragraphs. Stuart G. Tipton, president of the Air Transport Association (ATA), said:

On the basis of the downward trend in growth rates, it would appear the Administration's desires to curtail the outward flow of U.S. dollars have been substantially achieved through a voluntary cut back in travel.

"Further actions leading to additional constraints," Tipton added, "would not seem to be called for at this time and would probably weaken further the efforts of the U.S. flag carriers to improve their share of traffic."

Tipton said the declining growth rate was shown in an industry study covering the first five months of 1968. According to the study, 1,345,326 passengers were carried across the North Atlantic (both directions) on scheduled flights by airlines belonging to the International Air Transport Association (IATA).

Although this was a gain, as the Secretary has mentioned, of 6.9 percent over the same period in 1967, it is only slightly more than half the 13.6 percent growth rate experienced in 1967 over the comparable period in 1966, and substantially below the 18.7 percent growth registered for the same months 1966 over 1965.

I mention this because there seems to be, while there has been a 6.9-percent growth, it is substantially below the growth we have had in 1967, 1966, and 1965, and on that basis, we haven't done too well as far as expanding our travel has been reduced.

(The press release referred to follows:)

AIR TRANSPORT ASSOCIATION OF AMERICA,
Washington, D.C.

(For immediate release)

DECLINING GROWTH RATE IN TRANSATLANTIC AIR TRAVEL CURBS DOLLAR OUTFLOW—AIRLINES SPOKESMAN SEES FURTHER RESTRAINTS HARMFUL TO U.S. CARRIERS

WASHINGTON, June 25.—Proposals to curb travel abroad by U.S. citizens as a partial solution to the gold flow problem are being reflected in a declining growth rate so far this year in air travel over the North Atlantic, a leading airlines spokesman said today.

Stuart G. Tipton, president of the Air Transport Association (ATA), said: "On the basis of the downward trend in growth rates, it would appear the Administration's desires to curtail the outward flow of U.S. dollars have been substantially achieved through a voluntary cut back in travel.

"Further actions leading to additional constraints," Tipton added, "would not seem to be called for at this time and would probably weaken further the efforts of the U.S. flag carriers to improve their share of the traffic."

Tipton said the declining growth rate was shown in an industry study covering the first five months of 1968. According to the study, 1,345,326 passengers were carried across the North Atlantic (both directions) on scheduled flights by airlines belonging to the International Air Transport Association (IATA).

Although this was a gain of 6.9 per cent over the same period in 1967, it is only slightly more than half the 13.6 per cent growth rate experienced in 1967 over the comparable period in 1966, and substantially below the 18.7 per cent growth registered for the same months 1966 over 1965.

The study found that February has been the only month so far this year in which growth in IATA traffic (19.3 per cent) exceeded growth rates over comparable months in 1967 and 1966. February, however, had an extra day because of Leap Year and there was some traffic stimulus from the Winter Olympics in Grenoble.

The study found a steady decline in the rate of growth in IATA traffic from March onward, culminating in the carriage of 3.3 per cent fewer Trans-Atlantic passengers in May 1968 than in May of 1967. The study reported that May results were influenced by civil disorders in France and curtailment of Air France Trans-Atlantic services in the latter half of this montth. As a result, the foreign flag carriers, as a group, experienced a 7 per cent decline in May 1968 traffic, over May of last year.

The growth rate in North Atlantic traffic for U.S. carriers as a group was about the same in the first six months of 1968 as in the first six months of 1967, 8 per cent versus 8.1. But the study found that the monthly trend for the U.S.

carrier group has been sharply downward—2.7 per cent in April, for example, and 1.4 in May. The study reported that the downward trend in May would have been even more severe had it not been for the substantial diversion gains from Air France traffic.

The study reported only a negligible shift in the ratio of passengers using U.S. flag versus foreign flag carriers. Through May, 43.4 per cent of the passengers traveled on U.S. flag carriers, compared with 43 per cent in the first five months of 1967 and 45.2 per cent in the first six months of 1966.

Commenting on the trends reflected in the study, Tipton said; "As each month passed, it has been necessary to scale down forecasts on a late recovery surge in summer travel abroad which would reflect deferred but not cancelled vacation plans. Were it not for the Air France traffic diversion in May and the BOAC pilots' strike which will also shift foreign flag traffic to U.S. flag carriers, the situation would be more critical."

Secretary FOWLER. Senator Carlson, I want to make one comment on that; one swallow doesn't make a spring and I doubt very much that even our air carriers in projecting their long-term prospects are not counting in terms of ordering equipment and placing equipment orders and what not on a continuing expansion in this movement somewhat along the pattern previously projected and shown here in this Chase Manhattan Bank study of around 9 percent per year, which I think has been the overall average in recent years. It ebbs and flows; there is no question about that.

A task force under Ambassador McKinney has examined ways to achieve this goal and has made a series of recommendations, some of which are already in effect. This represents a significant step toward a long-term solution.

It cannot be expected, however, that travel by foreigners to the United States will serve to moderate sufficiently the projected U.S. foreign payments abroad, at least over the near future while the recommendations of the travel task force are being put into effect and their results assessed. The major problem is that the present disposable income base from which travel by foreigners can be financed is much smaller than the U.S. disposable income base from which our foreign travel is financed. Moreover, there are fewer Europeans than Americans with sufficient income to finance travel overseas.

If one looks at the principal travel expenditure potential as located in people with incomes over $10,000, there are about five times as many of these travel spenders in the United States as there are in the principal countries of Western Europe.

Moreover, for 1965, U.S. disposable income was about $470 billion, while the disposable income of the major Western European countries was around $275 billion. Thus, even though some Europeans may put a heavier emphasis on travel in their budget priorities than do Americans, and even if there were an immediate significant increase in the percentage of disposable income spent by Europeans in travel to the United States, the absolute dollar gap between their spending in the United States and our spending could still grow over the short run. Therefore, remedial measures of a less pleasant and a more restraining nature are necessary.

The travel program which we proposed to the House Ways and Means Committee contained three elements:

1. Permanent elimination of the exemption of international flights from the 5-percent tax on airline tickets.

2. Permanent reductions in the duty-free allowance for articles brought into the United States by returning travelers and for gifts sent by mail.

3. A temporary tax based on expenditures made by travelers abroad.

The bill before you, H.R. 16241, essentially carries out the first two of these recommendations but contains no provisions regarding the third.

Our total travel program was estimated to yield an improvement in our travel deficit of $500 million. The legislation before you, it is estimated, will improve our balance-of-payments position by $140 million, less than a third of the needed $500 million. As I have already indicated there has been no lessening in the need for a savings nearer the proposed $500 million level. Therefore, I urge your committee to add to H.R. 16241 a tax, along the general lines we have proposed, to restrain spending in connection with foreign travel.

Members of the committee, the proposal I am going to make here now is somewhat different in its character from the one made publicly to the House Ways and Means Committee in February. It is the result of our assessment of the situation in executive sessions with the House Ways and Means Committee during much of February and March, and our own further reflection on the comments and criticisms that have been made since the original proposals were advanced.

More specifically, we propose that a progressive tax be imposed on foreign travel expenditures. Under the rate schedule, the first $15 per day of expenditures, computed on an average basis over the entire trip would be exempt from tax.

The CHAIRMAN. Mr. Secretary, what page are you on?

Secretary FOWLER. Page 22.

The CHAIRMAN. Thank you.

Secretary FOWLER. The total of expenditures in excess of that basic exemption would be taxed at a 30-percent rate. The tax is structured in this manner in order to achieve the necessary balance-of-payments effect by encouraging travelers to keep their spending to a modest level rather than to cancel their trips. In this way it offers the greatest opportunity for foreign exchange savings with the minimum interference with travel.

This proposal differs in only one major respect from that which we presented to the Ways and Means Committee. Under our original proposal, only the first $7 of average daily expenditure would have been completely exempt from tax; the next $8 would have been taxed at a 15-percent rate and the excess at the 30-percent rate. Thus, while practically all travelers would have been subject to at least some tax, it would have been very modest for those who traveled modestly and generally would not have required people to cancel their trips.

Senator SMATHERS. Mr. Secretary, what is the difference in savings, if any, between your recommendation to the House and the recommendation that you make to us now?

Secretary FOWLER. The recommendation made to the House, I am going to give you figures which combine the savings with the ticket tax——

Senator SMATHERS. Yes.

Secretary FOWLER. The 5-percent ticket tax. The savings under the package we recommended to the House would have been about $250 to $300 million, and under the recommendation posted here today it would be between $165 and $190 million.

The CHAIRMAN. Let me see if I understand the difference between the two now. You are now proposing that there be a complete exemption on the first $15 per day of expenditures?

Secretary FOWLER. That is correct.

The CHAIRMAN. Then that——

Secretary FOWLER. Everything over that is 30 percent, just a one stage.

The CHAIRMAN. Just a one-bracket tax on what you spend over and above the $15 a day?

Secretary FOWLER. $15 a day average, yes.

Senator SMATHERS. Would this be the place to ask you, because I want to ask it somewhere, when would you collect this tax?

Secretary FOWLER. This we come to directly in a moment.

Senator SMATHERS. All right.

Secretary FOWLER. In trying to answer the various objections that have been made to this kind of tax.

The CHAIRMAN. Mr. Secretary, in some respect that tax could be helpful to a husband who tries to persuade his wife not to spend so much while they are away, not to bring so much merchandise back.

Secretary FOWLER. I expect that as a result of this tax I will receive a vote of thanks from the male group in the United States, the only monument, I imagine, that I would get.

Nevertheless, some of those who commented on our original proposal indicated that even a modest tax would force cancellation of some desirable trips especially those made by students and others on very strict budgets. As revised our proposal would avoid this possibility in that a student or other traveler could completely avoid the expenditure tax by keeping his average daily expenditures below $15. This level of daily expenditures would seem completely realistic, especially for the type of trips taken by students and others traveling on modest budgets. Moreover, the elimination of one of the tax brackets will simplify the tax computation.

Senator BENNETT. Mr. Chairman, may I ask a question? You are talking about daily expenditures. If the person traveling made his complete travel transportation arrangements before he left the United States, of course, he could travel on an American-flag airline to his general destination, and I assume that would be outside these daily expenditures.

Secretary FOWLER. That is right.

Senator BENNETT. Now, what about transportation on airlines or railroads of other countries arranged in advance?

Secretary FOWLER. Well in the first place, there would be the ticket tax which is in the bill at 5 percent.

Senator BENNETT. That is on an American airline only?

Secretary FOWLER. No; that is on all airlines.

Senator BENNETT. On all airlines?

Secretary FOWLER. Now, beyond the 5-percent ticket tax coming to the point of your question, the income derived by the foreign airline would in some part accrue to that particular country where it is based

and some part to the United States, taking into account costs of procurement in this country, fuel, the various charges for service at airports, and so forth.

I don't have a very good fix, Senator Bennett, on just what the percentage of that dollar received would, in effect, come back to the United States. There is a good deal of literature on the subject, but I can't give you a very hard answer.

Senator BENNETT. My point is in computing the tax against the particular tourist, will it be necessary to take into consideration the money he spends for transportation to get from place to place abroad or will that be out?

Secretary FOWLER. No. On going overseas, no, but when he travels abroad, let's say from London to Rome, yes, that is a travel expenditure abroad.

Senator BENNETT. And that is taken into his daily total?

Secretary FOWLER. That is right.

Senator BENNETT. Even though he makes arrangements here?

Secretary FOWLER. That is correct.

Senator BENNETT. I just wanted to get it straight in my mind.

Mr. SURREY. If he traveled by air abroad, there would be a rate of only 5 percent. In other words, the cost of all air travel would be considered as part of his basic transportation costs and taxed at 5 percent.

Senator BENNETT. That is what I want to get at.

Mr. SURREY. In other words, he wouldn't gain or lose by planning a stopover on his way to his final destination.

Senator BENNETT. In other words, any air travel which is subject to the 5-percent tax will be outside of the computations for the daily minimum?

Mr. SURREY. That is right. Any air travel in Europe that he didn't happen to plan at the very start would nevertheless be subject only to a 5-percent tax and would therefore not be subject to the 30-percent rate.

Senator SMATHERS. Some of these airlines are now buying chains of hotels; they own their own hotels in Europe. Suppose they work out a package whereby they take tourists over on their planes and keep them at hotels which they own perhaps in Istanbul, Madrid, and so on, around Europe, would that be subject to a tax, a foreign travel tax, or not?

Secretary FOWLER. That charge would, or everything outside of the transportation ticket would, be included in the total of expenditures from which you would derive either that he was taxable at the 30-percent level over $15 a day or that he had spent less than $15 a day and therefore was not taxable.

Senator SMATHERS. In other words, the expenditure would come under the $15 a day even though it were spent, you might say, in a U.S.-owned hotel?

Secretary FOWLER. That is correct.

Senator SMATHERS. If you went over $15 a day, you would still be subject to the 30-percent tax.

Secretary FOWLER. That is correct.

It has been suggested that the per diem exemption be replaced by a flat per trip or per year exemption. This alternative present certain problems. First, it would graduate the degree of spending restraint by

the length of the trip and, by so doing, would favor shorter trips over longer trips. The available statistics show that in income groups below $20,000 the total expenditure per trip are relatively the same, but the less affluent spend less per day and stay longer. This latter group is heavily weighted with students, teachers, and individuals visiting foreign relatives, all of whom are likely to need extended trips in order to meet their objectives. A per diem exclusion recognizes this trend by allowing a basic exemption based on the number of days of travel. Thus, even those whose travel objectives require a trip of above average length will be able to take the trip at a modest spending level without undue concern for the tax. A flat exemption per trip would, on the other hand, favor those who take shorter trips by allowing them a higher average per day rate of expenditures subject to the exemption. This group consists generally of the more affluent, where the so-called big spending is more likely.

Furthermore, if the exemption were on a per trip basis, it would unfairly favor frequent short trips over a single trip of the same total duration. For example, a person who took four 20-day trips would be entitled to four times the amount of exemption as a person who took one 80-day trip. Again, in this respect, a per trip exemption would favor the wealthy who are more table to take many trips abroad.

If some provision were added to limit the multiple trip problem, such as no more than one exemption per year, an undesirable degree of rigidity would be interjected into the tax structure. For example, a businessman may honestly believe that he is going to take only one trip during a year and, accordingly, use up his whole exemption on that trip. If a business emergency were to require a second trip, each dollar would be subject to the full 30 percent tax no matter how modest the spending by the individual. This could result in an unreasonable burden. Thus, we recommend retaining the per diem approach.

By structuring the tax in the manner we have, there is no necessity for providing a list of exemptions for specific types of travel which might be considered especially important, either from a business or a cultural standpoint. Instead, the traveler can avoid or minimize the impact of the tax by keeping his spending to a modest level. It would seem clear that specific exemptions are undesirable as they require arbitrary distinctions and administrative complexities.

Senator WILLIAMS. You would have to keep it below the $15 per day.

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. Do you think that is possible?

Secretary FOWLER. I think certainly for a very large number of the students and those in modest incomes it is possible.

Senator WILLIAMS. Does that include the hotel?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. What does the Government figure on Government travel per diem?

Secretary FOWLER. About $15, I think, or $16.

Senator WILLIAMS. I mean overseas.

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. Including hotels and everything?

Secretary FOWLER. Yes, sir.

The CHAIRMAN. Mr. Secretary, some of the companies do business in such a way that an employee goes to Europe, attends some business meetings, and takes full advantage of the business expense provisions in the tax law. The company pays the expense of holding meetings, entertaining people with whom they do business, getting its own directors together if there are European directors. Now, if a company is paying it, do they get around that travel tax?

Secretary FOWLER. No, under this system we make the comptroller of the company kind of help us hold this spending down.

The CHAIRMAN. In other words, let's just say the executive of the ABC Co. which would be presumed to be a company doing business in several countries goes oversea and the corporation pays the expense of the entertaining.

Secretary FOWLER. Yes.

The CHAIRMAN. Which could perhaps be very lavish, on the theory that that executive must come over there to meet with other directors of that corporation. Does the company claiming that as a necessary business expense owe this 30-percent tax?

Secretary FOWLER. Yes, a tax is owed if the individual spends above that $15 a day level.

The CHAIRMAN. When the company claims it——

Secretary FOWLER. It reimburses the traveler for the outlays that he has made. The traveler will have made an outlay and he will presumably be subject to the 30-percent tax, and it is between him and the company. If he can collect the tax from the company, he either bears the tax or the company bears the tax.

The CHAIRMAN. Now, legally can the company under American tax law pay the expense of the entertaining which is done in connection with a company-sponsored event? Now the company-sponsored meeting of its executives to discuss the company's affairs——

Secretary FOWLER. Yes, I assume so.

The CHAIRMAN. Now, in that case where the company sponsors it and the company pays for it as an expense of doing business, if I understand correctly, you say that the company then owes the 30-percent tax?

Mr. SURREY. Perhaps it is best to start with the simplest case of the company which is going to pay for all the executive's meals and lodging.

The CHAIRMAN. Yes.

Mr. SURREY. The executive who is traveling is subject to the tax and presumably, as Secretary Fowler said, the company is going to reimburse him, if they want to, for the tax.

Then you come to the question of entertainment. This presents some borderline questions as is described in our technical explanation, if the executive goes out and buys some dinners, he is subject to the tax just as if he were entertaining privately, rather than for business purposes.

Other business expenses, such as displaying inventory and matters of that nature, would not come under the tax. The line would be drawn with meals, lodging, gifts, and entertainment. However, we are continuing to consider whether it is proper to cover all busi-

ness entertainment, especially in situations where the objective is to entertain foreigners.

The CHAIRMAN. If the company pays the tax, can the company deduct it?

Mr. SURREY. The company can deduct it, just as it can deduct the executive's entertainment and travel expenses themselves.

Secretary FOWLER. As a business expense.

Senator BENNETT. Mr. Chairman, may I have a question? A company with a foreign institution which already has access to foreign currency, if an American executive of that company goes over, can that company supply him with foreign currency tax free?

Mr. SURREY. No. If it is an American-owned foreign subsidiary, then all expenses out of these funds would come under the tax. The use of the foreign currency in this situation is costing us foreign exchange, in effect, since otherwise the moneys would have come back to the United States.

Senator WILLIAMS. How do you determine that? Suppose company A sends the man over for purely business reasons. They have an apartment they keep on an annual basis in Paris, as many of the companies do. They put this man up there, and all expenses are paid. What do you do charge up for each meal if he is eating there? Or suppose the company is holding on a dealers meeting and this man is addressing them. Suppose this particular meal costs $10 or $15 each; it is a legitimate transaction. Do you charge this dinner up to this man in computation of the tax? Let us be realistic. You don't do it, do you? You can't.

Secretary FOWLER. I wouldn't go so far as saying we can't because we never had occasion to have a tax of this nature.

Senator WILLIAMS. No; but how did you determine what it is?

Mr. SURREY. I would assume the company itself, even today, must be keeping some track of its expenses for foreign travel. In a well-run company it would want to know from its own standpoint what it is spending.

Now, the question, I think, you are asking is, if they had to account to us in these cases would it be feasible? Now, then you have to break that question down into two parts: One, a company that desires to comply and make its best efforts to do so, and then the company that has no desire at all to comply.

Senator WILLIAMS. I am assuming for the moment that a company wants to comply, but this man is over there. Two or three of the executives get in a car. Do they charge up one-third of that car to this man, and when they eat the meal do they charge that to his man's account? Aren't we dealing with something unrealistic, to charge a percentage?

Mr. SURREY. There may be some de minimis expenses obviously. But you see the other aspect of the matter, Senator. It would not seem equitable to have a disparity of treatment between those American businesses which did not maintain apartments abroad and those American business that did. Therefore, it would seem far better to try to work out rational rules of allocation to reduce that disparity which would be the more serious problem. In this regard, it might ease individual allocation problems if the employer were allowed to elect to pay a tax on the total amount it spends during the year on its foreign traveling employees. We will look into this.

Senator WILLIAMS. I wasn't questioning what you are trying to achieve, but I am just wondering how you can do it.

Secretary FOWLER. Well, I say you would work out reasonable methods of allocations that would take into account the important expenses.

The CHAIRMAN. If you will yield, a thought that occurs to me is that a corporate executive who has firm control of his company of substantial size might not worry too much about accounting to the stockholders for this expense. If your purpose is to discourage that type of activity perhaps you should attribute that income to the executive and then let him pay the tax on the income plus the tax on the travel. Then you would have much more of a deterrent effect for that type expenditure than you would do if the company can just pay it for him.

Secretary FOWLER. That is undoubtedly the case. That is what I meant by saying in this fashion we may get some of the comptrollers in the various companies working for the program. If there is any type of control on it there would be a tendency to say "well, now, look, be pretty careful and try to hold down because every dollar you pay out over a certain amount Uncle Sam is going to pick up an additional 30 percent from us."

The CHAIRMAN. I was thinking about a situation where a company in good conscience holds a directors meeting in Europe. If we had a tax that was severe enough to make them really give serious thought to the desirability of holding it there and if we were to give a credit for just holding it every second year over here, then they could certainly pay the expense of bringing the executives over here rather than paying the expense of taking them to Europe. In some instances, especially at the corporate level, if the tax were severe when they hold it in Europe, but they could claim a credit for holding it here, it might serve a double purpose. It might help our balance of payments very much.

Secretary FOWLER. I am very much for the tax and not very much for the credit.

The CHAIRMAN. Mr. Secretary, as I understand it, it is not the revenue that you are so much concerned about, it is the balance of payments.

Secretary FOWLER. It is the balance of payments, that is right.

The CHAIRMAN. As a practical matter if we could work something out that would have a lesser impact on overall Government revenues but a more effective impact on the balance-of-payments problem you would probably prefer it. In fact those are your own thoughts on what you recommended to the House.

Secretary FOWLER. You put it quite aptly.

Senator SMATHERS. All right, Mr. Secretary, you go right ahead.

Secretary FOWLER. I have referred to the fact that we tried to avoid the need for any specific exemptions.

On the other hand, our proposal does draw a distinction between individuals who are traveling and those who have essentially shifted their residence abroad. The tax would not apply to this latter category, which includes businessmen transferred abroad for a substantial period and students and teachers who are either studying or teaching abroad. In these situations, the individual is likely to have substantial expenses in setting up his household with the result that the imposition of a tax

might cause considerable hardship. These exemptions, as well as the other details of our proposal, are explained in the attached technical explanation of the foreign travel tax.

We estimate that the balance-of-payments savings from this expenditure tax would be about $115 to $140 million per year.

This travel tax has been criticized on several different levels and, at the risk of appearing defensive, I would like to catalog these criticisms and give you the other side. This seems particularly required in view of the general lack of balance in the testimony which has been presented to date.

There are those who argue that there is no balance-of-payments problem. I have already discussed this in some detail and am sure you are as well aware as I am that this is just not the fact.

In this regard, it has been contended that we have overstated the travel deficit by not including the purchase of airplanes by foreign airlines as an offsetting expenditure in the United States. First, certainly not all foreign airplanes are used solely to transport travelers to and from the United States. Second, moving airplane sales from the trade account to the travel account will not alter the overall balance-of-payments deficit or the fact that Americans spend about $4 billion each year in connection with foreign travel—which is almost 10 percent of this country's total foreign payments. Thus, a mere bookkeeping change will not eliminate the immediate need for reducing our foreign travel payments.

It has frequently been stated that the travel tax would interfere with the inalienable right to travel. While the value of travel is unquestionable, the fact nevertheless remains that a family must budget for its travel outlays and so must the nation budget its international expenditures to the foreign exchange available. As I have already indicated, we have structured the travel tax to accomplish this national budgeting with as little interference with travel plans as possible. The bulk of the foreign exchange savings will come from reduced spending while on a trip, and not through cancellation of the trip.

Other critics claim that an affirmative program restraining our travel expenditures abroad will be ineffective because of the retaliation it will evoke. An area of retaliation frequently pointed to by these critics is a reduction in foreign orders for U.S. aircraft. Close examination does not lend credence to this fear. The travel program is specifically designed to have the least impact on the number of people traveling abroad. This effect should be even more pronounced with our proposed modification in that there would be no expenditure tax imposed—and, therefore, no motive to cancel the trip—where spending is below $15 per day. The tax should thus have the least effect on the airline business, and therefore on aircraft orders, of any form of restraint on travel expenditures.

The next group of critics focuses directly on the structure of the travel tax and takes the position that it is unworkable, unenforceable, unfair, and ill-conceived—to say the least. They say that the tax will fall heavily on teachers, students, and other low-income people; that it will have little effect on "jet-setters"; that it will involve mountains of redtape; and that it will encourage prohibition-type evasion.

The proposed tax clearly cannot be faulted on equity grounds. The tax is progressive according to expenditures, which, after all, is the factor contributing to the balance-of-payments problem.

It is designed so that one traveling modestly will incur little or no tax. On the other hand, the 30-percent rate on expenditures over $15 per day is a significant continuing deterrent to marginal expenditures even by the most affluent traveler.

A substantial tax on tickets, such as 30 percent, or a tax on each traveler in a fixed amount, or a tax graduated by the number of days of travel would fall equally on the modest traveler and on the lavish traveler. Such taxes would, therefore, represent a far greater proportion of the expenditures of the less affluent and would be no continuing deterrent to the more affluent. In other words, they would be grossly inequitable.

As to enforcement, just as one can argue that there are ways to evade the travel tax, one can argue that there are ways to evade the income tax—and some people try it. Out of 100 million returns filed in the United States, however, and out of 3 million returns examined, there were about 1,000 fraud indictments last year. This clearly demonstrates that the great mass of American taxpayers accept their responsibility to pay taxes—if not happily, at least honestly. There is no reason to believe the travel tax would not be accepted in the same way.

Much of the criticism based on complexity and evasion involves a misconception of the tax. The tax does not involve the itemization of any expenditures. Therefore, the pictures presented by some critics of European hotel clerks busily grinding out $3 receipts for $25-a-day suites would not materialize. The tax is based on the difference between the amount of money and traveler's checks a traveler leaves the United States with and the amount left when he returns. This will be the extent of the computation for most travelers. For those who use credit cards and personal checks, these amounts would be added. But no one need carry pencils and pads—or take his accountant—with him on his trip to Europe.

The final level of criticism is that, even accepting the need for a travel tax and the structure of this proposal, it cannot do the job of effecting the anticipated balance-of-payments savings. These critics point to the fact that the tax is applicable only to travelers outside the Western Hemisphere and, moreover, that large groups of such travelers, such as businessmen, persons visiting relatives in Europe, teachers, and students, will travel to Europe despite the tax. They claim that it will have no effect on the wealthy. They therefore contend that the base on which the tax can operate is only vacation travel outside the Western Hemisphere by middle-income people and that a base so limited is insufficient to yield the balance-of-payments savings we are seeking.

This criticism ignores the structure of the tax. The tax indeed assumes that most travelers to Europe will not cancel their trips. On the other hand, it is fair to assume that all types of travelers will respond in some degree to the tax, either by keeping their spending below the exemption level, by shortening their stay by a few days, or by eliminating some marginal expenses. Indeed, a traveler contemplating spending $25 a day could absorb the entire tax, including the ticket tax, by cutting only 4 days from a 30-day trip. If the $25-a-day traveler wanted to spend his full 30 days in Europe, he could offset the tax by reducing his expenditures to about $22 a day. It is therefore reasonable to believe that travelers of all types will examine their spending plans with the tax in mind. On this basis, a $115 to $140 million balance-of-payments savings out of the almost $1.5 billion in contemplated

travel expenditures for travel outside the Western Hemisphere seems clearly attainable.

It is also reasonable to expect that this would be a real savings and not produce just a transfer of the travel to countries in the Western Hemisphere. There may, of course, be a certain number of travelers who will revise their plans. But it is clear that the existing tourist facilities in the Western Hemisphere outside of the United States will not accommodate a large amount of additional tourism.

In other words, the tax is designed to meet equitably the need for temporary restraint on foreign travel spending, with due regard to the varying types of travelers. Its mechanics for the vast majority of travelers are uncomplicated and can be readily understood and satisfied. The tax, thus, offers an essential and feasible bridge to the time when our longer range programs to increase tourism to the United States take hold.

If no measure is enacted to deal directly with expenditures by U.S. travelers, the overall improvement required in our balance-of-payments position can be achieved only if other sectors of the economy contribute more than their fair share. Thus, I consider the foreign travel tax today, as I did on February 5, as an essential part of our balance-of-payments programs. The confidence of the rest of the world in our dollar depends, in part, upon the resolve we demonstrate to put our financial house in order. The bill before you today is a step in the right direction as well as a solid structural revision in our tax and customs laws. But the dramatic demonstration of our resolve and a sizable reduction in our travel deficit rests upon the absent portion of the administration's program—the foreign-travel tax.

Now, Mr. Chairman and members of the committee, I have the remaining part of the statement which deals with the substance of the bill before you. I hesitate to take up the committee's time to read the remaining 15 pages of the statement, but we will reserve that for questions and ask that it be included as a part of the record.

In conclusion, I urge that this committee take immediate and affirmative action to narrow the balance-of-payments deficit in our foreign-travel account. The first step is to approve, subject to the revisions we have recommended, the extension of the air-ticket tax and the customs measures included in H.R. 16241. The second is to add to this bill the tax we have proposed to encourage restraint in foreign-travel spending. In this form, H.R. 16241 would represent a balanced and effective program for dealing with the important balance-of-payments problem in the travel area. Solution of this problem, in turn, is critical if we are to improve our overall balance-of-payments deficit—an improvement that is so necessary to maintain strength and confidence in the dollar.

Thank you, Mr. Chairman.

(The balance of Secretary Fowler's statement follows:)[1]

IV. SUBSTANCE OF H.R. 16241

1. Ticket Tax

Present law imposes a 5-cent tax on the amount paid for an airline ticket purchased in the United States. International flights are, however, exempt from

[1] Attachments to Secretary Fowler's statement; the technical explanation of the foreign travel tax and the technical explanation of the proposed changes in the customs rules for returning residents appear at pp. 157–166.

this tax. This exemption was enacted in 1947 for the purpose of stimulating overseas travel by Americans and thereby to increase the flow of dollars to Europe. Obviously, this exemption is no longer justified and this bill eliminates it by permanently extending the existing air ticket tax to all amounts paid for air transportation where the tickets are purchased within the United States.

The bill, in addition, eliminates most of the present exemptions from the ticket tax. The basic domestic airline ticket tax is in the nature of a user charge in that the revenues derived from it are considered as payments in return for the activities of the Federal Aviation Administration in providing services principally concerned with air navigation and safety. Viewed this way, exemptions from the tax are unjustified. Therefore, exemptions previously accorded state and local governments, colleges and universities, and U.S. government travelers have been eliminated as a permanent structural improvement in the law. These entities certainly have no less an interest in the safety of their employees who travel by air than do other employers. Equally, they have no less an obligation to help meet the costs of insuring this safety.

The changes made by the bill in the existing air transportation tax would apply to amounts paid for tickets sold on or after 10 days after enactment of the bill for transportation which begins on or after that date. It is estimated that this tax will improve our balance of payments by $50 million per year and raise $95 million in revenue each year.

We are in basic agreement with the provisions in the bill as they affect the ticket tax.[1]

2. Customs Measures

A. BALANCE OF PAYMENTS IMPACT OF PRESENT $100 DUTY-FREE TOURIST EXEMPTION

The estimated value of articles acquired abroad and brought into the United States during 1967 by United States residents returning from countries other than Mexico and Canada, and the Caribbean area totaled approximately $200 million. Of this amount, $100 million was brought in under the present $100 customs duty-free exemption granted to returning residents. A substantial reduction in this duty-free exemption would achieve a significant reduction in the value of articles brought into the United States by returning United States residents.

B. BALANCE OF PAYMENTS IMPACT OF $10 GIFT EXEMPTION FOR PARCELS ARRIVING BY MAIL

An estimated 11 million packages arriving by mail during 1967 were admitted duty free under the existing exemption for gifts valued at less than $10. In addition, many other parcels presently being admitted without payment of duty would have duty owing if there were adequate customs manpower available to assess the duty. The elimination of the $10 gift exemption, and a more intensive processing by Customs of packages arriving from abroad by mail would bring about a decline in the shipment of such parcels to the United States. Since many such parcels are purchased by United States residents, this would result in a significant balance of payments saving.

C. REDUCTION OF RETURNING RESIDENT EXEMPTION

I. Introduction

I have set forth below, for purposes of convenience and of clarity, a table indicating customs exemptions for returning residents: (1) under present law; (2) under H.R. 16241; and (3) under the proposal that I am now about to make to you. During the rest of my statement, you may find it useful to refer back to this table.

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[1] The Treasury Department suggests two changes in the ticket tax provisions of H.R. 16241:

(1) The House bill, while eliminating most exemptions, retains the present exemption for domestic flights by small aircraft on nonestablished lines (sec. 4263(d)). The retention of this exemption is inconsistent with the user charge nature of the domestic ticket tax and it is recommended that it be deleted.

(2) The Treasury Department recommends excluding from the ticket tax flights completely within Puerto Rico (or, consistently, within one of the possessions) in that this is more in the nature of an internal matter of concern to Puerto Rico under its Commonwealth status.

RETURNING RESIDENT EXEMPTION

Location	Present law	House action		Treasury proposal	
		Temporary (until Oct. 15, 1969)	Permanent	Temporary (until Oct. 15, 1969)	Permanent
Canada and Mexico	$100	$100	$100	$100	$100
Caribbean area	100	10	50	100	100
Virgin Islands, American Samoa, and Guam	200	100	200	200	200
Elsewhere	100	10	50	10	50

II. House action

In order to reduce foreign expenditures by returning United States residents and thereby achieve a balance of payments savings, we had proposed legislation to the House of Representatives which would permanently reduce the present $100 duty-free exemption granted to returning United States residents to $10 for persons returning from countries other than Canada, Mexico and the Caribbean area.

The House agreed that a reduction to the $10 level was presently warranted in view of the current United States balance of payments problems. However, the House concluded that on a permanent basis, commencing in October, 1969, the United States should adopt an exemption of $50, which is the exemption which the Organization for Economic Cooperation and Development has recommended that all countries grant to their returning residents.

