

One can only conjecture about the precise pattern and sequence of events through which tightened credit conditions would envelop the market in the absence of a tax increase, but last year's experience might provide some guidance.

One could expect, for example, that as the Treasury and Federal agencies came to market in greater and greater volume, higher rates would have to be paid to draw in additional investors. Increasingly, the funds might be drawn from the thrift institutions that are the mainstay of the mortgage market.

In the meantime, corporate borrowers would bid rates up, and attract investment from institutional lenders that have the flexibility to shift among government securities, corporate issues, and mortgages. Banks might well face insistent business demands to draw on credit lines, while lessened reserve availability kept a tighter lid on the banks' total portfolio, so that less could be put into Federal Government securities or tax-exempt issues even at steeply higher interest rates.

Along with the mortgage market, and State and local government borrowers, other borrowers with relatively limited bargaining power and limited flexibility of alternative credit resources would also be likely to suffer disproportionately at the hands of tightened credit conditions—including small business and farmers.

It would be a case of "pay up or do without," and perhaps a case of "doing without" even for those willing to "pay up" to a considerable extent.

It would be sheer hypothesis to guess what heights interest rates might have to scale in the grim process of sorting out the credit demands that would be met, and those that would not be met, but the pressures would clearly be there, in the absence of tax action and tight expenditures control action, to push rates substantially higher than they are now.

One need look only around the world, even at highly industrialized countries, to see government bond yields of 7 percent or more—and indeed of more than 8 percent during much of last year in Germany. Rates on prime industrial bonds in the United Kingdom have ranged as high as 8 percent as recently as a year ago, and these yields touched 9 percent in Germany.

These, I submit, are not tolerable conditions for the United States.

I have dwelt at some length on the importance of the proposed tax increase for the performance of financial markets and interest rates, because to my mind that is a key reason for its enactment. With the proposed tax increases, and tight expenditure control, the net demand can be held to tolerable proportions that the credit markets can handle, given a reasonably supportive monetary policy climate.

Without the tax increase, we are convinced that the credit markets could not finance the resulting deficit—except at the cost of sharply reduced availability of credit to meet private demands, and sharply increased interest rates.

Since Chairman Ackley is going to cover, Mr. Chairman, in detail the problem surfaced in the next pages dealing with "To protect healthy economic growth and price stability," I will omit their treatment here.