to current policy. True, we have had an increase in gross national product of some $20 billion in the first quarter of this year, which includes about 4 percent inflation. We hear in many quarters that the economy is overheated, and we have to take some steps to cool it down. Yet, I would submit that there are some segments of the economy which are not overheated.

I come from an agricultural State. Farm parity prices are the lowest they have been since farm parity prices were introduced way back in the depression years. I had a call from a very substantial farmer in my State the other day. I think his farmland, his machinery, and storage facilities would be worth in the neighborhood of a million dollars. He has a $300,000 operating loan at the bank and he pays 8½ percent interest.

He says, I have not paid any income tax for the past 4 years out of 5. He said, please plead with Mr. Martin of the Federal Reserve Board to reduce interest rates and to put as much emphasis as is necessary on fiscal restraint by increasing income tax or surtax or what have you, because, he said, I am not paying any income tax—the interest rate is driving me out of business.

So I would ask you what do you see as the most prudent monetary policy to relieve the current inflationary pressure? You may make whatever assumptions you like about fiscal policy.

I will call first upon Professor Chandler.

Mr. CHANDLER. We have really reached a dangerous state in the country in terms of price expectations. In 1965, we were in a rather fortunate position in that prices had been pretty stable since about 1958 and not too many people were worried about price increases. Now, as a result of the price increases we have had for nearly 3 years, the expectational situation is extremely dangerous. You see it built into the new wage contracts, you see it built into forward pricing of products and so. I feel something has to be done to slow down the runaway behavior of expectations.

My own feeling is that in the absence of fiscal restrictions, the Federal Reserve simply cannot relax its restrictive policy and it might even have to go farther in the direction of restriction. I would much prefer to see some effective restrictive fiscal action taken so we could live with a somewhat lower level of interest rates. I do not think the present level of interest rates and the present level of reliance on monetary restriction is conductive to growth of the economy.

I think you have eloquently indicated some of the differences in the impact of restrictive fiscal policies as compared with monetary policies.

Senator JORDAN. I will add one question to it and ask you to comment on this, Professor Chandler.

What fiscal restraint would you recommend to go along with the present monetary policy?

Mr. CHANDLER. I would hope that the gentlemen in Congress would continue to look for expenditures that can be cut with little loss to the country as a whole. I would hope that you would keep in mind, however, a sense of priorities about expenditures and not cut back the ones that are, as Mr. Modigliani said, of the highest priority.

I would prefer heavy reliance on tax increases, especially personal and corporate income taxes.

Senator JORDAN. Mr. Modigliani?