

housing starts in that. Last week the Secretary of the Treasury and Chairman of the Council of Economic Advisers testified they thought credit tightness would have to be pursued throughout the year. In fact, Secretary Kennedy specifically called the relaxation in tightness in 1967 a mistake.

Recently, in an interview in U.S. News & World Report, Governor Mitchell of the Fed said this, and I quote:

We mean business—

Speaking of the Federal Reserve Board—

in braking the inflationary psychology that has developed. It will probably take a reduction in real growth about two percent to get the kind of environment in which the present inflationary psychology will be halted. Economic growth will be retarded for a year or more before the needed change in climate takes place.

How then can you justify an assumption that the discount rate would be in the first quarter at 5 percent and the net free reserves would be continued at \$500 million and then be allowed to raise to zero.

Mr. KLEIN. Let me comment on that. The public statement that the credit conditions will remain tight is just the kind of loose statement that you said we don't make. They are still fairly tight even at a 5-percent-discount rate. I am simply assuming there will be a change in the level but still at a very high level of tightness.

Now, as you also remarked in the previous commentary, that we hadn't considered expenditure policy, may I point out that due to the brevity in our presentation I didn't go into all the calculations that we have made. We have actually made alternative calculations.

Assuming, for example, that military expenditures, especially on sophisticated hardware systems, are somewhat higher and that the surcharge is continued not only through June 30, 1970, but even indefinitely, and that credit policy is kept severe for a longer period than through the first three quarters of 1969, then in those calculations we would find that the economy will perform at a somewhat better level on an overall basis. The unemployment rate will rise less, it will stay, according to my calculations, under 4 percent for almost all of 1970, but there is a considerable lag in the effects of monetary policy, and to maintain these very high rates of interest, and these very low levels of net free reserves at negative values, then we will find that by the end of 1970 there should be repressive—or there should be restrictive—signs in the economy, particularly in the areas of capital formation.

Senator PROXMIRE. Does this mean to you, first, that we will have a slowdown to perhaps a 2 percent level of real growth, 5 percent overall? You see, when Governor Mitchell—what he seemed to want was a 2 percent real growth and no more than a 3 percent deflator, in other words 3 percent rise in prices, so that together you wouldn't get a combination of more than a dollar increase of 5 percent at an annual rate in the GNP. Have you concluded a slowdown to that level by the end of this year?

Mr. KLEIN. Are you talking about the case in which interest rates are kept high, monetary policy is kept more restrictive, and expenditures are higher along with it; is that the case you want to present?

Senator PROXMIRE. Well, I am talking about what your assumptions