

would get short shrift at the discount window if they failed to "cooperate in the system's efforts to hold down the rate of business loan expansion." The action was taken pursuant to a Board regulation under which lending to member banks is to be made with:

* * * due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally.

The same power, so far as we have been able to determine, can be applied positively as well as negatively to encourage as well as to discourage the extension of credit for specified purposes. *The Federal Reserve System could have told its member banks, and can still tell them today, that they will be given no consideration at the discount window unless they increase, or attain some target level with respect to, the proportion of their assets held in housing mortgages and in school board, state and municipal bonds.* If the requirements were made stringent enough, the member banks would be impelled to compete for such securities with the result that their interest rates would be markedly reduced.

Protection of national priorities dependent upon credit, therefore, does not require a tax increase but rather steps to assure that the Federal Reserve System will respect those priorities through selective application of its monetary powers. The shibboleth of Federal Reserve Board "independence" must not be permitted to be translated into veto power over national goals or national economic policy as expressed in the Employment Act.

Effect on budget

It is argued, also, that a tax increase—or a cut in government civilian spending—is necessary to reduce the size of the expected budget deficit. An effort to achieve a greater degree of balance in the budget, however, could unbalance the economy with the result that the actual budget deficit would be vastly greater than the one sought to be reduced. The Eisenhower Administration, ignoring serious weaknesses in the economy, submitted a budget for fiscal 1959 designed to yield a surplus of half a billion dollars. The restrictive nature of that budget retarded recovery from the 1957–58 recession. Unemployment rose as high as 7.5 percent and averaged 6.2 percent for the fiscal year. Reduced revenues and increased expenditures turned the anticipated half-billion surplus into a deficit of \$12.4 billion or approximately 2½ percent of GNP—equivalent to \$20 billion in terms of today's GNP. Current signs of weakness in the economy suggest at least a possibility that a tax increase or a cut in spending could produce a similar result in the period ahead.

Signs of weakness

It is fortunate that the proposed tax increase is not intended to take effect before the middle of 1967. There are already many signs of weaknesses in the economy that suggest at least a distinct possibility that by mid-year stimulus may be called for rather than restraint. The proposed effective date for the tax increase allows time for careful evaluation of developments to minimize the danger that the wrong remedy may be applied to the wrong ailment at the wrong time.

The danger of an increase in unemployment is very real. Such a development would not require a downturn in the economy to bring it about—a slowing up would be quite sufficient. As the Council points out, about 1¼ million additional job-seekers will be in the labor market this year. On top of that, productivity advance will require the creation of another 2 to 2½ million jobs at least. Thus, any slowdown in the rate of economic growth that would result in the creation of much less than 3¼ to 3½ million jobs overall would probably mean rising unemployment.

The Council is already planning for a substantially smaller increase in Gross National Product (GNP) for 1967 than in 1966. Taking into effect the consequences of a proposed tax increase, the Council estimates that GNP will rise from \$740 billion in 1966 to \$787 billion in 1967—an increase of just under 6.4 percent. But of that, 2.5 percent or more will be the result of price increases, leaving only about 3.8 percent of real growth. This will be sharply down from last year's real growth rate of 5.4 percent. The Council describes it as "nearly in line with the 4 percent growth of potential" which would be necessary to keep unemployment from rising. Leaving aside the arguable point as to whether the growth in potential is not more than 4 percent, the difference between 3.8 and 4.0 could in itself mean rising unemployment.