III. Proposed changes in House action

A. Exemption for Canada and Mexico

The House left a permanent exemption for Canada and Mexico of $100. We basically agree with this decision because of the special relationship between the United States and those countries.

B. Exemption for Caribbean

The House reduced the exemption proposed by the Treasury for persons returning from the Caribbean area, from $100 to $10 on a temporary basis, and provided that it would be established at $50 on a permanent basis. I believe the Senate will wish to weigh carefully the desirability of a $10 exemption for the Caribbean area, even on a temporary basis. The economies of these small islands are largely dependent on United States tourism and a drastic reduction in the customs exemption will adversely affect their economies and their overall trade with the United States. Moreover, we have a special relationship with the Caribbean area similar to that which exists with our contiguous neighbors of Canada and Mexico and this makes it reasonable for all these areas to be given the same treatment. We propose, in short, that the exemption for residents returning from the Caribbean area be retained at the present $100 level.

C. Exemption for Virgin Islands, Guam and American Samoa

The House bill provides that the present $200 exemption for residents returning from the Virgin Islands and certain other United States insular possessions be temporarily reduced to $100 and returned to the present $200 exemption level in October, 1969.

In order not to disadvantage the Virgin Islands economy, it would be desirable to continue the $100 differential in customs exemptions between the Virgin Islands and the Caribbean area. Following this approach we recommend that the exemption for the Virgin Islands be retained at the present $200 level permanently.

D. Summary of proposed changes

In summary, with regard to returning United States residents, we propose that the present $100 exemption be retained for the Caribbean area as well as for Canada and Mexico. For United States residents returning from the Virgin Islands, and certain other United States insular possessions, the present $200 exemption should be retained permanently. For returning residents from other areas of the world, the present $100 exemption should be reduced to $10 now, but increased on a permanent basis to $50 in October, 1969, as in the House bill.

D. MODIFICATION OF GIFT EXEMPTION FOR PARCELS ARRIVING BY MAIL

We also proposed, and the House Report concurs, that the $10 duty-free gift provision for articles arriving in the mail from abroad should be reduced to $1. This will be accomplished administratively under existing law. No change is proposed in the $50 gift exemption applicable to gift parcels arriving from the United States servicemen serving in combat zones. Moreover, we do not plan to make a change in the $10 gift exemption level for servicemen in non-combat zones.

E. MODIFICATION OF DUTY ASSESSMENT PROCEDURES

In order to minimize the increased customs workload implicit in the changes described above, we recommend simplification of duty assessment procedures applicable to returning United States residents and to certain non-commercial mail parcels.

I. House action

The House bill provides that for returning United States residents a 10 percent flat rate of duty should be assessed on the fair retail value of all dutiable articles accompanying arriving travelers, provided their aggregate value, exclusive of any duty-free articles, does not exceed $500 wholesale.

The flat 10 percent rate of duty would also be applied on the fair retail value of non-commercial importations of dutiable articles, arriving by mail, express, and other means of transportation, which are valued at more than $10 retail but not over $250 wholesale, exclusive of duty-free articles. A $1 charge would be made on dutiable non-commercial parcels arriving by mail valued at between $1 and $10.

II. Proposed changes in House action

We believe the following modifications of these simplified duty assessment procedures are desirable in order to foreclose their becoming a possible avenue for substantial importations of high duty items. The intent of these modifications is to circumscribe the situations where the simplified procedures may be used.

A. Ceiling on use of flat rate by arriving travelers

1. General

The flat 10 percent rate would not apply if the aggregate retail value of articles brought in by returning residents exceeds $100. Under this proposal, the flat rate would not be applicable to persons arriving from areas benefiting from an exemption of $100 or more. Under the Treasury proposal, these areas are Canada, Mexico, the Caribbean Islands area, and the Virgin Islands and certain other United States insular possessions.

2. Operation of flat rate

This is how the flat rate will work. If the tourist has more than $100 worth of purchases with him, the flate rate will not be applicable to any of his purchases, and he will have to pay duty on the dutiable articles at the Tariff Schedule rates, due allowance being made for the duty-free exemption to which he is entitled. In totaling the tourist's purchases to determine whether the $100 ceiling has been exceeded, all dutiable articles would be counted, including those articles falling within the tourist exemption. If the purchases of the returning resident do not exceed the $100 ceiling, when calculated in this manner, he will pay duty at the flat 10 percent rate on all his dutiable purchases, due allowance being made for his duty-free exemption.

The same basic rule would apply in cases where the returning resident exemption becomes $50 permanently. In other words, the flat rate would continue to apply to dutiable purchase between $50 and $100. If the dutiable purchases exceed the $100 ceiling, then all purchases above the $50 exemption become subject to duty at the Tariff Schedule rates.

B. Applicability of flat rate for noncommercial shipments

1. Increase in flat rate

For noncommercial articles arriving in the mail or by other means of transportation, we propose that the flat rate of duty be increased from 10 percent, as provided in the House bill, to 15 percent. In the absence of such increase,

travelers desiring to avoid the impact previously described of the $100 tourist ceiling on the use of the flat rate, would be tempted to arrange for some of their purchases to be separately shipped. The increase proposed would help to discourage such separate shipments.

2. Ceiling on use of flat rate

The flat 15 pecent rate for noncommercial mail parcels would not apply to shipments exceeding $50 in retail value. Where the $50 limitation is exceeded, the Tariff Schedule rates would be applicable to all dutiable items in the parcel.

3. Charge on small value parcels

To coincide with the 15 percent flat rate, we propose that the charge on dutiable parcels valued at $10 or less retail, be increased from $1 to $1.50. Articles valued at $1 or less, would continue to be free of any duty or charge.

F. RESULTING BALANCE OF PAYMENTS SAVINGS

It is estimated that implementation of all of the above recommendations will achieve a balance of payments savings of about $100 million during the first year after enactment. This saving would be reduced to $75 million, on an annual basis, after October 1969 when the basic tourist exemption is scheduled, under the House bill, to be increased from $10 to $50.

G. INCREASED ADMINISTRATIVE COSTS FOR CUSTOMS AND POST OFFICE DEPARTMENT

Implementation of the above measures will entail increased administrative costs for the Customs Service, and also for the Post Office Department to the extent its expense in collecting the duty on parcels arriving by mail cannot be covered by postal handling charges because of the ceiling set under the Universal Postal Union Convention. Their ability to execute these measures is dependent upon adequate increased appropriations to implement the changes. However, I should point out that any increased cost will be offset by significantly increased revenues.

V. CONCLUSION

In conclusion, I urge that this Committee take immediate and affirmative action to narrow the balance of payments deficit in our foreign travel account. The first step is to approve, subject to the revisions we have recommended, the extension of the air ticket tax and the customs measures included in H.R. 16241. The second is to add to this bill the tax we have proposed to encourage restraint in foreign travel spending. In this form, H.R. 16241 would represent a balanced and effective program for dealing with the important balance of payments problem in the travel area. Solution of this problem, in turn, is critical if we are to improve our overall balance of payments deficit—an improvement that is so necessary to maintain strength and confidence in the dollar.

Senator SMATHERS. Chairman Long, do you have any questions you want to ask?

The CHAIRMAN. Not right now.

Senator SMATHERS. Senator Williams?

Senator WILLIAMS. Just one question. The suggestion has been made that a man in this country who is acquainted abroad can go abroad and have a gentleman's agreement with some friend he has over there that they will underwrite the cost of his trip over there, we will say $1,000, $1,500, and in turn when they visit back in this country he will set that much aside for their visit here. How can you handle that?

Mr. SURREY. How can we handle that?

Senator WILLIAMS. Of course, that would be canceled out in the balance of payments.

For example, if you spend a thousand dollars on me in France and I spend a thousand dollars on you over here, and——

Secretary FOWLER. I would just make one comment and ask Secretary Surrey to add his comment to it. I would say at least his thoughtfulness in arranging to neutralize the balance of payments as a result

of his own efforts would be appreciated, but from an enforcement standpoint I would still insist that he pay the tax.

Mr. SURREY. I think that is the general observation one would make. In theory the tax should be paid, since the favorable impact of his friend's visit to the United States would be offset by the American's spending abroad. There would obviously be problems in reaching every case in those situations. But in dealing with questions of that nature you are at the borderline of enforcement of a measure, and when you are at the borderline, no 100-percent satisfactory answer can be given really to any question.

We should be looking at the whole range of American travel, and really when you get down to it, Senator, most American travelers just go into American Express or a bank and buy their traveler's checks when they go to Europe, and that is about all that it comes to. Or they go to an airline and pay for a package tour. That is pretty much the way most average fellows travel.

Now, for that kind of a fellow, who is going in to buy American Express checks and spend them in Europe and come back, there is no complication in this tax.

If, on the other hand, you come over to the borderline, there are problems with people who deliberately want to evade and who use their ingenuity and start matching wits with the United States. Certainly some will succeed, and some will fail. Those are the kind of people that we deal with under the income tax, too, and probably some succeed, probably a great many fail, and no one person is certain whether he will succeed or fail.

Senator WILLIAMS. A suggestion has been made that in many of the underdeveloped countries we have an excess of currencies on deposit in the treasury. Couldn't there be some program worked out where we could sell them at a discount to the prospective tourist? We do not want to cause the country to think we are automatically going to devalue their currency, but maybe we could sell these currencies or make them available to American tourists, thus encouraging them to visit those countries where we have the excess currencies. They would use these currencies on some basis, rather than travel in the countries where we have deficits. In future negotiations where we are selling food under Public Law 480 this could be a standard program.

Secretary FOWLER. Senator Williams, this has been a matter that has given me concern over the last 2 or 3 years, and we have constantly looked at it. Representative Findley in the House of Representatives addressed a query to me in January in connection with the proposal he made for a debt credit plan designed to assist our balance-of-payments equilibrium by utilizing these currencies that we hold.

There is a rather full and definitive answer in a letter to Representative Findley, dated March 4, which I should like to include in the record at this point because it does give you more of a full picture of the problem.

(The letter referred to follows:)

MARCH 4, 1968.

Hon. PAUL FINDLEY,
House of Representatives,
Washington, D.C.

DEAR MR. FINDLEY: Thank you for your letter of January 29, 1968, outlining your proposal for a "debt-credit" plan designed to assist our balance of payments of expenditures by U.S. tourists.

I want to express my appreciation at the outset for the interest you have shown in our balance-of-payments problem.

We, in the Treasury, have examined your most recent proposal for a "debt-credit" plan very carefully both on the basis of your letter and your description of the plan in the January 15 issue of the *Congressional Record*. First, let me say that I hope I correctly read in your proposal a recognition of the need for a travel tax. You would have the tax fall on travel to countries that do not cooperate under the "debt-credit" plan and exempt "cooperating" countries. The proposal that the Administration has put forward does not contemplate this kind of exemption, but would bear most heavily on travellers who spend larger amounts and lightly, or not at all, on those who spend smaller amounts in travel abroad. There would not seem to be any essential difference of view on objectives and the problem turns to other questions. For example, there is the potential difficulty that the "debt-credit" proposal could give the public an unwarranted anticipation that the program could be successfully put into effect in a wide range of countries. This could give an impetus to travel plans without, for the most part, any restraint on expenditures. Also, we have great difficulty in seeing the amount of help to our balance of payments that you mention in your figures.

It would seem to us that the bulk of the balance-of-payments savings in your plan would have to come from the $5 per traveller per day payments by governments who owe us World War I debts. The thought underlying the plan appears to be that these countries, mainly as you say, Britain, France, Germany, and Italy would be encouraged to cooperate in order to be exempt from the travel tax. However, since payments are not now being made on those debts and tourist payments go to individuals for goods and services rather than governments, the $5 per traveller per day payment to the United States envisaged by your plan would be purely and simply a government subsidy, requiring a government appropriation. A payment by a foreign government of $5 for every $18 of private expenditure to private sellers of goods and services would be a rather high rate of subsidy, and any particular country could not, in any event, be sure how much money was actually being spent in its country. It seems very doubtful that countries would consider it worthwhile to participate in the scheme on that basis. I think these governments might well consider a travel tax which would involve a reduction in tourist expenditures as less costly to them than a debt-credit plan which could involve budget appropriation. Furthermore, from the point of view of our balance of payments, there would be no restraint on larger spending by those of our travellers who could so afford in countries that would be exempt under your plan. If this occurred the cost to our balance of payments could be significant.

As for that part of your plan that deals with the seven excess currency countries now permitting sales to tourists, I think it fair to say that tourism to those countries, at least to some extent, would probably be stimulated and sales of those excess currencies increased if tourists to those countries were exempted from the tax. The balance of payments, however, would be improved only to the extent tourists actually shift their expenditures to these countries from "non-cooperating countries", and to the extent they actually purchase their local currency needs from the U.S. Government rather than from other sources. However, as you cite in your letter, $91 million out of the $112 million available currencies in those countries is concentrated in the UAR where diplomatic relations have been broken. In India and Pakistan (the two countries in which we have the largest concentration of excess currency holdings outside the tourist dollar exchange program) U.S. tourist expenditures amount to a few millions of dollars a year. In those countries we now require, pursuant to law, that new P.L. 480 agreements provide for early payment to us in convertible currencies to the extent that there is a difference between estimated U.S. travel expenditures and actual sales we make of currency to U.S. travellers and businessmen.

With respect to the category of excess currency countries not now permitting sales to tourists, specifically Poland and Yugoslavia (where we have large holdings as a result of sales of surplus agriculture products in earlier years) there have been no new PL 480 agreements in recent years in which such a provision could be included. I am sure you are aware of the ways in which we are right now seeking in one of these countries to make use of some of our excess holdings and the difficulties that have arisen. In any event, these two countries plus Burma which makes up the rest of this category do not loom large in our tourist problem.

In addition, I do not believe that the redemption of U.S.-owned currencies in non-excess currency countries would help the U.S. balance of payments. We need these local currencies for normal U.S. Government operations, and if the currencies were redemmed under the "debt-credit" plan we would then have to purchase for dollars the amounts needed to meet our normal U.S. Government requirements.

A further problem is that it does not appear possible to save as much as we need for the balance of payments even if we were to assume that the plan were completely successful in getting all countries to join in cooperation. Using your figures of $5 a day payments and $18 expenditures, it would be necessary for U.S. travellers to spend $1.8 billion abroad for us to receive $500 million in payments. This would seem to imply a net balance of payments cost of U.S. travellers' expenditures in the "cooperating countries" of $1.3 billion for receipts of $500 million. In 1966 U.S. travellers spent gross $1.4 billion outside Canada and Mexico.

For reasons such as indicated above, I do not feel your over-all proposal provides the best means at this time of obtaining the kind of balance-of-payments savings on travel that we need; nor do I believe that it would be equitable or practicable to make such an over-all exemption to the travel tax for such a selective and geographically disparate group of countries.

Again, let me say that I am grateful for your interest in this whole question. While I regret I cannot provide encouragement to your present "debt-credit" plan, I look forward to your continuing cooperation in our efforts to achieve balance-of-payments benefits in our foreign currency programs, and to your support in our over-all effort to correct our payments deficit.

Sincerely,

HENRY H. FOWLER.

Secretary FOWLER. We have constantly tried to encourage the determination of where these currency holdings are excess to the needs of the U.S. Government, and to take advantage of new agreements with the countries concerned to provide that they can be used by our civilian tourists in those countries.

Arrangements have been effected, with countries that are currently operating now.

Unfortunately most of our holdings of excess currencies are not in the countries where there is major tourist travel, so the cause is a worthy one, it needs to be constantly pursued, but it does not meet the major problem in such a massive way.

Senator WILLIAMS. I realize that, and I wasn't suggesting this as an alternative. Since in a few of these countries, we have these currencies in surplus which we cannot spend except within those countries; I cite India as a case in point, why not use them for travel?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS. Could we not work out something so that it would be cheaper for this teacher or student who is going abroad, that if he will direct his travel in that area rather than in Western Europe, this would help our balance of payments and make his travel much cheaper, too. In other words, offer him an incentive. We would end up ahead of the game because you have got these currencies in the Treasury that you cannot use for any other purpose; let him pay dollars into the Federal Treasury for them.

I think you may encourage a lot of people to travel in that area.

Secretary FOWLER. Well, I think that the thrust of plans, such as Mr. Findley's and others are ones that we must constantly take into account. I think this suggestion that you make here is one we would like to consider. As I understand it, it is saying if you go to a country where the excess currency is available for tourist expenditures you can buy the currency from us at a very substantial discount.

Senator WILLIAMS. That is correct.

For example, if Mr. X is going to take a trip, if he will direct the bulk of his trip in three or four countries in the Near East where you have a surplus of currency he can buy them at a substantial discount and can go in there much cheaper.

I made that suggestion on the 31st of January, when we were talking about the general tax increase, and I wish you would review this suggestion and see if you cannot submit some language where we can at least implement this on a trial basis; I think it has much merit.

Secretary FOWLER. Let me read you two paragraphs at this point because I think insofar as there is an answer, a comment to be made now, Senator Williams; I want to be responsive to it. This is what we said to Representative Findley.

> As for that part of your plan which deals with 7 excess currency countries now permitting sales to tourists, I think it fair to say that tourism to these countries at least to some extent would probably be stimulated and sales of these excess currencies increased if tourists to these countries were exempted from the tax. The balance of payments, however, would be improved only to the extent tourists actually shift their expenditures to these countries from "non-cooperating countries", and to the extent they actually purchased their local currency needs from the United States Government rather that from other sources.
>
> However, as you cite in your letter $91 million out of $112 million available currencies in these countries is concentrated in the U.A.R.—that is Egypt—where diplomatic relations have been broken, in India and Pakistan, the two countries in which we have the largest concentration of excess currency holdings outside the tourist dollar exchange program. U.S. tourist expenditures amount to only a few million a year. In these countries we now require pursuant to law that a new P.L. 480 agreement provide for early payment to us in convertible currencies to the extent that there is a difference between the estimated U.S. travel expenditures and actual sales we make of currencies to U.S. travelers and businessmen.
>
> With respect to the category of excess currency countries not now permitting sales to tourists—and this goes to your new agreements point—specifically Poland and Yugoslavia where we have large holdings as a result of sales of surplus agricultural products in early years, there have been no new P.L. 480 agreements in recent years in which such a provision could be included. I am sure you are aware of the ways in which we are right now seeking in one of those countries to make use of some of our excess holdings and the difficulties that have arisen. In any event these two countries, plus Burma, which make up the rest of this category do loom large in our tourist problem.

Secretary FOWLER. That was the basic thing. His proposal was that we exempt people from the tax who go to those countries where there are excess currencies that are usable by tourists.

Senator WILLIAMS. I was proposing to go beyond that, not only exempt them but——

Secretary FOWLER. An incentive.

Senator WILLIAMS (continuing). Sell them these currencies at a reduced price because we don't have the use for them. While there may be only seven countries involved we could expand that in new negotiations under Public Law 480. Also, I note that you are entering into negotiations with some of the countries of Western Europe now concerning the blocked off social security payments; there are about $22½ million involved there which I understand you have just agreed to release to them. Now, that is a complete loss in balance of payments. Why could we not use that as a travel incentive and at least get some credit for it.

Secretary FOWLER. I am not on those particular negotiations. I think there are some reciprocity elements involved and I am not on

that. It is a State Department matter and I am not sufficiently acquainted.

Senator WILLIAMS. The State Department yesterday first told me they had agreed 2 weeks ago, but I understand that the agreement is coming out today. About all they received in return is a hope of getting something later; they figure if we give these countries something now they may give us something later. That has been the trend of our negotiations and I am just wondering if we should not do it just as you and I would if we were sitting across the counter. I just wonder if we don't need a little bit of Yankee ingenuity here in our negotiations.

Secretary FOWLER. Well, being a good southerner I won't admit that is wholly limited to Yankees but anyway you and I would negotiate the same way.

Senator WILLIAMS. I wish you would give this some careful study because I happen to be one who thinks if this bill is going anywhere such a proposal should be a part of any measure we are concerned with.

Secretary FOWLER. Yes.

(The following information was subsequently supplied by the Treasury Department:)

ON SALE OF GOVERNMENT-OWNED FOREIGN CURRENCY AT A DISCOUNT TO AMERICAN TOURISTS

There is a critical and unavoidable international problem involved in this proposal. Under the rules of the International Monetary Fund we, as a member, are obligated to avoid engaging in disorderly or multiple exchange practices. Moreover, sales of foreign currency by the Government at a depreciated rate in whatever form to American tourists or to other private persons would also require the consent to such transactions by the foreign government whose currency was used. The diversion of dollars to the U.S. Government, by means of discount incentives, which would otherwise enter host country foreign exchange receipts would exacerbate the financial position of countries which already suffer from perilously short foreign exchange holdings. However, as the financial positions of these countries improve, the value of their currencies will strengthen and opportunities now exist under existing legislation for greater use of foreign currencies at full value by the United States without selling at discounts.

Senator WILLIAMS. I don't know what may be done on this suggestion, but I think this has merit.

If we are going to curtail this foreign travel to hold our balance of payments what steps is the administration taking toward disciplining itself? I might say that includes Congress, too, because a good bit of this foreign travel originates on the homefront, as you and I know. There are a lot of American taxpayers who are paying their own expenses looking with questionable eyes when they read about some of the Government trips, which have the appearance of being more or less a junket, whether executive, legislative, or judiciary. Should we not have some provision in here that would at least indicate that if we are going to ask for discipline on the part of the taxpayer who is paying his own expenses, we are going to set the example as Government officials?

Secretary FOWLER. Senator Williams, on the general proposition there has been action taken early in the year to curtail very sharply, travel expenditures by Federal employees abroad. Each department and agency is involved in that, and there was a Presidential directive which I should like to include as a part of the record here because I think it is pertinent, and it is valuable to have this emphasized, that there has been a new discipline imposed as of January 18—that was

the date of the release—on the budgeting processes involving travel expenditures by a Government employee. I do not think that included the Congress, however. It was limited to the executive branch.

(The Presidential directive referred to, follows:)

REDUCTION OF U.S. PERSONNEL AND OFFICIAL TRAVEL OVERSEAS

THE PRESIDENT'S MEMORANDUM TO HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES. JANUARY 18, 1968

Subject: Reduction of overseas personnel and official travel

Today I sent the attached memorandum to the Secretary of State and the Director of the Bureau of the Budget directing them to undertake a four-part program to reduce United States personnel overseas. I expect each Department and agency to cooperate fully in this endeavor.

In addition, I hereby direct the head of each Department and agency to take steps to reduce U.S. official travel overseas to the minimum consistent with the orderly conduct of the Government's business abroad. I have asked private U.S. citizens to curtail their own travel outside the Western Hemisphere in the interest of reducing our balance of payments deficit. Federal agencies should participate in this effort.

The policy applies particularly to travel to international conferences held overseas. Heads of Departments and agencies will take immediate measures to—

—reduce the number of such conferences attended.

—hold our attendance to a minimum and use U.S. personnel located at or near conference site to the extent possible.

—schedule conferences, where possible, in the U.S. or countries in which excess currencies can be used.

You should present your plans for travel to international conferences held overseas to the Secretary of State, who, with the Director of the Budget, will undertake a special review of this matter.

This directive shall not apply to—

—travel necessary for permanent change-of-station for U.S. employees, for their home leave, and for medical and rest and recuperative leave.

—travel made necessary by measures to reduce U.S. employment overseas outlined in the attached memorandum.

—travel financed from available excess foreign currencies.

You are requested to submit to the Director of the Budget, not later than March 15, a statement on the actions you have taken to reduce all types of overseas travel, the results expected from such actions, and your recommendations as to any additional measures that might be taken.

LYNDON B. JOHNSON.

NOTE: For the memorandum to the Secretary of State and the Director, Bureau of the Budget to which the President referred, see the following item.

REDUCTION OF U.S. PERSONNEL AND OFFICIAL TRAVEL OVERSEAS

THE PRESIDENT'S MEMORANDUM TO THE SECRETARY OF STATE AND THE DIRECTOR, BUREAU OF THE BUDGET, JANUARY 18, 1968

Subject: Reduction in U.S. employees and official travel overseas.

As a part of my program for dealing with our balance of payments problem, announced on New Year's day, I would like you jointly to take the specific measures to reduce U.S. employment and curtail official travel abroad, as outlined herein. Within the Department of State, the Senior Interdepartmental Group, chaired by Under Secretary Katzenbach, shall serve as the focal point for carrying out this directive.

You should make these reductions in a way which maintains the effectiveness of our international programs. I would like you to give particular attention to personnel reductions which can be made through relocation and regrouping of functions, the elimination of overlapping and duplication, the discontinuance of outdated and marginal activities, and a general streamlining of operations.

I. Reduction in U.S. personnel overseas

This directive applies to all employees under the jurisdiction of U.S. diplomatic missions and includes the representatives of all U.S. civilian agencies which have

programs or activities overseas. It also includes military attaches, Military Assistance Advisory Groups, and other military personnel serving under the Ambassadors. It does not apply to U.S. personnel in Vietnam.

The Secretary of Defense has already initiated measures to reduce staffing of the military assistance program. I am asking the Secretary to complete these studies in time to support the goals outlined below.

You are directed to take the following actions:

1. *As a first step, you should proceed, with appropriate participation by U.S. Ambassadors and agencies, to reduce the total number of American personnel overseas by 10 percent,* with reductions of at least this magnitude applied to all missions of over 100. Similar reductions should be made in employment of foreign nationals and contract personnel. Your decisions on this first phase, which shall be final, shall be completed by April 1.

2. *You should also initiate a special intensive review of our activities and staffing in 10 countries with very large U.S. missions.* Your objective, in this second step, should be to reduce U.S. employment by substantially more than the 10 percent immediate reduction taken in the first step. Your final decisions should be made on this phase by August 1.

3. *As a third step, you should proceed to extend these intensive reviews of U.S. activities to other countries beyond the first 10 as rapidly as feasible.*

4. *Simultaneously, you should initiate special studies from Washington of functional* areas aimed at reducing instructions, assignments, and activities which unnecessarily create the need for maintaining or increasing overseas staff, e.g., reporting requirements, consular work, and administrative support.

Clearly, reductions of this magnitude will involve major changes in agency staffing and personnel plans. I am asking Chairman Macy of the Civil Service Commission to assist agencies in solving attendant personnel problems and in facilitating the reassignment of employees returning to the United States.

II. Curtailment in official travel

I am requesting all Department and agency heads to reduce official travel outside the U.S. to the minimum consistent with orderly conduct of the Government's business. I would like you to give special attention to measures to minimize travel to international conferences.

By April 1, I would like you to report on the actions taken in this regard and to recommend any additional steps required.

LYNDON B. JOHNSON.

NOTE: For the President's memorandum to heads of executive departments and agencies on overseas reductions, see the preceding item.

Senator WILLIAMS. Well, I was speaking in broad terms, too; and I wasn't just talking about the Executive. I am familiar with that press release and I agree completely with its objectives. I don't question for a moment but what it has been effective. But in order that we can determine just how effective this press release of January 18 was, could you furnish at this point in the record, a list or a report broken down by months and by agencies, the amount that was spent for foreign travel during 1967 along with similar information of such travel in 1968? We can then see just how far we have gone toward reducing this.

Secretary FOWLER. Yes, Senator Williams, I will try to supply the information that is available on that subject.

Senator WILLIAMS. I would appreciate it.

(The following information was supplied by the Bureau of the Budget:)

Accounting data are not available that will supply information on foreign travel by agencies on a month to month basis for the fiscal years 1967 and 1968.

As a result of the President's Directive of January 18, 1968, each agency submitted an expenditure plan for the balance of the fiscal year 1968 and fiscal year 1969 that reflected a substantial reduction for foreign travel below the levels budgeted. The agencies' reports to the Bureau of the Budget reflect that they have now reduced their planned foreign travel costs both for the last half of the fiscal year 1968 and the full year 1969, by approximately 25% below the amounts included in their appropriations for 1968 and their estimates for 1969.

Because of differing degrees of essentiality for foreign travel and the varying nature of the program requirements of the agencies to travel abroad, some have cut back more than 25% and some less. The reduction averages to about 25% Government-wide.

The actual results of the reduction for fiscal year 1968 will not be available until approximately September 1, 1968; thereafter, quarterly reports for the entire Government are to be prepared about 45 days after the close of each quarter.

Senator SMATHERS. Mr. Secretary, before yielding to Senator Carlson, who is next in asking questions, I want to say this: There is a feeling, I think, among this committee, and I think in the Senate, that this particular proposal is not as essential in meeting our balance-of-payments deficit and our domestic and foreign deficit as you apparently think that it is. You know that we passed a tax increase bill coupled with an expenditure reduction bill which originated right here with members on this committee, but we got the very strong feeling from you that it was absolutely essential.

I want you to state, without reading anything if you can—bleed for us a little bit—how important is this proposal in the overall balance-of-payments program? Do we really have to act on this this year? Is this essential in the overall picture?

Secretary FOWLER. Yes, Senator Smathers, in my judgment it is. I think that the action that has been taken in our fiscal and monetary field is the fundamental base on which any constructive program must proceed, and it is my hope that it will result in improving our trade surplus which has very nearly disappeared in the first quarter. There was some recovery in the month of April. I would hope that it would bring it back toward the level of 1967, but I would be less than optimistic if I said that I thought we would do as well in the trade field in the calendar year 1968 as we did in the calendar year 1967 because the impact of the recent revenue act, will take some time to have its effect on the trade picture.

Therefore, we have to look at the other fingers of the hand, the so-called direct measures to help us achieve balance. In a sense, it is more important for the travel program this year and in the period ahead, than it was when it was presented in January because it was the premise of the entire program then we would get some action on the fiscal side early in the year. Now, it is late June and, therefore, I, for one, feeling a sense of responsibility about this, cannot see any rational basis whereby we would retreat from any of the measures set forth in this program in January because we have finally, at long last, managed to get the revenue act through.

So in the field of reducing and neutralizing Government expenditures, in the field of carrying through on the direct investment program, on the bank lending program, on the other features involving encouragement of our trade surplus, I, for one, don't think we can back off one step and, indeed, coming to this program, the travel program, I think a retreat on this front is just as unhappy as a retreat on any of the other fronts, and furthermore——

Senator SMATHERS. When you were talking about the tax bill you used such words as catastrophic if we didn't pass it and that we were in a crisis of enormous proportions. Do you feel the same urgency or an equal urgency about this bill as you did about the revenue bill, recognizing, of course, that it is not as large? What I am trying to

get really from you is whether or not this committee has to act on this measure or whether it would be all right if we passed it over. Very frankly, there is a feeling that the proposal involves so little money, is so late in the year in being considered, and involves so much redtape, that it is probably not worth the effort. This is what I am trying to get from you, is the effort worth it?

Secretary FOWLER. I think it is essential that we make a start on this problem of travel. I just don't think we can keep putting it off and keep waiting for something else to turn up. This has been the story of our balance-of-payments problem for the last 5 years, waiting for something else to turn up that will make it unnecessary to grapple with the difficult aspects of the problem.

Therefore, I think my answer would reluctantly have to be very strongly in the affirmative.

(Discussion off the record.)

Senator SMATHERS. The committee will then stand in recess until 10 a.m. tomorrow morning.

(Whereupon at 11:45 a.m., the hearing was recessed until Wednesday, June 26, 1968, at 10 a.m.)

FOREIGN TRAVEL TAX

WEDNESDAY, JUNE 26, 1968

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

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

Present: Senators Long, Smathers, Gore, Hartke, Williams, Carlson, Bennett, and Morton.

The CHAIRMAN. Mr. Secretary, at the hearing Senator Gore asked that you be prepared to discuss S. 3204 to tax the undistributed earnings and profits of foreign corporations controlled by U.S. persons and S. 3205 repealing the exclusion from gross income of certain income earned outside the United States. Are you prepared to discuss those bills?

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY, ACCOMPANIED BY FREDERICK L. DEMING, UNDER SECRETARY FOR MONETARY AFFAIRS, DEPARTMENT OF THE TREASURY, AND STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY—Resumed

Secretary FOWLER. Yes.

Senator GORE. Mr. Chairman, before we get to that, I would like to ask permission to have printed in the record at this point or at some point, an analysis of the second annual report of the President to the Congress on the operation of the Automobile Products Trade Act of 1965 known as the United States-Canadian Automobile Agreements.

This study has been made at my request by the staff of the Senate Finance Committee under the direction of Mr. Tom Vail, the chief counsel. The study shows that this unfortunate agreement has brought a massive shift in the international structure of the automobile industry, has cost thousands of jobs to the United States, and an estimated $1 billion in unfavorable balance-of-payments effect.

The CHAIRMAN. How much?

Senator GORE. $1 billion.

As another result automobile production has been going up rapidly in Canada and has suffered a decline for 3 years in the United States.

I will offer an amendment to this bill or to such other bill as may emerge from this committee to repeal this improvident agreement. I ask, renew my request, that it be printed in the record.

The CHAIRMAN. Yes, the analysis will be printed at this point in the record.

(The analysis of the report referred to follows:)

ANALYSIS OF SECOND ANNUAL REPORT OF THE PRESIDENT TO THE CONGRESS ON THE AUTOMOBILE PRODUCTS TRADE ACT OF 1965 (U.S.-CANADIAN AUTOMOBILE AGREEMENT)

BACKGROUND OF THE AGREEMENT

The U.S.-Canadian Automobile Agreement was born out of a plan by the Canadians to subsidize automobile engine and parts exports to the U.S. through a duty remission scheme. The scheme would have enabled a Canadian firm which increased its exports of engines and parts to get a remission of duties on $1's worth of imports for each additional $1 of exports over the base year 1963. Thus, a firm which increased its exports from $10 million in 1963 to $20 million in 1964 would be able to import $10 million duty free.

This would have been an indirect subsidy to Canadian exports and thus be subject to our countervailing duty statute (Section 303 of the Tariff Act of 1930).

The U.S.-Canadian auto pact resulted from negotiation between the two Governments over disagreements arising out of the Canadian duty-remission plan.

