played a key role in the acceleration. It contributed to the already great and growing strength of business investment demand by generating needs for new capacity and by lifting economic expectations. Defense was the extra margin, unanticipated and economically unwanted. Yet, over this interval of three quarters, the increase in defense outlays was only $5½ billion (annual rate) out of the $48 blllion rise in GNP. It was much smaller than the increase of $9 billion in private business fixed investment. A little extra stimulus went a long way—but it was only a little extra stimulus.

THE WELCOME SLOWDOWN

Since the first quarter of 1966, the pace of advance has clearly moderated. The growth of industrial production and nonfarm payroll employment since March has been about half as large as the spectacular growth of the preceding 6 months. The recent expansion in the economy has proceeded essentially in parallel with the growth of capacity, Thus, the unemployment rate has been on a plateau between 3.7 and 4 percent for 9 months, and average operating rates of manufacturers have also been stable.

Thus, in a relative sense, we have witnessed a "slowdown." More descriptively, we have adjusted to a safe speed from an excessive speed that threatened to generate intolerable price and wage pressures. An economic slowdown can be worrisome or it can be welcome—our recent experience clearly belongs to the second variety. Fiscal and monetary policy since the turn of the year have aimed at bringing about such a slowdown. The recent moderation is a tribute to their effectiveness and a piece of reassuring evidence on our ability to operate flexible policies in a changing economy.

Fiscal policy, after years of expansionist aims, was shifted into reverse with the President's budget in January. Six billion dollars of private purchasing power were siphoned off through higher payroll tax rates legislated last year for medicare and social security liberalization. The President requested and Congress promptly enacted legislation to reverse some of the earlier excise tax reductions and to accelerate payments of both individual and corporate income taxes. At the same time, apart from Vietnam costs, the administrative budget for fiscal year 1967 was held to an increase of 1 percent or $600 million, as requests for new appropriations for less essential nondefense programs were stringently pared down.

In the first half of 1966, the Federal budget on the national income accounts basis—our best measure of the economic impact of fiscal policy—was operating at a surplus of $3 billion. In years gone by, we have always carefully made another calculation of where that budget would have been if the Nation had been operating at full employment. This year I need not offer that hypothetical calculation because the economy has come up to its statistical full employment benchmark; thus, the actual and hypothetical surpluses are essentially identical. Within the initiation of medicare benefit payments, the significant surplus will not be repeated in the second half of this year; but present prospects for revenue and expenditures do not suggest that we will be consuming red ink.

Monetary policy has played a particularly important role this year. By pursuing a strategy of active restraint, it deliberately restricted