

the eyes of the Council, the fact that the Federal budget on "National income and product account" moved into surplus in the 1st quarter of 1966 signaled sufficient fiscal restraint. The Council also remarks that the monetary authorities pursued a complementary policy in the last half of 1966. While there is concern with the distributional effects of the monetary restraint and some disappointment with the rate of price increase, the Report suggests that the stabilization policies were generally appropriate to the tasks of the year. We take a different view.

A shift of the Federal Budget, in the national income accounts, from surplus to deficit between the first and second half of 1965, accompanied by rapid monetary expansion, contributed to converting vigorous economic growth into an inflationary boom. Perhaps it is too much to expect that policy, especially fiscal policy, could be so flexible or so foresighted as to prevent such a development. However, when fiscal decisions were being made at the beginning of 1966 it was time to recognize what was happening and to take balanced restraining measures. In fact, partly because of incorrect estimation of the probable military expenditures, the measures taken were inadequate in total and left too much of the problem of restraining inflation to monetary policy. The budget did move into surplus at the beginning of 1966, but this was largely the result of the sharp rise in prices and thus taxable incomes. Fiscal policy, while it became more restrictive than it had been, was not sufficiently restrictive to keep the demands of the public and private sectors within the bounds of our capacity to produce at stable prices. As demands outstripped capacity, prices and wages rose rapidly. The monetary authorities found themselves with the major burden of responsibility for stabilization. The amount of monetary restriction necessary to keep the rise in prices and costs to the rates actually realized pushed interest rates up very rapidly to levels not experienced in 40 years.

The credit stringencies induced by the anti-inflationary monetary policy resulted in a very sharp drop in residential construction. The balance in capacity utilization which the Council commented upon in its 1966 report deteriorated. At the end of 1966 the gap between actual and preferred operating rates was only one percentage point different from that in the previous year. There was, however, much wider variation in this gap among industries at the end of 1966 than was true of 1965. Many industries found themselves operating considerably above preferred levels while others were operating substantially below their preferred levels. Finally, the last quarter of 1966 saw one of the sharpest rises in inventory accumulation in the postwar period.

The high interest rates of 1966 attracted extraordinarily large amounts of private savings to open market instruments including some of the assets accumulated in savings institutions. Mortgage lending institutions found themselves with very small net inflows and mortgage extensions fell sharply. Commercial banks found themselves under substantial pressures throughout the summer and the Federal Reserve instituted selective controls over discounting in early September further to restrain bank loans to business. These belated actions together with the elimination of the investment tax credit on machinery and equipment and certain of the accelerated depreciation pro-