I should like to end with a few comments on fiscal policies and their relationships to monetary policies. I believe that in recent years we have relied too heavily on monetary policy and have not properly exploited discretionary fiscal policies. In fact, fiscal policy has too often been destabilizing in its effects. For some years after 1960, Federal tax collections were too large and retarded the growth of private demands for output. By delaying tax reductions until 1964 and 1965, we lost billions of dollars worth of potential real output and millions of man-years of employment. Then, late in 1965 fiscal policy turned strongly inflationary. Rapidly rising Government expenditures on top of a strong investment boom escalated demands for output and injected huge amounts of additional income into the hands of business and the public. In the absence of tax increases to drain off this excess income the result was inevitable—strong inflationary pressures were created.

The Federal Reserve need not, of course, have responded by stopping the growth of the money supply, however defined. It could have allowed the money supply to increase steadily at some prescribed rate, which would have allowed prices to rise faster. Or it could even have created money fast enough to hold interest rates down, which would surely have escalated inflation.

Whether the Federal Reserve followed the most appropriate policies under these circumstances is debatable. But one thing is clear: a highly inflationary fiscal policy exacerbated the problems faced by the monetary authorities and must bear at least some part of the responsibility for the ensuing extremely high rates of interest, the diversion of funds from thrift institutions, and the sharp impact on the construction industry.

The very least that fiscal policies can do is to avoid creation of such unfavorable conditions for monetary policies.

Thank you.

Chairman Proxmire. Thank you, Professor Chandler.

Professor Modigliani?

STATEMENT OF FRANCO MODIGLIANI, PROFESSOR, DEPARTMENT OF ECONOMICS AND SLOAN SCHOOL OF MANAGEMENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. Modigliani. I also wish to congratulate the committee for carrying out these very important hearings, and express my appreciation for being allowed to share my views with you.

I hope these hearings will persuade the committee of the undesirability of imposing any precise rules of behavior on the Federal Reserve, particularly rules taking the form of a stated rate of increase in money supply.

I might also say that Professor Chandler has, I think, admirably stated the main points that I would have liked to make, and perhaps the only thing I can do is to elaborate on some of the points he has made and try to provide some answers to the questions that have been raised by Mr. Reuss.

It is certainly true that if we lived in a very static world, in a world in which things never changed, or changed according to some very stable rules, where population grew at a constant rate, where tech-