

depends on the vagaries of private demand and the response of private demand to monetary and fiscal actions. Fundamental to success is whether budget policy is sufficiently flexible to move in accordance with changing economic and monetary conditions.

The budget program for the first half of calendar 1967 is essentially determined. Forces governing the course of expenditures and receipts are already in motion. The CEA indicates that the sizable stimulus of a \$5 billion NIA deficit will be appropriate in its timing and magnitude of impact on an economy characterized by weakening private demand.

Included in the budget program for the second half of 1967 is a proposed surtax which is supposed to provide restraint on strengthening private demand at that time. Such plans provide flexibility in that the surtax proposal could be dropped if economic conditions do not warrant fiscal restraint. Furthermore, if inflationary pressures intensify, the surtax rate could be increased above that which is proposed.

The 1966 experience suggests that budget policy was not sufficiently flexible to counter movements in private demand. During the first quarter of 1966, when it was quite obvious that further monetary or fiscal restraint was required, budget policy fell short as an instrument of stabilization. Fiscal restraint was not forthcoming because of the slow and cumbersome nature of the budget machinery. It was not possible to implement a tax increase because of the slowness of the Congressional process. Furthermore, most Government spending programs are of the type that cannot be slowed or speeded in accordance with the desire of the policymaker. Because of the relative inflexibility of fiscal policy, it was necessary for monetary policy to carry the burden of stabilization in 1966.

Taking these considerations into account, it appears that monetary policy may again be assigned a critical role in the total of stabilization policy in 1967. Monetary policy is flexible in its implementation, though there is a question about flexibility in its impact. Incomplete knowledge of the magnitude and timing of monetary actions on economic activity indicates that it should be used carefully as a tool of stabilization policy.¹⁰

Uncertainty about the length and variability of time lags in the implementation and effect of monetary and fiscal policy suggests that stimulus or restraint be applied in moderate doses when the economy is at high employment. Large adjustments in policy variables may cause instability, which is precisely what policymakers are trying to avoid.

The economic situation in early 1967 is believed to dictate a need for more stimulative economic policy. An indication that the fourth quarter 1966 increase in GNP contained some involuntary accumulation of inventory portends further slowing of production and attempts to reduce inventory. Since fiscal and monetary policies tend to affect total demand with lags, excessive stimulation in the next months might be too late to avert a slowdown in the first half of 1967 but might create serious inflationary problems in the second half. On the other hand, insufficient stimulation might cause the slowdown to continue well into the second half.

KEITH M. CARLSON.

¹⁰ Some evidence has recently been presented to support the view that monetary actions may affect total demand quite quickly via portfolio behavior of holders of liquid assets. See Donald P. Tucker, "Dynamic Income Adjustment to Money Supply Changes," *American Economic Review* (June 1966), pp. 433-449.