

Chairman REUSS. Just one final question on this point, Mr. Bernstein.

If our Chairman, Senator Proxmire, has been right in recent months in his opposition to a U.S. income tax increase—and I do not ask you to comment on whether he has been right or not—but if he has been right, is he still right in opposing it after the British devaluation, because the British devaluation has not wounded the long-term standing of the dollar?

Would you care to encourage our Chairman?

Sir ROY HARROD. I really do not think that the devaluation can have much relation to the need for a tax increase here, because I suppose that in the short term in so far as the British devaluation increases British exports, it is bad for the U.S. export-import pattern, and that that would be a deflationary factor for this country, and to that extent it would make the tax increase less necessary.

Senator PROXMIRE. One other point, of course, is that it has had the immediate impact of increasing our interest rates. We do not know how pervasive that is going to be or how permanent, but this is another deflationary element.

Sir ROY HARROD. Yes, but it will be short-lived.

Mr. BERNSTEIN. I do not think it will stay.

Senator PROXMIRE. Well, I say it will be temporary.

Mr. BERNSTEIN. It is likely to be temporary.

You see, Senator, I do not want to be in the position of commenting on the legislative judgment of the Congress of the United States.

Senator PROXMIRE. You would if you agreed with this comment. If you do not, I understand.

Mr. BERNSTEIN. That is precisely my point, Senator. I, myself, favor the tax increase. I believe that, in fact, the devaluation of sterling does make it more important to have the tax increase.

I hope that the Congress and the administration will work out a solution on taxes and expenditures that is satisfactory to both, and that will improve the budget considerably.

Chairman REUSS. Why does the devaluation make it more important?

Mr. BERNSTEIN. Mainly I think it makes it more important because we cannot afford a further deterioration in our balance of payments.

I think our big loss on the balance of payments is a consequence of the Vietnam war. You cannot help spending \$1,500 million or more across the exchanges for that war.

But we must be absolutely sure that we are not impairing our competitive position for a long period ahead by allowing an inflation of our prices and costs as a consequence of the war, the budget deficit, and everything that goes with it.

Senator PROXMIRE. Dr. Bernstein, here we have a slack capacity, and it is getting slacker by the quarter. This economy was operating at 91 percent of capacity a year ago; the first quarter of this year it was down to 87½; the second quarter, 85; the third quarter, 83.8; this quarter it seems to be lower, maybe in the area of 81, 82; hours of work in our factories are close to the lowest level in 6 years; unemployment has increased in the last 2 months more rapidly than any 2 months in the past 7 years—from 3.8 to 4.3 percent—and you put all these things together and it seems apparent to me this is not an inflation that is caused by excessive demand, it is an inflation that is