Under the pact, the U.S. exports of vehicles and parts (except tires, and tubes, and replacement parts) to a "bona fide" Canadian manufacturer are admitted duty free, while the U.S. gives duty-free treatment to Canadian imports. It is not really a "free trade agreement" for several reasons. A "bona fide" Canadian importer is one who maintains the same Canadian value added and the same ratio of assembly to sales in Canada that he had in 1964. Thus, if a manufacturer assembled 90 percent of his car production in Canada in 1964 and this ratio dropped to 89 percent in 1965, he would not be able to import duty-free U.S. engines and parts. There were also "voluntary," "letters of undertakings" by U.S. auto firms to increase their investment and production in Canada.[1] These letters extend through 1968 models. It is probable that they will not be renewed, although the Canadian Government would like other forms of commitments from U.S. firms to increase their investment and production in Canada.[2]

EFFECT ON TRADE

The precise effect of the agreement on the U.S. trade balance in automobiles and parts is difficult to determine. This is because U.S. exports of certain semi-fabricated parts, which are covered under the agreement, are classified under non-automobile tariff definitions. However, under any basis of measurement the U.S. trade in automobiles and parts has suffered.

The April issue of the Federal Reserve Bulletin, in commenting on the effect of the auto agreement on the U.S. balance of trade, stated:

"Part of the recent extraordinary expansion in imports reflects a massive shift in the international structure of the automobile industry as a result of the U.S.-Canadian Automotive Agreement in 1965. Imports of autos and parts from Canada increased from almost nothing in 1964 to $1.25 billion a year in 1966–67, and to a rate of more than $2 billion early in 1968. (There was a rapid but only partly offsetting rise in automotive exports to Canada)."

Based on U.S. statistics provided in the Annual Reports of the President on this agreement, the trade picture is shown in Table I.

The U.S. has shifted from a net exporter to Canada of passenger cars, buses and chassis of $22 million in 1964 and 1965 (average) to a net importer of $130 million in 1966 and 1967 (average). In 1964, $21.9 million or 29 percent of our automotive imports from Canada were passenger cars; in 1967, passenger car imports from Canada amounted to $818 million, or 53 percent of total automotive imports from Canada. The large U.S. exports of parts (over $1 billion in 1967), kept the U.S. in an overall surplus position, albeit a declining one. But, if the trends continue, the surplus will disappear in a few years.

Even on the basis of imports statistics of the two countries, which is the way the State Department feels best depicts the situation, the U.S. trade surplus fell from an average of $633 million in 1964–65 to $483 million in 1966–67. This approach to measuring the trade balance is shown in Table II.

Thus, one can conclude that the agreement has created a dramatic shift in U.S.-Canadian automotive trade, not to the U.S. advantage.

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[1] These were published in the Committee hearings and are attached.

[2] The two governments are now completing a joint review of experiences under the agreement. A special report will be submitted to the Congress in accordance with Sec. 205 (a) and (c) of the Act. Perhaps at that time we can find out what, if any, further commitments will be made.

PRODUCTION

The increased investment and production in Canada by U.S. firms has resulted in longer production runs and increased specialization of production there. And, the gap between higher production costs in Canada and lower U.S. costs has narrowed.

U.S. production in 1964 was 9.3 million vehicles (including trucks and buses); it increased to 11.1 million in 1965, but has since declined to 10.4 million in 1966 and 9.0 million in 1967, mainly because of market conditions. Passenger car production in 1967 at 7.4 million is the lowest it has been in five years. (See Table III)

Motor vehicle production in Canada has increased steadily since the agreement entered into force, rising from 671,000 motor vehicles in 1964 to 847,000 in 1965, 902,000 in 1966, and 947,000 in 1967. (See Table IV)

It is difficult to tell how much U.S. production and employment may have been lost to Canada as a result of this agreement. The increased assembly of finished automobiles in Canada undoubtedly replaced some assembly operations in the U.S. Over 2,000 workers *involved in assembling* automobiles in the U.S. have applied for adjustment assistance, which is a clear indication that there has been some shifting.

EMPLOYMENT

Automobile employment in both Canada and the U.S. has gone up since the agreement.[1] Within the North American industry complex there have been shifts in plant locations in both directions. For example, one Chevy plant in New York was closed and the operation was shifted to Canada, while a Buick plant in Canada was closed and that operation was shifted to New York. Inasmuch as there generally has been more assembly in Canada of finished automobiles, some assembly jobs have been lost to Canada, but it is impossible to tell how much this may have been offset by more jobs in say, parts production, within the U.S. Table V gives data on employment in the U.S. and Canada. Later in the paper it will be seen that adjustment assistance has been provided to 2,500 workers in the U.S., which is an indication of the magnitude of displacement of U.S. jobs.

PRICES AND DIFFERENTIALS

The consumer price index for new passenger cars in the U.S. and Canada shows that both U.S. and Canadian prices fell between 1963 and 1966, but rose slightly in 1967.

CONSUMER PRICE INDEX, NEW PASSENGER CARS

[1957-59=100]

	United States	Canada
1963	101.5	99.7
1964	101.2	96.8
1965	99.0	96.1
1966	97.2	94.2
1967 (11 months)	97.8	95.6

However, there has been a slight narrowing of the absolute price differential. Factory list prices of the same model car (4-door sedan) 6 cylinder with comparable standard equipment) were only 5.7 percent higher in Canada for the '68 model introduction, as compared with a differential of 9.6 percent for the '64 model. The higher Canadian sales tax (12 percent in '68 as compared with 7 percent in U.S.) made the suggested Canadian retail price for '68 models 9 percent higher than in the U.S.

ADJUSTMENT ASSISTANCE

Under Section 302 of the Automotive Products Act of 1965, firms or groups of workers were entitled to petition for help (adjustment assistance) if they felt they were being injured by the agreement. No firms have petitioned for assistance. Through April 1968, 5,684 workers have applied for assistance, 2,493 have been certified eligible and $3.5 million has been paid out in adjustment assistance.

A list of the number of workers petitioning by firm, and adjustment assistance board action is provided in the attachment.

[1] There was a decline in U.S. employment from 1966 to 1967, but this was a result of slack domestic demand and the Ford Motor Company strike.

CONCLUSION

The U.S.-Canadian auto agreement has benefited mainly Canada and the large U.S.-Canadian automobile companies. While trade has increased both ways. Canadian exports to the U.S. have risen much faster than U.S. exports to Canada. If these trends continue, the traditional, favorable U.S. automotive trade balance with Canada will disappear.

The agreement has undoubtedly made Canada a more efficient producer of automobiles. Longer production runs and greater specialization have reduced the cost differentials between U.S. and Canadian plants.

A number of assembly operations have been shifted into Canada. Over 2,000 assembly workers in the U.S. have sought adjustment assistance; 540 have received such aid.

Certain U.S. suppliers have been injured. Out of 21 petitions for adjustment assistance by workers, 14 have been certified and 7 denied. A total of 2,493 workers have received such aid out of 5,684 petitioning, at a cost of $3.5 million.

AUTOMOTIVE PRODUCTS TRADE ACT OF 1965

ADJUSTMENT ASSISTANCE CASE RECORD, WORKER PETITIONS. ONLY [1]

Petitioner's firm product, and union	Number of workers petitioning	Date filed	Board action		
			Determination	Date	Number certified
1. Ford: Pennsauken, N.J.; export packing. UAW Local 918.	150	Feb. 4, 1966	Certified......	Apr. 14, 1966	150
2. General Motors: Grand Rapids; interior trim. UAW Local 1231	600	Apr. 14, 1966	.....do.....	July 28, 1966	375
3. Fram Corp.: Birmingham; air filters. Bridge, Structural and Ornamental Iron Workers Local 539.	100	June 16, 1966	.....do......	Aug. 25, 1966	100
4. Maremont Corp.: Cleveland; shock absorbers. No union, 3 individuals.	400	Oct. 14, 1966	.....do......	Dec. 23, 1966	400
5. Borg-Warner Corp.: Memphis; Universal joints. UAW Local 237.	130	Dec. 19, 1966	Denied.......	Apr. 6, 1967	....
6. Rockwell-Standard: Adrian, Mich.; wheel covers. Machinists Local 1268, Metal Polishers Local 69.	300	Jan. 10, 1967	Certified......	Mar. 22, 1967	300
7. Eaton Spring: Detroit; leaf springs. UAW Local 368.	300	Feb. 2, 1967	.....do......	Apr. 14, 1967	300
8. Eaton Spring: Lackawanna, N.Y.; leaf springs. Steelworkers.	170	Feb. 23, 1967	.....do......	Apr. 28, 1967	170
9. AMC: Milwaukee; Auto bodies. UAW Local 75.	200	Feb. 28, 1967	.....do......	June 15, 1967	100
10. AMC: Kenosha, Wis.; complete assembly. UAW Local 72.	230	.....do.....	.....do.....	.....do......	215
11. Chrysler: Detroit; Dodge Polara assembly. UAW Local 7.	1,000	Mar. 3, 1967	.....do......	June 16, 1967	265
12. General Motors: Wilmington; Chevrolet and Buick assembly. UAW Local 435.	740	Apr. 12, 1967	Denied.......	June 21, 1967	....
13. Chevrolet: North Tarrytown, N.Y.; Chevrolet assembly. UAW Local 664.	325	Apr. 14, 1967	Certified revised certification.[2]	June 23, 1967 Sept. 5, 1968	60
14. Fisher Body: North Tarrytown, N.Y.; automobile bodies. UAW Local 664.	400	Apr. 17, 1967	Certified revised certification.[2]	June 23, 1967	45
15. Borg-Warner: Detroit, Mich.; Long Manufacturing; oil coolers. UAW Local 314.	26	June 7, 1967	....	Sept. 5, 1967	....
Revised..................................	49	Aug. 2, 1967[3]	Certified......	Nov. 13, 1967	6
16. Eaton Yale & Towne: Cleveland; stampings. UAW Local 307.	65	June 21, 1967	Denied.......	Aug. 30, 1967	....
17. Rockwell-Standard: Mishawaka, Ind.; bumper division; UAW Local 586.	66	Aug. 23, 1967	.....do......	Nov. 1, 1967	....
18. Borg-Warner: Detroit, Long Manufacturing; condensers. UAW Local 314.	9	Nov. 1, 1967	Certified......	Feb. 15, 1968	7
19. Pittsburgh Plate Glass Co.: Ford City, Pa., Works No. 4, Glass Workers No. 14.	150	Nov. 8, 1967	Denied.......	Jan. 18, 1968	....
20. Pittsburgh Plate Glass: Creighton, Pa., Works No. 1. Glass Workers No. 12.	150	.....do.....	.....do.....	.....do......	....
21. C. M. Hall Lamp Co.: Detroit, Mich., die cast parts. UAW Local 304.	150	Jan. 18, 1968	.....do......	May 3, 1968	....
Total..............................	5,684	....	14 certified; 7 denied.	....	2,493

[1] No petitions have been filed by firms.
[2] Certification revised to reflect corrected information.
[3] Original petition withdrawn and investigation terminated July 31, 1967; revised petition submitted Aug. 2, 1967.

TABLE I.—U.S. AUTOMOTIVE TRADE WITH CANADA, 1964–67

[In millions of dollars]

Year	U.S. exports				U.S. imports				Trade balance [1]			
	Passenger cars	Trucks, buses, and chassis	Parts and accessories	Total	Passenger cars	Trucks, buses, and chassis	Parts and accessories	Total	Passenger cars	Trucks, buses, and chassis	Parts and accessories	Total
1964	45.4	17.7	591.1	654.1	21.9	4.7	49.3	75.9	+23.5	+13.0	+541.8	+578.3
1965	114.0	45.4	700.5	860.0	84.1	23.7	94.0	201.8	+29.9	+21.7	+606.5	+658.1
1966	275.6	83.6	952.1	1,311.4	370.7	158.3	315.2	844.1	−95.1	−74.1	+636.9	+467.8
1967	563.0	138.3	1,099.9	1,801.2	818.0	269.9	427.5	1,515.4	−255.0	−131.6	+672.4	+285.2

[1] U.S. favorable equals +.

Source: Bureau of Census data given in President's Annual Reports on Canadian Automobile Agreements, Mar. 22, 1967, and May 21, 1968.

TABLE II.—UNITED STATES-CANADIAN AUTOMOTIVE TRADE BASED ON UNITED STATES AND CANADIAN IMPORT DATA[1]

[In millions of U.S. dollars]

Subject	1964	1965	1966	1967[2]
United States exports to Canada:[3]				
Passenger cars	41.0	116.0	291.8	613.0
Trucks, buses, chassis	21.2	41.7	81.6	133.8
Parts and accessories	597.1	771.7	[4] 1,037.9	[4] 1,254.3
Total exports	659.3	929.4	1,415.9	2,001.1
United States imports from Canada:				
Passenger cars	21.9	84.1	370.7	818.0
Trucks, buses, chassis	4.7	23.7	158.3	269.9
Parts and accessories	49.3	139.2	360.2	474.1
Total imports	75.9	247.0	889.1	1,562.0
U.S. net exports	583.4	682.4	526.8	439.1

[1] Tires and tubes not included. Figures may not add to totals due to rounding.
[2] Preliminary and subject to revision.
[3] As measured by Canadian import statistics.
[4] Canadian imports of parts and accessories in 1966 and 1967 adjusted to include coverage of products comparable to United States automotive parts imports from Canada.

Source: U.S. exports: BDSA (based on DBS data of Canadian imports from the United States, converted to U.S. dollars, exchange rate $0.925). U.S. imports: BDSA (based on Bureau of the Census data).

TABLE III.—U.S. MOTOR VEHICLE PRODUCTION, CALENDAR YEARS 1963-67

[In thousands of units]

	Passenger cars	Trucks and buses	Total
Calendar years:			
1963	7,644.4	1,464.4	9,108.8
1964	7,745.5	1,562.4	9,307.9
1965	9,335.2	1,802.6	11,137.8
1966	8,604.7	1,791.6	10,396.3
1967[1]	7,412.7	1,611.1	9,023.8

[1] Subject to revision.

Source: Automobile Manufacturers Association.

TABLE IV.—CANADIAN MOTOR VEHICLE PRODUCTION, CALENDAR YEARS 1963-67

[In thousands of units]

	Passenger cars	Trucks and buses	Total
Calendar years:			
1963	532.2	99.1	631.4
1964	559.6	111.4	671.0
1965	706.8	139.8	846.6
1966	701.5	200.6	902.1
1967[1]	720.8	226.4	947.2

[1] Preliminary.

Source: Dominion Bureau of Statistics.

TABLE V.—EMPLOYMENT IN THE AUTOMOTIVE PRODUCTS INDUSTRY, UNITED STATES AND CANADA, 1963-6

UNITED STATES

[In thousands]

Annual average	Total motor vehicles and equipment	Motor vehicles	Passenger car bodies	Trucks and bus bodies	Parts and accessories
1963	741.3	299.9	60.6	32.4	326.9
1964	752.9	306.1	55.7	32.0	336.7
1965	842.7	352.9	66.4	34.5	362.8
1966	859.2	361.5	65.3	36.8	368.4
1967	809.5	341.4	60.3	36.7	347.5

CANADA

	Motor vehicles	Assembling	Parts and accessories
1963	60.3	29.9	26.1
1964	69.3	34.3	30.5
1965	80.0	40.3	34.6
1966	84.9	40.4	38.8
1967	83.8	40.4	37.1

LETTERS OF UNDERTAKING

GENERAL MOTORS OF CANADA, LTD.,
Oshawa, Ontario, January 13, 1965.

Hon. C. M. DRURY,
Minister of Industry,
Parliament Buildings,
Ottawa, Ontario.

DEAR MR. MINISTER: This letter is in response to your request for a statement with respect to the proposed agreement between the Governments of Canada and the United States concerning trade and production in automotive products, as you have described it to us. The following comments assume that the proposed agreement for duty-free treatment has the full support of the respective Governments, and that the program may be expected to continue for a considerable period of time.

It is our understanding that the important objectives of the intergovernmental agreement are as follows: (*a*) the creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved; (*b*) the liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view of enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; (*c*) the development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade. We subscribe to these objectives and agree with the suggested approach of removing tariff barriers and moving in the direction of free trade even in this limited area. Such an approach is fully compatible with General Motors' expressed position with respect to the desirability of free trade in automotive vehicles and components, not only in Canada, but in all other countries in the free world.

It is noted that under the proposed agreement the right to import vehicles and certain automotive parts, free of duty, into Canada will be available to Canadian vehicle manufacturers who (1) maintain Canadian value added in the production of motor vehicles in ensuing model years at not less than the Canadian value added in motor vehicle production in the 1964 model year; (2) produce motor vehicles in Canada having a net factory sales value in a ratio to total net factory sales value of their motor vehicle sales in Canada and those of their affiliated companies in Canada of not less than the ratio prevailing during the 1964 model year; (3) increase in each ensuing model year over the base model year, Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 percent of the growth in their market for automobiles sold for consumption in Canada and by an amount equal to 50 percent of the growth in their market for commercial vehicles sold for consumption in Canada (for this purpose, growth in their market means the difference between the cost

of vehicles sold in Canada during the ensuing model year and the cost of vehicles sold in Canada during the base model year net of Federal sales tax in both cases); and (4) undertake, in addition to meeting the above three conditions, to achieve a stipulated increase in the annual Canadian value added by the end of the model year 1968.

With respect to General Motors, in connection with the conditions outlined in the previous paragraph, it is our understanding, in the case of (1) that Canadian value added would be decreased in circumstances where the value of General Motors sales declined below that achieved in the base year, and in the case of (3) that in the event of a decline in General Motors net value of vehicle sales for consumption in Canada, a decrease in Canadian value added of 60 and 50 percent in cars and trucks, respectively, is acceptable. In addition, it is our understanding, with respect to (4), that for General Motors the stipulated annual increase in the Canadian value added by the end of the model year 1968 is $121 million.

We understand that certain changes are proposed in the regulations pertaining to the determination of Canadian value added. We believe that several of these changes require further review and consideration as in our opinion they tend to impede rather than aid in the attainment of the objectives of the agreement.

In particular, these are (*a*) the elimination of the profit on components purchased from affiliated Canadian companies; (*b*) the elimination of profit on sales of vehicles and parts by General Motors of Canada or by Canadian affiliated companies to affiliated companies outside of Canada; and (*c*) the elimination of depreciation on non-Canadian facilities used in the manufacturing process both in our plants and in those of our Canadian suppliers.

(*a*) We believe that the elimination of the profit element on purchases of components purchased by General Motors of Canada from affiliated Canadian companies is discriminatory. McKinnon Industries, a major supplier of components, has been an affiliate of ours since 1929. McKinnon prices to us are competitive with those for similar components manufactured by other manufacturers. It is a policy of General Motors that pricing between affiliated operations be competitive and the purchasing unit has the obligation of negotiating the best possible price with the supplying unit. McKinnon and other affiliated Canadian parts manufacturers supply parts to other Canadian vehicle manufacturers and the profit on these transactions is not required to be eliminated by those manufacturers. We feel that at most any elimination of profit from value added should be confined to the elimination of profit above the percentage level in the base period.

(*b*) It is our opinion that the elimination of the profit on sales of vehicles and parts produced in Canada by General Motors of Canada and affiliated Canadian companies to affiliated General Motors companies in the United States and other countries is also discriminatory and should be given added consideration. It is recognized in the tariff regulations of most countries that the value of imported goods includes a "reasonable" rate of profit. Further, on sales by nonaffiliated Canadian suppliers to General Motors Corp. in the United States and its oversea subsidiaries the profit in such sales would be considered as Canadian value added.

(*c*) On the matter of exclusion of depreciation on non-Canadian machinery and equipment used in the production of automotive products in Canada, it seems that this only hinders the attainment of the objectives of the plan. In order to increase production in Canada, additional capacity is a necessity either in our plants or those of our suppliers. As much of this required equipment is either unavailable or more costly in Canada, it appears that not allowing depreciation on such equipment as Canadian value added discourages rather than encourages the enthusiasm required to effect the desired increase in Canadian value added. It should be noted, however, that it is our intention to maintain our present policy of obtaining any additional machinery and equipment in Canada whenever economically feasible.

You have requested that we should increase Canadian value added in our products by $121 million between 1964 and the end of the model year 1968, as outlined under condition (4). Also you have requested that the amount should be further increased to the extent required under condition (3) stated above. We think that this objective in that time is extremely ambitious, particularly in view of the fact that one-half of the first model year has already passed.

We have carefully reviewed our situation in the light of your proposals and requests and have asked that our affiliates do the same. We can see areas where we can and will achieve a significant portion of your suggested objective of $121 million increase in Canadian value added by 1968. This is possible because Gen-

eral Motors of Canada and our affiliated Canadian companies have recently engaged in the Canadian manufacture of certain automotive components heretofore imported. These include the fabrication and assembly of automatic transmissions at McKinnon Industries Windsor plant not only for Canadian requirements but for export to assembly plants in other countries as well. In addition, in the 1964 model year the oversea market for North American-type passenger cars and commercial vehicles has been increasingly served by our plants in Canada. Of course, any slowing down in the rate of growth in the industry or any adverse developments in the economies of Canada, the United States, or other principal markets, or failure to achieve duty-free entry into the United States would make this achievement more difficult.

To attain your stated objective ratably over the 4 years of the plan amounts to an increase in Canadian value added of $30 million a year plus growth. Our plans, which have been underway for more than a year, should accomplish about $60 million of the total or, putting it another way, we can see our way clear to accomplish that portion applicable to the first 2 years of the plan.

Studies are underway of various steps we might take to accomplish that portion applicable to the last 2 years. However, we are and have been operating our facilities in Canada at full capacity, and so, I believe, have most of our suppliers. Therefore, the Canadian value added applicable to the last 2 years will probably require added facilities on our part, or on the part of our suppliers, or both. A further reappraisal of our present facilities and our capacity and those of our suppliers must be made. The extent and nature of any additional facilities can be determined only in the light of the plan as finally published. You can appreciate, I am sure, that all of this takes time.

Subject to the imponderables mentioned above, it is our intention and that of our affiliates to make every feasible effort to meet the objectives of the agreement to be made between the Governments of Canada and the United States, and to achieve the indicated goal as rapidly as possible.

Referring again to the items which appear to impede the program, we hope you will review your position further in the light of the information included earlier in this letter.

In conclusion, therefore, I am prepared to say at this time that, first, General Motors of Canada has plans underway to increase Canadian value added by about $30 million in each of the first 2 years of the plan; and, second, we are continuing our studies of ways to accomplish the remainder of the program and will undertake to meet the full objective of $121 million by the end of the model year 1968.

It is anticipated that these studies will take between 3 and 4 months to finish, and I will be prepared to discuss the results with you when they are completed. From time to time, as requested, we will be glad to discuss our current operations and our plans for future development with the Minister of Industry, and to receive and consider his suggestions.

Sincerely,

E. H. WALKER.

FORD MOTOR CO. OF CANADA, LTD.,
Oakville, Ontario, January 14, 1965.

DEAR MR. MINISTER: Enclosed are executed copies of our two letters to you of this date relative to the proposed agreement between the Governments of Canada and the United States concerning trade and production in automotive products under which it is proposed that the customs duty in each country on the importation from the other of automotive vehicles and original equipment parts therefor be eliminated.

We consider it essential that any substantial administrative interpretation or treatment that may be extended by you to any other motor vehicle manufacturer, the lack of which would place Ford Motor Co. in a noncompetitive position, also be extended to Ford.

You have provided us with a draft of the proposed order in council expected to be adopted in order to implement that agreement and with a draft of the regulations proposed to be adopted under that order in council.

Our undertakings are, of course, conditional upon the execution of that agreement, upon the adoption of an order in council, and regulations substantially in

the form of the drafts that you have already delivered to us, and upon an acceptable response in respect of the enclosed supplementary letter.

Yours sincerely,

FORD MOTOR CO. OF CANADA, LTD.,
By KARL E. SCOTT, *President.*

FORD MOTOR CO. OF CANADA, LTD.,
Oakville, Ontario, January 14, 1965.

DEAR MR. MINISTER: We are writing with respect to the agreement between the Governments of Canada and the United States concerning production and trade in automotive products.

Ford Motor Co. of Canada, Ltd., welcomes the agreement and supports its objectives. In this regard, our company notes that the Governments of Canada and the United States have agreed "* * * that any expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential * * *." In addition, we note that the Governments of Canada and the United States shall seek the early achievement of the following objectives:

(*a*) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(*b*) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; and

(*c*) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

Our company also notes that the right to import motor vehicles and original equipment parts into Canada under the agreement is available to vehicle manufacturers in Canada who meet the conditions stipulated in the Motor Vehicles Tariff Order 1965. These conditions are, in brief, that vehicle manufacturers shall maintain in each model year their production of motor vehicles in Canada in the same ratio to sales of motor vehicles for consumption in Canada and the same dollar value of Canadian value added in the production of motor vehicles in Canada, as in the period August 1, 1963, to July 31, 1964.

We understand that—

(i) in ascertaining whether Ford qualifies as a motor vehicle manufacturer and whether the requirements of paragraphs 1 and 2, below, are satisfied, production of automotive vehicles in Canada by Ford Motor Co. of Canada, Ltd., and by any person designated as associated with Ford Motor Co. of Canada, Ltd. ("an associated person") will be taken into account, whether sold in Canada or exported;

(ii) in determining whether the requirements of paragraphs 1 and 2, below, are satisfied, export sales of original equipment parts by Ford Motor Co. of Canada, Ltd., and by any associated person in Canada (as well as production of automotive vehicles in Canada by Ford Motor Co. of Canada, Ltd., and by any associated person, whether sold in Canada or exported), and purchases of original equipment parts by any affiliated Ford company outside of Canada from Canadian vendors, will be taken into account. An "affiliated Ford company" is one that controls, or is controlled by, or is under common control with, Ford Motor Co. of Canada, Ltd.

(iii) for the purpose of computing the ratios referred to in paragraph 2(1)(e)(ii)(A) of the order in council of the definition of manufacturer, the numerators of the fractions will consist of the net sales value of all passenger automobiles (or specified commercial vehicles or buses) produced by the motor vehicle manufacturer in Canada, including those sold in Canada and those sold in export, and the denominators of the fractions will consist of the net sales value of all passenger automobiles (or of specified commercial vehicles or buses) sold by the motor vehicle manufacturer for consumption in Canada, including imported passenger cars (or specified commercial vehicles or buses) but excluding passenger cars (or specified commercial vehicles or buses) that are produced by the motor vehicle manufacturer in Canada and sold in export.

The undertakings in his letter are based on the definition of "Canadian value added" in your present regulations.

We understand that in the computation of Canadian value added for vehicle assembly in Canada, section 2(a)(i) of the regulations would prevent us from including the cost of parts produced in Canada that are exported from Canada and subsequently imported into Canada as components of original equipment parts; this provision reduces the incentive to source in Canada parts that would be incorporated in U.S. engines and other original equipment parts. Accordingly, we request that you give careful consideration to the revision of this clause.

In addition to meeting these stipulated conditions and in order to contribute to meeting the objectives of the agreement, Ford Motor Co. of Canada, Ltd., undertakes:

1. To increase in each model year over the preceding model year Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 percent of the growth in the market for automobiles sold by our company for consumption in Canada and by an amount equal to 50 percent of the growth in the market for the commercial vehicles specified in tariff item 950 sold by our company for consumption in Canada, it being understood that in the event of a decline in the market a decrease in Canadian value added based on the above percentages is acceptable. For this purpose, growth or decline in the market shall be measured as the difference between the cost to our company of vehicles sold in Canada during the current model year and the cost to our company of vehicles sold in Canada during the preceding model year net of Federal sales taxes in both cases.

   We understand that in the event that the total passenger car and/or total truck sales of our company in any model year fall below the total passenger car and/or total truck sales of our company during the base period, Canadian value added requirements would be reduced below the base period amendments for the purpose of this section, and for the conditions stipulated in the Motor Vehicles Tariff Order 1965.

   We believe that the definition of growth is unfair because it includes as growth the difference between the cost of vehicles produced in Canada and the cost to us of identical imported vehicles. In the event that we rationalize our vehicle production in Canada so as to concentrate our production in Canada on high volume models for the North American market with other models being imported, the difference in cost as defined above would result in a substantial growth even though there was no change in the number and models of vehicles sold in Canada. We request your careful consideration of a change in the definition that would eliminate this inequity. This inequity is compounded by the fact that Ford Motor Co. of Canada, Ltd., is compelled by the Canadian antidumping law to import vehicles at dealer price, and we request that your Government also give careful consideration to a change in the antidumping law in respect of vehicles imported under the Motor Vehicles Tariff Order 1965.

2. To increase Canadian value added over and above the amount that we achieved in the period August 1, 1963, to July 31, 1964, and that which we undertake to achieve in (1) above, by an amount of $74.2 million during the period August 1, 1967, to July 31, 1968.

The undertakings given in this letter are to be adjusted to the extent necessary for conditions not under the control of the Ford Motor Co. of Canada, Ltd., or of any affiliated Ford company, such as acts of God, fire, earthquake, strikes at any plant owned by Ford or by any of our suppliers, and war.

The Ford Motor Co. of Canada, Ltd., also agrees to report to the Minister of Industry, every 3 months beginning April 1, 1965, such information as the Minister of Industry requires pertaining to progress achieved by our company as well as plans to fulfill our obligations under this letter. In addition, Ford Motor Co. of Canada, Ltd., understands that the Government will conduct an audit each year with respect to the matters described in this letter.

We understand that before the end of model year 1968 we will need to discuss together the prospects for the Canadian automotive industry and our company's program.

Yours sincerely,

FORD MOTOR CO. OF CANADA, LTD.,
By K. E. SCOTT, *President*.

FORD MOTOR CO., OF CANADA, LTD.,
Oakville, Ontario, January 14, 1965.

DEAR MR. MINISTER: I wish to bring to your attention a matter of major importance to the Ford Motor Co., which will affect the ability of the company to participate under the Motor Vehicle Tariff Order 1965.

You will recall that our company and its parent, Ford Motor Co., have made commitments to spend in excess of $50 million to increase production of a limited range of automotive engines in Canada for use in our Canadian plants and for export to the United States. This plan provides for greatly expanded production of engines in Canada, thus making possible substantial cost savings. The production of certain engines now produced in short high-cost runs will be discontinued in Canada but will be imported as required.

As a result of this plan, the contribution of engines to our Canadian value added in the production of motor vehicles in Canada in the 1966 model year and subsequent years, will be substantially reduced below the amount contributed by engines in the 1964 model year. The total Canadian value added of our engine operations for domestic use and for export will, however, be increased substantially over our actual value added of engine production in the 1964 model year. For the purpose of the definition of a motor vehicle manufacturer, however, our value added in Canada in the production of motor vehicles in Canada in the base year may experience a short fall of approximately $22 million. Regardless of this possibility, our total Canadian value added will be maintained at the level of our basic undertaking set forth in paragraph 2 of our letter of January 14, 1965.

Should the total Canadian value added in Ford's vehicle assembly in Canada in any model year fall below the level prevailing in model year 1964, Ford undertakes to purchase an additional amount over the amount purchased in the base year of automotive components from Canadian vendors who are not affiliated with a vehicle manufacturer, which is equal to the short fall in Canadian value added below the level achieved in model year 1964.

This undertaking is conditional upon the Ford Motor Co. of Canada, Ltd., being accorded the same tariff treatment it would receive as if it qualified under the Motor Vehicle Tariff Order 1965.

Yours sincerely,

FORD MOTOR CO. OF CANADA, LTD.,
By KARL E. SCOTT, *President.*

CHRYSLER CANADA, LTD.,
January 13, 1965.

HON. C. M. DRURY,
Minister of Industry,
Ottawa, Canada.

DEAR MR. MINISTER: I am writing with respect to the agreement between the Governments of Canada and the United States concerning production and trade in automotive products.

Chrysler Canada, Ltd., welcomes the agreement and supports its objectives. In this regard, our company notes that the Governments of Canada and the United States have agreed "* * * that any expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential * * *." In addition, we note that the Governments of Canada and the United States shall seek the early achievement of the following objectives:

(*a*) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(*b*) The liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; and

(*c*) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

Our company also notes that the right to import motor vehicles and original equipment parts into Canada under the agreement is available to vehicle manu-

facturers in Canada who meet the conditions stipulated in the Motor Vehicles Tariff Order 1965.

These conditions are, in brief, that vehicle manufacturers shall maintain in each model year their domestic production of motor vehicles in the same ratio to their domestic sales of motor vehicles and the same dollar value of Canadian value added in the production of motor vehicles in Canada, as in the period August 1, 1963, to July 31, 1964.

In addition to meeting these stipulated conditions and in order to contribute to meeting the objectives of the agreement, Chrysler Canada, Ltd., undertakes—

1. To increase in each model year over the preceding model year, the dollar value of Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 percent of the growth in the market for automobiles sold by our company for consumption in Canada and by an amount equal to 50 percent of the growth in the market for the commercial vehicles specified in tariff item 950 sold by our company for consumption in Canada, it being understood that in the event of a decline in the market a decrease in such dollar value of Canadian value added in the above percentages is acceptable. For this purpose, growth or decline in the market shall be measured as the difference between the cost to our company of vehicles sold in Canada during the current model year and the cost to our company of vehicles sold in Canada during the preceding model year net of Federal sales taxes in both cases, and

2. to increase the dollar value of Canadian value added in the production of vehicles and original equipment parts over and above the amount that we achieved in the period August 1, 1963, to July 31, 1964, and that which we undertake to achieve in (1) above, by an amount of $33 million during the period August 1, 1967, to July 31, 1968.

Chrysler Canada, Ltd., also agrees to report to the Minister of Industry, every 3 months beginning April 1, 1965, such information as the Minister of Industry requires pertaining to progress achieved by our company, as well as plans to fulfill our obligations under this letter. In addition, Chrysler Canada, Ltd., understands that the Government will conduct an audit each year with respect to the matters described in this letter.

I understand that before the end of model year 1968 we will need to discuss together the prospects for the Canadian automotive industry and our company's program.

Yours sincerely,

——— ———.

JANUARY 14, 1965.

HON. C. M. DRURY,
Minister of Industry,
Parliament Building,
Ottawa, Canada.

DEAR MR. MINISTER: I am writing with respect to the agreement between the Governments of Canada and the United States concerning production and trade in automotive products.

