taining a loss on monetary transactions would have had a gain of approximately $170 million. This gain is more than accounted for by the purchase of $200 million in gold from Canada which leaves a net balance of U.S. gold losses of approximately $30 million distributed among transactions with over thirty countries.

The United States, as is well known, stands ready to sell gold to monetary authorities for legitimate purposes upon demand and requests for gold are not refused. The United States, on occasion, has indicated its belief that it is not generally appropriate for an aid-recipient country to be adding to its gold reserves but since most developing nations are well aware that the needs of their economies require goods rather than gold, the purchase of gold from the United States is seldom a matter which arises. While some less developed countries appear as purchasers of U.S. gold the large majority of the transactions were in amounts of less than $5 million and represented purchases by numerous countries to cover payments which they were obliged to make in gold to the International Monetary Fund or other international institutions.

Our current efforts in the negotiation for new means of providing international liquidity which I described in my testimony to the committee, stem in part from the fact that there is not a sufficient amount of gold entering monetary reserves each year to provide for growing liquidity needs. Agreement on a new form of reserve asset should, therefore, be an important step in economizing on the use of gold which is in monetary reserves and relieve some pressure on the gold stocks of the United States.

2. *Question:* If the spending budget were reduced by $5 billion, as some are advocating in lieu of the $5 billion tax increase, there would still be the same budget deficit as forecast. And in order to stop inflation, would it still not be necessary to have a tax increase?

Answer: Hypothetically speaking, a tax increase would probably not be necessary to curb inflationary pressures (assuming no change in the general economic situation we foresee in FY 1968) if spending could be reduced to yield the same budget deficit as the one expected as a result of the proposed tax increase. For it is the net impact on the economy of Government receipts and expenditures—the budget deficit or surplus—which must be considered in judging the effects of Government activity on prices in the economy.

In practice, however, we believe that the tax increase which the President has proposed provides the best means for decreasing inflationary pressures after the beginning of the new fiscal year. The budget for fiscal 1968 has already been reduced to the lowest levels commensurate with our responsibilities at home and abroad.

In this connection, it might also be noted that a budgetary deficit (as for example the one expected in FY 1968) does not necessarily mean that the Government is stimulating inflationary pressures in the economy. The relationship between budgetary deficits and price movements is not a simple, direct one. As a general rule, if there is a deficit it indicates that the government is stimulating the economy by injecting more money into the income stream than it takes out. Conversely, if there is a surplus, the economy is being restrained by the government's draining off more money than is being spent. Whether inflation will result from either a surplus or a deficit depends on what is happening in the private sector of the economy at the time. If demand in the private sector is depressed, a sizable Federal deficit may be compatible with relative price stability, while if private demand is running strong, a budget surplus may accompany large price increases. Table 1 shows calendar year Federal administrative budget surpluses and deficits and the rate at which the GNP price deflator rose during those years. If we omit 1948 and 1951, when price controls and the Korean War had special influences, we see that the largest price increases occurred in 1956 and 1957, two of the few years in which the Federal budget showed a surplus. On the other hand, the calendar year with the largest deficit, 1953, had the smallest post-Korean price increase. (The same results hold if we take the Federal surplus/deficit on a National Income Accounts basis instead of looking at the Administrative Budget.)

The explanation behind the seemingly paradoxical results shown in Table 1 lies, of course, in the varying strength of the private sector. In 1956 and 1957, for example, demand in the private sector of the economy was very high and as a result prices increased very rapidly even though the government was taking more out of the economy (through taxes) than it was putting in (through expenditures). For the last few years, the private sector has been growing rap-