

RETROSPECT

Despite the moderation after the first quarter, expansion for 1966 was more rapid than virtually anyone expected at the outset. At the time it was presented last January, the Council's forecast that GNP in 1966 would rise strongly by \$46½ billion was somewhat above the typical forecast of private economists. Yet it turned out to be \$12 billion too low. In part, the underestimate reflected the difference between the predicted real growth of nearly 5 percent and the actual rate of 5½ percent. In addition, the overall price deflator rose by 3 percent—about 1 percentage point more than projected.

The primary sources of the underestimate were in Federal defense purchases and business fixed investment. While both had been expected to be key sources of strength they were even stronger than anticipated. As the prospective duration of Vietnam hostilities and the intensity of our military commitment exceeded those assumed in the budget, Federal spending for defense in the calendar year ran above last January's estimate by \$4 billion. Spurred in part by defense outlays, expenditures on plant and equipment topped the Council's expectations by \$2 billion to \$3 billion. State and local purchases and inventory investment also were above the projections, while homebuilding and net exports fell below the estimates.

As it became clear that public and private demand was exceeding expectations, the desirability of further increases in taxes came under public discussion. Continuing and careful consideration of this issue within the administration, sharpened by the increasing strain on financial markets, led to the fiscal program of September 8. In retrospect it is clear that, after March, monetary and fiscal policy in combination provided adequate total restraint. It may be debated whether a better balance of demands and policies would have been achieved if a program of additional fiscal restraint had been undertaken earlier in order to relieve the pressure on monetary policy. It may also be argued that the capital boom could have been cooled off sooner if the investment tax credit had been suspended earlier in the year. The question of whether a different timing or different magnitude of fiscal actions might have produced a more favorable balance in 1966 will long interest and challenge analysts of economic policy. But the main lesson is clear from the record: economic policy was used effectively to restrain the economy during 1966, much as it had been used during the preceding 5 years to stimulate demand.

THE PATTERN OF OUTPUT

In contrast to the reassuring balance of the expansion from 1961 to 1965, the advance in 1966 was uncomfortably uneven among sectors. The nature of these imbalances is illustrated by chart 2, which shows the shares of GNP absorbed by various types of expenditures since 1954.

It is striking that the portion of GNP devoted to Federal purchases in 1966 was much the same as in earlier years. Indeed, despite the sharp growth of defense outlays, Federal expenditures represented a smaller share of national product than in any other post-Korean year.