

billion dollars worth of obligations each year do not seem to result in actual expenditures. A number of technical factors are at work here, including some double counting of contracts awarded by one military agency in behalf of another military agency. Such a case might be Air Force procurement of aircraft for the Army, which may show up as an Army obligation to the Air Force, as well as an Air Force obligation to the airplane manufacturer. In computing both the A and B adjustment series, the annual obligation figures were reduced by \$3 billion in each case to take account of the double counting and to assure that any error is on the conservative side.

It can be seen, referring to the A column on the right hand side of Table 6, that adjusting for defense obligations by this method results in some significant changes in the usual measure of Federal fiscal impact. The second half of 1965 is now seen to be a period of much more substantial expansionary effect in the Federal budget than shown on the official basis. Of greater interest of course is the indication that the first half of 1966 was not a period of fiscal restraint but instead one with a substantial excess of outgo over income.

The B adjustment is a more conservative effort. It is a statistical compromise between the two approaches, the result of an arithmetic averaging of military obligations and expenditures for each period. The theoretical rationale that can be offered is that a more proper counterpart to the liability basis of the corporate revenue computations might be somewhere between the extremes of contract placement and governmental disbursement.

As would be expected, the B results are somewhat more moderate than the A series. The adjusted Federal deficit for the latter part of 1965 is rather large, but, on this basis, the first half of 1966 witnessed a deficit of somewhat reduced proportions. The adjusted deficit rises in the second six months of the year. Even the B series provides a very weak case for the widely made claim that fiscal restraint occurred during 1966.

E. Monetary and fiscal policy complications

The mild fiscal policy restraints recommended in the January 1966 budget turned out to be inadequate to stem the inflationary pressures that were building up. Some private observers were more concerned over the inflationary impact of the January 1966 budget recommendation. A report prepared at Washington University in early February 1966, stated:

"* * * the inflationary impact of the January 1966 Budget submission has been underestimated and that fiscal policy measures may need to be modified substantially * * * the current, immediate inflationary potential—during the fiscal year 1966—has been virtually ignored."⁵⁵

This report was picked up by a number of publications at that time, including the *Wall Street Journal* and *Business Week*. The latter referred to "skepticism of the degree of restraint that the Federal budget in fact provides for the economy."⁵⁶

To some extent, the inflationary pressures of the Vietnam buildup were accentuated by a rather liberal monetary policy in 1965, some of the results of which were continued to be felt in 1966. It has been pointed out that the rate of monetary expansion should have decelerated as early as 1965 as the economy regained reasonably full employment. Nevertheless, the rise in the money supply was allowed to pick up speed from an 8.0 percent annual rate in the first six months of 1965 to a 10.6 percent rate in the second half.⁵⁷ Beginning in December 1965, the Federal Reserve Board undertook a series of steps to tighten the availability of credit. By April 1966, the steep rise in the money stock was halted and a slight decline occurred through the remainder of 1966.

The most dramatic, early action was the Fed's raising the discount rate from 4 to 4½ percent. Effective December 6, 1965, the interest rate charged member banks for borrowing from their district Federal Reserve Banks was increased in an effort to "maintain price stability." Simultaneously, the Federal Reserve Board increased the maximum rates that member banks were permitted to pay their depositors to 5½ percent on all time deposits and certificates of deposit

⁵⁵ M. L. Weidenbaum, *The Inflationary Impact of the Federal Budget*, Washington University, Department of Economics Working Paper, February 10, 1966.

⁵⁶ *Business Week*, February 19, 1966, p. 29; George Shea, "The Business Outlook," *Wall Street Journal*, February 21, 1966, p. 1.

⁵⁷ Testimony of Paul W. McCracken in *Hearings on 1967 Economic Report*.