

TABLE 2.—*The money supply, GNP, and the Federal budget surplus*

[Dollar amounts in billions]

Calendar year	GNP	Money supply ¹		Federal budget surplus	
		Amount	Percent of GNP	Cash	National accounts
1957.....	441.1	191.1	43.4	\$1.1	\$2.1
1958.....	447.3	199.9	44.6	-7.2	-10.2
1959.....	483.7	207.9	42.9	-8.0	-1.2
1960.....	503.7	211.7	42.0	3.6	3.5
1961.....	520.1	221.1	42.4	-6.8	-3.8
1962.....	560.3	236.8	42.2	-5.7	-3.8
1963.....	590.5	255.3	43.2	-4.6	.7
1964.....	631.7	275.8	43.6	-5.2	-3.0
1965.....	681.2	300.2	44.0	-4.5	1.6
1966 ²	739.5	321.2	43.5	-5.7	.2

¹ Time deposits are included in the money supply.² Preliminary.

Source: Federal Reserve, Department of Commerce, and Bureau of the Budget.

A little easing of fiscal policy and a modest tightening of monetary policy, therefore, will not, in the end, have a neutral effect on the course of business activity. After some lag the pace of the economic advance is quite apt to settle to a lower rate consistent with the reduced rate which credit and the money supply are rising.

Fiscal policy, of course, still has a role in stabilization. For one thing, it can activate the economy to expand more promptly and more vigorously. The 1964 tax reduction, for example, certainly produced a more vigorous and prompt expansion than we could have achieved even if our external payments problem had permitted a more aggressive use of easy money. On the other hand an easier fiscal policy not validated by a more rapid monetary expansion is not apt to have more than a transient effect.

A second role for fiscal policy is essentially monetary in character. While the pace of monetary expansion may set the basic course that the economy will tend to follow, the state of the budget has a powerful effect on capital markets and the level of interest rates. And this market for credit—like other markets—cannot perform its allocative functions smoothly if subject to large displacement influences—in this case from the fiscal operations of Government. Moreover, if the pressure of swollen demand against limited supply gets too intense, political pressures to expand credit more rapidly begin to mount.

This is the transmission process by which excessive budget deficits tend to produce inflation. Thus, a major responsibility of fiscal policy is highly monetary in character. And, in a world of fixed exchange rates and convertible currencies, this is particularly important. We must not only achieve full employment but we must do so with a level of interest rates consistent with those prevailing throughout the industrial world. Only with the right fiscal policy can we hope to achieve both the rate of monetary expansion and orderly credit markets consistent with the full-employment growth path for the domestic economy and the level of interest rates consistent with equilibrium in our external payments.

Thus, in a sense, we now see it as the task of monetary policy to set the growth path for the domestic economy, and it is the task of fiscal policy to achieve the money and capital market conditions that will validate this course.