

Let me remind you of the great fiscal debate that stirred our Nation during 1963. Some citizens urged that the Government seek to stimulate the economy by larger Federal spending. Others argued for tax reduction. Still others urged that we travel both roads at the same time. President Kennedy belonged to the latter group, but he put much the heavier emphasis on tax reductions. Even so, the Congress balked.

In the revenue bill passed by the House in the fall of 1963, Congress took the unusual step of spelling out its fiscal philosophy. The preamble of this bill explicitly assigned top priority to tax reduction, with debt reduction next. Congressman Wilbur Mills described the preamble as a "firm, positive assertion" that the Nation is choosing tax reduction, and rejecting larger spending, as its "road to a bigger, more progressive economy."

President Kennedy accepted this declaration of policy. So, too, did President Johnson. His first budget message, presented in January 1964, called for smaller expenditures under the administrative budget in fiscal 1965 than in fiscal 1964. With this much assured, the Senate promptly passed the House bill with only minor revisions.

In line with the new fiscal policy enunciated in the tax reduction bill, Federal spending actually stopped rising for a time. From the third quarter of 1963 to the first quarter of 1965 cash expenditures moved along a horizontal trend. Then, despite numerous signs of pressure on available resources, spending began to climb again. Expenditures rose rapidly both for defense and for civilian programs.

Since the economy was already booming in 1965, governmental revenues also rose, but the increase was held in check by new tax reductions. The deficit mounted, and this fresh injection of money into the economy was reinforced by a great wave of spending and borrowing by business firms and consumers.

As was bound to happen, the economy became overheated in the process. To be sure, when 1965 ended, the unemployment rate was finally down to 4 percent. But the widespread exuberance of both public and private spending produced also other and less-welcome results—in wholesale markets, prices that were 4 percent higher than in mid-1964; in consumer markets, prices that were nearly 3 percent higher; in the labor market, wages that were beginning to rise at an accelerated rate; and in the money and capital market, interest rates that were moving up sharply, despite an enormous expansion in the supply of credit.

Much has been said and written about the causes of the recent inflation and distortion of our economy. In particular, the Government has been blamed for not raising income tax rates at the beginning of 1966. But I believe that the fundamental mistake of policy was made in 1965, not in 1966. It was in 1965 that we pursued boldly and simultaneously a policy of tax reduction, accelerated spending, and credit ease.

Certainly, both monetary and tax policy moved toward restraint last year. In the spring, the Federal Reserve authorities shifted to a policy of credit restriction quite bluntly. Changes on the tax front were much less dramatic, but their significance should be not underestimated. Higher social security taxes went into effect at the beginning of the year. A little later some excises were raised, and in the fall