

Monetary restraint—signaled by the December 1965 discount rate increase by the Federal Reserve—was applied with increasing effect as the year proceeded. By late summer, strong credit demands and monetary restraint had led to an intensification and concentration of pressures which called at one and the same time for further fiscal action to restrain certain areas of excessive demand—notably in the business borrowing sector—and also for action to relieve the excessive burden of monetary restraint that was threatening the very functioning of our financial markets. President Johnson's anti-inflationary program of September 8 and responsive action by the Congress led to a dramatic improvement in financial markets and a lessening of inflationary strains.

This fiscal restraint—its nature, timing, and amount—was measured with care against the most realistic and updated picture of the Nation's economic condition that we could obtain. Our problem during most of last year was not primarily one of overall excess demand or insufficient total restraint. This is illustrated by the much slower advance in gross national product beginning by the second quarter of 1966, and by the flat trend in overall unemployment and industrial utilization rates during the same period. Rather the problems were those of selective imbalance and the financial strains that can develop with a sharply increasing degree of monetary restraint.

Some intensification of price pressures—aggravated by a rise in food prices due primarily to special and largely temporary agriculture difficulties—could not be avoided under the circumstances. But by yearend, the price situation was much improved. Wholesale prices had fallen back from their August peak, and the rise in consumer prices was slowing. The year-to-year increase in the Consumer Price Index was a little less than 3 percent, certainly more than we wished to see—but far less than the 8.0 percent between 1950 and 1951 during early stages of the Korean defense buildup, and even less than 3½ percent between the peacetime years 1956 and 1957.

FLEXIBILITY IN FISCAL POLICIES

In summarizing last year's fiscal action and that planned for the year to come, it is convenient to focus on the Federal sector in the national income accounts. This is the best single measure of Federal fiscal stimulus or restraint. Over time, it tracks the changing course of the Federal Government's fiscal impact, which both influences, and is influenced by, the pace of private spending and taxable income. As you know, the administrative and cash budget positions, while important from other standpoints, do not provide as meaningful information on the Federal fiscal impact in terms of current spending on the output of the economy.

A year ago when I appeared before your committee, I emphasized that there was a clear need for a shift away from the stimulative fiscal policies of earlier years. That shift took place as planned and is mirrored in the swing from stimulus in the second half of 1965 to a restraining posture through the first half of 1966.

Last fall, with further selective fiscal action being taken in reduction of nondefense spending and suspension of the investment tax credit, the need for overall restraint had clearly lessened. Mone-