The American Motors (Canada), Ltd., welcomes the agreement and supports its objectives. In this regard, our company notes that the Governments of Canada and the United States have agreed "* * * that any expansion of trade can best be achieved through the reduction or elimination of tariff and all other barriers to trade operating to impede or distort the full and efficient development of each country's trade and industrial potential * * *". In addition, we note that the Governments of Canada and the United States shall seek the early achievement of the following objectives:

(*a*) The creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

(*b*) The liberalization of United States and Canadian automotive trade in respect to tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; and

(*c*) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade.

Our company also notes that the right to import motor vehicles and original equipment parts into Canada under the agreement is available to vehicle manufacturers in Canada who meet the conditions stipulated in the Motor Vehicles

Tariff Order 1965. These conditions are, in brief, that vehicle manufacturers shall maintain in each model year their domestic production of motor vehicles in the same ratio to sales of motor vehicles and the same dollar value of Canadian value added in the production of motor vehicles in Canada, as in the period August 1, 1963, to July 31, 1964.

In addition to meeting these stipulated conditions and in order to contribute to meeting the objectives of the agreement, the American Motors (Canada), Ltd., undertakes:

1. To increase in each model year over the preceding model year, Canadian value added in the production of vehicles and original equipment parts by an amount equal to 60 percent of the growth in the market for automobiles specified in tariff item 950 sold by our company for consumption in Canada, it being understood that in the event of a decline in the market a decrease in Canadian value added in the above percentages is acceptable. For this purpose, growth of decline in the market shall be measured as the difference between the cost to our company of vehicles sold in Canada during the current model year and the cost to our company of vehicles sold in Canada during the preceding model year net of Federal sales taxes in both cases; and

2. To increase Canadian value added over and above the amount that we achieved in the period August 1, 1963, to July 31, 1964, and that which we undertake to achieve in (1) above, by an amount of $11,200,000 during the period August 1, 1967, to July 31, 1968.

The American Motors (Canada), Ltd., also agrees to report to the Minister of Industry, every 3 months beginning April 1, 1965, such information as the Minister of Industry requires pertaining to progress achieved by our company, as well as to fulfill our obligations under this letter. In addition, the American Motors (Canada), Ltd., understands that the Government will conduct an audit each year with respect to the matters described in this letter.

I understand that before the end of model year 1968 we will need to discuss together the prospects for the Canadian automotive industry and our company's program.

Yours sincerely,

EARL K. BROWNRIDGE,
President, American Motors (Canada), Ltd.

Senator GORE. I wish to compliment Mr. Vail and his staff upon doing an excellent job. It should be noted in the title of this, that this is an analysis of the President's report, which report is required by law. There is information other than that contained in the President's report, which casts further unfavorable light upon the continuation of this agreement. Such information will be supplied later.

(Senator Gore's remarks on the floor of the Senate follow:)

[From the Congressional Record, May 15, 1968]

THE CANADIAN AUTOMOTIVE AGREEMENT

Mr. GORE. Mr. President, I have addressed the Senate on several occasions on the subject of the unwise Canadian Automotive Agreement. This agreement has been in effect for more than 3 years, and its damage to the United States should now be apparent to anyone who studies the matter. Results have clearly borne out the warnings issued by me and other at the time of the unfortunate approval by Congress of the legislation which put this agreement into effect. One can understand why the big automobile companies and Canada wanted this deal. They are the beneficiaries. But there is no justification from the standpoint of the U.S. Government. I can undestand, I think, why Henry Ford wanted it, but I do not understand how President Johnson could justify his recommendation of it, or how Congress could have approved it, or why it should not be promptly repealed.

The legislation passed by Congress called for an annual report from the President to Congress on the functioning of the agreement. The first report was not submitted until the agreement had been in effect for more than 2 years, and was transmitted to Congress by the President on March 21, 1967. Another annual report is now long past due. I made inquiry some weeks ago about the next report and was told that a final draft was to go to the White House on March 22. I have

not yet seen a copy of this official report, and I do not know when it may arrive.

Pending the receipt of the delayed official report, it might be of interest to Senators to read a report prepared by Mr. James E. Burke, who is a consultant to a trade organization, the Automotive Service Industry Association. Although I cannot vouch for the accuracy of all the statistics and statements in the report, it does appear to be accurate.

Mr. Burke, having served as consultant on the United States-Canadian Automotive Agreement, is well qualified for his position with the Automotive Service Industry Association. For 45 years he was in charge of export sales for Stewart-Warner Corp., of Chicago, and was a vice president of that company from 1953 until his retirement at the end of 1964.

During his years with the Stewart-Warner Corp., Mr. Burke spent from 3 to 6 months each year in overseas travel for the company, visiting virtually every nation of any consequence in the world. He was president of the Overseas Automotive Club in 1953 and 1954, and was cofounder of the Automotive Exporters Club of Chicago as well as its first president.

Since coming with ASIA, Mr. Burke has interviewed automotive service industry manufacturers in both the United States and Canada to obtain their views with regard to the automotive treaty between the two countries. He also subscribes to and studies all of the important automotive and financial periodicals and newspapers from both sides of the border.

I ask unanimous consent that the report be printed in the RECORD.

(There being no objection, the report was ordered to be printed in the RECORD, as follows:)

THE UNITED STATES-CANADIAN AUTOMOTIVE AGREEMENT: 3 YEARS LATER

(A report by James E. Burke, special consultant to ASIA, issued April 1968)

The United States-Canadian Automotive Agreement governing tariffs on automobiles and automotive parts went into effect in January of 1965, shrouded in secrecy (including secret letters of commitment given the Canadian Government by the major American vehicle manufacturers) and surrounded by conflicting opinions as to its probable effect on the automotive parts industry. After three years, that effect is beyond doubt.

The Financial Post (Canada) on March 1, 1968 reported that over these three years Canadian exports of automobiles and parts to the United States increased nearly 800%, while U.S. Exports of the same commodities to Canada grew just over 125%. It comments that these figures demonstrate that this was "the most successful bilateral trade arrangement in Canadian history". Looking a the other side of the coin, one could add that it is probably the most disatrous bilateral trade agreement in United States history. If the present trend continues, the United States-Canadian automotive account will be balanced within a few years . . . in fact, it is not inconceivable that the automotive trade surplus may be in Canada's favor just as some other commodities are now.

WHY THE AGREEMENT?

Why was the agreement advanced by the Canadians? Because they contended that while they bought 7% of the American type vehicles for what they term the "North American Market", they produced only 4% of those types. This they considered unfair and contrary to their economic and labor interests. The treaty is designed to correct that imbalance. This reasoning is strictly unilateral since, if applied both ways, it would result in a considerable cutback of our consumption of such Canadian imports as wood and petroleum products (including natural gas), and other commodities where Canada enjoys a considerable surplus on her merchandise trading account with the United States.

How did our Government come to accept this contra-liberal trade agreement? The Administration told the Senate Finance Committee at the hearings on the treaty in September of 1965 that if the treaty was not approved, Canada would follow the example of Argentina, Brazil and Australia by shutting out vehicle imports and most of the parts, resulting in Canadian manufacture of all cars and trucks for their market, and with close to 100% Canadian content. These discussions failed to bring out the important differences in the situations in Argentina, Brazil and Australia as compared to Canada. These differences are:

(1) Argentina, Brazil and Ausrtalia are located great distances from the U.S. and are, therefore, remote from the influences caused by contiguity.

(2) Argentina and Brazil have different languages and have been dictator-controlled for a long term of years.

(3) Argentina and Brazil went into local vehicle production only after they exhausted their foreign exchange resources for everything but dire necessities.

(4) Local vehicle production for all four countries has resulted in higher vehicle prices than prevailed when vehicles were imported and were paying substantial tariffs. Only a few years ago, new Chevrolets smuggled into Argentina were selling for the equivalent of $12,000 (U.S.).

(5) A large percentage of the Canadian population lives very close to the U.S. border. We not only share a common language, but the Canadians listen to and watch the same radio and television programs, are regular readers of our periodicals, and closely follow U.S. events and trends.

(6) People in marketing centers such as Buffalo-Hamilton-Niagara Falls-Toronto, Detroit-Windsor, Halifax-Boston, and Seattle-Portland-Vancouver have much more in common with the people in their respective area groups than they do with their own nationals located hundreds or thousands of miles away.

(7) If Canada went in for the manufacture of vehicles with near 100% Canadians content, it would be necessary to concentrate on a very few makes and models and even these would undoubtedly sell for considerably higher prices than their American counterparts. This is evidenced by the inability of the Canadian producers to bring their costs down to U.S. levels, even under the rationalization program resulting from the treaty.

(8) Any Canadian political party which limited the publics choice to a few models, particularly at prices higher than prices for equivalent models in the U.S., would find the going very rough indeed.

WHAT THE TREATY PROVIDES

The United States agreed to free trade in vehicles and parts (subject to imports from Canada having at least 50% Canadian content) *for the vehicle manufacturers only*. Replacement parts were not included because of the objections of the Canadians.

The Canadian's agreement had three provisos in an addendum. These three provisos were in the separate letter commitments made by the U.S. Vehicle producers with the Canadian Government, plus a fourth commitment not referred to in the treaty.

The first proviso or condition required the vehicle manufacturers to maintain, *as a minimum*, the Canadian content of their 1964 models. For example, if General Motors had $250 million Canadian content in their 1964 models, they were required to provide at least this amount of Canadian content every year regardless of the condition of the market. There has been no difficulty meeting this "floor".

The second proviso required that on any increase in domestic demand over the 1964 base year, there would be at least a 60% Canadian content on passenger cars, and a 50% Canadian content on trucks for the increased demand. These were the same percentages stipulated in 1964 and established some time prior in order to qualify for British Commonwealth preferential tariff treatment. There obviously has been no difficulty in achieving these percentages.

The third condition required the vehicle producers to maintain the same ratio of production to sales in Canada as prevailed in the 1964 model year. Ford testified at the 1965 Senate Finance Committee hearings that their 1964 ratio was 99 production to 100 of sales on passenger cars, and 100 of production to 100 of sales on trucks. The ratios of the other producers have not been revealed, but is believed to run about 95 production to 100 of sales. Assuming that the ratio is 1 to 1, the net effect of this proviso is that the value of each producer's exports must equal *or exceed* the value of the producer's imports from the U.S. in order to qualify for duty free entry into Canada. Regular duty rates must be paid on any export deficiencies. Because the overseas market for North American type cars is now limited, all (or nearly all) Canadian vehicle exports must go to the United States.

Finally, the letter agreements stipulate that within the period of the 1968 model year—that is between July 31, 1967 and August 1, 1968—the four vehicle producers agreed to increase their Canadian content by $260 million (Canadian). *Those commitments are over and above the three previously described. Exported parts are credited toward the satisfaction of the commitments.*

The treaty has no termination date, but can be cancelled by either party giving twelve months' notice.

SELLING THE TREATY TO CONGRESS: A CREDIBILITY GAP

In seeking Congressional approval for the treaty, representatives from the State, Treasury and Commerce Departments assured the Senate Finance Committee that the U.S. automotive trade surplus with Canada—which amounted to $578 million in 1964 and $692 million in 1965—would, under the treaty, drop to $500 million and then stabilize at that figure.

The first annual report to the Congress on the operation of the treaty put our 1966 surplus at $486 million. Several times during 1966 the observation was made that the treaty results would not show up in the 1966 figures, but would appear in 1967 as the treaty effects took hold. The figures for the first eleven months of 1967 are now in and, based on these figures, our 1967 Canadian automotive surplus will not amount to more than $286 million. *This is 45% below the forecasts given to the Senate Finance Committee in 1965.*

That is not all. The trend anticipated in 1966 continues. In fact, one of the automotive trade reporting services recently raised the possibility that the U.S.-Canadian automotive account would come into balance within a few years—and it is not inconceivable that the surplus will move over to the Canadian side of the ledger before too long. It is estimated that in the years 1965 through 1967 approximately $650 million has been invested in new Canadian automotive production facilities.

THE TREATY REVIEW

During the past year the Canadian press has occasionally carried intimations from Ottawa that in the review of the treaty now taking place between the two governments (as required by the treaty) *the Canadians will require the vehicle manufacturers to make further Canadian-value-added commitments.* Our Government was not a party to this commitment in 1965 and, apparently, only became aware of it shortly before the signing of the treaty.

Considering its adverse effect upon our automotive trade balance with Canada, it is to be hoped that the American negotiators will refuse to carry on under the treaty beyond the twelve months' notice period if such further commitment is to be made a part of the treaty, or if another separate letter agreement is arranged with the vehicle producers. It is estimated that the vehicles being produced in Canada now have from 72% to 75% Canadian content.

UNITED STATES-CANADA BALANCE OF TRADE

While it is true that a large factor in lowering the U.S. trade surplus has been the heavy preponderance of Canadian vehicles entering the U.S. over American vehicles moving to Canada, there has also been a substantial reduction in the U.S. surplus of automotive parts since the creation of the treaty. Following are the figures, going back to 1963.

[In millions of dollars]

OEM	1963	1964	1965	1966	1967 (11 months)
U.S. parts exports to Canada	472.6	466.4	435.0	546.7	561.5
Parts imports from Canada	20.2	37.6	76.6	170.4	227.0

The above figures do not include engines where the flow in each direction is of approximately equal value, or stampings exported from the U.S. and which are largely captive items and, likewise, not generally regarded as parts.

Replacement automotive parts imports from Canada are not separately listed in the U.S. import statistics, but U.S. exports of such parts are given. Following are the figures, also from 1963:

[In millions of dollars]

Replacement	1963	1964	1965	1966	1967 (11 months)
U.S. parts exports to Canada	86.9	96.0	68.6	83.9	64.5

Again, the export statistics do carry some separately identified replacement parts, but they are not listed above for the reason given previously.

It would seem from the statistics given that the Canadian parts producers would be happy over what these figures show, particularly the ones in the O.E.M. grouping. Such, however, is not the case. The Automotive Parts Manufacturers Association of Canada is complaining that most of the additional Canadian content in Canadian vehicles represents increased assembly operations, or parts obtained from captive parts plants of the vehicle manufacturers. *They are pressing the Canadian Government to modify the treaty so as to provide for greater Canadian content.* There is no doubt—if our Government should yield to such demands—that the further Canadian content would come from parts production since the vehicle manufacturers are now well set up on their assembly facilities.

COMPLACENCY BY A.S.I.A. MANUFACTURERS

Some A.S.I.A. manufacturers may be complacent if their exports to Canada have not suffered as a result of the treaty, *even though they may not be sharing in the expansion resulting from increased Canadian vehicular production. They could be in for a shock later on if the Canadians have their way about higher Canadian content.*

DUTY-FREE ACCESS INTO UNITED STATES FOR OVERSEAS FIRMS

It was earlier mentioned that articles covered by the treaty can enter the U.S. duty-free if they contain 50% or more Canadian content. The U.S. law implementing the treaty, HR 9043, provides for free entry "whether imported directly or indirectly". There are now two companies void of U.S. interest undertaking vehicle manufacturing-assembly operations in Canada—Volvo and a company named Soma, financed by the Quebec provincial government, set up to produce the Renault and Peugeot. A Japanese group is also preparing to produce a car in Nova Scotia.

One Canadian newspaper reported that Renault of France was considering the production of a car *in France* with 50% Canadian content for purposes of securing duty-free entry into the United States. The idea may seem far-fetched—Canadians exporting parts to France for incorporation into vehicles destined for the U.S. just for the sake of saving 5½% duty. However, if enought vehicles are involved, the triangular operation would make economic sense.

There is also the possibility that "third" countries will take advantage of the treaty to assemble in Canada (or have assembled for them) automotive components with 50% or slightly more of Canadian content. The Japenese, for example, might do this with anti-friction bearings on which they are proving to be strong international competitors. As evidence that this is not a remote threat, imports from the Virgin Islands are currently admitted duty-free into the United States under a similar 50% provision. A very large volume of watches now enter this country from the Virgin Islands, with the slightly under 50% of content *being supplied by the Russians.* What is occurring in the Virgin Islands could just as easily develop in Canada.

WHAT THIS MEANS TO A.S.I.A. MANUFACTURERS

The treaty is a bad one in terms of U.S. interests, not only because of the results to date but also because any further deterioration in our automotive trade balance will fall heaviest on the independent parts manufacturing sector. There is now considerable sentiment in the Congress for import quotas on certain items, notable steel and textiles, which would limit the quantities of products brought in under those categories. The Administration has indicated that it would veto any such import legislation passed by the Congress. The U.S.-Canadian Automotive Treaty, coupled with the separate letter agreements, constitutes a Canadian quota system, and a very tough one at that.

The legislation proposed in the Congress puts ceilings on certain imports. The quotas in the U.S.-Canadian Automotive Treaty, and the letter agreements, not only establish Canadian production "floors", but also force on the United States the $260 million additional Canadian content requirement. It is hard to see how the Administration can act negatively on any import quota legislation, if passed, and still espouse the treaty. Not only would these positions be inconsistent, but there is also the hard fact that we have suffered a drastic reduc-

tion in our automotive trading account with Canada—contrary to the Administration's assurances in 1965 that our surplus would level off at a constant annual figure of $500 million.

Senator GORE. Mr. Chairman, I am sorry that I must go to another committee.

Mr. HARTKE. Mr. Chairman, before the Senator from Tennessee leaves I would like to commend him on his statement. The improvidence of the U.S. commitment under the Canadian Automotive Agreement is amply demonstrated by the President's Second Annual Report on the agreement. I have not seen the finance staff analysis on the President's report prepared at Senator Gore's request, but the President's report has been analyzed by a member of my own staff and his conclusions are to the same effect. As a result I commented on the President's report in a statement appearing in the Congressional Record of May 29, 1968. In that statement I observed that as a result of the agreement the U.S. favorable automotive trade surplus with Canada has been reduced by more than 50 percent. In 1964 we had a favorable Canadian automotive trade surplus of $578.3 million.

In 1967, the third year in which the agreement was in effect, that surplus was only $285.8 million. In September 1965 when this committee considered, and subsequently favorably reported, over the objections of Senators Gore, Ribicoff, and myself, the enabling legislation implementing this Executive agreement, we were assured by the administration that, under the agreement, the United States would continue to "maintain our present sizable surplus with Canada in automotive trade." We now know how false this representation was. In concluding my statement in the Congressional Record I expressed the hope "that when the President of the United States submits his special report to Congress on the agreement and his recommendations" as his is required to do under the agreement "prior to September 1, 1968, that he take full account of this severe reduction in our automotive trade surplus with Canada and that he take such measures as are necessary to reverse the situation including, if necessary, the giving of the notice required to withdraw the United States from the agreement." At this juncture I would be prepared to ask for termination of the agreement consistent with that provision of the agreement which requires a year's notice of intention to terminate. I would join with the Senator from Tennessee in any proposal, consonant with this provision to effectuate discontinuance of this unwise agreement. I ask that my statement from the Congressional Record of May 29, 1968, appear in the record at this time.

(The remarks of Senator Hartke on the floor of the Senate follow:)

THE CANADIAN AUTOMOTIVE AGREEMENT

Mr. HARTKE. Mr. President, the Canadian Automotive Agreement has now been in effect for more than 3 years. The President's second annual report to the Congress on the operation of the agreement has now been received, albeit tardily. The President's report, Mr. President, demonstrably illustrates how unwise the U.S. commitment under the agreement has been. From a trade surplus with Canada in the automotive category—vehicles including cars, trucks, and buses and parts—of $578.8 million in calendar year 1964 our Canadian automotive trade surplus has diminished to $285.8 million in calendar year 1967 or a reduction in excess of 50 percent in the third year in which the agreement has been in force. This, Mr. President, after assurances from administration representatives at the time Finance Committee hearings were held on implementing legis-

lation to this agreement that our automotive export surplus would not be curtailed. I recall those hearings very well Mr. President and I recall Assistant Secretary of the Treasury Trued's statement that under the agreement we would "maintain our present sizable surplus with Canada in automotive trade." I did not join with the majority of my colleagues on that committee in referring the enabling legislation favorably to the full Senate; I do know, Mr. President, as the majority report evidences, that it was upon such representations that my colleagues on that committee favorably reported the legislation.

"Under the agreement neither country is a loser; both are winners. By the Treasury computations both nations will share in the expanded trade in such proportions that our favorable balance of trade will not be disrupted over the period covered by the letters of undertaking. Such a result of a trade agreement is truly unique. Generally one party or the other must suffer an unfavorable shift in trade patterns. By this agreement we will avoid an unfavorable shift in our export trade. P. 13-14, Report of the Finance Committee on the Automotive Products Trade Act of 1965."

I have prepared a table which shows, on a comparison basis for the years 1961 through 1967, inclusive, the severity with which the agreement has adversely effected our balance of payments. The table is a combination, in part, of table II, page 10 of the Finance Committee report on the agreement dated September 27, 1965, and which shows United States-Canadian automotive trade for the calendar years 1961 to 1964 inclusive, and table 14, page 52 of the President's report which, inter alia, provides the same information for the years 1965 to 1967, inclusive. This table is as follows:

U.S. AUTOMOTIVE TRADE WITH CANADA

[In millions of U.S. dollars]

	1961	1962	1963	1964	1965	1966	1967
U.S. exports:							
Passenger cars	45.2	50.2	26.9	43.4	114.0	275.6	563.0
Trucks, buses, and chassis	23.2	19.2	16.3	15.2	45.4	83.6	138.3
Parts and accessories	311.8	330.1	497.7	393.4	700.5	952.1	1,099.9
Total	380.2	399.6	541.0	654.0	860.0	1,311.4	1,801.2
U.S. imports:							
Passenger cars	.6	.8	.8	18.9	84.1	370.7	818.0
Trucks, buses, and chassis	.2	.3	1.6	4.7	23.7	158.3	269.9
Parts and accessories	6.9	8.4	18.8	52.2	94.0	315.2	427.5
Total	7.7	9.5	21.4	75.7	201.8	844.1	1,515.4
Total, U.S. net exports	372.5	390.1	519.6	578.3	658.1	467.2	285.8

While it is apparent, Mr. President, that our automotive exports to Canada have increased by 275 percent—comparing 1964 to 1967—our automotive imports from Canada have increased by 2,000 percent with a resultant decrease in our Canadian automotive trade surplus of more than 50 percent!

Mr. President, the reason for the enactment of enabling legislation to the Agreement—the Agreement itself was an Executive Agreement which was not ratified by the Senate but the enabling legislation was in substance a ratification of the Agreement—was because the Canadian Government in 1963 had unilaterally undertaken to remit tariffs in order to stimulate Canadian automotive exports. The Agreement and the corresponding legislative implementation, the Automotive Products Trade Act of 1965, was the reasoned compromise our Government sought in the face of the Canadian illegal and unilateral remission scheme. As Senators Ribicoff and Gore and myself stated in our minority views to the Finance Committee report on the enabling legislation:

"With regard to our balance of payments, the Assistant Secretary of International Affairs for the Treasury Department, the Honorable Merlyn N. Trued, testified that in 1964 we had a favorable trade surplus with Canada of $581 million. He further testified that under this agreement, we would retain that surplus, i.e., in 1968 our trade surplus is estimated to be, under the agreement, $580 million. He failed to say that it is estimated that, had the Canadians been persuaded to drop their illegal tariff remission scheme, our trade surplus with Canada would have reached $841 million by 1968. Further, had we done nothing

at all in the face of their remission scheme, our surplus would have been $650 million.

"In other words, from a balance of payments point of view, in protesting the drop from $850 million to $650 million, the State Department negotiated us down to $580 million."

In short, Mr. President, we have gone from a $650 million trade surplus—giving full consideration to the effect of the illegal Canadian remission scheme—to a trade surplus of only $285.8 million.

This Agreement was sold to the American people as free trade. In fact, Mr. President, the Agreement as we noted in our minority views "is the antithesis of free trade." There is no removal of tariffs generally but only for a few chosen automobile manufacturers. The Agreement and the implementing legislation is class legislation of the worst order.

To quote again from the minority views to the Finance Committee's report on the implementing legislation:

"The Canadian duty on American automobiles is not removed. A dealer in Montana or Maine cannot sell duty-free across the border in Canada. Only an automobile manufacturer can import into Canada free of the 17½ percent Canadian tariff. Not only that, it must be a qualified manufacturer; i.e., one who has provided satisfactory commitments to the Canadian Government.

"U.S. duties are not lowered for the benefit of everyone. Parts may be imported duty free only if they are going to an automobile manufacturer. The dealer or supplier who would attempt to sell Canadian made parts to automobile supply stores or automobile repair businesses, or directly to American consumers, must still pay the tariff."

Mr. President, I have always held to the view that the removal of barriers to trade through equitable and reciprocal concession is a valid and important principle in the promotion of commerce between nations.

The concessions in the Canadian agreement are neither equitable nor reciprocal. What has been hailed as "the most successful bilateral trade arrangement in Canadian history" is conversely one of the worst for the United States and the American people. The real beneficiaries of the agreement are a chosen few automobile manufacturers. America has gained nothing but a worsened reduction of a balance-of-payments surplus we can ill afford.

I would hope, Mr. President, that when the President of the United States submits his special report to Congress, on the agreement and his recommendations prior to September 1, 1968, that he take full account of this severe reduction in our automotive trade surplus with Canada and that he take such measures as are necessary to reverse the situation including, if necessary, the giving of the notice required to withdraw the United States from the agreement.

Senator HARTKE. I again wish to commend the Senator from Tennessee on the fine work he has been doing in this area.

Senator GORE. Thank you.

This was an agreement primarily for the benefit of the big automobile companies. They have benefited in fact from it. Canada has benefited vastly from it. I can understand why both wanted it. What I can't understand is how the President could agree to it or how this committee or the Senate could agree to it.

Senator HARTKE. I wonder if the Senator from Tennessee is aware if there has been a reduction in the price of automobiles in Canada or whether there has been only a reduction in tariffs to the corporations.

Senator GORE. Well, the reduction in tariff was not for the people of either country. The reduction in tariff is only for the benefit of the automobile companies, the big ones. It doesn't affect the tariff on an automobile or a part that a Canadian consumer or an American consumer will buy. The Senator realizes that.

I am unable to give you any exact answer to the question.

Senator HARTKE. Thank you.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, have you had occasion to read this memorandum prepared by the staff of the committee?

95-943 O—68—pt. 1——7

Secretary FOWLER. No.

The CHAIRMAN. It might be well if you would look this over and comment on it if you feel disposed to do so at this time, or it might be that the Department of Commerce might want to respond to it.

Secretary FOWLER. I think the Department of State and the Department of Commerce are the appropriate departments to which it should be referred. I have only a very general knowledge of it.

The CHAIRMAN. Now that the matter has come up, and I am on notice that this amendment will be offered at such time as the sponsors think appropriate, I think it well for you to comment on the two bills.

Secretary FOWLER. On the two bills?

The CHAIRMAN. Yes; S. 3204 and S. 3205.

Secretary FOWLER. These are Senator Gore's bills.

The CHAIRMAN. Pardon me, Mr. Secretary, I see that we are talking about three different things.

Since this matter about the automobile parts agreement came up, I thought it might be well just to draw out your reaction for the record, keeping in mind that you are more than just Secretary of the Treasury. You are a good lawyer and in years gone by you represented the American automobile industry in private practice and I would just like to, if I might, draw from you your reaction to the way this automobile agreement has gone on.

Secretary FOWLER. Senator Long, I don't have any reaction to offer to the committee this morning. I am not familiar in any detail with the annual report submitted by the President to which Senator Gore referred, and I have not seen the analysis of that report which was prepared by the staff of the committee. Therefore, I would like to ask the committee to reserve at this point in the record an opportunity for the Department of State and the Department of Commerce or the President's Special Representative on Trade, Ambassador Roth, to submit an appropriate statement and commentary at this time.

(The comments referred to follow:)

COMMENTS BY THE DEPARTMENTS OF STATE AND COMMERCE ON THE ANALYSIS* OF THE SECOND ANNUAL REPORT OF THE PRESIDENT TO THE CONGRESS ON THE OPERATION OF THE AUTOMOTIVE PRODUCTS TRADE ACT OF 1965

BACKGROUND OF THE UNITED STATES-CANADA AUTOMOTIVE PRODUCTS AGREEMENT

The United States-Canada Automotive Agreement of 1965 arose out of a dispute over unilateral Canadian actions to stimulate the growth of the Canadian automotive industry by measures the United States considered unfair and prejudicial to our interests. The Agreement represented a positive solution designed to create a broad market for automotive products and to develop conditions in which market forces could operate.

Prior to the Agreement the U.S. and Canadian automotive industries were in many respects similar. Models produced in Canada were made by U.S. subsidiaries using parts largely interchangeable with those used in U.S.-made cars. Despite many common elements, artificial and uneconomic barriers divided what was essentially a single industry.

Faced with increasingly higher costs of production, a small market and steadily mounting imports, Canada in 1962 adopted a plan to remit import duties in return for expanded exports. Some U.S. automotive parts manufacturers complained that the remission of duties was tantamount to a subsidy and petitioned the Treasury Department for countervailing duties on imports from Canada. An investigation was begun but some questions existed as to the legality of imposing countervailing duties. Considerable uncertainty existed for industries in

*Analysis prepared by the Staff of the Senate Finance Committee at the request of Senator Gore—Hearings on the Travel Tax Proposals, June 26, 1968, p. 74.

both countries. There was also the possibility of further Canadian measures which would have also had adverse trade effects for the United States. As President Johnson said in his letter dated March 31, 1965 to the President of the Senate and the Speaker of the House of Representatives. "We were faced by the prospect of a wasteful contest of stroke and counterstroke, harmful to both Canada and the United States, and helpful to neither. Our broader good relations with our Canadian friends would have suffered serious strain."

After some nine months of discussion and negotiation, the United States and Canada agreed to adopt an alternative—an arrangement to remove the barriers between the two industries and permit the creation of a single North American industry. The Agreement was signed on January 16, 1965 by President Johnson and Prime Minister Pearson.

Under the Agreement the U.S. removed its import duties on Canadian cars, trucks, and buses, and parts for assembly. Canada did the same (its duties ranged from 12½–25%) except that, in recognition that costs and prices of cars in Canada would remain higher for some time, only manufacturers meeting certain criteria could import duty free into Canada. These criteria were included in the Agreement as special transitional measures until the smaller and higher-cost Canadian automotive industry could adjust operations to the much larger North American market.

Additionally, apart from and wholly outside the Agreement, Canada obtained letters of undertaking by Canadian vehicle manufacturers (reproduced in the appendix to the analysis).

RESULTS OF THE AGREEMENT

In response to the opportunities afforded by the Agreement, manufacturers moved quickly to rationalize production between the two countries. As a result some car models are no longer produced in Canada but are imported from the U.S. On the other hand, Canadian plants are specializing in fewer models with longer and more efficient production runs. Most producers have now largely completed their major production adjustments.

TRADE EFFECTS OF THE AGREEMENT

Under the agreement, automotive trade between the U.S. and Canada has quadrupled, rising from $730 million in 1964 to over $3.3 billion in 1967. In addition, trade in allied products, such as machinery, tires and tubes, paint, and chemicals has increased significantly although the relationship of that trade growth to the Auto Agreement is not measurable. Canada continues to be the largest export market for products of the U.S. automotive industry. Total U.S. automotive exports in 1964 were $1,765 million and the Canadian market accounted for 37 percent of this total, or $654 million. In 1967 exports to Canada amounted to $1.8 billion and constituted 61 percent of total U.S. automotive exports.

As noted in the analysis and the President's Annual Report, serious statistical problems arise in measuring United States-Canadian automotive trade. Imports into both countries of duty-free vehicles and original equipment automotive parts are precisely identified but the export statistics are less detailed and do not identify as "automotive" substantial exports of parts, which are subject to duty-free entry into the other country as a result of the Agreement. Because of such problems, there is an increasing divergence between U.S. and Canadian trade figures with U.S. data showing lower U.S. net automotive exports than are shown by Canadian data.

As a result both the United States and Canadian Governments agree that the most representative and comprehensive measure of total automotive trade between U.S. and Canada may be derived from their respective import statistics.

The net export surplus of $439 million in 1967 was below the $500 million level projected by Administration witnesses during the 1965 hearings before the Senate Finance Committee. However, the average U.S. trade surplus during the three years under the Agreement (1965–67) was $549.4 million compared with an average of $551.5 in the two years prior to the Agreement.[1]

The $500 million net surplus projected by the Administration in 1965 assumed an annual growth rate of the Canadian market of 8 percent (as compared with

[1] These figures are based on U.S. and Canadian import statistics—see page 20 of the Second Annual Report (1963 figures estimated).

the 10.6–12.0 percent annual Canadian growth in the period 1960–64). The 1966 and 1967 decline in the U.S. export surplus was due in large part to a less than 8 percent annual sales growth in both countries while record sales in 1964 and 1965 contributed to high trade surpluses those years. Thus, as expected, automotive trade balances moved in the same direction as sales and production figures.

It is very difficult to project meaningful trade trends on the basis of only three years experience under the Agreement. The declines in the U.S. automotive trade balance in 1966 and 1967 appear to be of a temporary nature resulting from lower than projected sales growth in Canada and the initial adjustments arising from the rationalization and integration of U.S. and Canadian production.

PRICES

The difference between prices in the United States and Canada for the same model car with similar equipment has narrowed since 1964. The narrowing of the price differential has been greater at the manufacturers level than at the retail level because of increases in the Canadian sales tax.

PRODUCTION AND EMPLOYMENT

It is difficult to estimate how much of the increased assembly of finished vehicles in Canada was at the expense of U.S. assembly operations. It does appear that vehicle manufacturers have met the Canadian requirements to a greater extent by increased assembly operations than by parts production and parts procurement in Canada.

As noted in the analysis, there have been some shifts within the North American automotive industry in both directions. Automotive employment in both countries has increased. North American rationalization has increased job opportunities in some U.S. plants.

ADJUSTMENT ASSISTANCE

In recognition that the operation of the Agreement might cause dislocations to some firms or workers as the industry moved toward integration with Canada, the Automotive Products Trade Act provided for a special adjustment assistance program. Petitions for assistance under this program can be filed through June 30, 1968. In the proposed Trade Expansion Act of 1968 (H.R. 17551), the President has recommended that the program be extended for three years.

