

INFLATIONARY PSYCHOLOGY DEVELOPING

In the absence of appropriate administrative policies, speculative excesses, such as recent inventory building, will continue to mount and an inflationary psychology, already taking hold among our people, will dominate economic decisionmaking in the year ahead. Unless stopped now, this could lead to a distortion of cost-price relationships such as the Eisenhower administration was obliged to correct through its economic policies in the late fifties. This difficult but vital action of the Eisenhower administration left a sound legacy of stability which until recently permitted rapid expansion with relatively little inflation.

Barring a further acceleration of Vietnam spending, a recession next year is a likely reaction to growing inflationary imbalances and excesses already in evidence today. The tendencies toward recession will be strengthened since failure to take action to halt inflation now may force the administration to slam on the fiscal and monetary brakes later this year. Restraint—which is required now—would then begin to take hold just when economic conditions may call for a somewhat easier budget policy.

The administration's inflationary economic policy will have other serious consequences as well. The continuance of this policy will—

- severely harm those segments of our population least able to sustain economic injury, such as lower income groups, including social security beneficiaries and other pensioners, and young people trying to get a college education, buy a home, and start a family;

- intensify capital outflows from the United States, reduce further our already shrinking trade surplus, drastically worsen our balance-of-payments position, and intensify the gold outflow;

- result in a breakdown of delicate international discussions on monetary reform and threaten the successful conclusion of the Kennedy round of trade negotiations.

The relevant choice is not between “guns and butter.” Our private enterprise system is flexible and inventive enough to provide both in an atmosphere of confidence fostered by wise and cooperative Government policies. The critical choice today is between inflation and a stable rate of growth which will strengthen, not weaken, our capacity to solve our domestic problems as well as meet our international commitments.

MAINTAIN BUT MODERATE THE EXPANSION

Rapidly increasing civilian, military, and Government demands are beginning to exhaust available resources. As pressure mounts throughout the year on the shrinking reservoir of employables and production facilities, an opportunity is needed for the economy to adjust. An adequate but noninflationary advance can be maintained if Government policies are restrained until the adjustments take hold.

This requires a balanced and moderate program of Government fiscal and monetary restraint. However, monetary policy cannot carry too heavy a burden in tempering the boom. Interest rates already are at a high level and a further sharp and abrupt rise in rates will create serious disturbances in the financial markets. Fiscal restraint also is essential to hold down the level of demand for funds.

A reduction in the growth of the money supply and bank credit in keeping with the real growth of the economy should be accompanied by an immediate deferral of Federal spending for nonessential and low-priority projects and the elimination of those that are redundant and inefficient.¹ The administration should aim for a surplus on the national income accounts budget in calendar 1966 rather than the substantial deficit now anticipated.

If the administration is unwilling to reduce spending, an increase in taxes will be necessary, which would cause economic damage itself. Increasing taxes is a less desirable way to moderate the boom than by deferring expenditures. A cut in tax rates that are already too high is a sound way to lower barriers to economic growth. To raise taxes now would restore an obstacle to long-term

¹ Senator Javits would support necessary reductions or deferrals of expenditures for nonessential domestic programs, but he considers that recently enacted programs in education, welfare, and antipoverty and other human investment measures to be essential. They contribute to the Nation's economic strength and its capacity to fight inflation. He would rather increase taxes to fight current inflationary pressures than to accept material curtailment of these programs.