fiscal years 1966 and 1967 by virtue of their relative demand on the economy than they were in the period from 1960 to 1964, and therefore by themselves are not sufficient cause for predicting inflation."[40]

In retrospect, things did not work out so well as anticipated. Although the unemployment rate declined below 4 percent, *the year 1966 witnessed the most rapid period of price inflation since the Korean War.* In striking contrast to the virtual stability during the period 1958–64, the wholesale price index, which had been rising by about 1½ percent annually in recent years, mainly due to the rising cost of services, climbed more than 3 percent in 1966.[41]

The second, related result of economic pressures in 1966 was the virtual collapse, at least temporarily, of the Council of Economic Advisers' wage-price guideposts. These were designed to reduce or avoid inflationary pressures in the economy by encouraging management and labor to hold wage increases to the trend increase in productivity in the economy as a whole. The CEA's guidepost of 3.2 percent was widely violated during the year, and prices rose even in the absence of cost pressures.

The basic explanation would appear to be that—despite the assurances in the Economic Report—*the increases in government civilian and military demand, coupled with the continued expansion in business expenditures for new plant and equipment, exceeded the capability of the economy to supply goods and services in 1966 at then current prices.*

Some perspective may be helpful prior to attempting to identify the specific factors which help to explain the 1966 circumstances. The United States has been engaged in a large-scale war; but it has not shifted to a war economy. Ours is truly a mixed economy: the Nation literally is concerned with social security as well as national security. The controls or runaway inflation often associated with war-time experiences are not present. Yet, the economy has been pressing very closely to the limits of available capacity and the nation is making choices somewhat analogous to guns versus butter, but not quite so. In a sense, as a country, we are choosing both more guns and more butter. However, we are also choosing less private housing and fewer automobiles while we are voting for more urban redevelopment and additional public transportation—thus simultaneously increasing both the military and civilian portions of the public sector in both relative and absolute senses (see Table 4).

TABLE 4.—*Changing proportions of GNP*

	1964 4th quarter	1966 4th quarter
National Defense purchases	7.5	8.6
Consumer durables and residential housing construction	13.2	12.1
All other	79.3	79.3
Total	100.0	100.0

Source: U.S. Department of Commerce.

An evaluation by the Federal Reserve Bank of New York of the role of military demand in the American economy was typical of that of many observers during the period: "The rapid growth of defense requirements was the largest single factor shaping the course of economic activity in 1966."[42]

The Bank pointed out that although the share of GNP directly attributable to defense requirements was still only a relatively modest 8½ percent at the end of 1966, the significance of defense is suggested by the fact that enlarged *defense outlays for goods and services accounted for nearly 25 percent of the increase in GNP in 1966.* This represented a striking shift from the earlier years of the current economic expansion when such spending contributed little or nothing to the overall growth of demand.

To cite again the words of the Federal Reserve Bank of New York, "The military buildup and the demand pressures associated with it affected virtually every

[40] U.S. House of Representatives, Committee on Appropriations, *Department of Defense Appropriations for 1967*, Part 1, 1966, pp. 4–5.
[41] *Economic Report of the President*, January 1967, pp. 262, 264.
[42] Federal Reserve Bank of New York, *Annual Report, 1966*, 1967, p. 13.