Adjustment assistance has involved only a small proportion of the more than 800,000 workers employed in the automotive industry. To date, 21 petitions for relief have been filed by groups of workers who claimed that they became unemployed because of the U.S.-Canadian Agreement. The Automotive Agreement Adjustment Assistance Board determined that the operation of the Agreement was the primary cause of dislocation for 14 of these petitions and issued certifications of eligibility covering about 2,500 workers, approximately half the number originally petitioning for assistance. The facts in many instances indicated that the primary reason for the layoffs of many workers was the slump in automobile sales (in early 1967) rather than the Auto Agreement.

Not all of the workers certified by the Board actually applied for assistance at their State Employment Security agencies, or, upon application were determined to have complied with the special requirements of the law. About 1,850 individuals did apply and met the standards. They have received benefits of about $3.5 million. Many of the dislocated workers have been either recalled to their former job, found new work, or left the labor force. On December 31, 1967, only about 325 of all auto workers who had received adjustment assistance were unemployed.

About 2,400 of all workers who petitioned were employed in assembly plants. About 685 such workers were among the total 2,500 certified by the Board as having been dislocated as a result of the Agreement.

JOINT REVIEW OF THE AGREEMENT

In accordance with article IV(c) of the Agreement, the Governments of Canada and the United States are at the present time jointly undertaking a comprehensive review of the progress made towards achieving the objectives of the Agreement. During the current review the two Governments are also considering such further steps as may be necessary or desirable for the full achievement of these objectives.

It is not yet clear what changes will result from the review. However, in accordance with Section 205(a) of the Automotive Products Trade Act of 1965, the President will submit a special report on the review to Congress not later than August 31, 1968.

In accordance with Section 205(b) and (c) of the Automotive Products Trade Act, the President is also required to report to Congress and recommend further steps necessary for the achievement of the purposes of the Agreement and the Act if he finds that any manufacturer has entered into any undertaking, by reason of governmental action, to increase Canadian value added after August 31, 1968. We have thus far no reason to believe that as a result of the review there will be further undertakings by manufacturers to the Canadian Government to increase Canadian value added.

CONCLUSION

We believe the U.S.-Canada Automotive Agreement has clearly benefited the industry, labor, and consumers of both countries. Commerce has grown and efficiency in the use of labor, capital and materials has been increased. The industries of both countries have already moved far toward the goal under the Agreement of specialization and large-scale production. The reduced U.S. net automotive export surpluses in 1967 appears to have been largely the result of relatively poor sales and the transition to an integrated North American industry. As the current joint comprehensive review is completed and in our continuing consultations with the Government of Canada, we will be determined to see that every effort is taken to achieve fully the objectives of the Agreement.

The CHAIRMAN. Mr. Secretary, you may prefer not to comment on the matter. Propriety may dictate that you not comment in view of the fact that many of these automobile firms were once your clients in private practice, and there is a sort of lingering relationship.

One time I advised my former law partner that he should refuse to testify with regard to the conduct of his former clients. Some of those former clients wound up going to jail. If they could have persuaded my friend, the lawyer, to testify, perhaps all of them would have wound up in jail.

But I was satisfied in my mind that when someone employs a lawyer and pays him a fee he shouldn't say anything that would injure the case of his clients even though the relationship has been terminated. So, I am somewhat aware of legal ethics as I am sure you are.

Secretary FOWLER. Well, it isn't a matter of delicacy at all involved here. It simply is that I don't have sufficient knowledge of the operation of the agreement or of the committee's analysis of it to entitle me to make the comment and, therefore, I plead ignorance, not ethics.

The CHAIRMAN. Would you give us just your offhand reaction to these two bills? We would like to get your reaction to them.

Secretary FOWLER. Senator Gore's——

The CHAIRMAN. Yes; the tax treatment of income earned abroad by corporations and individuals.

Secretary FOWLER. I would make just two short comments. First, on the bill that is designed to eliminate tax deferral on income from foreign subsidiaries: The keystone of our present balance-of-payments program insofar as direct investment and repatriation of earnings from direct investment is concerned, is the program being administered by the Department of Commerce under a regulatory act. I believe that for the time being, and it is a temporary program, the Commerce Department's program is more flexible and a more useful device for implementing our current balance-of-payments objectives than changing the

tax system either to provide incentives or disincentives for various capital flows. So I would not at this time advocate any major change in the tax laws until we can evaluate the effect of the Department of Commerce's regulatory program which involves very directly repatriation of earnings.

I think over the longer pull from the standpoint of tax policy the issue which is raised by Senator Gore's proposal will undoubtedly call for some attention in the long-term future. But my own position now would be that we ought to stay with the program regarding direct investment and repatriation of earnings as it is established and being administered by the Department of Commerce before superimposing on it or substituting for it any substantial change in the tax laws.

I now turn to the other bill which has to do with elimination of the foreign-earned income exemption of U.S. citizens. This has come up in connection with several of the Congress' actions in the tax field in, I believe, the Revenue Act of 1962, and again in the Revenue Act of 1964.

You will recall that it has been the policy of the administration to eliminate, wherever possible, special treatment for certain types of income, and we think that this particular legislation would be a proper subject to consider in connection with a general tax reform measure, because it is one of the types of special treatment of a certain kind of income which would naturally come up in that connection.

The issue then which would have to be considered by the Congress would involve a decision as to whether or not the advantages of an incentive to U.S. citizens working abroad have a desirable purpose or beneficial effect or whether the provision, in the present condition and situation in which we find the world, represents an unjustifiable exclusion of income from the tax base.

I think there are various aspects that the committee would want to consider. What effect this would have on meeting competition; what effect there might be on increased costs to the Government; whether or not such an exemption should be limited to payments of salaries to those resident in less-developed countries; or whether it should be across the board.

I think this is a subject which would be naturally and properly considered in any general reform measure.

It certainly is not our desire to consider this matter at this time, I would hope that the committee would deal with the problem at hand in this particular bill—what we are going to do about travel—and not allow its other broader concerns, in the closing period of this session, to prevent or delay action on the matter before you.

The CHAIRMAN. I have come to moderate my views on this subject, Mr. Secretary, as time has gone by. The advocates of the Gore proposal tend to look upon income earned in a foreign country somewhat along the line of, or parallel to, the income which is taxed by a State for which a deduction is allowed, and then the remainder taxed by the Federal Government.

The one thought that occurs to me about all that is that in the last analysis a foreign nation is entitled to tax all the income earned in that country. It has that privilege. It can tax a hundred percent of it if it wants to, and it has complete sovereignty over that individual while he is in that country. That is somewhat different from the situa-

tion that exists where a State collects a tax and the person also is subject to tax by the Federal Government.

Secretary FOWLER. As I understand Senator Gore's proposal he wouldn't interfere with the foreign tax credit; that would still be retained. But whatever tax was due from the corporation after the foreign tax credit was applied would be exacted straight away rather than waiting for the funds to be in fact repatriated.

The CHAIRMAN. Do I understand that you do not advocate these proposals at this time, although you would like to consider them at some future date, is that the idea?

Secretary FOWLER. Well, as far as the balance-of-payments situation is concerned we think we have at the present time in the direct investment program being administered by the Department of Commerce under the Banking Act a more flexible and effective means of dealing directly with the problem of capital flows. This program specifically involves repatriation of earnings.

Therefore, from the balance-of-payments program standpoint, I don't see any short-term necessity for it. I think, therefore, the question of continuing the deferral of taxation on income abroad is a longer range problem that need not come up at this time as long as we have the existing Department of Commerce program. I think when that program is abandoned and done away with, then the question of the relative weighing of incentives and disincentives affecting investment abroad and returned income from abroad, will onc again be presented to the committee.

The CHAIRMAN. Senator Smathers informs me that Senator Carlson should be called upon at this point. Do you have any questions to ask?

Senator CARLSON. Mr. Secretary, I have received considerable mail from Governors, State officials, officials of local governments, such as mayors, and heads of colleges and universities asking that they be exempt from the travel tax on the theory that they are not just tourists in the ordinary sense of the word. They represent their State or their government or their college in international programs. Have you got any comments on that?

Secretary FOWLER. You are referring, I believe, to the question of the application of the ticket tax, and the question of whether there should be a continuing exemption for State and local officials from the application of the ticket tax?

Senator CARLSON. Not only the ticket tax, but also the expenditure tax that you are now proposing to this committee.

Secretary FOWLER. Let me deal with the expenditure tax then, first. It does not seem to me to be reasonable or necessary or indeed desirable to exempt anyone from the expenditure tax. The purpose of the tax is to encourage American travelers, whoever they may be, traveling outside the Western Hemisphere, to spend dollars at a modest rate from now until October 1969. For that period of time, given the $15 minimum daily exemption, it seems to me that the case, if there is any case, for exempting particular groups in the population is pretty well dissipated by this change in the proposal. The original proposal would have started a 15-percent tax at any expenditure over an average of $7 a day. I can see how people, even though traveling modestly, would have been affected by that tax. But now having the

proposal in front of the committee for a $15-a-day exemption, I see no reason for a concern about anyone traveling outside the Western Hemisphere being sorely afflicted by this particular tax. It is an easier one to live with, provided one who is traveling chooses to live modestly.

Senator CARLSON. Well, Mr. Secretary, these people that I had reference to are not tourists. They are participants in programs that affect their governments, and they go as representatives of their governments, not tourists, and while, as you say, $15 a day is exempt, which was not true in the original legislation that they wrote me about——

Secretary FOWLER. Senator Carlson, the tax would be applicable to all kinds of travelers, not just tourists, For instance, we would propose that this tax be applicable to Federal employees traveling in the interest of the U.S. Government, and since it applies to them, I see no reason why it shouldn't apply to those who are working for a State government or on behalf of State government programs, whatever their status might be.

Senator CARLSON. Well, I think I should say, Mr. Secretary, that these people who travel for the U.S. Government are paid by the U.S. Government also. They will pay their tax, too.

Secretary FOWLER. Our proposal would be that all regular employees, all temporary employees, all those acting on a contract basis, all private citizens, be similarly affected. U.S. Government employees would have to meet the tax out of their ordinary per diem allowances. There would be no extra reimbursement.

Senator CARLSON. Well, of course, that just adds an additional charge to the Government, as I see it, and that would not be true in some of the situations which concern our State officials. I probably see their point a little more closely than you would, having served as a Governor, because I do know we send people abroad. We appoint them and we send them over. Having traveled some myself, I think it could be said that students staying at hostels and other places probably could travel at $15 a day. But $15 a day does not go very far in most of the countries in which I have traveled.

Secretary FOWLER. You are only going to pay the tax on the excess and that isn't going to add up to a very great deal and, as I indicated yesterday, cutting your stay short a day or two or having the Mrs. avoid those last-minute shopping purchases can make up for any impact of the tax and that is what it is designed to do.

Senator CARLSON. You will admit, will you not, that 30 percent is a pretty high tax? In other words, if I spend $20 and my tax is $6, that is pretty high.

Secretary FOWLER. If you spend $20 your tax would only be 20 percent on the $5 over the $15 daily exemption.

Senator CARLSON. Well, $20 in addition to $15 is what I had in mind.

Secretary FOWLER. Oh, well, then it would cause you to pause and think, and that is its design.

Senator CARLSON. That is all, Mr. Chairman.

Secretary FOWLER. Senator Hartke.

Senator HARTKE. I hope I don't repeat some of the things said before.

Mr. Secretary, what you propose here is a restriction, isn't that right? Isn't that the purpose of it?

Secretary FOWLER. No, it is not trying to restrict travel. It is trying to cause those who do travel to spend at a modest rate.

Senator HARTKE. It is a penalty, then, on them?

Secretary FOWLER. It is a penalty on spending beyond an average of $15 a day.

Senator HARTKE. In other words, what you are proposing here, in effect, is a form of quota?

Secretary FOWLER. No, we don't think of it as a quota, and we don't think of it as having the effect of causing people to cancel trips. We think of it primarily as causing people who do wish to travel and make a trip outside the Western Hemisphere, to spend that marginal dollar above the $15 a day average, with some thought that this is exhausting or utilizing the foreign exchange that is available to the United States just as the man of the house in fixing his budget allocates so much for vacation——

Senator HARTKE. And the intention then is to put into his mind that he just has so much to spend, why he has to restrict the term of his travel, isn't that true?

Secretary FOWLER. Or else——

Senator HARTKE. As you said a moment ago——

Secretary FOWLER. Or else pay the tax or forgo some expenditure that otherwise he might find attractive.

Senator HARTKE. Forgo is the same as restrict. I mean it is a nicer word but it is the same thing.

What I do not understand is how the Treasury can come here and say that there is a possibility of retaliatory action in regard to a quota bill similar to the type I have sponsored along with Senator Dirksen and other Senators, saying such action would precipitate a retaliatory action in other countries and, at the same time, come here and say that you are taking a restrictive action in regard to travel by our citizens and that you will not have the same type retaliatory action by other countries in regard to travel by their citizens? How can you come up with an explanation of this contradiction in approach?

Secretary FOWLER. We had a number of exchanges of views in January and February with the officials of other countries as to their reactions to the various features of the President's program that was announced on January 1. On the basis of those exchange of views, of their recognition of the fact that this is a serious problem—that they are enjoying a very substantial advantage in this travel field as far as relative positions are concerned—we have had no intimation there would be any serious intention of retaliation by these governments.

Senator HARTKE. In other words, you have obtained a waiver from them regarding retaliatory action?

Secretary FOWLER. There has been no formal waiver. It was not necessary to do that. After having reviewed our entire program with them, we came away with the feeling that, whatever their private or personal reservations might be about these proposals, that there would not be retaliatory action by the governments concerned.

Senator HARTKE. You certainly don't contend, Mr. Secretary, that there is not an exact parallel between the situations. What you are saying in substance is that you do not think in this case there will be retaliation but in the other case there would be retaliation?

Secretary FOWLER. There is quite a difference, Senator Hartke, in one respect; namely, that the treatment of travel and travel expenditures, the area affected by the Treasury proposals, is not subject to the General Agreement on Tariffs and Trade or to the surrounding policies and interpretations that are involved in that.

Senator HARTKE. It is a distinction without a difference. There is no reason under GATT why you cannot have a quota. This is not a distinction between the two situations. Both of them are of similar character. I don't see any difference—and I don't think that so far you have shown me any difference—you are willing to admit are you not, that the same kind of retaliation could be anticipated for a restriction of this nature as could be expected from a quota?

Secretary FOWLER. No.

Senator HARTKE. And the reasons you say you are not expecting it is because you have reached a prior agreement with these foreign countries?

Secretary FOWLER. No, no prior agreement; but an assessment of their reactions to the various features of our January 1 program that was announced, and having reviewed that program with them, a feeling that any risk of retaliation in this area was de minimis.

It has been the practice and custom of various countries at various times to put on some type of restraint on foreign exchange expenditures in connection with tourism. This is not an unusual practice.

Senator HARTKE. What you are saying, and I know you don't want to admit it, and I am not blaming you for not wanting to admit it, but what you are saying is that the situations are the same, but you have obtained some type of assurance that the results would not be the same, isn't that true?

Secretary FOWLER. I am just saying that I do not have any apprehension that there would be retaliation by countries in the event Congress chose to enact law that is requested here.

Senator HARTKE. Now, you have no fear. Do we have any assurances from the French?

Secretary FOWLER. We have no assurances or agreements. We have very definite impressions that there would be no retaliation.

Senator HARTKE. You mean to say what has happened is that there was an announcement by our Government indicating that this was going to be the policy, and as a result you waited for some type of word or whisper back from some of these authorities and since you received no communication you now make the assumption that there would not be a retaliation?

Secretary FOWLER. No, no. Shortly after the announcement of the President's program in the month of January and in the month of February there were visits made by a delegation representing the U.S. Government to review with the responsible officials in the principal governments in Western Europe, Japan and Canada, the purview of the program which was contemplated and announced on January 1. There were exchanges of views about that program, the necessity for it, the various aspects of it, and it was on the basis of those series of meetings which took place in January and February that I give you this assessment.

Senator HARTKE. All right.

Now, did you ever make such a followup in regard to any imposition of quotas by the United States?

Secretary FOWLER. Yes, special trade representative, the President's special trade representative——

Senator HARTKE. Mr. Roth?

Secretary FOWLER. Mr. Roth discussed the area of trade as it was reflected in the President's message on January 1, which was a part of these general discussions.

Senator HARTKE. Now, do you view all these things in similar vein? If a foreign government, in other words, should give some type of indication that they would respond, for example, if there was a threat of a quota from some other country, would our Government respond in similar fashion? Would you reply in some way or would you ignore it? What would you do about it?

Secretary FOWLER. Well, I would certainly first examine very carefully our own laws and the General Agreement on Tariffs and Trade to see whether or not in the light of the action taken there should be responsive action on our part, given our laws and given the General Agreement on Tariffs and Trade.

Senator HARTKE. You are familiar with the fact that in today's Washington's Post there is an article in which France warns of her intention to impose quotas on the importation of automobiles, refrigerators, washing machines, textiles, steel and other products to protect her own balance-of-payments position.

Secretary FOWLER. I have received a preliminary report on the action contemplated by the French Government. The final word as to whether the French Cabinet has officially acted today or not I haven't received. Until we do know the precise nature of the official action that is taken by the French Government, I would prefer not to make statements as to our actions. But I can assure you that the French steps, when they are taken, will be very carefully analyzed in connection with our own laws as well as their undertakings under the General Agreement on Tariffs and Trade. And I would think that if the committee is interested in this particular problem, the President's special representative on trade should be available for discussion with the committee.

Senator HARTKE. In the event that they do proceed toward taking some action in establishing these import quotas, and prior to that action, prior to the time that such action becomes final, would the administration warn the French that they could expect retaliatory action from the United States.

Secretary FOWLER. I think that is the question, Senator Hartke, which is much more properly answered by the President's special representative on trade, Ambassador Roth, and I would defer to him on what official position the United States takes.

Senator HARTKE. I don't wish to go into a long discourse on this whole question, but I think it can be firmly stated and there can be no denial of one simple fact: That the basic operation here is identical in its effect in that your proposal is an action contrary to the normal free flow of persons as distinguished from the free flow of property. If there is going to be retaliatory action taken by any country in regard to the restriction of the flow of property, it certainly is fair to say that a similar retaliatory action could be anticipated or would be the natural result of a restriction of the free flow of persons. In other

words, what you are proposing is a restriction on the free movement of people between nations; isn't that right?

Secretary FOWLER. I don't consider it as such, Senator Hartke. It has not been considered in international circles as being in the same category and in the same character as restrictions on movements of goods and services in the form of quotas. It is quite a different operation to apply a tax to an expenditure above a given amount, and to say that only so much goods can be admitted to a given country. You are comparing apples and elephants.

Senator HARTKE. Yes, I understand what you are saying. I understand you say it doesn't make any difference.

Isn't it true that Great Britain has followed the same basic approach with respect to her travelers that you are proposing for this country?

Secretary FOWLER. In the United Kingdom, the equivalent of $120 is granted for travel during the year ending October 31, 1967, and it is our understanding that the amount of $120 will be maintained for the period November 1, 1967, through October 31, 1968.

Senator HARTKE. This was done for the same purpose, was it not? That is, it was done in order to alleviate and to correct their balance-of-payments deficits?

Secretary FOWLER. Yes, that is correct.

Senator HARTKE. Let me ask you what is the current status of Great Britain's balance of payments; has it improved or has it steadily deteriorated?

Secretary FOWLER. It has improved, as my statement noted yesterday, Senator Hartke.

Senator HARTKE. What month?

Secretary FOWLER. The first quarter——

Senator HARTKE. I am talking about the last figures, not the first quarter.

Secretary FOWLER. Well, we don't have reliable and authentic figures covering the second quarter. The first hard assessment of them can be made in August, although we can get some preliminary indication of their flow about the middle of July.

Senator HARTKE. Yes.

Isn't it true that in the House of Commons on Thursday of last week a report was made that balance-of-payments deterioration had continued and that there was no improvement?

Secretary FOWLER. Are we talking now about the United Kingdom?

Senator HARTKE. I am talking about the United Kingdom.

Secretary FOWLER. I am sorry, I thought we were talking about our own situation.

Senator HARTKE. No, I am talking about the United Kingdom.

Secretary FOWLER. Yes, as far as the United Kingdom is concerned, I think that their balance-of-payments situation currently has been disappointing in the improvement that had been expected and hoped for in this calendar year although there are considerable indications that the impact of the measures taken is showing promise of very favorable results in the latter part of this year.

Senator HARTKE. Yes.

I am not talking about what they hope for. All I am saying is that this action along with other very severe restrictive measures have been taken by the British, but the result is that the balance-of-payments

situation as a factual matter has continued to deteriorate in the United Kingdom?

Secreary FOWLER. Well, I would put it the other way, has not improved to the degree that had been hoped for.

Senator HARTKE. The fact is it has deteriorated.

Let me ask you another question here in regard to the House bill. As I understand it, the amount of tax revenue that will be derived from the proposed 5 percent travel is something in the vicinity of $100 million; is that correct?

Secretary FOWLER. The ticket tax proposal will produce a tax revenue of about $95 million with a resulting balance-of-payments savings of about $50 million.

Senator HARTKE. Can you tell us how much of this $95 million tax revenue is attributable to the removal of the exemption from tax travel by representatives of local and state governments and representatives of universities and colleges?

Secretary FOWLER. A minor amount; I don't have the exact figure.

Senator HARTKE. What do you mean by a minor amount—a million, 5 million, 10 million?

Secretary FOWLER. No, I think it is less than that.

Senator HARTKE. Less than 10 or less than one? There is a difference.

Secretary FOWLER. Less than 10.

Senator HARTKE. Less than 10 million out of a tax revenue of $95 million?

Secretary FOWLER. Yes.

Senator HARTKE. All right.

Now, as I understand it, also, you say in the calendar year 1967 that the deficit attributable to our balance of payments as a result of travel is $2.1 million, is that correct?

Secretary FOWLER. That is correct.

Senator HARTKE. It is also my understanding that in that year U.S. citizens spent $1.1 billion in Canadian travel, is that correct?

Secretary FOWLER. That is correct.

Senator HARTKE. I also understand that of that amount of $1.1 billion——

Secretary FOWLER. That is out of a $4 billion total, a gross expenditure of about $1.1 billion in Canada.

Senator HARTKE. With a deficit of $2.1 billion, right?

Secretary FOWLER. That is the net; that is the deficit.

Senator HARTKE. I understand. That is the difference between how much we spend here and what they spend, I understand. Is it also true that there was an increase in the year 1967 of $660 million from the year 1966?

Secretary FOWLER. That is right.

Senator HARTKE. All right.

It is quite well known that Expo '67 was in Montreal in 1967, isn't that true?

Secretary FOWLER. That is right.

Senator HARTKE. And it has been estimated that of the $660 million increase some $500 million was attributable to Expo '67. Is that a fair assumption?

Secretary FOWLER. I think that figure is a little high. I think we would tend to say $300 to $400 million.

Senator HARTKE. All right.

Now, would you comment as to what the effect this legislation will have in regard to such a balance-of-payments deficit? In other words, that deficit is not going to be there next year, is that true? Even if you call it three, 350 and I say five, there is already going to be an improvement of that amount, isn't that true?

Secretary FOWLER. Well——

Senator HARTKE. Are those people going some place else or what?

Secretary FOWLER. We don't know whether that will be diversionary spending to go elsewhere or whether it will be a reduction of the $2.1 billion deficit. However, it is our expectation that the steady growth of this travel deficit year in and year out going all the way back to certainly 1960, will continue, and that, therefore, there is a considerable chance that unless action is taken the travel deficit in the year 1968 and the year 1969 will be comparable to or in excess of the travel deficit in the year 1967.

Senator HARTKE. How can you say that, Mr. Secretary, in light of the fact that the passports in March of 1968 are 9 percent lower than they were in the comparable period a year ago?

Secretary FOWLER. That is not our information.

Senator HARTKE. That is not true?

Secretary FOWLER. That is not our information.

Passport applications show the following pattern in the fourth quarter of 1967: the number of applications were 239,000, which was an increase over the same period of the previous year of 13 percent. I am rounding the figures.

For the first quarter of 1968 passport applications were 452,000, an increase of 9 percent over the same period in the previous year.

They are currently running in April and May at 450,000, which is an increase of 5 percent over the previous year.

Senator HARTKE. What about March? Am I wrong on March?

Secretary FOWLER. I have the figures for the first quarter, January, February and March taken together, which were a 9-percent increase. I don't have them broken down here on March.

Senator HARTKE. My figures are that for the month of March 1968 passport applications are down 9 percent from March of 1967. We might go back and check that. I would like to have that complete chart inserted in the record so I can take a look at it.

(The chart referred to follows:)

PASSPORT APPLICATIONS, BY MONTH, OCTOBER 1966 TO MAY 1967 AND OCTOBER 1967 TO MAY 1968

Period	1966-67	Percent change from same period preceding year	Period	1967-68	Percent change from same period preceding year
October 1966	72,177	+23	October 1967	84,368	+17
November 1966	71,985	+20	November 1967	80,946	+12
December 1966	67,259	+13	December 1967	73,950	+10
4th quarter 1966	211,421	+19	4th quarter 1967	239,264	+13
January 1967	104,752	+21	January 1968	131,602	+26
February 1967	115,579	+8	February 1968	142,797	+24
March 1967	194,541	+10	March 1968	177,148	-9
1st quarter 1967	414,872	+12	1st quarter 1968	451,547	+9
April 1967	200,547	+5	April 1968	216,801	+8
May 1967	231,694	+10	May 1968	237,327	+2
April-May 1967	432,241	+8	April-May 1968	454,128	+5

Source: Passport Office, U.S. Department of State.

Senator HARTKE. Let me ask you one final question. Maybe you have covered it before. As you know there is no prohibition, for example, if I live in Detroit for me to go to Windsor, is there, rather than fly from Detroit? And if I live in Seattle for me to go to Vancouver? In other words, I can go outside the United States, I can go to Canada, and avoid this travel or ticket tax?

Secretary FOWLER. Yes.

Senator HARTKE. Or I can go to Mexico to avoid this tax?

Secretary FOWLER. I would like to ask Mr. Surrey to comment on that.

Mr. SURREY. We have had some discussions with travel agents as to what they feel might be the degree of avoidance and the steps that should be taken. We will be in a position to consider with the committee, whether, if necessary, steps should be taken to deal with that precise situation. We have asked them——

Senator HARTKE. I understand what you are saying, but what you are saying is you recognize the problem and you are discussing it, is that correct?

Mr. SURREY. Yes, and we are asking for——

Senator HARTKE. Should I vote for it or introduce some type of amendment like that?

Mr. SURREY. We have asked the travel agents to help us in assessing the situation and indicate whether their concern is such that we should include some special provisions on this matter. Undoubtedly they will come and respond. By the time you take this up in executive session——

Senator HARTKE. What is the Treasury's recommendation at this time?

Mr. SURREY. The Treasury's recommendation at this time is that we are not fully certain that a provision is necessary, but we are preparing a provision in the event the travel agents come to the conclusion that such a step is necessary.

Senator HARTKE. I am not as much concerned about what the travel agents say, but what the effect is. I want to know what the facts are.

Mr. SURREY. Obviously the travel agents have a good deal of information and, therefore, we wanted their judgment on it, because they would be the ones who would have some loss of business in this situation. The question of whether we should act directly or whether we should act in cooperation with the Canadian Government is something that we are assessing. We had not thought it was a matter of major avoidance; otherwise we would have included a provision in the first instance.

Senator HARTKE. It is true that if they moved this over, all we would be doing would be shifting this travel on to these foreign carriers and to foreign countries. Then you will not have an effect upon travel, whatever you anticipate, but you will have lost revenue for our own carriers.

Mr. SURREY. If we in our assessment of it feel that that is a possibility, then we have provisions which can be used to prevent that.

Senator SMATHERS. What are those provisions?

Mr. SURREY. Those provisions in a sense would be to extend the scope of our ticket tax to Americans who simply go across the border and start their journey by air rather than from the United States.

Senator HARTKE. It is not in the bill.

Mr. SURVEY. We have not submitted a bill to the committee as yet.

Senator SMATHERS. Isn't it logical, as the Senator from Indiana suggests, that if they can make this trip on a foreign carrier and do it without the expense of the 5-percent ticket tax, they will do it?

Mr. SURREY. Well, that depends on the amount of inconvenience involved in relation to the 5 percent.

Senator SMATHERS. Well, do you think it is any different in convenience whether you decide you are going on TWA or whether you are going on SAS if your destination is the same?

Mr. SURREY. It isn't a question of foreign carriers from the United States, Senator, that isn't the problem. This tax would apply to people going on U.S carriers or foreign carriers from the United States. The question is whether persons deciding to go to Europe will decide to travel in one way or another—other than by air—to Canada, and then start their European air journeys from Canada.

Senator SMATHERS. Yes.

Mr. SURREY. Now, the question of the convenience and the scheduling involved in leaving from Canada, is what is being assessed, not the question of domestic versus foreign carriers starting from the United States, because any flight originating in the United States would be subject to the 5-percent tax.

Senator SMATHERS. I see.

Senator HARTKE. Two final statements.

Mr. Secretary, I would suggest that the administration give thought to proposing an international conference on travel, with the idea that they give the same type of overall considerations to the effect upon balance of payments and upon the free movement of persons as is presently given in the so-called GATT arrangements in regard to property.

I see no reason why we shouldn't have an overall consideration. After all, since it constitutes, as far as we are concerned, a substantial part of our balance-of-payments deficit there certainly is no reason why it should not be given higher priority than the movement of goods. Isn't that true?

Secretary FOWLER. I think, Senator, that what governments can do in this area in dealing with the problem is quite limited. We have felt that from a long-range standpoint by far the preferable way of dealing with this deficit, of holding it to its present level or retarding its growth or causing it to decline, would be by promoting foreign travel in the United States and, therefore, a commission was set up which was headed by Ambassador Robert McKinney, and it did a very intensive study of ways and means of promoting foreign travel to the United States and submitted its report in February, which I filed yesterday with my statement.

Although something can be done by other governments to deal with the problem, I think that the encouragement of travel this way has to fall mainly to the private sector, to the airlines, the hotels, the bus services, the railroads. There is a good deal that the U.S. Government can do to encourage that travel but not very much that you could expect other governments to do other than to avoid or minimize their restraint.

Senator HARTKE. Mr. Secretary, I understand exactly what you are saying. However, what you are talking about is that our country is,

by far and away, the richest country in the world, and this in itself presents a problem because our people have more money to travel than other people in the rest of the world. So necessarily, if they are going to travel overseas it is going to mean they are going to spend American money. But that does not apply only to persons, that is true in the whole field of economics. That is true here at home.

What you are saying is—it is up to the private sector to try to bring people here. That amounts to a sale and salesmanship.

Secretary FOWLER. That is right.

Senator HARTKE. This amounts to a sale, in respect to people. And this is the same thing as a sale of goods. This is the argument you made in regard to exports. We have in the Commerce Department the equivalent of what you are talking about with respect to Mr. McKinney's suggestion, not alone the travel service, but what amounts to a sale or export of American goods in exchange for American dollars.

Now, there is no difference except that one deals with people and the other deals with property. But it has the same effect upon the balance of payments. Once that dollar leaves this country, you cannot tell me specifically, except in the grand total of things, which dollar is attributable to the person and which to the property. I mean the dollars look exactly the same. They both have the picture of Washington on them, the serial number, and everything else. There is not one dollar that says property dollar and another that says personal dollar.

Secretary FOWLER. That is correct.

Senator HARTKE. They are identical.

Secretary FOWLER. That is correct.

Senator HARTKE. So the same type arguments have to apply or else you find yourself meeting yourself coming through the door. That is exactly where you find yourself now.

Secretary FOWLER. Some of the same economic arguments have to be applied.

For the very reason we are concerned about a travel deficit here, we have to be concerned about a trade surplus, we have to be concerned about the so-called military expenditure deficit, we have to be concerned about all the major factors that enter into the balance-of-payments problem, and that is the function of the President's action program of January 1 which is concerned with those major elements.

Senator HARTKE. Yes, but the President's action program on January 1 has destroyed every argument made against this quota bill. What you ought to do is throw back in my face the arguments you are making today by saying, "Senator, if you oppose this you ought to drop your idea that quotas ought to be effective." All I am trying to do is get us on a consistent policy.

Secretary FOWLER. I filed yesterday with the committee cumulative assessments of the U.S. balance of payments for the period 1961 to 1967, with a debit column, a credit column, and a net column and on merchandise imports and exports, the net during those years show a plus of $33½ billion.[1]

Senator HARTKE. Can I stop you there?

Secretary FOWLER. The result on tourism, was a minus of $11.2 billion. Now these call for different approaches.

Senator HARTKE. Yes.

[1] See p. 21.

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Now, Mr. Secretary, I want to be very critical of that. All the statements that are coming out recently in regard to whole fields of trade are in the cumulative. It is all right to talk about the cumulative, but anyone can make the cumulative look good, if you let him select the cutoff point. But the fact is in 1964 we had almost a $7 billion trade surplus, not quite, $6.9, isn't that correct?

Secretary FOWLER. That is correct.

Senator HARTKE. That has deteriorated continually and steadily and it is continuing to deteriorate, so there is no reason for us to assume there is going to be any rapid turnabout. The fact of the matter is there is every good reason to believe——

Secretary FOWLER. There is a very good reason for us to——

Senator HARTKE. You say there is and I say the facts are to the contrary and there is every reason to look at it to see that we are following the pattern of Britain and the result is the steady deterioration of our trade balance and the steady deterioration——

Secretary FOWLER. Senator Hartke, you and I had a difference on what was the answer to this. You voted against the tax and expenditure bill.

Senator HARTKE. Right.

Secretary FOWLER. I was strongly for it. That is the answer to a restoration of our trade balance.

Senator HARTKE. The difference is I believe in an expanded economy and you believe in a restricted economy. I believe in growth not restriction. I am against restriction in travel, restriction in economy, restriction in jobs, all those things which Britain has done with such sad results. I don't want to use them as a pattern. I would like to have people working. I would like to cure the problem, not kill the patient.

