

squeeze." The events of 1966 have been used to discredit monetary policy as the primary instrument of restraint. But the 1966 credit squeeze was largely a matter of poor policy execution. Monetary policy not only should be used to restrain excessive demand but it must be used—tax increase or no tax increase—if we are to avoid still higher rates of inflation and still higher rates of interest.

Against the background of these two theoretical views, let us examine the experiences of 1966 and 1967. I know that much has already been said about the 1966 experience and I will be as brief as possible.

You must recall that during the second half of 1965 heavy defense orders were superimposed on a capital goods boom—a combination of events without precedent in recent economic history. This combination alone was sufficient to push the demand for credit sharply higher, but other stimulants to borrowing were introduced.

The 1964 program to speed up corporate income tax payments was accelerated further in early 1966. In addition, social security taxes were increased January 1 of that year. Corporations were also required, beginning in the second quarter, to speed up their payments to the Treasury of withholding and other taxes for which they act as collectors.

At the same time, monetary authorities began to move in late 1965 toward a less-expansive policy. Nevertheless, total bank reserves and money supply continued to grow at a relatively rapid rate in the first quarter of 1966. Beginning in the second quarter, Federal Reserve policy shifted abruptly toward a policy of severe restraint, which was, in retrospect, too sudden and too severe. Public statements made by monetary authorities made it clear that the Federal Reserve was trying hard to produce a sudden and sharp slowdown in commercial bank loans to business. However, considering the degree to which monetary expansion had just previously been stimulating growth of incomes, spending and credit demands, and considering the leadtime of corporate financial plans, it was unreasonable for monetary authorities to expect a prompt drop in bank loans to business.

Corporations had been hit, in a sense, by a temporary tax increase in the form of accelerated tax payments in the first half of 1966. This shows up in the marked increase in business borrowing over the tax payment dates in April and June of that year. (See table A.)

In effect, corporations were forced to borrow on behalf of the U.S. Treasury. The Federal Reserve did not accommodate this borrowing as it would have had the borrowing been done directly by the Treasury.

We had a situation in which American business was being asked by the Defense Department to tool up and staff for heavy defense needs at the same time that it was heavily committed to capital goods orders. It was also asked to help meet the Treasury Department's financing requirements. Yet the Federal Reserve aggressively sought, and expected, a prompt slowdown in business borrowing.

So hard did monetary policy squeeze in, trying to stop business borrowing, that it seemed to many to overlook the damage it was doing to the housing industry. It was, in my opinion, clearly a case of excessive restraint, of poor execution of monetary policy. Less obvious was the damage to the overall economy. Long historical experience demon-