

to 1966; total member bank reserves have increased at a 10 per cent rate since December compared with a 4 per cent average annual rate in 1964 to 1966; the money supply has increased at an annual rate of 7 per cent since December 1966 compared with a 4 per cent rate in the period 1964 to 1966. Despite these expansive influences the enormous demands for credit swollen by the huge Federal deficit have pushed long-term interest rates to the levels attained in the summer of 1966.

Thus the lack of sufficient restraint in the Federal budget has resulted in the worst of several circumstances—interest rates are back at their historical highs, and the saving necessary to finance the private investment which will expand our capacity to produce is being absorbed by a huge Federal deficit. Furthermore, the recent rapid increases in bank credit and the money supply point to the prospect of subsequent excess demands relative to our capacity to produce.

All of these circumstances call for a concerted effort to reduce Federal expenditures and for an increase in taxes. It is for these reasons that we support a substantial tax increase.

In supporting a tax increase, we are aware that all economic projections are uncertain. At the currently high level of total private demand, the more stimulating the fiscal and monetary policies we pursue, the larger is the chance that it will fall short.

The costs of excessive demands are clear and substantial. Pressures for wage increases are already strong and will only be increased by further rises in prices. Monetary policy has been strained to the extreme in late 1966 and it would be unwise to take actions which raise the possibility of the need for another very restrictive monetary policy in late 1967. The balance of payments position of the United States would also be adversely affected by a renewal of inflationary pressures. If prices continue to rise, exports will be diminished, and, with delivery times lengthening for domestically produced goods, imports will once again grow sharply. Cost increase, i.e. wage increases, price increases or interest rate increases, become institutionalized as a permanent part of the economic structure. For all these reasons excessive demands leading to renewed price inflation in 1967 and 1968 would be most detrimental to both our short-run and long-run objectives.

There are undesirable consequences of a level of Federal spending and taxing which results in insufficient aggregate demands, and CED has consistently recognized this—most recently by supporting the tax cut of 1964. An obvious and undesirable consequence would be unemployment. In addition, the profitability of investment would decline, adversely affecting investment and our capacity to grow. If later it appeared that total demand was rising less than is now widely anticipated, the depressing effects of insufficient demand could be offset by prompt actions to reduce taxes, to move toward greater monetary ease, and to restore currently deferred but desirable public expenditures.

Thus the damages from a too expensive fiscal policy would be substantial while at the moment the risks of potential under-utilization are small, in large part because of our ability to respond. This strongly suggests that the appropriate fiscal policy for 1967 and 1968 is one which exposes us to only a very small chance that total demands will exceed our capacity to produce at stable prices.

It is such a balancing of risks which leads us to recommend:

(1) a substantial reduction in presently projected government expenditures; and (2) an across-the-board tax increase of the simplest character that makes no changes in the fundamental tax structure.

The swing of the Federal budget from a surplus at an annual rate of nearly \$3 billion in the first half of 1966 to a budget deficit at an annual rate of \$13 billion in the first half of 1967 represented a fiscal stimulus which we have not experienced since the Korean War. If the deficit is maintained at its current rate we run the risks of excess demands and price inflation. But to attempt to redress the balance by taking actions to achieve a moderate surplus in 1968 would overly expose the economy to the risks of recession. It is our firm conviction, however, that over longer periods the path of fiscal prudence is to pursue the often enunciated CED budget rule of setting expenditures and revenues so that at high employment we attain a budget surplus of some \$3 billion.

Mr. WILDE. To appear before this distinguished committee with a recommendation for a tax increase is an unpleasant duty. The present corporate and personal income taxes are too high for the best growth and success of our society. Reform in the tax structure may be needed,