Secretary FOWLER. Well, Britain used the pattern of import restrictions in its past, too, if it has any bearing on the present state of affairs. I think the maintenance of a healthy economy that can produce a trade surplus of $4, $5, to $6, billion is the keystone of the strength of the dollar and the American position. Therefore, you and I have a sharp difference of view as to how that is to be maintained.

Senator HARTKE. Let me say——

Secretary FOWLER. I don't think it can be maintained by following the pattern of restrictionism.

Senator HARTKE. Let me say to you, Mr. Secretary, I think you are 100 percent sincere. I think you are trying to base it upon what you think is right, but I couldn't disagree with you more and I think we understand each other.

Secretary FOWLER. That is a common posture in which we find ourselves. It is what makes for horse racing.

Senator HARTKE. I like you very much.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Thank you, very much.

I take you to a very few simple questions in a variety of other fields. The bill before us removes the air transportation tax exemption domestically for local governments and nonprofit educational institutions, and you can understand that the Governor of the State of Utah is very unhappy.

Now, it seems to me that this doesn't affect our balance-of-payments problem, and I wonder how, what is the total revenue effect of this? Is it worth disturbing the present Federal-State relationships?

Secretary FOWLER. Well, I would like to, Senator Bennett, give you the reasons we would advance, in connection with, this ticket tax since we are dealing with it legislatively and now hopefully will extend it internationally as well as domestically, as to why we think it is timely to repeal this exemption.

Our reasons are as follows: The domestic ticket tax is basically in the nature of a user charge. The revenues from it are used, although there is no trust fund arrangement, in our minds to repay the Federal Government for the air safety facilities and the services which it maintains through the FAA and, as such, it seems illogical to exempt the State and local governments from paying their share of the costs of insuring the safety of their personnel who use the airways.

Secondly, it is not wholly unprecedented for State and local governments to repay the Federal Government for other services they use. Postal services come readily to mind and also material printed by the Government Printing Office.

Third, the overall increase in cost to governments will not be significant. We estimate that repealing this exemption will result in an additional cost equal to only .006 of 1 percent of the total Federal, State and local government expenditures, or 6 cents of tax for each $1,000 of expenditures.

In this regard, it is interesting to note that States often impose their user taxes on the Federal Government. Moreover, contrary to some assertions, there would appear to be no constitutional barrier to including the air ticket tax to cover travel by employees of State and local governments. You well recall the interest equalization tax does apply to those governments.

Senator BENNETT. What will it amount to in gross, in actual dollars? What is the revenue effect rather than the percentage?

Mr. SURREY. We don't have the precise figures because the FAA lumps together Federal, State, and local travel. We estimate the total revenue involved at $15 million, but the great bulk of that is attributable to the Federal exemption, which is equally removed under the House bill.

Senator BENNETT. So you are taking it out of one pocket and putting it back into another?

Mr. SURREY. Yes, but it affects the appropriations of the various departments.

Senator BENNETT. So we are talking a total gross of $15 million.

Secretary FOWLER. Federal, State, and local.

Mr. SURREY. Federal, State, and local, and probably colleges, which don't amount to very much.

Senator BENNETT. So you say the Federal share, you think, is the largest part of it?

Mr. SURREY. Yes.

Senator BENNETT. So we are talking about State and local, less than $7½ million.

Mr. SURREY. I would say so.

Senator BENNETT. Probably less than $5 million.

Mr. SURREY. We would think so.

Senator BENNETT. Well, I wonder if it is worth it to stir up the problem or the question that is raised, that you are interfering with the State and local taxing, and since while you may consider it in the nature of income to be used for a purpose, it goes into the general revenue and in effect it is an excise tax.

Secretary FOWLER. That is correct. We think of it as a use tax.

Mr. SURREY. It has been denominated by the congressional committees dealing with it as a user charge. In other words, there used to be a tax on all forms of transportation, and the only form on which a tax was finally retained is on transportation by air as a user charge. Furthermore, as you will recall, the President's message concerning this tax deals with it in that form. In a sense it is accidental that the user charge is in this form. It could have been a fuel tax. If we raised our funds from a fuel tax, the State and local governments would have paid for it through increased ticket charges because the fuel tax would have been passed on. There wouldn't have been any argument. However, the user charge happens to be in the nature of a ticket tax.

It is rather interesting that many States apply their user charges for their highways to the Federal Government.

Senator BENNETT. That is earmarked.

Mr. SURREY. Well, this is earmarked in the sense that the level of the tax is determined by Federal costs for the airways. That is what governs the level of the tax.

Senator BENNETT. Are you telling me then that $15 million is the total cost of these services and that it is paid for out of this user tax?

Mr. SURREY. $15 million is the additional revenue that would be collected if the ticket tax is extended to travel by Government employees. In total, the revenues from the present 5-percent tax are less than the FAA costs attributable to commercial aviation. In this sense, therefore, Government employees, like other air travelers, would be repaying some, but not all, of the FAA costs. The level of 5 percent, or any increase in this tax rate, is determined not by domestic revenue needs, but by the Federal expenditures for safety on the airways. Therefore, the tax has been treated throughout as a user charge.

Senator BENNETT. Let me ask the question another way: Is the total amount received from this user charge equal to the amount spent for safety in the airways?

Mr. SURREY. It was once about that insofar as the amount allocated to commercial airlines was concerned. It is less now. For that reason there has been a recommendation by the President this year that the ticket tax be raised to 8 percent to maintain equality, and he also recommended that there be a tax on air freight, waybills, and the like. But the recommendations for these amounts are strictly justifiable in terms of air safety costs and not general Federal revenue in any way whatsoever.

Senator BENNETT. All right.

I have a couple of other questions. I am interested in the exemption that is available on this travel tax to Americans residing abroad. Just for the record, at what point does a man cease to be a tourist and become a resident? What is the standard by which residence is determined? I couldn't find it in——

Secretary FOWLER. In the technical explanation.

Senator BENNETT. In the technical explanation. It simply says on page 5 of the technical explanation,

An individual who after his departure from the United States establishes residence in a foreign country would be considered to be on a non-taxable trip.

Mr. SURREY. We would apply one of two tests. If a person is going over a work trip, a business trip or the like, and he was to stay 120 days or more, then that person we would consider has so changed his living status that he would be exempt. But I think you are asking the question if a person decides for one reason or another——

Senator BENNETT. No; I am coming to your other person. I think you have answered my question.

Mr. SURREY. Yes.

Senator BENNETT. To be specific, a man who works for an American corporation with a branch abroad is assigned to that branch let's say to serve for 1 year, you would have considered him to have become a resident?

Mr. SURREY. He would get the benefit of the 120-day rule so he wouldn't have to establish that he is in residence abroad.

Senator BENNETT. So your rule is 120 days?

Mr. SURREY. Yes. But let me put it this way. We would say a person who was going abroad on business for more than 120 days, even though he is going to return, should be exempt from tax and I think this would cover the vast bulk of the people involved.

Now, there may be a few persons who are not going over there for business reasons at all, but have decided to become permanent residents of the foreign country. Those people also would not be covered by the tax.

Senator BENNETT. Well, I have a friend who goes regularly every December to stay in the south of France until the winter is over in the United States. If he stays more than 120 days he is not a tourist, he is a regular temporary resident. In other words, he goes every year for those 4 months, what is his status?

Mr. SURREY. He has not permanently changed his U.S. residency. In other words——

Senator BENNETT. But he is there more than 120 days.

Mr. SURREY. The 120-day rule is only for people on business trips, teachers, and the like. But persons who are deciding to——

Senator MORTON. Get away from the severe climate.

Mr. SURREY (continuing). They would come within this travel tax.

Senator BENNETT. There is just one other technical question. In reading the explanation of the bill, the two-page explanation, I read on the bottom of the second page noncommercial importations and an indication that if a person brings back not over $500 wholesale or has follow him not over $250 wholesale with an interpretation of the retail price, he would be allowed a 10-percent tariff charge on value, and I am confused about the application of the duty-free articles. In arriving at the $500 wholesale value do you include duty-free articles to arrive at the $500 limit or are those excluded?

Mr. SURREY. They are excluded in arriving at those figures. I want to add that the figures you are quoting from are the figures from the House bill. Our recommendations would change those levels. I just wanted to note that, Senator.

Senator BENNETT. That is fine. But if we adopt the House bill, to be specific, to state an example so I can understand it, a traveler can bring back $1,500 worth of merchandise so long as less than $500 wholesale is made up of dutiable articles, he can do that anyway, but I am wondering whether the duty free—I will say it another way: If he brings back $500 or less than $500 at wholesale——

Mr. SURREY. You, in a sense, Senator, disregard the duty-free articles and assume they were not in his baggage.

Senator BENNETT. Completely.

Mr. SURREY. That is right.

Senator BENNETT. You would disregard them completely in every sense?

Mr. SURREY. That is correct.

Senator BENNETT. That clears up my question.

Secretary FOWLER. There is an important change——

Senator BENNETT. Pardon?

Secretary FOWLER. There is an important change from the House bill in our proposals.

Senator BENNETT. Recommendation?

Secretary FOWLER. Because we think these figures about articles not returning with the traveler are too high in the House bill.

Senator BENNETT. But you still leave the $500 exemption on what he brings back?

Secretary FOWLER. But it leaves the duty free part of your answer——

Mr. SURREY. The present exemption today is $100.

Senator BENNETT. Yes, that is right.

Mr. SURREY. That would be cut to $10.

Senator BENNETT. I shouldn't have used the word "exemption." I used the power to apply a flat 10 percent rather than the regular duty——

Mr. SURREY. We are recommending that the provision in the House bill, which would have applied the flat 10-percent rate on dutiable articles up to $500, be changed to cover dutiable articles up to $100 rather than the $500, which we feel on reflection now is too generous and can produce some distortion in the practices of purchasers.

Senator BENNETT. But you do leave duty-free articles out completely in arriving at the total?

Mr. SURREY. That is right.

Senator BENNETT. That is all, Mr. Chairman. I appreciate the opportunity to ask these questions.

The CHAIRMAN. Senator Morton?

Senator MORTON. You were talking about this 5 percent on user tax, ticket tax. I happened to be on the Aviation Subcommittee of the Commerce Committee and we have been going into this problem at great length. There is a difference between Federal aid to building an airport or terminal facility and the question of providing runways and safety devices and what not. And I just want to make this observation, that I think sooner or later we are going to have a trust fund operation of some kind in connection with airports as we have with our defense highway system, and I think the States and the colleges and the universities, and so forth, they are frankly going to have to find the money to pay their share of this even though it only amounts

to $4 or $5 million today. We are going to be, with these 500 passenger planes coming along even before we get into SST's, your problems at these airports are going to be, just unbearable. It is bad enough now.

Secretary FOWLER. That is right, and undoubtedly it is going to have to be moved up.

Senator MORTON. That is all, Mr. Chairman.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Secretary, on another matter, do you have any idea when the President is going to sign this tax bill we passed last Friday?

Secretary FOWLER. No, sir; in the next day or two though, would be my judgment.

Senator WILLIAMS. You think he will sign it then?

Secretary FOWLER. I think he will sign it.

[Laughter.]

Senator WILLIAMS. Now, you have testified on a somewhat different bill from that which was passed by the House. Will the administration be submitting that in draft form either as a substitute bill or as an amendment, and will they be introduced by somebody so we will have them for study by the committee?

Secretary FOWLER. We would like to do so, Senator Williams.

Senator WILLIAMS. So it is available to other interested parties who may want to examine it before we do it?

Secretary FOWLER. We would like to do so.[1]

Senator WILLIAMS. One other question which doesn't relate to this bill. What would be the administration's position today on a proposal to repeal completely the 4¼-percent farce we have as the ceiling on Government bonds?

Secretary FOWLER. I haven't canvassed this recently, Senator Williams, in the administration circles as such. I can only give you my own personal view. I would favor further liberalization to the extent of removal of the ceiling. I think for the long pull, as well as the short range, this is an unnecessary and undesirable restraint on the debt management activities of the Federal Government. I have long felt so.

Senator WILLIAMS. I appreciate that comment. As you know, I have for years been advocating that this ceiling was a farce. Money is a commodity, and as Secretary of the Treasury, if you are borrowing the money you pay the povailing rate or you don't get it. It does handicap the administration in the management of the national debt, and I certainly am glad you endorse the proposal.

One other question on another subject which I have mentioned many times heretofore and that is the rates that are being paid on savings bonds. I feel, as you know, that the present 4¼-percent rate on series E bonds is not fair. We have a situation where if an investor has $5,000 or more to invest he can get 6.45 percent interest on a 100-percent Government-guaranteed bond, but they are sold only in denominations of $5,000 or more. If he has less than $5,000, perhaps only $1,000, to invest, he can get 6 percent on a 7-year Government note. But if he doesn't have $1,000 but only $100 to invest in the payroll savings plan he gets 4¼ percent interest. This doesn't look fair to me.

I have always supported the savings bonds program, but it has always been on the premise that it was to attract the investment of

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[1] See p. 127.

the small investors. Heretofore they have been paid a premium on that small investment even to the extent that we had a limitation as to the amount that a man could buy, to prevent the larger fellow from taking advantage of it.

But we are now in a situation where it is completely reversed. If a man has $100,000 he can get a higher interest rate from Government bonds. I am wondering if the time hasn't come when we should reverse that and put out a savings bond which will pay to these small investors a rate comparable to that which is being paid to those with larger amounts to invest, and if you want to limit it to $2,000 per year for these small ones I would not be worried. But how would you feel about making some change in this structure, putting out such a new bond issue. I think it would have two purposes: First, it would correct a gross inequity in the manner in which we are treating these small investors, and, second, it would have a tendency to siphon out of the spending stream a certain amount of money which is now going into an overheated economy. I think that it would have a tendency to tone down an inflation threat in the economy. It would have the same mathematical effect as raising taxes and be much less painful. Furthermore, these people would be putting aside some savings now.

How would you feel about supporting such a proposal as a part of this bill? What would be your reaction?

Secretary FOWLER. Senator Williams, I would want to think a little bit about it as coming at this particular time, although from a longer range standpoint, assuming that there is going to be some continuation in the light of the money market supply and demand picture a continuation of interest rates at the higher levels than pertained to, say, the first 4 or 5 years of this decade. I think on that assumption over the long term we will have to reevaluate the element of fairness to the saver in the savings bond program you have suggested.

I am a little concerned that in moving to do that at this particular time we may have to run some risk of reducing the flow of funds from the small saver into savings and loan institutions and mutual savings banks, which are the base for the mortgage money which keeps the housing industry going. I would want to weigh somewhat carefully the state of the money market with regard to the maintenance of a good flow of funds into housing. I would think that the action that has been taken in the last week in connection with fiscal affairs is going to, over the long pull, loosen up the money situation to some extent, and that we can feel that the future of housing as far as the money market is concerned is a bright one.

Under those circumstances I think I would be inclined to favor some adjustment along the lines you have mentioned, but the one reservation which I do have is the question of timing. Until we can be sure that there is an adequate flow of funds for the maintenance of the housing industry at what would be considered a healthy level, I would be a little reluctant to move right at this time.

Senator WILLIAMS. Well, as far as a matter of timing, if and when we reach that day when there is a free flow of funds, interest rates will be back down to a more realistic level.

Secretary FOWLER. That is the question I am really posing, whether they would come all the way back down. There is quite a difference of opinion in the private community as to whether or not they would come

all the way back down so as to restore the previous relationships that the savings bond had to other forms of savings. I think there is some considerable opinion that that will not come about in certainly any short period, over the next year or two, because there is still a tremendous demand for money in the money market.

Senator WILLIAMS. I agree with that premise.

But the point is what they are suggesting is that we wait until there is no need for this. While I respect the need of the housing industry for this cheaper money, on the other hand, if we are going to subsidize the interest rates for the housing industry is it fair to shoulder this so-called subsidy on the backs of the small investor alone? I certainly am not advocating an interest subsidy; but if we are going to do it shouldn't it be done by all Americans rather than just singling out the small investor? As it is now, I think we will agree that it is this small investor who is buying the series E bonds today and who is receiving this low-interest rate. The only cheap money that the Government is borrowing today, the 4¼ percent, is what it is borrowing from the small investor. Anybody who has $1,000 to invest at the moment will buy a 6-percent Government bond with the same 7-year maturity. He is not even locked in for 7 years to get 6 percent. He can sell it in 6 months and get 6 percent. But we are locking these 4¼ percent individuals in for 7 years in order to get 1¾ percent less than is being paid to others. As one who supported the truth in packaging, I am wondering if the Government in its savings bond advertising program were to tell these small investors the actual truth as to the advantage that is being taken of them, the savings bond program would not automatically fold up.

Secretary FOWLER. I don't think so, Senator Williams. I think there are many other factors that enter into both the motivations and the advantages of the savings bond program, that it is not entirely a question of rate. If that had been the case it would have been very seriously affected and that has not been the case. We have continued through this period where there has been this disparity of rates, thanks, I think, in good measure to the splendid promotional effort of the Industrial Payroll Savings Bonds Committee and the support of various institutions and the desire of the person on wage income to have a steady, regular method of saving, and also a desire to, a patriotic feeling of a willingness to, participate in this program. I think that the sales have done remarkably well.

But I do think the question of equity and fairness is an appropriate one, the one you raise, and that some consideration ought to be given to it. We have, as you know, moved up the regular savings bond, the E bonds, up to the very limit of the permitted rate. We have also recently modified the Freedom Share arrangement so that that is a more attractive rate, and I would certainly not want to say no. I think we, on the other hand should say yes, that a proposal for a longer term adjustment of the sort you have indicated is one that ought to be very carefully examined at this stage of the game, particularly now that we do have fiscal policy moving in to join with monetary policy and we can look for less pressure on the housing industry in the months to come.

Senator WILLIAMS. Well, I won't pursue this further. I am not convinced on your argument that we should wait too long on this. Unless

I do change my mind, and I don't think I will, Congress is going to be confronted with this question in the near future, and so I hope the administration will give careful study. If you have any recommendations in that connection submit them to us, and be ready to pass on it, whether you are for or against it, because this is going to be proposed and presented for a vote. I can assure you of that.

Secretary FOWLER. We would like to work with you on this, and because we do want to——

Senator WILLIAMS. Thank you.

Secretary FOWLER. Because we do want to encourage and maintain and sustain and develop the savings bond program. We think it is the most, perhaps the most, desirable and the most useful of all of our debt-management techniques.

Senator WILLIAMS. I agree completely on that, and I don't want to do anything that would disrupt it, as you know. That is the reason—even though you may not endorse this plan or recommend it at this time—that I would appreciate an opportunity to work with you in order that we could get an amendment drafted in the most workable form. I am very much interested in this for two reasons: From the standpoint of equity it has merit, and from the standpoint of the advantages that it would have in siphoning some extra money out of the spending stream at this time.

Secretary FOWLER. This is the point we are conscious that you are stressing.

Senator WILLIAMS. And I would be prepared to cooperate with you in helping to work it out.

Secretary FOWLER. Thank you, Senator.

The CHAIRMAN. Before we proceed further permit me to say we have something of a scheduling problem here today that is insurmountable. That being the case, I will accommodate myself to the facts as I find them, with the concurrence and judgment of the committee, and modify our whole procedure.

It had been my hope that we could have concluded this hearing on yesterday and that we could have had an executive session this morning to consider nominations and also to consider our procedure with regard to further witnesses on the pending measure.

Unfortunately the Senate was voting yesterday on a number of very important amendments to the defense bill. There was objection, which, of course, anyone has a right to enter, to the committee meeting. Therefore, we continued the hearing until today, and as the hearing has progressed we can see we will obviously not have a quorum by the time the Senate meets.

There are a number of items that the committee would like to inquire about, particularly with reference to the nominee for the Tariff Commission and he is not here today. I understand he is in the Virgin Islands so we could not conclude the meeting even if we did try to hold an executive session today. We already have a hearing scheduled for tomorrow. So I would like to inform those who are here to meet with the committee with regard to their nominations that we won't be able to get to that today. Is Mr. McCrocklin here, and is Mr. Sylvester here? I regret very much having kept you gentlemen here. I had hoped we would be able to hold an executive meeting which we had scheduled, but it is beyond my power sometimes when the Senate is

in session and we have objections to committees meeting during the session of the Senate. We will have to call you at a later date, either tomorrow or as soon thereafter as we can conveniently schedule a meeting.

Now, Senator Smathers wants to ask the Secretary a few more questions about this matter.

Senator SMATHERS. Mr. Secretary, first, not on this matter, but as we are covering the whole spectrum of economic affairs today, let me ask you just this one question: Since the Congress has adopted the tax increase and expenditure control bill, as was recommended, the tax increase by the administration, and the expenditure control by the Congress, there have been a number of writers in the economic world, as well as a number of Senators who speak with some authority on the matter of economic matters who say that this bill is now going to throw the country quickly into a depression; do you agree with that?

Secretary FOWLER. I do not.

Senator SMATHERS. You do not?

Secretary FOWLER. I do not.

Senator SMATHERS. All right, the next question I want to ask you——

Secretary FOWLER. May I say, Senator Smathers, that both the administration and the Federal Reserve System will be working closely together to appraise the impact of the bill, and Chairman Martin has stated publicly that the Federal Reserve System will, in connection with its responsibilities over monetary policy, will follow the situation very closely, and having made its appraisals will be concerned that monetary policy will move. For those who do have concern on the points that you mentioned, I think we can count on flexibility in policy in this area, and for that and for a number of other reasons, I do not share the concerns that have been voiced. While I think we always, of course, should be very careful.

Senator SMATHERS. It has been demonstrated, has it not, that the various branches of Government will move with great facility, and expedition in the areas of inflating the economy whereas it has been very difficult for them to move in those areas of controlling inflation.

Secretary FOWLER. The time problem on restraint is a much more severe one than on stimulation.

Senator SMATHERS. Now, back to the bill here, I would like to suggest to you, Mr. Secretary, that when you send a draft of a bill over, you and Mr. Surrey, that you do include in it provisions which will make it impossible for people to travel into our neighboring areas and there purchase their air tickets. As you know, I am very pleased with the change which you have recommended with respect to the Caribbean area, particularly Bermuda, the Bahama Islands, Jamaica, and so on, and I think that was a wise decision because for every tourist dollar the Bermudians get they spend back in the United States $1.67. For every dollar which the Bahamans get they spend back in the United States $1.80 and I think it is relatively the same with respect to Jamaica.

However, Nassau is only 30 minutes away from Miami. I would not like to see anyone be encouraged to fly over to Nassau to purchase their tickets to go on to Europe because there is considerable good travel opportunity from there direct to Europe. The same thing, of course,

is true of Winnipeg, Canada, and other areas, so I think you might as well be smart and head off that prospective loophole in your draft bill before it becomes a bigger loophole.

The next question I want to ask is what effective date do you think we should put, if we do pass this bill, on the travel expenditure tax?

Mr. SURREY. Our recommendation is to apply the tax to people leaving 20 days after the effective date of the bill. I think it is just a question of our tooling up and their getting information.

Senator SMATHERS. So it could be that those who wanted to, who thought they may want to, travel this year may go and get their tickets now?

Mr. SURREY. Are you talking about the ticket tax?

Senator SMATHERS. I am talking about the ticket tax——

Mr. SURREY. The ticket tax would apply to tickets purchased 10 days after the effective date of the bill.

Senator SMATHERS. Ten days after?

Mr. SURREY. That is in the House bill, yes.

Senator SMATHERS. That is in the House bill?

Mr. SURREY. That is in the House bill.

Senator SMATHERS. All right.

Now, Mr. Secretary, again I want to ask you this question because it seems to me this is the real question once again, and I asked you this yesterday, but I want you to go over it: Do you believe that this proposed expenditure travel tax, as I think we call it, is so urgent that the Congress must act before we adjourn, hopefully on August 2?

Secretary FOWLER. Yes, I do think it is so urgent that the Congress should act. It would not be becoming for me to use the word "must" and I, therefore, amend it that way. But I would say that it is very urgent that the Congress act affirmatively and definitely to indicate the seriousness with which it continues to view our balance-of-payments problem and express its determination in this very direct and tangible way, that we are going to continue to be concerned about it and we are going to take the measures that are necessary to deal with it until we have the balance of payments clearly back into equilibrium and keep it there. I don't see how that assurance can be felt over the short pull or the long pull unless the Congress grapples definitively, maybe not in just the way we have recommended, but in some very definitive way with this travel deficit problem.

This is not a reversal of our principle in that we have been the foremost nation in the world, I believe, in advocating free trade and greater travel and intercourse back and forth between the peoples of the world. This bill is not designed to be in conflict at all with that principle. It simply says "go ahead and travel. But while you are traveling, remember, when you are spending your dollars you are also spending U.S. foreign exchange," and this is an important consideration.

Senator SMATHERS. We hear the argument made many times that the best way people in other countries can get the dollars with which to buy our goods is to take advantage of our tourists who do travel. I am sure you recognize there is some validity in that argument. But is it your contention that this matter of our deficit in the international balance of payments is so severe, and we need so urgently to do something about it that we can forego that particular——

Secretary FOWLER. There is no shortage of dollars in the world today with which to buy our goods. It is really the reverse. The balance-of-payments deficits that we are concerned about here have totaled $16 billion over the last 7 years which came on top of a period of 3 years, 1958, 1959, and 1960, when the balance-of-payments deficit was a total of about $11 billion. So there is no shortage of dollars in the world. Indeed the problem is just the other way.

Senator SMATHERS. When you say that the administration wants it you mean yourself and the President of the United States and——

Secretary FOWLER. Yes, sir; I am speaking for the administration.

Senator SMATHERS. Regarding the totality of influence which each of you have?

Secretary FOWLER. Yes, sir.

Senator SMATHERS. You are for it?

Secretary FOWLER. Yes, sir.

Senator SMATHERS. All right, sir.

The CHAIRMAN. Mr. Secretary, I don't want to beat the wrong horse about these matters, and I am not particularly critical of people who are doing their job the best way they can. I know the kind of pressures that they live under but I was just looking at some of the different items within the power of the executive branch of the Government to correct with regard to the balance of payments but with regard to which not much is being done.

This measure before us I think would improve our balance of payments about $140 million a year. Isn't that correct?

Secretary FOWLER. Yes.

The CHAIRMAN. Now, the Secretary of Interior is a good man who is doing a good job overall and I don't really complain about his handling of the problem because I think he is confronted with such tremendous pressures from such a variety of sources. But I was just looking at a complaint, for example, from the Independent Petroleum Association to me with regard to the oil import program. When Suez was closed as a result of this Israel-Arab war, it was necessary for us to call upon the domestic oil industry to bear the burden for providing fuel for this country, to take over what would have been provided to us as a result of Near East production and also to help relieve free Venezuelan exports to go to Europe rather than to come to the United States. The domestic oil industry was more or less called upon to provide the full requirements of the Nation for oil and that was, of course, the kind of thing for which we had an oil import program so we would have an industry capable of seeing us through a near emergency or tight spot.

The fact that Near East oil could be easily cut off from us and denied access to us and our allies is one of the reasons we instituted an oil import program.

Now, when that crisis subsided and it was then practical for the oil companies to readjust their situation to rely upon that Near East oil again, to provide it to markets where they wanted it and to put more Venezuelan oil in here, the Interior Department proceeded to give the oil companies, most of them very large corporations, additional tickets to make up for the oil that they didn't ship us during the time they couldn't provide us with our needs. The effect of it was that for 1967, and for the 2 succeeding years after 1967, 1968, and 1969, Interior

provided the oil importers with an additional 150,000 barrels a day of oil imports to pay them off for a couple of years for the oil they couldn't deliver to us. We were rewarding foreign oil for not being able to provide oil to us in times of emergencies and similarly we were punishing the domestic industry from an economic point of view for the fact that this industry did provide the oil during that time of emergency.

That works out to about a $70 million adverse balance-of-payments situation over a period of 2 years.

Then the domestic producers complain about this $100 million of bonded jet fuel that comes in here which they feel the oil import program did not contemplate and which should not be a part of it. There is also the oil that is permitted to come in from Canada over and above the Canadian estimates which works out to about $60 million a year. So those items come to almost $200 million a year of decisions made in the Department of Interior, each one of which affects our balance of payments adversely. That $200 million a year deficit is about $60 million more than this program here would gain for us.

I have also been trying to do something about the problem of our sugar producers having a big surplus on hand for which they desperately need a market. If they can't market it, they definitely have to take a very big cut in acreage which is disastrous from their point of view in the cane area of Louisiana and Florida. We have been trying to get the Secretary of Agriculture to buy some of that sugar rather than to have to buy sugar offshore. Why not sell off sugar we have stored which otherwise we would have to wait a few years to sell and for which we would have to take a big acreage cut while waiting for the opportunity to sell it. That is about a $60 billion item.

It does seem to me it would be very good if on some of these questions the balance-of-payments aspect of it would be viewed with the same emphasis that you at Treasury would give to it. I just wish that we could persuade some of those in the other departments to look upon this matter as being as serious a matter as you do. Maybe it is because you have to worry about the money and about the fact that the people are losing confidence in that money that you are managing, that you put more emphasis on it than someone else does. But I certainly would hope that, one way or another, we could persuade these other Departments, Agriculture and Interior, to view this problem as being as grave as you view it.

Secretary FOWLER. Mr. Chairman, I think that as one looks at the situation over the last 10 years it used to be true that the problems of the dollar and the balance of payments were the preoccupation of the Secretary of the Treasury and the Treasury Department and their counterparts in other countries and ministers of finance.

I think the problems of maintaining the type of economic growth and prosperity that the free world has witnessed over the last 15 years, 20 years, which has been greatly aided by this international monetary system, the importance of this and the fact that it is a matter on which not just one part of the Government has to function but all parts of the Government have to function, has been brought home by events of the last year or two in a way so that the balance-of-payments problems are no longer just the preoccupation of the Treasury Department. They are the concern of the President, they are the concern of the Secretary of State, and the Secretary of Defense, of the

Secretary of Agriculture. We have the Secretary of Agriculture serving on the Cabinet Committee on balance of payments. We don't have the Secretary of Interior and, perhaps, we should add him in this regard. Now, that certain of the pressing legislative matters are hopefully behind us, I shall have more time and occasion to visit my colleagues in other departments of Government where there is a relationship to what they are doing to balance of payments, than I have had before. We will have more opportunity for collective consideration of the kind of issues which you very properly raise here.

I don't attempt to make any judgment or make any assessment of the pros and cons of the decisions you have mentioned, but certainly you have referred to their relevance to the balance-of-payments problem and we will inquire into them.

The CHAIRMAN. These things, of course, do tend to get very complicated. I know the contending views about oil imports. One group says the oil imports are the biggest single thing in the balance of payments. The imports are over $2 billion a year, and reducing that figure by exports in chemicals and products would leave our balance at a $1.5 billion deficit.

Now, the major producers will hasten to contest that figure by claiming that in the last analysis they bring more money back in than they take out because of the profits and the sales over in Europe and elsewhere. They produce oil in the Near East and in Venezuela, ship it to Europe and make profits on that and the profits they make they bring back here.

But the importing companies contend that if you give them credit for the profits they bring back into this country they wind up giving you a major surplus.

Secretary FOWLER. Yes.

The CHAIRMAN. And it tends to work out, I suppose, that it is just like a great number of other things where you have to make a whole pattern in order to see what the picture is.

If we didn't have these troops over there in Europe, didn't have a war in Vietnam, it might well be that we actually would not have a balance-of-payments problem. What is your reaction to that?

Secretary FOWLER. Well, we had a balance-of-payments problem before the war in Vietnam. We had, we have had, a deficit, a serious deficit, as I indicated, running at the level of $3.4 to $3.9 billion in 1958, 1959, and 1960. We then reduced it to a pattern of about $2½ billion in 1961, 1962, 1963, and 1964, and got it down to a low of $1.3 billion in 1965. So while I think there is no question that the hostilities in Vietnam and Southeast Asia are directly contributing to our balance-of-payments deficit, in the order of magnitude currently in the neighborhood of about $1½ billion, I don't think that the end of the war in Southeast Asia would mean the end of a concern on our part with the balance-of-payments problem. Just looking at the picture as it existed prior to the war in Southeast Asia gives you a full answer to that. There is no easy, simple answer and no one single event or fact that is likely to be determinative. Our balance of payments is going to be the end result of a large number of different transactions.

This table that was presented to the committee shows the tourist problem and the problem of military expenditures abroad are two of the major deficit items in the picture, and I would contend that we have to be concerned with both. I would contend we have to be con-

cerned and we are concerned, as the President's message indicates, with reducing and neutralizing the balance-of-payments expenditures in our Military Establishment. We can't turn our back on that. This is one of the things, of course, that has happened to the United Kingdom. They have been suffering under that but I don't think, to come back to it, that we can ignore any signficant elements that contribute to the balance-of-payments deficit or the encouragement of any significant element that is on the plus side.

The CHAIRMAN. Now, with regard to some of our trading partners who would not be affected by this legislation, I understand that what they earn in tourist dollars is very essential to their ability to trade with us and buy the commodities they want from us. That would be true of countries like Mexico, Canada, and the Bahamas?

Secretary FOWLER. Canada, that is right; and to some lesser but still very marked extent, the Latin American countries.

The CHAIRMAN. So in the last analysis to correct our balance-of-payments deficit aren't we to a considerable extent going to have to look to some of these items over which this Government has complete control, such as the amount of imports of certain items we are going to bring in which we have under control at the present time, the level at which we want to maintain a merchant marine, the extent to which we can afford troop commitments and matters of that sort, rather than to hope to negotiate ourselves out of this box in which we find ourselves?

Secretary FOWLER. I think it is going to be both of these things, Senator Long. That undoubtedly the counterpart of our deficit is somebody else's surplus. It is the design of the President's program to focus the impact of the direct measures we take primarily on those surplus areas. That is why the concern about tourism to Western Europe is the sharp focus of this proposal before you, because it is in Western Europe that we have had this succession of you might say chronic surpluses which have been the counterpart of our chronic deficits.

