

it is my judgment that major cuts cannot be made without serious impairment to vital national objectives—in defense, in education, in health, in the rebuilding of our cities, and in the attack on poverty.”

4. *Question:* Would you forecast the impact on the mortgage interest rate of the level of the sale of participation certificates proposed by the Administration during the coming fiscal year and the financing of the deficit estimated under the Administrative budget?

Answer: the sale of participation certificates proposed for fiscal 1968 is expected to have practically no effect on interest rates on home mortgages. To the extent that participation certificates are not sold in the coming fiscal year there would have to be an increase in direct Treasury financing. Consequently, the argument that the sale of participation certificates would adversely affect mortgage rates must depend upon the assumption that participation certificates are closely competitive with home mortgages and significantly more so than direct Treasury obligations. There is no indication that participation certificates have been bought heavily by those institutions that play an important role in the mortgage market, and to a considerable extent the maturities of participation certificates have not been closely competitive with those of home mortgages. Of course, to some extent, all debt instruments compete with each other in financial markets; but there is little indication that competition between participation certificates and home mortgages is especially great or that is especially greater than the competition between Treasury obligations and home mortgages. Moreover, the Treasury's intention is that participation certificates will only be sold to the extent that the market can reasonably absorb them. This would limit any adverse impact on the mortgage market that might otherwise occur.

With respect to the impact of the budget deficit on the mortgage market, it is important to realize that the Administrative deficit is not the most relevant figure. The operations of the various trust accounts will reduce the need for Treasury borrowing from the public. As a general proposition, policies designed to reduce the net borrowing of the Treasury and various Federal agencies will tend to increase the availability of funds to the private sector, including the mortgage market. An example of such a policy approach is the Administration's proposed surtax on corporate and personal incomes. In addition to reducing the need for Treasury borrowing, these surtaxes will reduce the level of private demand and thereby encourage monetary policies that will tend to ease financial market pressures and lower the level of interest rates.

5. *Question:* In view of the fact that defense expenditures were budgeted last year on the assumption that the war would end June 30, 1967 which assumption was made to permit a more accurate assessment of follow-on costs to be made last fall, would it not have been more prudent for the level of domestic spending to have been held down pending the latter assessment of defense costs? My point is that this would have prevented the deficit now forecast for the current fiscal year.

Alternatively, would it not have been more prudent to have had a tax increase to be triggered by the President's determination that defense expenditures would continue to rise?

Answer: The fiscal 1967 budget which was recommended last year set civilian expenditure levels at the minimum consistent with the responsibilities of the Federal Government. Outside of defense, international affairs and interest recommended expenditures represented an increase of only \$1.4 billion over fiscal 1966.

The level of civilian spending was indeed held down by the President's action in preventing \$2.6 billion in increases from being made. Without this action, such spending would have risen \$5.8 billion above the original estimates instead of \$3.2 billion as is currently projected.

A tax increase to be triggered by the President's determination on defense expenditures would not have had a desirable fiscal result. The assessment of Viet Nam costs were not finally determined until late in calendar year 1966. By that time inflationary pressures had abated and a tax increase, automatically triggered by the expenditure determination, would have been most inappropriate.

6. *Question:* In your comment on reasons for the decline in our favorable balance of trade you did not mention price rises due to inflation. It had been my understanding that these were a major factor in increased imports into this country, and decreased expansion of exports to overseas markets.