—Monetary policy will once again be the only restraining influence with the result that interest rates will be under strong upward pressure. It is quite clear that if fiscal restraint is not exercised in the face of excessive demand and inflation, an expanded demand for loans in both public and private sectors will, unless deliberately accommodated by expanding reserves, produce a tighter monetary policy and rising interest rates.

—Our domestic capital markets, advanced as they may be, are not perfect and, as we were reminded in 1966, the pressures caused by restrictive monetary policy can cause confusion, disturb confidence generally, and lead to severe distortions in the pattern of economic activity. Small businesses, farmers, and prospective homeowners lose out to the Federal Government and other strong borrowers in the struggle for funds. Housing construction and local government projects can be substantially affected. In an economy with excessive total demand, some spending must be cut if price level increases are to be kept within bounds. To restrain housing substantially again in 1968 is to postpone a considerable amount of construction spending into some later period when finance is available. At that later time, rapid increases in construction will most likely lead to large price and wage increases in this sector of industry. Thus we will provide inadequate housing in 1968 and sectoral inflation in the housing industry whenever the level of demand in the economy moves back closer to its potential.

On the other hand, if we enact the tax surcharge and find that the strength of demand is not excessive several courses of action are open:

—Monetary policy could remain expansive or only moderately restrictive, thus assuring an acceleration of savings flows to savings institutions. This flow, given the high levels of income and low vacancy rates, could accommodate a substantial increase in the demand for housing. Moreover, under such a monetary policy, interest rates would moderate from their highs and credit would be made more available to those sectors unable to compete under current conditions.

—Certain of the more desirable Federal as well as State and local government expenditures which have been postponed could be undertaken or reprogramed.

—In the most unlikely event that private demands showed themselves to be so weak that a relaxation of monetary policy and an increase in government expenditures would not assure high employment at stable prices, the tax surcharge could always be revised or repealed.

Thus the course of prudence in policy decisions and flexibility in the use of stabilization instruments available to the Government argues strongly in favor of the proposed surcharge. The risks of excessive growth in demand and accelerated inflation are great, given the possibility of an acceleration of defense expenditures, significantly higher consumer spending, or an acceleration of inventory accumulation or plant and equipment expenditures. In the summer and fall of 1966 when monetary policy was the only instrument used to restrain the economy in the face of very strong demand, we experienced a very rapid rise in interest rates, severe distortions in credit markets, and