Now, the President's program is designed to proceed on the premise that, therefore, its impact should be primarily, although not exclusively, but at least primarily, on the surplus areas. We should try to work with them so that they will take the actions that will make it possible and feasible for our deficit to be cured. For example, a policy in Western Europe of using fiscal and monetary measures to stimulate the growth of the economy of Western Europe at a greater rate than has characterized the rate of growth in some countries in the last year or two would result in a greater volume of economic activity which, in turn, in view of our export potentials would result in a substantial increase in the rate of exports to Western Europe.

This is the kind of cooperative action that we have elicited and has been to some extent forthcoming in recent months as a result of this program. I won't say it is the sole reason for it. There are domestic policy considerations that always enter in. But I think it is a combination of our taking a certain amount of unilateral action with reference particularly to our own Government expenditures abroad, but also trying, through the patterns of international economic cooperation, to achieve an equilibrium that is healthy and hits the areas that have been enjoying the surpluses rather than having its primary impact on the areas that have deficits.

The CHAIRMAN. Here is something which does somewhat confuse me. These European countries do not want to give up the surplus that

they have in trade with the United States, and in their foreign trade they view that as a profit, in effect, and they don't want to give it up by negotiations. They prefer to retain it, if they can. Wouldn't that be basically correct or substantially so?

Secretary FOWLER. I would have to question the premise of your question, because by and large we have trade surpluses with most of the Western European countries. It is the capital flows and the tourist expenditures and the military expenditures that have added to the picture. If you leave those to one side and just thing of it in terms of balance of trade rather than balance of payments, the United States has a favorable balance as far as Western Europe is concerned.

The CHAIRMAN. But now, if you call that balance of payments they don't want to give up their favorable balance of payments, do they?

Secretary FOWLER. They recognize and join with us and have since 1966, August 1966, in a report of the OECD in recognition that the surplus countries have a responsibility to take actions to diminish the level of their surpluses and to come back towards equilibrium just as the deficit countries have responsibilities to take action to cure their deficits, and this has become an accepted premise and tenet of our economic working relationships particularly with the countries in the OECD. This is part of the underlying basis. You will find in this Blue Book, Senator Long, in chapter 9, a pretty detailed examination of the reasons why we must ask for and get responses from our trading partners, if this adjustment back to equilibrium is going to be made in a healthy, constructive way rather than by unilateral action which could trigger various forms of retaliation and difficulty.

The CHAIRMAN. Well, my question is do those countries favor this action that we are seeking to take to reduce the flow of American tourist dollars over there or do they reluctantly accept it as a necessary fact of life?

Secretary FOWLER. I think it is the latter. They reluctantly accept it as being necessary, a necessary element, in an overall balance-of-payments program which includes a number of other things.

Naturally each country has a set of priorities as to what they would have us do in order to cure our balance-of-payments problem, and they put at a very high position on the list those things that don't affect them and very low on the list the things that would affect a particular country directly. But, by and large, there is no question but what all of the governments and central banks concerned recognize that it is important not only to us but important to them and to the international monetary system to which they depend for the United States to cure its deficit.

The CHAIRMAN. That is the thing that is somewhat confusing. They want our money, on the one hand, they want a surplus in their balance of payments with us, but on the other hand, they don't want to accept our money. They——

Secretary FOWLER. Let me say the problem of communication here——

The CHAIRMAN (continuing). They want our money but they are unhappy about it.

Secretary FOWLER (continuing). The problem of communication is a very real one, so that the attitudes of the prime minister or the chief of state or the minister of finance get reflected in what the minister for trade and commerce does, there is a gap there reflected in what

the minister of defense does or what the tourist bureau does, and a lot of the problem, just as it is a problem in this Government to persuade and to make it possible for all of the elements in the departments and agencies of Government whose actions will affect the balance of payments to be concerned about the problem. So there is a lag in communication in those particular countries, particularly in getting them, their departments and agencies, to take the necessary actions to help us. This is not an easy thing for a foreign minister or finance minister to persuade the minister of trade that he ought to make concessions to the United States in order to help the United States cure its balance-of-payments problem. He says, "What is this balance-of-payments problem? You know, I am concerned with trade. Let somebody else worry about that." You find in this business two very stark realities, that when you have a difficult and disagreeable measure to take, you find, first, that there are fertile minds that develop other means of solving the problem quite naturally that aren't really related to reality, that provide easy answers to intractable problems. It is a normal human instinct.

Secondly, when the harsh reality has to be faced and there is a need for strong measures or disagreeable measures such as the one before you that will do the job, then all the interests that are involved or the constituencies that are affected explain how wise and proper it is to solve the problem by doing something else rather than the matter at hand; and this goes on in our country just as it goes on in other countries.

The CHAIRMAN. With regard to this 10-percent surtax, isn't that likely to increase the cost of U.S. goods in world markets and to that extent make it more difficult for us to compete, thereby cutting our balance of trade?

Secretary FOWLER. No, I don't think that will be the result. I think that the end result of the surtax will be to improve the competitiveness of our exports by curbing inflation, while also bringing our economy back to a cruising speed that will not suck in imports at the terrific rate we have been sucking them in the last half of 1967 and up to this point in 1968, and I think that it will create an environment, it should help, at least, to create an environment by removing the demand-pull inflation in the picture, yet an environment in which the problem of cost-push inflation which is the one you referred to, can hopefully be tackled.

The CHAIRMAN. Well, thank you very much, Mr. Secretary, and Mr. Surrey. You have given us——

Secretary FOWLER. Thank you for the opportunity to present this. I know it is a difficult problem and I know the committee's docket is full, but I wouldn't have insisted upon it and urged it if I didn't feel a compelling duty to stress it as strongly as it was within my power.

The CHAIRMAN. Would you be so kind as to have your Department prepare and submit a draft of your recommendations so that they can be included?

Secretary FOWLER. They are in preparation and I think my staff is in touch with your staff. You will have them within the next couple of days.[1]

The CHAIRMAN. Thank you very much.

(Whereupon at 12:20 p.m., the hearing was adjourned.)

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[1] The Treasury Department recommendations appear on p. 127.

[COMMITTEE PRINT]

TREASURY DEPARTMENT RECOMMENDATIONS

NOTE: This committee print contains the text of H.R. 16241 as it would appear if the Treasury recommendations presented to the Committee on Finance of the United States Senate on June 25, were substituted for the text of the House bill. It also contains a technical explanation of the Treasury recommendations. The Committee print has not been reviewed by the Committee. It is published only for the information of the public and does not reflect the approval or disapproval of the committee or any member thereof.

90TH CONGRESS
2D SESSION

H. R. 16241

IN THE SENATE OF THE UNITED STATES

APRIL 10, 1968

Read twice and referred to the Committee on Finance

JUNE 25, 1968

[Insert the part printed in italic]

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AN ACT

To extend the tax on the transportation of persons by air and to reduce the personal exemption from duty in the case of returning residents.

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

3 # TITLE I—TAX AMENDMENTS

4 ## SEC. 101. TAX ON TRANSPORTATION OF PERSONS.

5 (a) TAX ON TRANSPORTATION OF PERSONS.—Sub-
6 chapter C of chapter 33 (relating to tax on transportation of
7 persons by air) is amended to read as follows:

8 "Subchapter C—Transportation of Persons

"Sec. 4261. Imposition of tax on transportation of persons by air.
"Sec. 4262. Imposition of tax on transportation of persons by water outside the United States.
"Sec. 4263. Exemption.
"Sec. 4264. Special rules.

9 "SEC. 4261. IMPOSITION OF TAX ON TRANSPORTATION
10 OF PERSONS BY AIR.

11 "(a) AMOUNTS PAID WITHIN THE UNITED STATES.—
12 There is hereby imposed upon the amount paid within the
13 United States for transportation of any person by air, within
14 or without the United States, a tax equal to 5 percent of the
15 amount so paid.

16 "(b) AMOUNTS PAID WITHOUT THE UNITED
17 STATES.—There is hereby imposed upon the amount paid
18 without the United States for transportation of any person
19 by air, but only if such transportation—

20 "(1) begins and ends in the United States;

21 "(2) is provided pursuant to a ticket or order under

1 *which the first transportation by air begins in the United*
2 *States; or*
3 *"(3) in the case of amounts paid within Canada,*
4 *Mexico, or the Caribbean island area (as defined in 19*
5 *U.S.C. 1202) for transportation of a resident of the*
6 *United States, is provided pursuant to a ticket or order*
7 *under which the first transportation by air begins in*
8 *Canada, Mexico, or the Caribbean island area within*
9 *forty-eight hours after such individual departed from the*
10 *United States;*[1]
11 *a tax equal to 5 per centum of the amount so paid. In the*
12 *case of any transportation by air which is interrupted by*
13 *a scheduled stopover in the United States of 6 hours or more,*
14 *paragraph (1) shall be applied separately to the portion of*
15 *such transportation before the interruption and to the portion*
16 *of such transportation after the interruption.*
17 *"(c) SEATS, BERTHS, ETC.—There is hereby imposed*
18 *upon the amount paid for seating or sleeping accommodations*
19 *in connection with transportation with respect to which a*
20 *tax is imposed by subsection (a) or (b), a tax equivalent*
21 *to 5 percent of the amount so paid.*
22 *"(d) BY WHOM PAID.—Except as provided in section*

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[1] This provision is designed to extend the tax to individuals who cross into Canada or Mexico or travel to a Caribbean island to embark on a foreign flight. It has been added as a result of the concern over the possible diversion of U.S. passengers to Canada.

1 *4264, the taxes imposed by this section shall be paid by the*
2 *person making the payment subject to the tax.*
3 *"(e) United States Defined.—For purposes of this*
4 *subchapter, the term 'United States' means the States, the*
5 *District of Columbia, the Commonwealth of Puerto Rico, and*
6 *the possession of the United States.*
7 *"(f) Special Rule for Air Transportation*
8 *Within a Possession.—The tax imposed by this section*
9 *shall not apply to amounts paid within the Commonwealth*
10 *of Puerto Rico or a possession of the United States for*
11 *transportation which begins and ends within the Common-*
12 *wealth of Puerto Rico or which begins and ends within such*
13 *possession (in either case, determined with the application*
14 *of the second sentence of subsection (b)).*
15 *"SEC. 4262. IMPOSITION OF TAX ON TRANSPORTATION*
16 *OF PERSONS BY WATER OUTSIDE THE*
17 *UNITED STATES.*
18 *"(a) Amounts Paid Within United States.—*
19 *There is hereby imposed upon the amount paid within the*
20 *United States for taxable transportation of any person by*
21 *water a tax equal to 5 percent of the amount so paid for*
22 *transportation which begins before October 16, 1969.*
23 *"(b) Amounts Paid Outside United States.—*
24 *There is hereby imposed upon the amount paid without the*
25 *United States for taxable transportation of any person by*

1 *water, but only if such transportation is provided pursuant*
2 *to a ticket or order under which the first transportation by*
3 *water begins at a port in the United States, a tax equal to*
4 *5 percent of the amount so paid for transportation which*
5 *begins before October 16, 1969.*

6 *"(c) SEATS, BERTHS, REQUIRED CHARGES, ETC.—*
7 *There is hereby imposed upon amounts paid for—*

8 *"(1) seating or sleeping accommodations in connec-*
9 *tion with transportation with respect to which a tax is*
10 *imposed by subsection (a) or (b), or*

11 *"(2) food, services, or facilities on the vessel the*
12 *charge for which must be accepted as a condition to*
13 *taking transportation with respect to which a tax is im-*
14 *posed by subsection (a) or (b),*

15 *a tax equal to 5 percent of the amount so paid.*

16 *"(d) BY WHOM PAID.—Except as provided in section*
17 *4264, the taxes imposed by this section shall be paid by the*
18 *person making the payment subject to the tax.*

19 *"(e) TAXABLE TRANSPORTATION.—For purposes of*
20 *this section—*

21 *"(1) GENERAL RULE.—The term 'taxable trans-*
22 *portation' means any transportation where the vessel*
23 *makes one or more stops at a port within the nontaxable*
24 *area (as defined in section 4944(b)) and one or more*

1 stops at a port within the taxable area (as defined in
2 section 4944(c)).
3 "(2) EFFECT OF 12-HOUR STOPOVER.—In the case
4 of any transportation by water which is interrupted by
5 a scheduled stopover of twelve hours or more, paragraph
6 (1) shall be applied separately to the portion of such
7 transportation before the interruption and to the portion
8 of such transportation after the interruption.
9 "SEC. 4263. EXEMPTION.
10 "The tax imposed by section 4261 or 4262 shall not
11 apply to the payment for transportation or facilities fur-
12 nished to an international organization, or any corporation
13 created by Act of Congress to act in matters of relief under
14 the Treaty of Geneva of August 22, 1864.
15 "SEC. 4264. SPECIAL RULES.
16 "(a) PAYMENTS MADE OUTSIDE THE UNITED STATES
17 FOR PREPAID ORDERS.—If the payment upon which tax
18 is imposed by section 4261 or 4262 is made outside the United
19 States for a prepaid order, exchange order, or similar order,
20 the person furnishing the initial transportation pursuant to
21 such order shall collect the amount of the tax.
22 "(b) TAX DEDUCTED UPON REFUNDS.—Every per-
23 son who refunds any amount with respect to a ticket or order
24 which was purchased without payment of tax imposed by sec-

1 *tion 4261 or 4262 shall deduct from the amount refundable,*
2 *to the extent available, any tax due under such section and*
3 *shall report to the Secretary or his delegate the amount of*
4 *any such tax remaining uncollected.*
5 *"(c) PAYMENT OF TAX.—Where any tax imposed by*
6 *section 4261 or 4262 is not paid at the time payment for*
7 *transportation is made, then, under regulations prescribed by*
8 *the Secretary or his delegate, to the extent that such tax is*
9 *not collected under any other provision of this subchapter—*
10 *"(1) such tax shall be paid by the person paying*
11 *for the transportation or by the person using the trans-*
12 *portation;*
13 *"(2) such tax shall be paid within such time as the*
14 *Secretary or his delegate shall prescribe by regulations*
15 *after whichever of the following first occurs:*
16 *"(A) the right to the transportation expires; or*
17 *"(B) the time when the transportation becomes*
18 *subject to tax; and*
19 *"(3) payment of such tax shall be made to the*
20 *Secretary or his delegate, to the person to whom the pay-*
21 *ment for transportation was made, or to any person fur-*
22 *nishing any portion of such transportation.*
23 *"(d) APPLICATION OF TAX.—The tax imposed by sec-*

1 *tion 4261 or 4262 shall apply to any amount paid within the*
2 *United States for transportation of any person by air or*
3 *water unless the taxpayer establishes, pursuant to regulations*
4 *prescribed by the Secretary or his delegate, at the time of*
5 *payment for the transportation, that the transportation is*
6 *not transportation in respect of which tax is imposed by such*
7 *section."*

8 *(b) TERMINATION OF EXEMPTIONS.—Sections 4292*
9 *(relating to State and local governmental exemptions) and*
10 *4294 (relating to exemption for nonprofit educational orga-*
11 *nizations) are each amended by striking out "or 4261".*
12 *Section 4293 (relating to exemptions for the United States*
13 *and possessions) is amended by striking out "subchapters*
14 *B and C" and inserting in lieu thereof "subchapter B".*

15 *(c) CONFORMING AMENDMENTS.—Section 6415 is*
16 *amended by striking out "4251 or 4261" each place it appears*
17 *and inserting in lieu thereof "4251, 4261, or 4262".*

18 *(d) EFFECTIVE DATE.—The amendments made by this*
19 *section shall apply with respect to amounts paid on or after*
20 *the 10th day after the date of the enactment of this Act for*
21 *transportation beginning on or after such 10th day.*

22 ***SEC. 102. EXCISE TAX ON FOREIGN TRAVEL.***

23 *(a) IMPOSITION OF TAX.—Subtitle D (relating to mis-*
24 *cellaneous excise tax) is amended by adding at the end thereof*
25 *the following new chapter:*

1 "*Chapter 42.—FOREIGN TRAVEL*

"*Sec. 4941. Tax on foreign travel.*
"*Sec. 4942. Taxable trip.*
"*Sec. 4943. Taxable amount.*
"*Sec. 4944. Other definitions.*

2 "*SEC. 4941. TAX ON FOREIGN TRAVEL.*

3 "*(a) IMPOSITION OF TAX.—There is hereby imposed*
4 *on the taxable amount (as defined in section 4943) with*
5 *respect to any taxable trip (as defined in section 4942) of*
6 *any individual who is a United States person (as defined*
7 *in section 4944(d)(1)) a tax equal to 30 percent of such*
8 *taxable amount.*

9 "*(b) PER DIEM EXCLUSION.—In the case of any indi-*
10 *vidual, there shall not be taken into account under subsec-*
11 *tion (a) an amount equal to $15 multiplied by the number*
12 *of days during any part of which such individual was on a*
13 *taxable trip.*

14 "*(c) 5-PERCENT RATE IN CASE OF CERTAIN TRANS-*
15 *PORTATION EXPENSES.—*

16 "*(1) ELECTION.—In the case of any amount paid*
17 *which, if it had been paid within the United States dur-*
18 *ing the taxable trip, would have been subject to tax under*
19 *subchapter C of chapter 33 (relating to tax on transpor-*
20 *tation of persons), or the value of any air transportation*
21 *furnished which otherwise constitutes a taxable amount,*
22 *the taxpayer may elect—*

1 *"(A) that such amount shall not be subject to*
2 *the exclusion under subsection (b), and*
3 *"(B) to have the rate applied to such amount*
4 *under subsection (a) be 5 percent in lieu of 30*
5 *percent.*
6 *"(2) FORM OF ELECTION, ETC.—Any election*
7 *under paragraph (1) shall be made at such time and in*
8 *such manner as the Secretary or his delegate may by*
9 *regulations prescribe.*
10 *"(d) PERSON LIABLE FOR TAX.—The tax imposed by*
11 *this section shall be paid by the individual who makes the tax-*
12 *able trips: Provided, however, That an employer who fur-*
13 *nishes facilities and services to an employee the value of*
14 *which constitutes a taxable amount under section 4943 may*
15 *elect (in the manner provided in regulations prescribed by*
16 *the Secretary or his delegate) to assume the liability (in lieu*
17 *of such employee) for the tax imposed on such amount (com-*
18 *puted without regard to subsection (b)).*[2]
19 *"SEC. 4942. TAXABLE TRIP.*
20 *"(a) GENERAL RULE.—For purposes of this chapter,*
21 *the term 'taxable trip' means that portion of any foreign trip*
22 *(as defined in section 4944(a)) which is not excluded under*
23 *subsection (b).*

[2] This election will obviate the need for employers having to break down their expenditures for employee foreign travel among individual employees and, thus, will eliminate the allocation problems raised by members of the committee.

1 *"(b) EXCLUSIONS.—For purposes of this chapter—*

2 *"(1) BONA FIDE RESIDENCE ABROAD.—An indi-*
3 *vidual shall not be considered on a taxable trip for the*
4 *entire trip if such individual, after his departure, estab-*
5 *lishes his residence outside the United States.*

6 *"(2) TRADE OR BUSINESS.—An individual shall*
7 *not be considered on a taxable trip for the portion of the*
8 *trip during which such individual is engaged in a trade*
9 *or business in the taxable area on a full-time basis (A)*
10 *for a period of at least 120 consecutive days, or (B) as*
11 *an employee of an international organization.*

12 *"(3) MILITARY SERVICE.—An individual who is*
13 *a member of the Armed Forces of the United States shall*
14 *not be considered on a taxable trip for any portion of*
15 *the trip during which he is serving on active duty and is*
16 *assigned to duty in the taxable area.*

17 *"(4) STUDENTS AND TEACHERS.—An individual*
18 *shall not be considered on a taxable trip while he is en-*
19 *rolled at and attending as a student, or while he is em-*
20 *ployed as a member of the faculty at, a foreign school or*
21 *university for a normal unit of regular instruction ap-*
22 *proximating at least one-quarter of a school year, but in*
23 *the case of a student only if such individual is studying*
24 *for a degree at such foreign school or university or re-*
25 *ceives academic credit for such schooling at a school or*

1 *university in the United States at which he is enrolled*
2 *either before or after the trip.*
3 *"(5) CREW MEMBERS.—An individual shall not be*
4 *considered on a taxable trip for the entire trip if such*
5 *individual makes a trip as a bona fide member of a crew*
6 *of a transportation facility, but not including any period*
7 *of layover longer than normally provided in similar*
8 *situations.*
9 *"(6) SPECIAL RULE.—If a portion of an individ-*
10 *ual's trip is not considered to be a taxable trip by reason*
11 *of paragraph (2) or (4), then, if the portion of his trip*
12 *which would otherwise be considered a taxable trip does*
13 *not exceed 14 days (plus a reasonable period for travel-*
14 *ing to and from the taxable area), no part of his trip*
15 *shall be considered a taxable trip.*
16 *"(c) SPECIAL RULES FOR APPLICATION OF SUBSEC-*
17 *TION (b).—*
18 *"(1) SPOUSE AND DEPENDENTS.—If, in the case*
19 *of any individual, any portion of a trip is considered*
20 *not to be a taxable trip by reason of paragraph (2),*
21 *(3), or (4) of subsection (b) (with the application of*
22 *paragraph (6)), a comparable portion of the trip of*
23 *his spouse and dependents (within the meaning of section*
24 *152(a)) while accompanying him (or joining him)*
25 *on such portion shall not be considered a taxable trip.*

1 "(2) UNFORESEEN CIRCUMSTANCES.—The 120-
2 day requirement of subsection (b)(2) and the one-
3 quarter requirement of subsection (b)(4) shall not apply
4 in the case of an individual who fails to meet such
5 requirements because of circumstances which could not
6 have been reasonably foreseen at the time he began the
7 trip.

8 "SEC. 4943. TAXABLE AMOUNT.

9 "(a) GENERAL RULE.—For purposes of this chapter,
10 except as provided by subsection (b), the term 'taxable
11 amount' means, with respect to any taxable trip of any
12 individual—

13 "(1) The value of the facilities and services received
14 during such trip by such individual in connection with
15 such trip, other than the value of facilities and services
16 which are furnished to such individual without cost to
17 him or to another United States person.

18 "(2) The value of tangible personal property pur-
19 chased—

20 "(A) for delivery to the individual on a taxable
21 trip, or

22 "(B) by such individual in the taxable area
23 while on a taxable trip.

24 This paragraph shall not apply to (i) an automobile, boat,
25 or other vehicle, (ii) property purchased for use or sale in

1 *carrying on a trade or business, or (iii) property purchased*
2 *for use or sale by an organization which is exempt from*
3 *income tax.*
4 *"(3) The value (not otherwise included under para-*
5 *graph (1)) of the use in the taxable area of any auto-*
6 *mobile, boat, or other vehicle, or any housing accommo-*
7 *dations, owned by such individual or by another United*
8 *States person.*
9 *"(b) EXCLUSIONS.—For purposes of subsection (a),*
10 *there shall not be taken into account—*
11 *"(1) TAXABLE TRANSPORTATION.—Any amount*
12 *paid for transportation which is subject to tax under*
13 *section 4261 or 4262 (or would be subject to such tax*
14 *but for section 4263).*
15 *"(2) BUSINESS EXPENSES.—Except as provided*
16 *by subsection (c)(2), any amount which—*
17 *"(A) is deductible as an expense in carrying on*
18 *a trade or business, or*
19 *"(B) in the case of an organization which is*
20 *exempt from income tax, is an expense in carrying*
21 *out the purpose or function constituting the basis of*
22 *its exemption.*
23 *"(c) SPECIAL RULES.—*
24 *"(1) FACILITIES OR SERVICES RECEIVED BY TAX-*
25 *PAYER.—For purposes of subsection (a), facilities or*

1 *services purchased by an individual (on his own behalf*
2 *or on behalf of another person) in the taxable area and*
3 *furnished to another person in the taxable area shall be*
4 *considered as received by such individual.*
5 *"(2) LIMITATION ON BUSINESS EXPENSE EXCLU-*
6 *SION.—Subsection (b)(2) shall not apply with respect*
7 *to (i) transportation of any individual and his personal*
8 *effects, or (ii) meals, lodging, gifts, or entertainment of*
9 *a United States person while on a taxable trip.*[3]
10 **"SEC. 4944. OTHER DEFINITIONS.**
11 *"(a) FOREIGN TRIP.—For purposes of this chapter,*
12 *the term 'foreign trip', means that portion of the travel of an*
13 *individual who travels outside the nontaxable area which—*
14 *"(1) begins with the later of (A) his departure from*
15 *the last port or station within the United States, or (B)*
16 *his departure from the last port or station within the non-*
17 *taxable area outside the United States at which his trans-*
18 *portation is interrupted by a scheduled interval of more*
19 *than 12 hours, and*
20 *"(2) ends when he returns to the first port or station*
21 *in the United States or (if earlier) when he arrives at*
22 *the first port or station within the nontaxable area at*

[3] Under this provision, which has been added as a result of questions raised by members of the committee, no tax would apply to the business expenses of entertaining foreigners. Thus, these expenses would have the same tax exempt status as other business expenses which are not primarily associated with travel.

1 *which his transportation is interrupted by a scheduled*
2 *interval of more than 12 hours.*
3 *"(b) NONTAXABLE AREA.—For purposes of this chap-*
4 *ter, the term 'nontaxable area' means (1) the area lying west*
5 *of the 30th meridian west of Greenwich, and east of the*
6 *130th meridian west of Greenwich, and (2) Canada, Alaska,*
7 *Hawaii, the possessions of the United States, and the Trust*
8 *Territory of the Pacific.*
9 *"(c) TAXABLE AREA.—For purposes of this chapter,*
10 *the term 'taxable area' means any area which is not a non-*
11 *taxable area.*
12 *"(d) UNITED STATES PERSON.—For purposes of this*
13 *chapter, the term 'United States person' means—*
14 *"(1) An individual who is a resident of the United*
15 *States except an individual admitted into the United States*
16 *pursuant to section 101(a)(15) (A) or (G) of the*
17 *Immigration and Nationality Act of June 27, 1952*
18 *(8 U.S.C. 1101(a)(15) (A) or (G)), or a spouse*
19 *or dependent as defined in section 152(a)(9)) of such*
20 *individual.*
21 *"(2) A corporation or partnership engaged in trade*
22 *or business in the United States.*
23 *"(3) The United States, a State, a political sub-*
24 *division, or any agency or instrumenality thereof.*

1 *"(4) An estate or trust which is a United States*
2 *person within the meaning of subparagraph (F) of sec-*
3 *tion 4920(a)(4).*

4 *"(5) A corporation not engaged in trade or business*
5 *in the United States of which a person described in para-*
6 *graph (1), (2), (3), (4) owns more than 50 percent*
7 *of the voting stock.*

8 *"(6) An organization which is exempt from income*
9 *tax.*

10 *"(e) UNITED STATES; STATE.—For purposes of this*
11 *chapter, the term 'United States' when used in the geographi-*
12 *cal sense includes the States, the District of Columbia, the*
13 *Commonwealth of Puerto Rico, and the possessions of the*
14 *United States; and the term 'State' includes the District of*
15 *Columbia, the Commonwealth of Puerto Rico, and the pos-*
16 *sessions of the United States."*

17 *(b) CLERICAL AMENDMENT.—The table of chapters for*
18 *subtitle D is amended by adding at the end thereof the fol-*
19 *lowing:*

"CHAPTER 48—FOREIGN TRAVEL"

20 *(c) EFFECTIVE DATE.—*

21 *(1) GENERAL RULE.—The amendments made by*
22 *this section and sections 103 and 104 shall apply with*

1 *respect to foreign trips beginning on or after the 20th*
2 *day after the date of the enactment of this Act and before*
3 *October 16, 1969.*
4 *(2) SPECIAL RULE.—For purposes of the pro-*
5 *visions of the Internal Revenue Code of 1954, added*
6 *by the amendments made by this section and sections 103*
7 *and 104, any taxable trip which has not been terminated*
8 *as of October 15, 1969, by the taxpayer's return to the*
9 *nontaxable area, shall be considered terminated at the*
10 *close of such date.*
11 *SEC. 103. RETURNS.*
12 *(a) MAKING OF RETURNS.—Section 6011 (relating to*
13 *general requirement of return, statement, or list) is amended*
14 *by redesignating subsection (e) as subsection (f), and by*
15 *inserting after subsection (d) the following new subsection:*
16 *"(e) FOREIGN TRAVEL TAX RETURN.—*
17 *"(1) REQUIREMENT.—Except as provided by para-*
18 *graph (2), every individual who is a United States*
19 *person (as defined in section 4944(d)(1)) who makes a*
20 *foreign trip (as defined in section 4944(a)), or makes*
21 *an election under section 4941(d), shall make a return*
22 *with respect to the tax imposed by section 4941.*
23 *"(2) EXCEPTIONS.—Paragraph (1) shall not*
24 *apply if no portion of the foreign trip is a taxable trip*
25 *by reason of—*

1 *"(A) section 4942(b)(1) (relating to estab-*
2 *lishing residence outside the United States),*
3 *"(B) section 4942(b)(3) (relating to military*
4 *service), or*
5 *"(C) section 4942(b)(5) (relating to members*
6 *of crew).*
7 *"(3) JOINT RETURNS OF FAMILIES.—A husband*
8 *and wife, and any of their dependents (as defined in*
9 *section 152(a)), who were together on a foreign trip*
10 *may make a single return jointly with respect to the tax*
11 *imposed by section 4941. If a joint return is made and*
12 *there is liability for tax, the liability with respect to such*
13 *tax shall be joint and several."*
14 *(b) TIME FOR FILING RETURNS.—Part V of subchap-*
15 *ter A of chapter 61 (relating to time for filing returns and*
16 *other documents) is amended by adding at the end thereof the*
17 *following new section:*
18 *"SEC. 6077. TIME FOR FILING FOREIGN TRAVEL TAX*
19 *RETURNS.*
20 *"Returns required to be made by section 6011(e) shall*
21 *be filed at the time (not earlier than 60 days after the end*
22 *of the foreign trip) provided by regulations prescribed by*
23 *the Secretary or his delegate."*
24 *(c) PUBLICITY OF RETURNS.—Section 6103(a)(2)*
25 *(relating to public records and inspection) is amended by*

1 *striking the phrase "and chapter 41" and inserting in lieu*
2 *thereof "chapter 41, and chapter 42".*
3 *(d) Clerical Amendment.—The table of sections for*
4 *part V of subchapter A of chapter 61 is amended by adding*
5 *at the end thereof the following:*

"Sec. 6077. Time for filing foreign travel tax returns."

6 *(e) Effective Date.—For effective date of the amend-*
7 *ments made by this section, see section 102(o).*
8 *SEC. 104. DECLARATION AND PAYMENT OF ESTIMATED*
9 *FOREIGN TRAVEL TAX.*
10 *(a) Declaration of Estimated Foreign Travel*
11 *Tax.—Subpart D of part II of subchapter A of chapter 61*
12 *is amended by adding at the end thereof the following new*
13 *section:*
14 *"SEC. 6022. DECLARATIONS OF ESTIMATED FOREIGN*
15 *TRAVEL TAX*
16 *"(a) Definition.—For purposes of this title, the term*
17 *'estimated foreign travel tax' means, in the case of any indi-*
18 *vidual, the amount he estimates as the amount of his liability*
19 *for tax imposed by section 4941 with respect to any foreign*
20 *trip.*
21 *"(b) Filing of Declarations and Statements.—*
22 *Every individual (other than in individual referred to in*
23 *paragraph (3) or (5) of section 4942(b), relating to mili-*

1 *tary service and crew members) who makes a foreign trip*
2 *(as defined in section 4944(a)) shall—*
3 *"(1) before beginning such trip, make a declaration*
4 *of estimated foreign travel tax, and*
5 *"(2) at the time of making the declaration under*
6 *paragraph (1) and when entering the United States at*
7 *the end of such trip (or when first entering after the end*
8 *of such trip), file statements as to the amount of cash or*
9 *its equivalent the individual has with him.*
10 *"(c) JOINT FAMILY DECLARATION AND STATE-*
11 *MENT.—In the case of a husband and wife, and any of their*
12 *dependents (as defined in section 152(a)) who depart on a*
13 *foreign trip together, declarations and statements under this*
14 *section may be made by them jointly. If a joint return is made*
15 *with respect to the declaration of estimated travel tax the lia-*
16 *bility with respect to the estimated travel tax shall be joint*
17 *and several. If a joint declaration of estimated travel tax is*
18 *made for a trip but a joint return is not made for that trip,*
19 *the estimated foreign travel tax for such trip may be treated as*
20 *the estimated foreign travel tax of any individual who joined*
21 *in such declaration or may be divided between them.*
22 *"(d) TIME FOR FILING, ETC.—Any declaration or*
23 *statement required by this section shall be filed at such time*

1 *and at such place as the Secretary or his delegate may by*
2 *regulations prescribe. Such regulations many require a dec-*
3 *laration and statement to be filed when an individual departs*
4 *from the United States if he reasonably expects at such time*
5 *to make a foreign trip before he returns to the United States.*
6 *"(e) CONTENTS OF DECLARATIONS AND STATE-*
7 *MENTS.—The declarations and statements required by this*
8 *section shall contain such pertinent information as the Sec-*
9 *retary or his delegate may by forms or regulations prescribe,*
10 *including information with respect to the amount of cash or*
11 *its equivalent the individual has with him upon leaving or*
12 *returning from a foreign trip.*
13 *"(f) EXECUTION OF RETURN BY SECRETARY.—The*
14 *authority of the Secretary or his delegate to make a return*
15 *under section 6020 shall not apply with respect to declara-*
16 *tions required to be filed under this section.*
17 *"(g) PUBLICITY OF DECLARATIONS.—For purposes of*
18 *section 6103, the declarations required to be filed under this*
19 *section shall be held and considered a return under this*
20 *chapter.*
21 *"(h) ADDITION TO TAX FOR FAILURE TO FILE*
22 *STATEMENT.—*
23 *"(1) AMOUNT ADDED.—In the case of failure to*
24 *file a statement under this section, unless it is shown*
25 *that such failure is due to reasonable cause and not will-*

1 *ful neglect, $200 shall be added to the tax under section*
2 *4941 for each such failure. Section 6651 (relating to*
3 *failure to file tax return) shall not apply to any failure to*
4 *file a declaration under this section.*
5 *"(2) APPLICABLE RULES.—For purposes of para-*
6 *graph (1) and section 6157(b)—*
7 *"(A) any amount added to the tax under para-*
8 *graph (1) or section 6157(b) shall be paid upon*
9 *notice and demand, and shall be assessed, collected,*
10 *and paid in the same manner as taxes, and*
11 *"(B) any reference in this title to 'tax' im-*
12 *posed by this title shall be deemed also to refer to the*
13 *additions to tax provided by paragraph (1) and*
14 *section 6157(b)."*
15 *(b) PAYMENT OF ESTIMATED FOREIGN TRAVEL*
16 *TAX.—Subchapter A of chapter 62 (relating to place and due*
17 *date for payment of tax) is amended by renumbering section*
18 *6157 as section 6158, and by inserting after section 6156 the*
19 *following new section:*
20 ***"SEC. 6157. PAYMENT OF ESTIMATED FOREIGN TRAVEL***
21 ***TAX.***
22 *"(a) TIME FOR PAYMENT.—The amount of estimated*
23 *foreign travel tax shown on the declaration required under*
24 *section 6022 shall be paid to the Secretary or his delegate at*
25 *the time such declaration is filed.*

1 "(b) ADDITION TO TAX FOR UNDERPAYMENT OF
2 ESTIMATED FOREIGN TRAVEL TAX.—
3 "(1) In the case of an underpayment of estimated
4 foreign travel tax, there shall be added to the tax under
5 section 4941 an amount equal to 10 percent of the
6 amount of the underpayment. For purposes of this para-
7 graph, the amount of the underpayment is the excess of
8 the amount imposed by section 4941 over the payments
9 of estimated foreign travel tax made at the time of filing
10 the declaration of estimated foreign travel tax.
11 "(2) CROSS REFERENCE.—

"For applicable rules, see section 6022(h)(2).

