idly as the unemployment rate has dropped from 7 percent to 4 percent. The Federal deficits for these years have, however, been accompanied by below average price increases. If the economy had been operating nearer to full capacity, deficits of this magnitude might have led to more rapid price increases.

Thus we see that while the government's surplus/deficit position is a key factor, it is still only one of many factors to be considered in forecasting price movements. With a large amount of slack in the economy, large deficits do not necessarily imply price increases, while under circumstances of high utilization, these same deficits can mean inflation. It is just because the economy is so close to balance between demand and productive capacity that we have proposed the present tax program for fiscal year 1968. As a result of this program, we anticipate a decrease in inflationary pressures and a movement toward greater price stability.

Budgetary deficits and inflation

Calendar year	Federal administrative budget surplus or deficit (−)	Percent increase in the GNP price deflator	Calendar year	Federal administrative budget surplus or deficit (−)	Percent increase in the GNP price deflator
	Billions			*Billions*	
1948	$5.2	6.7	1958	−$7.1	2.6
1949	−3.6	−.6	1959	−7.0	1.6
1950	−.4	1.4	1960	2.0	1.7
1951	−3.4	6.7	1961	−6.3	1.3
1952	−5.8	2.2	1962	−7.2	1.1
1953	−9.2	.9	1963	−6.7	1.3
1954	−3.7	1.5	1964	−8.2	1.6
1955	−2.8	1.5	1965	−4.7	1.8
1956	3.8	3.4	1966	−7.3	3.0
1957	.6	3.7			

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 13, 1967.

3. *Question:* Would you comment on the impact on our economy and on the problem of inflation of the various alternatives:

(a) Keep expenditures at level proposed in the budget, with no tax increase.

(b) Reduce expenditures by $5 billion, with tax increase as proposed by the budget.

(c) Reduce expenditures by $5 billion, with no tax increase.

Answer: (a) Maintaining the level of expenditures proposed in the budget but *without* a tax increase would, of course, provide more stimulation to the economy than was provided in the budget. As the President stated in his Budget Message, under such a course of action, we would run substantial risks of:

—choking off the much-desired move toward lower interest rates by placing too much of our stabilization effort on the shoulders of monetary policy, and

—renewing inflationary pressures, particularly in the latter half of this year.

(b) A tax increase combined with a large expenditure reduction would be an extremely restrictive fiscal policy. Incomes, both of persons and of businesses, would be lowered substantially from what they would otherwise be. Not only would we run the risk of terminating our present, record-breaking expansion, but the adverse impact on revenues might be so great as to result in a larger, rather than a smaller deficit.

(c) A large expenditure reduction, in place of a tax increase, would be preferable if it were feasible, but in my judgment it is not. To quote again from the President's Budget Message:

"The economy, the budget, and the aims of our society would be jeopardized by either a larger tax increase or by large slashes in military or civilian programs. I have reviewed these programs carefully. Waste and nonessentials have been cut out. Reductions or postponements have been made wherever possible. The increases that are proposed have been carefully selected on the basis of urgent national requirements.

"The Congress through the appropriations process, will, of course, subject these programs to a searching examination. I welcome that examination. But