

heavily on increases in social security benefits and other transfer payments, and on some squeeze in profits to raise personal and disposable incomes, and also on a continuation of the rather low saving ratios of 1966, in spite of observed weaknesses in consumer durable goods markets and possible delayed effects of tight money on consumer credit.

Second, the Council expects the rate of inventory accumulation to fall by half, or from \$11 billion increase in inventories in 1966 to about \$5½ billion this year. The excessive accumulation of inventories in late 1966 is perhaps the major threat to prosperity in 1967. Selling from inventory instead of from new production is the classic mechanism by which slowdowns are converted into recessions.

The Council's figure on the reduction of inventory investment is a guess, and it might be overoptimistic.

Third, on the basis of equipment investment anticipations surveys for the first half of the year, the Council is forecasting a \$3 billion, or 4 percent, rise in business fixed investment. This could prove overoptimistic if the scheduled restoration of the tax credit next January 1 causes postponement of projects as 1967 wears on.

Moreover, the cost of capital for business investment was sharply increased in 1966, as evidenced both in interest rates and in stock values. This may have delayed effects on investment in 1967, not fully registered in surveys of intentions last fall.

I concluded that in spite of the anticipated growth of Federal expenditures, including the proposed improvements of social security benefits, the restraints of current taxes and monetary policies taken together, are likely to be too severe. Therefore, I do not now see a case for the proposed 6-percent surcharge. Indeed, I can well imagine that in the course of the year it will prove desirable to restore the investment tax credit ahead of schedule.

If Federal expenditures are cut below the budget, or if social security benefits are increased less or later than proposed, then stabilization considerations suggest that taxes should be reduced. Let me emphasize that it does not make sense to argue that since the economy is too weak to stand a tax increase, Government expenditures must be cut instead. If the economy can't stand a tax increase, neither can it stand the same degree of fiscal restraint applied via a reduction of expenditures.

Expenditure programs should be considered on their intrinsic merits, and cut or added to as Congress judges the merits of the programs. Then, by flexibility in tax and in monetary measures, stabilization policy can be adapted to whatever decisions the Congress makes about national priorities.

During 1967 the monetary authorities should, I think, try to reverse most, if not all, of the increases in interest rates that occurred in 1966. Such a policy cannot be expected to produce early miracles, because both financial institutions and other businesses and individuals will be rebuilding their liquidity positions. The main obstacle to monetary ease is that omnipresent bogey, the balance of payments. Last year the extraordinary tightness of credit conditions in the United States provided a windfall for balance of payments by making it possible to borrow short-term money abroad—the balance of payments on the official settlements basis, that is.

As our interest rates decline this year, the incentives may turn the other way. That is why efforts to bring about a concerted interna-