cause recession. In any case, increases in the price level are decelerating and, as spelled out later in this statement, the remaining sources of upward price pressures are to a large degree manageable.

I therefore believe that fiscal policy in 1967 should:

Be designed to promote economic growth at a rate that will bring about a further significant reduction of unemployment; and

Assign first priority in nonmilitary government spending to adequate funding of Great Society programs even if that should require stretching out of the space program, highway construction and other activities that do not directly affect human welfare and the quality of life in America.

No general excess of demand

Measures to reduce total demand, such as a tax increase or a cut in government spending, can be justified as weapons against inflation only when demand is excessive in relation to potential supply. Under those circumstances, unemployment need not result from lowered demand.

Demand, reducing measures are not appropriate, however, to combat price increases which occur while productive resources are not fully utilized. The cause of such price increases may be abuse of administered pricing power or a mismatch between the composition of demand and the goods and services which the unused resources are capable of producing, or a combination of both. Price rises that occur in the face of unemployment and unused physical capacity call for rifle-shot solutions aimed precisely at the particular problems involved rather than the blunderbuss approach of a reduction in the general level of demand. The latter is wasteful, in that it deprives the economy of the goods and services which the unused resources are capable of producing, and it is cruel because it inflicts the hardships of unemployment upon the most vulnerable groups of the population.

Clearly, there is currently no general excess of demand. Secretary Fowler attested to that. In his testimony in these hearings he said:

"Our problem during most of last year was *not primarily one of overall excess demand* or insufficient total restraint . . . Rather the problems were those of *selective imbalance* and the financial strains that can develop with a sharply increasing degree of monetary restraint." [emphasis added]

As will be shown, the imbalances, although very definitely selective, were not all attributable to monetary restraint. The absence of any general excess of demand is apparent from the January 1967, unemployment rate which, although substantially reduced since 1961, was still 3.7 percent (on the new basis)—approximately twice as high as the rest of the industrialized free world has averaged in recent years. Physical resources, as well as workers are available to increase production. According to the Federal Reserve Board, manufacturing output in the fourth quarter of 1966 was only 90 percent of capacity—down from 91 percent in the preceding three quarters. Moreover, capacity is increasing rapidily—at an annual rate of approximately 7 percent.

Price increases not inevitable

Price increases are by no means inevitable if currently idle resources are put to work. Higher rates of capacity utilization and lower rates of unemployment than those presently prevailing can be compatible with reasonable price stability. That is evident from the experience of the 12-month period from the fourth quarter of 1952 through the third quarter of 1953. Utilization rates during this period ranged between 95 and 96 percent. The unemployment rate during the same period ranged between 2.6 and 3.0 percent. Yet, even the removal of Korean War price controls in March 1953 resulted in no major upsurge in prices. During the entire 12-month period, the increase in the index of wholesale prices, other than farm products and foods, was only 1.3 percent. The Consumer Price Index increased by only 1.0 percent.

There is no danger of generalized inflation until demand presses much more closely on the limits of labor and physical resources than it does at present.

Remaining price pressures manageable

The remaining major sources of upward pressure on the price level are by no means so serious or unmanageable as to justify (if such a policy can ever be justified) the deliberate maintenance of the present level of unemployment in order to combat them. There are tools available which, even if they do not function perfectly, can be effective in holding the rate of increase in prices well within tolerable limits.