

mands that would revive inflationary pressures, in turn boosting spending and income and eventually stimulating still greater credit demands.

The fact that this can happen against a background of expansionary monetary policy has been demonstrated clearly in recent weeks and months. So it is no answer for those who inveigh against high interest rates to call for easy money unless they are ready to see higher taxes or unless they are willing to take the risk of a serious inflation.

A special reason for prompt action to cut the prospective Federal deficit is the desirability of encouraging the current uptrend in homebuilding and the increased availability of money in the mortgage market.

Last year the mortgage market was starved for funds and homebuilding went through the wringer—particularly as thrift institutions lost funds to higher paying open market paper and bank deposits.

This year, traditional mortgage lenders have experienced record inflows of funds. Some of this inflow has been used to rebuild depleted liquidity, but the availability of mortgage funds has also improved greatly.

Yet there can be no complacency about this improvement, for since this spring, rising interest rates on corporate securities have tended to attract some funds from thrift institutions into these securities rather than into mortgages. The recent rise in short-term rates, if it goes much further, could pull savings funds directly out of the thrift institutions. These developments raise the possibility of a new stringency in housing credit.

We do not present the proposed tax surcharge as something that will cut interest rates immediately and sharply, or eliminate all the problems that have faced the financial markets, the mortgage market, or homebuilding in the past 2 years since the Vietnam escalation began.

Even with a tax increase, there will be a sizable Federal deficit, and sizable competing demands from the private sector.

But a tax surcharge will reduce the size of the Federal deficit and the size of Federal borrowing needs. It will help assure a continuation of expansionary monetary policy, and it will reassure borrowers and lenders that there is no need for a renewed scramble for funds or runup of interest rates.

It could well turn the tide in the credit markets, calm down the precautionary borrowing and produce freer flows of funds at more reasonable rates of interest.

We have discussed the recent role of certain key private sector demands on the credit markets, but it is particularly important, in weighing the need for fiscal action, to look at the Federal Government demands.

Consider these facts relative to Federal credit demands on the private sector in the fiscal year ended June 30, 1967:

The total outstanding volume of Treasury securities, Federal agency securities, and participation certificates increased by slightly under \$10 billion.

But Government investment accounts increased their holdings of these issues by \$11.6 billion, and the Federal Reserve added \$4.5 billion to its holdings.