

rapidly widening full-employment surplus—which reached the \$14 billion zone by 1960. And the 2.9 percent per year rate of growth of the money supply—defined to include time deposits—from 1955 to 1960 was obviously inadequate. Since the basic capacity of the economy in real terms was growing at the rate of at least $3\frac{1}{2}$ percent per year during that period, rising unemployment was the inevitable result of this sluggish monetary expansion.

Again in recent months we have seen the economy pursue an unnecessarily erratic course because of the operations of fiscal and monetary policy—a story that, by now, needs no detailed elaboration. The rate of monetary expansion should, of course, have decelerated during 1965 as the economy regained reasonably full employment, but it was allowed to pick up speed from an 8-percent annual rate in the first half of that year to a 10.6-percent rate in the second half. Since the ongoing ratio of the money supply to GNP is fairly stable, though the visible effect on business activity of monetary changes often shows up with a lag, this accelerating pace of monetary expansion was appropriate only if we were wanting the economy to be on a 10- or 11-percent growth path well into 1966. With the economy already at reasonably full employment as we moved into last year, these accelerating monetary pressures for expansion increasingly took the form of price pressures. The 3.5 percent per year rate of rise in the Consumer Price Index during the first half of 1966 was, therefore, an almost inevitable consequence of the policies we pursued. Moreover, inflation is a process which unfolds through time. It begins with rising prices and then moves on to become rising labor costs as these higher prices become the basis for subsequent wage demands. This is the part of the process that we shall see a good deal of in 1967.

The whole problem was, of course, vastly exacerbated by the January 1966, budget message, laying out the President's program for fiscal year 1967. The underestimate of defense estimates is by now a well-explored chapter in fiscal history. The January 1966, budget message implied that purchases of goods and services for national defense by the end of fiscal year 1967 would be at the rate of not over \$57 billion per year, compared with the \$69 billion rate that seems probable now. With this projected slow rise to an early plateau the case could not be made for the tax increases warranted by the actual path of these outlays through the fiscal year 1967.

(Table 1 follows:)