12 "(c) ADMINISTRATIVE PROVISIONS.—
13 "(1) ASSESSMENTS.—No unpaid amount of esti-
14 mated foreign travel tax under this section shall be
15 assessed.
16 "(2) PAYMENTS OF TAX.—Payments of the esti-
17 mated foreign travel tax shall be considered payment
18 on account of the taxes imposed by section 4941.
19 "(3) PREPAID TRAVEL TAX.—Any amount paid
20 as estimated travel tax for any foreign trip shall be
21 deemed to have been paid on the last day prescribed
22 for filing the return under section 6011(e) for such
23 taxable trip for purposes of determining the period of

1 *limitation on credit or refund and the date of over-*
2 *payment.*

3 *"(4) ERRONEOUS TRAVEL TAX PREPAYMENT*
4 *CREDIT.—If on any return or claim for refund of taxes*
5 *imposed by section 4941 there is an overstatement of*
6 *the amount paid as estimated travel tax, the amount so*
7 *overstated which is allowed against the tax shown on*
8 *the return or which is allowed as a refund may be*
9 *assessed by the Secretary or his delegate in the same*
10 *manner as in the case of a mathematical error appearing*
11 *upon the return."*

12 *(c) CLERICAL AMENDMENTS.—*

13 *(1) The table of sections for subpart D of part II*
14 *of subchapter A of chapter 61 is amended by adding at*
15 *the end thereof the following:*

"Sec. 6022. Declarations of estimated foreign travel tax."

16 *(2) The table of sections for subchapter A of chap-*
17 *ter 62 is amended by striking out the last item and insert-*
18 *ing in lieu thereof the following:*

"Sec. 6157. Payment of estimated foreign travel tax.
"Sec. 6158. Payment of taxes under provisions of the Tariff Act."

19 *(d) EFFECTIVE DATE.—For effective date of the*
20 *amendments made by this section, see section 102(c).*

1 # *TITLE II—AMENDMENT OF*
2 # *TARIFF SCHEDULES*

3 ***SEC. 201. REDUCTION OF PERSONAL EXEMPTION OF CER-***
4 ***TAIN RETURNING RESIDENTS.***

5 *(a) REDUCTION.—The article description for item*
6 *813.31 of the Tariff Schedules of the United States (19*
7 *U.S.C. 1202) is amended—*

8 *(1) by striking out "Articles not over $100 (or*
9 *$200 in the case of persons arriving directly or indirectly*
10 *from American Samoa, Guam, or the Virgin Islands*
11 *of the United States, not more than $100 or which shall*
12 *have been acquired elsewhere than in such insular pos-*
13 *sessions)", and*

14 *(2) by inserting in lieu thereof "Articles not over*
15 *$10 (or $100 in the case of persons arriving directly*
16 *from a contiguous country or the Caribbean Island area,*
17 *or $200 in the case of persons arriving directly or indi-*
18 *recetly from American Samoa, Guam, or the Virgin*
19 *Islands of the United States, except that not more than*
20 *$10 of such $100 or $200 shall have been acquired else-*
21 *where than in a contiguous country or the Caribbean*
22 *Island area or in such insular possessions and not more*
23 *than $100 of such $200 shall have been acquired in a*
24 *contiguous country or the Caribbean Island area)".*

1 *(b) PERSONAL EXEMPTION AFTER OCTOBER 15,*
2 *1969.—Effective with respect to persons arriving in the*
3 *United States after October 15, 1969, the article description*
4 *for such item 813.31, as amended by subsection (a), is*
5 *amended by striking "$10" wherever it appears and inserting*
6 *"$50" in lieu thereof.*
7 *(c) The subpart A headnote for part 2 of schedule 8*
8 *of the Tariff Schedules of the United States (19 U.S.C.*
9 *1202) is amended by adding after headnote 3 the following*
10 *new headnote:*
11 *"4. For purposes of item 813.31 the term 'Caribbean*
12 *Island area' shall mean:*
13 *"(a) the Bahama Islands; the Turks and Caicos*
14 *Islands and the Bermuda Islands; and*
15 *"(b) all of the islands in the Caribbean Sea except—*
16 *"(i) those belonging to Central American and*
17 *South American countries;*
18 *"(ii) Cuba and its offshore islands; and*
19 *"(iii) Puerto Rico, the Virgin Islands of the*
20 *United States and all other islands of United States*
21 *sovereignty."*
22 *SEC. 202. ARTICLES IMPORTED FOR NONCOMMERCIAL*
23 *USE.*
24 *(a) RATE OF DUTY.—Part 6 of schedule 8 of the Tariff*

1 *Schedules of the United States (19 U.S.C. 1202) is amended*
2 *by inserting before item 870.10 the following:*

	Subpart A.—Noncommercial Importations *Subpart A headnote:* *1. For the purposes of this subpart—* *(a) The rates of duty for articles provided for in this subpart shall be assessed in lieu of any other rates of duty except free rates of duty on such articles.* *(b) Any article dutiable under item 869.05 shall be exempt from the payment of any internal-revenue tax imposed upon or by reason of importation.*		
	Articles not intended for sale or other commercial use:		
869.00	*If accompanying a person arriving in the United States and valued in the aggregate (exclusive of duty-free articles) not over $100 fair retail value*	*10% of fair retail value.*	*10% of fair retail value.*
869.05	*If imported in the mails in any package containing articles valued in the aggregate (exclusive of duty-free articles) not over $10 fair retail value*	*$1.50 per package*	*$1.50 per package*
869.10	*Other articles in any shipment (whether imported in the mails or otherwise but not accompanying a person arriving in the United States) containing one or more articles valued in the aggregate (exclusive of duty-free articles) not over $50 fair retail value*	*15% of fair retail value*	*15% of fair retail value*
	Subpart B.—Other Provisions		

3 *(b) CONFORMING AMENDMENT.—The headnote for*
4 *schedule 8 of the Tariff Schedules of the United States is*
5 *amended by inserting "(other than of subpart A of part 6)"*
6 *after "schedule" the first place it appears therein.*

1 *SEC. 203. EFFECTIVE DATES FOR SECTIONS 201 (a), (c),*

2 *and 202.*

3 *The amendments made by sections 201 (a) and (c)*

4 *and 202 shall apply with respect to persons and articles*

5 *arriving in the United States on or after the 10th day*

6 *after the date of the enactment of this Act.*

Passed the House of Representatives April 4, 1968.

Attest: W. PAT JENNINGS,

Clerk.

Explanation—Proposed Changes in the 5-Percent Ticket Tax

The Treasury Department suggests two changes in the ticket tax provisions of H.R. 16241:

(1) The House bill, while eliminating most exemptions, retains the present exemption for domestic flights by small aircraft on nonestablished lines (sec. 4263(d)). The retention of this exemption is inconsistent with the user charge nature of the domestic ticket tax and it is recommended that it be deleted.

(2) The Treasury Department recommends excluding from the ticket tax flights completely within Puerto Rico (or, consistently, within one of the possessions) in that this is more in the nature of an internal matter of concern to Puerto Rico under its Commonwealth status.

Technical Explanation—Tax on Foreign Expenditures

The following is a technical explanation of the Treasury Department's proposed foreign travel (expenditure) tax.

In General.—Under this proposal, a temporary tax would be imposed on certain expenditures in connection with a trip outside the nontaxable area (generally the Western Hemisphere and possessions of the United States) by a United States person. The tax base would include both expenditures made by him and those made by another United States person on his behalf. The tax schedule would be as follows: The first $15 of daily expenditures (computed on the basis of an average over the whole trip) would be exempt from tax. All expenditures over this level would be taxed at a 30 percent rate.

The cost of sea or air transportaion to and from the traveler's foreign destination would be taxed at a 5 percent rate—either as part of the expanded air transportation tax proposed by H.R. 16241, or as part of the expenditure tax. In addition, all air transportation while abroad would be taxed at a 5 percent rate, either under H.R. 16241, or, if that is not applicable, as a part of the expenditure tax but at a 5 percent rate. The use of the lower ticket tax rate removes the possibility of hardship in the case of persons whose purposes of travel can only be accomplished with numerous flights and frequent stopovers, as, for example, symphony orchestras on tour. The use of this rate also eliminates the possibility of discrimination between intra-European trips (where the flights tend to be short and therefore relatively inexpensive) and trips in other parts of the world where flights tend to be longer and therefore more expensive.

The application of the rate schedule in the case of families traveling together is discussed in a subsequent part of this memorandum.

United States Person.—The tax applies to expenditures made in connection with a taxable trip of a United States person. Except as noted below, the traveler would be liable for the tax on all expenditures in connection with his trip, which he himself makes or which are made on his behalf by another U.S. person. Amounts paid directly by an employer for meals and lodging of an employee while on a taxable trip would be taxable foreign travel expenditures of the employee as would the expenditures made directly by the employee (whether or not reimbursed). If a student travels abroad during the summer on funds given to him by his parents, he is taxable on the expenditures of his trip, whether he pays them or whether his father pays them directly. It is consistent with the nature of the tax—which is to tax the value of facilities and services received on a foreign trip—to tax the traveler on the entire value of his trip.

Where a United States person on a taxable trip makes expenditures for another person in the taxable area such as entertainment of a friend (whether or not a U.S. person) or payment of the family expenses of those accompanying him, the expenditures would be taxed to the person making them.

A United States person means:

(a) Any individual who is a resident in the United States, other than certain employees of international organizations or foreign governments and their staffs and families.

(b) A corporation or a partnership engaged in trade or business in the United States,

(c) An estate or trust which is considered a United States person within the meaning of section 4920(a) (4) (relating to the Interest Equalization Tax),

(d) The United States or any agency or instrumentality thereof,

(e) A State, including the District of Columbia, Puerto Rico and the possessions, or a political subdivision or any agency or instrumentality thereof, and

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(f) A foreign corporation not engaged in trade or business in the United States 50 percent or more of the voting stock of which is owned by a United States person.

United States.—For this purpose, the United States includes the States, the District of Columbia, the Commonwealth of Puerto Rico and all possessions. Thus, residents of Puerto Rico, the Virgin Islands, Guam, and American Samoa, will be subject to the expenditure tax on their travel outside the nontaxable area. A tax on expenditures by such residents while traveling abroad is consistent with the fact that the foreign expenditures of these areas are considered in United States balance of payments. On the other hand, there would be no tax imposed upon expenditures made while traveling in any of these areas. Thus, these areas would be treated in the same manner as the continental United States. Any revenue collected under the expenditure tax from residents of Puerto Rico, the Virgin Islands, or Guam will be covered into the treasuries of those areas.

Taxable Trip.—Only those expenditures in connection with a "taxable trip" would be subject to the expenditure tax.

Commencement and Conclusion of a Taxable Trip.—A taxable trip of an individual shall in general commence with the individual's departure from a port or station in the United States, including the possessions and Puerto Rico. However, since trips within the specified nontaxable area, primarily the Western Hemisphere, are not subject to the expenditure tax, if the individual after leaving the United States stops at a port or station in the nontaxable area for a scheduled interval of more than twelve hours, the taxable trip shall not begin until his departure from the last such port or station in the nontaxable area. The taxable trip shall end when the individual returns to a port or station in the United States; or, if he makes a prior stop at a port within the nontaxable area at that time, provided the stop is for a scheduled interval of more than twelve hours.

The tax will only be applicable to taxable trips beginning more than 20 days after the date of enactment of the legislation. The tax will terminate on October 15, 1969, which marks the end of the European travel season for 1969. If a person is on a trip on the termination date, he would pay tax only on the part of his trip falling within the term of the tax.

Nontaxable area.—The nontaxable area means the area lying west of the 30th meridian west of Greenwich, and east of the 130th meridian west of Greenwich, and all of Canada, the United States, its possessions and the Trust Territory of the Pacific Islands.

CERTAIN TRIPS EXCEPTED

Individuals establishing foreign residence.—An individual who, after his departure from the United States, establishes his residence in a foreign country would be considered on a nontaxable trip.

Students and Teachers.—An individual (and his dependents) would be considered on a nontaxable trip if he is enrolled at and attending, or employed as a member of the faculty at, a foreign school or university for a normal school term of at least one quarter. In the case of the student, he would have to be studying for a degree at the foreign school or would have to receive credit for such schooling towards a degree at a domestic school in order to qualify.

Trade or Business.—An individual (and his dependents) shall be considered on a nontaxable trip if he is outside the nontaxable area for at least 120 consecutive days while engaged on a full-time basis in a trade or business or profession. This category of exceptions will cover, for example, an employee transferred abroad by his employer for more than 120 days, or a professor on sabbatical leave abroad doing research on a full-time basis in connection with his trade or business. In addition, a resident (and his dependents) of the United States who is an employee of an international organization traveling on business would be considered on a nontaxable trip, regardless of the length of stay. Moreover, such an employee (and his dependents) present in the United States

on nonresident immigrant status would not be subject to the tax whether his trip was business or pleasure.

Partial Vacation Trips and Early Return to the U.S.—If the student, teacher, employee, or businessman meets the time qualifications for exemption described above and does not spend a total of more than 14 days outside the nontaxable area before and after the period he is carrying on exempt activities, his entire trip would be exempt. If he stays longer than 14 days, thus converting his trip to a partial vacation trip, he (and his dependents) would be considered on a taxable trip, but would be permitted to exclude all expenses incurred during the period he is engaged in the exempt activities.

If the student, teacher, employee, or businessman does not stay abroad for the prerequisite time period, his trip would be taxable unless he could not have reasonably foreseen the circumstances which caused him to cut his trip short.

Military.—A member of the armed services (and his dependents) who is serving on active duty and is assigned to duty in the taxable area would be considered on a nontaxable trip during his tour of duty at that duty station. Any trips he makes back and forth to the nontaxable area during that tour would also be exempt.

Crew Members of Ships or Airlines.—An individual would not be considered on a taxable trip while he is serving as a member of a crew of a facility providing transportation to or from a port or ports outside the nontaxable area provided that the portion of the trip outside the nontaxable area does not include any period of layover longer than normally provided in similar situations.

Taxable Foreign Travel Expenditures.—In general, unless specifically excluded, the tax applies to all expenditures in connection with the taxable trip of a United States person made by him or another United States person. They include not only the traveler's own living expenses, but also the cost of any entertaining he may do and the cost of most tangible personal property he may purchase while abroad. Expenditures for the use or maintenance of property while on a taxable trip, such as rent for an apartment or automobile, are taxable foreign travel expenditures. In the case of an automobile, boat, other vehicle, or housing accommodation purchased or owned by the traveler, or furnished free of charge by another United States person, a special rule would tax the value of the use of that item during the taxable trip. Consistent with this rule, the purchase price of such property would not be subject to tax. The value of the use of the article while traveling appears to be a more appropriate tax base than the full purchase price, since this treatment will put the person who purchases or borrows a vehicle or housing accommodation in the same position as one who rents one.

Only expenditures made for facilities or services to be provided on the taxable trip would be considered made in connection with the trip. Thus, any expenditures for pre-trip facilities or services, such as taxi fares to the airport in the United States; costs incurred during the trip for facilities and services not provided on the trip, such as in connection with the traveler's house in the United States while he is gone; or the cost of work done after the traveler's return, such as to repair damages occurring on the trip, would not be taxable foreign travel expenditures.

Expenditures of a taxable trip are taxable whether paid before, during or after the trip. For example, hotel bills are taxable foreign travel expenditures whether prepaid to a travel agent, paid in cash or by check while on the trip, or charged and paid for after return.

Consistent with the rules on deductibility for income tax purposes of ordinary and necessary business expenses, the expenditure tax imposed on amounts deductible as business expenses would itself be deductible.

Purchase of Property.—In general, amounts spent while on a taxable trip for the purchase of tangible personal property (other than property held for investment or purchased for use or sale in carrying on a trade or business, or by an organization exempt from income tax) would be taxable. Moreover,

the cost of property purchased for delivery to an individual on a taxable trip would be taxable. Thus, for example, if a person purchases a European suit of clothes (whether before leaving or while on a taxable trip) and takes physical delivery while on a taxable trip, the purchase price would be a taxable foreign travel expenditure. Or conversely, if a person purchases the suit while in the taxable area for delivery after his return to the United States, the purchase price would be subject to this tax. As mentioned above, in the case of the purchase of automobiles, boats, or other vehicles, there would be imposed, in lieu of a tax on the purchase price, a tax on the value of the use of the article during the taxable trip. The tax in all these cases would be in addition to any applicable customs duty.

Business Expenses.—In the case of an individual traveling on a taxable business trip or on a taxable trip on behalf of an organization exempt from income tax, his business expenses, or expenses incurred in carrying out the purpose of the exempt organization, *other than* for transportation, meals, lodging, gifts and entertainment, would be excluded from the tax base.

RATE OF TAX

The taxable foreign travel expenditures made in connection with a taxable trip of a United States person shall be subject to tax at the following rates:

Air Transportation in Connection with Foreign Travel.—The expenditure tax will not apply to the cost of any air transportation paid for in the United States. That transportation will be subject to the expanded ticket tax under H.R. 16241 at a 5 percent rate. If the air ticket is not subject to the ticket tax in H.R. 16241, because it is purchased outside the United States or before the effective date of the expanded air transportation tax, the expenditure tax will apply but only at a 5 percent rate. The cost of transportation exempt from the ticket tax under a specific exemption (*e.g.*, transportation furnished to international organizations) would not be subject to the expenditure tax.

Sea Transportation in Connection With Foreign Travel.—The expenditure tax will apply to the cost of all sea transportation in connection with foreign travel in the taxable area. In the case of sea transportation to the first and from the last scheduled stop in the taxable area of more than 12 hours, the rate of tax will be 5 percent. The cost of other sea transportation in the taxable area will be subject to the regular expenditure tax schedule, in the same manner as the cost of land transportation.

Amounts paid for food and services (where no separate charge is made), and seating or sleeping accommodations, during the period transportation is subject to the 5 percent tax rate shall also be taxed at the lower 5 percent rate. Thus, if a United States person takes a 30-day cruise leaving from the U.S. which makes no stops within the non-taxable area and which makes its first stop in the taxable area of more than 12 hours on the 5th day and makes the last such stop on the 25th day, one-third of the cruise fare plus any separate charge for sleeping accommodations will be subject to tax at a 5 percent rate under the expenditure tax. The remaining two-thirds of the cruise fare and separate sleeping accommodations charge and any additional expenditures (such as for sightseeing or food) not covered by the basic fare will be subject to the expenditure tax at the regular rate.

All Other Taxable Expenditures.—All other taxable expenditures will be taxed on the following basis:

(a) *Exclusion from tax.*—Each traveler is entitled to a $15 daily exclusion from the expenditure tax base. The amount excludable under this provision for a taxable trip shall be computed by multiplying the number of days during any part of which the individual was on such taxable trip by $15 to arrive at the total exemption.

(b) *30 Percent Rate.*—The remaining expenditures shall be subject to tax at the rate of 30 percent.

For example, if a corporate employee goes to London on business for 10 days and spends $200 for taxable expenditures (whether or not he is reimbursed by his employer) he would pay a tax of $15 computed as follows:

		Tax rate (percent)	Tax
Exclusion, $15 × 10 days	$150	0	0
Remainder, 30 percent rate	50	30	$15
Total	200		15

If in addition to his plane fare to London, the employer directly paid for the employee's hotel bill of $200, the employee would also include this amount in his tax computation. Under the above example, his tax would be increased by $60 (to a total of $75).

COMPUTATION OF THE TAX

In order to preclude the necessity of travelers having to keep detailed records of their expenses, taxable foreign travel expenditures would be computed, to the greatest extent possible, by a travel net worth method. For many people this would involve merely subtracting the money and traveler's checks with which they returned from the money and traveler's checks with which they left and adding this to the amounts paid before the trip began.

More specifically, the first step in the computation for all travelers would be to determine the cash expenses of the trip. To do this, the amount of money (including traveler's checks) with which a person returns from a taxable trip would be substracted from the sum of the amount of money (including traveler's checks) with which he departed plus all amounts received while on the taxable trip. Amounts received while on the trip must be included regardless of their origin. Thus, withdrawals from domestic or foreign banks, money sent from home, compensation for services received while abroad or money received from the sale of property would be included.

The second step in the computation would be to add to the cash expenditure figure, the amounts of expenditures in connection with the taxable trip paid before the taxable trip began, the amounts charged while on the taxable trip, and the amount of checks written while on the taxable trip. These are all amounts of which the traveler will have a record, e.g., credit card statements, personal check stubs. The resultant figure would represent the tax base for most travelers, and would be taxed according to the per day exemption and 30 percent rate, or in the case of certain transportation, the 5 percent rate of tax. For others, a further reduction would be made for expenses specifically excludible from taxable foreign travel expenditures (such as the cost of business inventory). The figure resulting from these reductions would represent their taxable foreign travel expenditures.

ESTIMATED TAX

Every individual, at his point of departure from the United States for a period during which he reasonably expects to be on a taxable trip, and whether or not he plans to make a stopover in the nontaxable areas, would be required to make a declaration of his estimated tax with respect to that taxable trip and pay the amount of the estimate to the Internal Revenue Service. He would include in his declaration a statement of the amount of cash (and traveler's checks) he is taking on the taxable trip. This figure is necessary in order to utilize the

travel net worth method for computing cash expenditures. Appropriate procedures will be developed for filing the declaration so that compliance with the requirement may be verified before the traveler's departure. The accuracy of the cash statement would be subject to verification at the point of departure by customs officials or other Treasury officials.

If a United States person departs on a taxable trip from a port in the nontaxable area outside the United States, and he did not make the required declaration and statement upon leaving the United States, he will be subject to penalty unless he can show such departure was not expected. In any event, the declaration or statement, if not previously filed, would be filed at this time.

Any individual returning from a taxable trip would be required to make a statement of his incoming cash (and traveler's checks) at the time he is processed through United States Customs. This statement would provide the incoming cash balance from which the travel net worth would be computed, and the accuracy would be subject to verification by a customs official.

RETURNS AND PAYMENT OF TAX

A tax return for a taxable trip, together with payment of any balance due, would be required to be filed with the Internal Revenue Service by the traveler within 60 days after his return. This will allow the taxpayer adequate time to receive all necessary credit card and banking records for preparation of the return. Of course, the return may be filed immediately upon arrival. A husband, wife, and any of their dependent children who travel together on a taxable trip may make a single taxable trip return jointly with respect to such trip. Such a return may be filed even though one or more of such individuals has no taxable foreign travel expenditures. A joint return would allow a family to utilize the full per diem exemption available to each traveling member without requiring that each have separate expenditures to absorb them.

ADMINISTRATION AND PROCEDURE

Generally the administrative and procedural requirements applicable to other excise taxes would be applicable to this expenditure tax. Thus, for example, the general provision for penalties for failure to file returns, requirements for claims for refund, assessment and collection procedures, and statutes of limitations would apply to the administration and procedure of this tax.

Two new provisions would be added to insure compliance with the requirements for declaration and payment of estimated tax.

A flat penalty of $200 would be imposed for failure to make a declaration of estimated tax and statement as to cash on hand, as required at the time of departure from the United States unless it were shown that such failure was due to reasonable causes. Thus, if an individual flew from New York to Europe without making a declaration and statement, a $200 penalty would be imposed for failure to make the declaration in New York. A significant penalty is necessary because of the importance of having an individual establish his outgoing cash figure for purposes of computing the tax base. An underestimation penalty would be imposed of 10 percent of the underpayment of estimated tax. The amount of the underpayment would be the difference between the estimated tax payment and the amount of tax shown on the taxable trip return.

Technical Explanation—Proposed Changes in Customs Rules Relating to Tourist Exemptions and Processing of Certain Noncommercial Importations

The proposal is intended to reduce noncommercial expenditures of dollars abroad where such expenditures adversely affect our balance of payments. It would do this by lowering the duty-free exemptions allowed returning U.S. residents. In order to ease the administrative burden of processing millions of dutiable noncommercial foreign acquisitions brought back to this country by returning U.S. residents and millions of dutiable noncommercial mail shipments, it would provide for a flat rate of duty on such articles within certain monetary limits.

At the same time, since the proposal deals only with noncommercial imports, it would not interfere with the favorable balance of payments aspects of our trade account or the legitimate business interests of American businessmen in the import trade.

The proposal would not assess any duty or charge on articles which are themselves free of duty under existing provisions of the Tariff Act. Most of such articles would be works of art, books, American goods returned, United States origin personal effects of residents abroad and similar items.

THE REDUCED TOURIST EXEMPTIONS

A. Present Practice

The present tourist exemptions granted to returning U.S. residents permit the duty-free importation of foreign acquisitions not exceeding a total retail value of $100. This exemption is granted to American residents who have been abroad for not less than 48 hours and may be used only once each 31 days (in the case of persons arriving from Mexico the *48-hour time limit* is waived). The resident is permitted to include within this exemption one quart of alcoholic beverages. This exemption is applicable to residents returning from any area or country. However a special exemption is granted to residents arriving from the Virgin Islands and certain other U.S. insular possessions. This special exemption permits the importation of acquisitions up to a value of $200 retail, of which not more than $100 may be acquired outside the Virgin Islands or other insular U.S. possessions, and may cover not more than one gallon of alcoholic beverages of which not more than one quart may be acquired outside the Virgin Islands or other insular possessions.

B. House Bill

The House bill contains the following exemption structure (computed on retail values as under existing law): (1) the exemption for U.S. residents returning to the United States from any place other than Canada, Mexico and certain United States insular possessions would be $10 on a temporary basis and $50 on a permanent basis after October 15, 1969; (2) the exemption for residents returning directly from Canada and Mexico would be $100 permanently and (3) the exemption for residents returning directly or indirectly from the Virgin Islands and certain of our other insular possessions would be $100 temporarily until October 15, 1969, when it would be restored to the present $200 level.

As under existing law, exemptions in excess of the minimum exemption would be restricted so that goods acquired would be exempt only to the extent of the exemption applicable to the area of acquisition. For example, the exemption for a tourist returning from the Virgin Islands after October 15, 1969 (when the $200 exemption would be in effect) would be limited to $100

in Canada or Mexico no more than $50 of which were acquired in Europe. Goods in excess of these amounts acquired in these areas would be dutiable, even though, in the aggregrate, they did not exceed $200.

Foreign acquisitions accompanying the returning U.S. resident valued in excess of the exemption would be dutiable at a flat 10 percent of the fair retail value. The 10 percent rate would be applied on such articles up to an aggregate value of $500 wholesale. If dutiable acquisitions *above the exemption* level exceed $500 in wholesale value, all dutiable articles would be assessed duty at regular Tariff Schedule rates. In addition to any customs duties, articles such as liquor and tobacco would, of course, be subject to any applicable Internal Revenue taxes.

C. Current Treasury Proposals

For the reasons set forth in the Statement by the Secretary of the Treasury, the current Treasury proposals would modify the House bill by:

1. Extending the exemption level of $100 for Canada and Mexico to the Caribbean Island Area.[1]
2. Retaining the present $200 exemption for U.S. residents arriving directly or indirectly from the U.S. Virgin Islands and certain other insular possessions. The same limitations on the exemptions for goods acquired in other areas would be provided, but at the changed exemption levels that would be applicable to those areas of acquisition.
3. Reducing the $500 wholesale ceiling on applicability of the flat rate to $100 retail.
4. Including acquisitions exempt from duty solely by virtue of the tourist exemption within the $100 ceiling for purposes of determining applicability of the flat rate.

ARTICLES NOT ACCOMPANYING RETURNING TRAVELERS

A. Present Practice

At present, low value items (under $1) such as newspapers are "passed free." The same "passed free" status is given to mail parcels identified as gifts valued at up to $10 retail and to gifts (whether imported by mail or otherwise) valued up to $50 retail from servicemen in combat areas.

All other dutiable articles, whether imported by mail or otherwise, are subject to the Tariff Schedule rates.

B. House Bill

The $10 exemption for all mailed gift parcels, with the exception of those orginating in noncombat areas, would be reduced to $1 retail administratively by a change of regulation. The statutory exemption of $50 for gifts from servicemen in combat areas would also be retained as would the $10 exemption for servicemen in noncombat areas.

C. House Bill

Dutiable mail shipments valued at over $1 and not over $10 retail would be assessed $1 in lieu of any other duty or tax.

Dutiable mail shipments valued at over $10, and dutiable shipments by other means, containing more than one article and valued at not over $250 wholesale, would be assessed duty at a flat rate of 10 percent of the fair retail value.

Shipments containing one article or exceeding the $250 ceiling would be assessed duty at regular Tariff Schedule rates.

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[1] The Caribbean Island Area would be defined as the Bahama Islands, the Turks and Caicos Islands, the Bermuda Islands, and all the islands in the Caribbean Sea except those belonging to Central and South American countries, Cuba and its offshore islands and Puerto Rico, the Virgin Islands of the United States and all other islands of United States sovereignty.

D. Current Treasury Proposals

For the reasons set forth in the Secretary's Statement, the current Treasury proposals would modify the House bill by:

1. Increasing the flat charge for mail packages valued at over $1 and not over $10 retail, to $1.50.
2. Reducing the $250 wholesale ceiling on applicability of the flat rate to $50 retail.
3. Increasing the flat rate from 10 to 15 percent.
4. Extending the flat rate to single article packages.

ESTIMATED FOREIGN EXPENDITURE REDUCTIONS

A. Changes in Tourist Exemptions

During 1967, the total value of foreign acquisitions made by returning U.S. residents arriving from all foreign countries was estimated to be in excess of $362 million. Of this total, persons arriving from Canada, Mexico and the Caribbean countries (including Caribbean cruise passengers) accounted for slightly over $162 million. Therefore, the value of articles acquired by returning U.S. residents arriving from other countries was approximately $200 million. Approximately $110 million was brought in by persons whose purchases totaled less than $100 per person, while approximately $90 million was brought in by persons whose foreign acquisitions exceeded the present duty-free exemption.

We estimate that the value of foreign acquisitions by persons now bringing in less than $100 each will be reduced by $45 million or approximately 40 percent of the total purchases made by this group.

The effect on foreign acquisitions made by the approximately 300,000 persons who now exceed our duty-free exemption and pay duty would be somewhat less. If we can assume that the foreign acquisitions by these persons will be reduced by an amount roughly equivalent to the additional duty which they would have to pay, the total reduction in foreign acquisitions by this group of returning U.S. residents would be about $5 million.

Thus, the total reduction in foreign acquisitions to be achieved by reducing the tourist exemption to $10 is estimated to be approximately $50 million on an annual basis through October 15, 1969. After that date, when the increased exemption for most of the world applies, the total reduction will approximate $30 million on an annual basis.

B. Mail Shipments

It is estimated that the total value of the 55 million mail parcels which arrived in the U.S. during 1967 was approximately $500 million. Of this 55 million total, an estimated 11 million parcels were gifts or purported gifts said to be valued at less than $10; 4 million were gifts valued $50 or less from servicemen in combat areas; and 25 million were "flats", newspapers, periodicals, samples and shipments of insignificant value. Of the remaining 15 million parcels duty was assessed on 1,600,000 parcels. However, our studies indicate that approximately one-third of the 15 million parcel total would have been dutiable if adequate manpower was available to properly handle them.

Certain parcels now included in the present $10 gift exemption are bona fide gifts mailed from nationals of foreign countries to persons in the United States. While elimination of this privilege with respect to such parcels will not affect expenditures of U.S. dollars abroad, it is nevertheless believed necessary to eliminate this free-gift privilege entirely because it is subject to widespread abuse and because, in practice, it would be exceedingly difficult to distinguish betweens gifts from foreign nationals and those from U.S. tourists.

Of the 11 million gift parcels under $10 we estimate approximately 4 million from U.S. tourists would be discouraged if the existing gift exemption were

eliminated. The average value of these parcels is éstimated to be $7. Therefore, foreign expenditure curtailment of approximately $28 million would be achieved. The application of a flat rate of duty to the remaining noncommercial shipments would simplify Customs' administrative task. Customs would be able to assess duty on an appreciable number of packages which now escape duty simply because Customs manpower cannot cope adequately with the number of packages involved. Closing this loophole will probably deter the sending of a number of these packages. It is a conservative estimate that approximately an additional $12 million reduction in foreign acquisitions, for a total of about $40 million, will result from the above-proposed changes in the Customs processing of foreign mail parcels.

ESTIMATED ADDITIONAL REVENUE COLLECTIONS

It is estimated that revenue collections will increase by about $10 million by reason of changes in the tourist exemptions, and by an additional $15 million on mail shipments, for a total additional revenue collection of $25 million.