Of course the fact that the use of monetary policy to combat inflation can bring on recession doesn't mean we should not use or even hesitate to use monetary measures to fight inflation when rising prices are a "clear and present" danger. It simply means that we must do so judiciously. Everyone can agree to this, for to say we must use monetary policy judiciously means different things to different men. Sooner or later, if we are to say anything substantive, we must define exactly what we mean as an operating procedure by a judicious monetary policy. I'll get to this definition later if you don't mind. For now it suffices to say a judicious monetary policy necessarily requires that the Fed is not fooled by events into believing it is doing something when it is doing nothing. This is a larger order than it may appear at first glance as we will later see.

But now let us answer the question under discussion. Is Chairman Martin's present concern with inflation relevant and realistic? It is. Today inflation definitely is a clear and present danger. Witness, for example, that in the first quarter of this year the CPI rose at annual rate of 4 per cent. We have to look back to the first six months of the Korean War to find U.S. prices rising this rapidly. There can be no doubt then that Chairman Martin's concern with inflation is both relevant and real.

My second preliminary question is what is causing this inflation we now are experiencing. In the abstract context of economic theory the proximate causes of inflation are (1) private expenditures by householders and businesses, and (2) Government purchases of goods and services. "Let's", as Al Smith said, "look at the record."

First let's look at the components of private spending: consumption and investment. In percentage terms consumption increased by 5.6 per cent in 1963, 7.0 per cent in 1964, 8.0 per cent in 1965, 7.6 per cent in 1966, and at an annual rate of 5.5 per cent in both the first and second halves of 1967. Since the current rate of increase of consumption is about what it was back in 1963 and 1964—years marked by a remarkable degree of price stability—consumption spending would not appear to be a major element in the inflation we now are experiencing. But it will prove to be a strong future force for inflation if it should again grow at the 7.5–8.0 per cent rate that obtained in 1965 and 1966.

Let's look now at investment spending, including both investment in structures and equipment and inventory changes. This expenditures item has been a major inflationary factor in recent months. In 1963 investment spending increased by 4.9 per cent. In 1964 it rose by 7.9 per cent, in 1965 by 14.3 per cent, and in 1966 by 9.9 per cent. In the first half of 1967 investment fell at the annual rate of 19.2 per cent. The bulk of the fall reflected a decline in the growth of business investories. This decline was the principal symptom of the mini-recession we suffered early last year. But partly because of renewed investment in inventories total investment increased rapidly in the second half of 1967 and acted to prevent the small business downswing of early 1967 from becoming a full-scale recession episode. At the same time, however, the rise in total investment in the second half of 1967, which for the record was at an annual rate of 16.2 per cent, has put considerable current upward pressure on prices.

Let me last call your attention to government purchases of goods and services, including state and local spending as well as federal purchases. In 1963 government spending rose by 4.6 per cent, in 1964 by 5.0 per cent, in 1965 by 6.0 per cent and again in 1966 by 6.0 per cent. In the first half of 1967 the rise in this item was at the whopping annual rate of 16.1 per cent. In the second half of 1967 the rate of increase in government purchases of goods and services dropped to an annual rate of 8.3 per cent. Today it is very nearly axiomatic in economics that increases in government spending act to increase national income in nominal terms and hence, as a corollary, prices when employment is full or nearly full and the growth of output constrained. Since employment was nearly full in 1967 the rise in government spending early that year put enormous inflationary pressure on the economy and though this pressure was reduced in the second half of 1967 it was still strong by historical standards.

In summary, trends in government spending and private investment are currently strongly inflationary. Fortunately however, government spending appears now to be rising at a rate the economy can absorb without substantial inflation, that is, at less than 10 per cent per year. But unfortunately private investment now is burgeoning at a rate that portends substantial future inflation. This item, recall, rose in the second half of 1967 at an annual rate of 16.2 per cent. And lastly, there is consumption. This item increased only moderately in 1967, by 5.5 per cent. It has not yet contributed substantially to the current inflation. But it may do so before the year is out. Indeed proponents of the 10 per