ployment surplus and whether the projections one is able to make between probable revenues and probable expenditures show a gap.

Chairman PROXMIRE. Full employment surplus is a function of the state of the economy, is it not?

Mr. MCCRACKEN. Precisely.

Chairman PROXMIRE. Presumably it is conceivable certainly that the tax increase could be counterproductive even from a strictly budgetary standpoint. In other words, you could increase taxes and have a lower revenue result, if it tended to depress business conditions.

I would like to come back to you, Professor Hansen, and say hail to you. I am just delighted to see somebody come in with something other than orthodox views that we have heard over and over again, which I disputed but ineffectively that wage-price guidelines are dead because you cannot put a cost-of-living escalator into wage-price guidelines without having an engine of inflation.

Even the staff of this committee keeps telling me I am wrong on this, and they are right on almost everything, so maybe I am wrong. And the Council of Economic Advisers—every economist that has come up has insisted that you cannot take a wage-price guideline of 3.2, tack onto that any significant part of the cost of living without ending up with an inflationary situation.

You flatly refute this. You say as I understand it that you can have the 3.2 or whatever the productivity increase is, and add on that a cost-of-living escalator, and that that simply takes account of what has happened before. It should not result in an increase in the cost of living in the future, is that correct?

Mr. HANSEN. Right.

Chairman PROXMIRE. How do you answer the argument that they make over and over again, whether this should be the situation, it is likely to be the situation, because if you have the expected increase in the cost of living this year of 2.5 percent, and add on, say, a 3.2-productivity increase, you would then permit a 5.7-percent-wage-price guideline, and isn't this likely to have some effect in pushing up prices?

Mr. HANSEN. As I understand the argument, those who believe that it starts a wage-price spiral, it is this: The escalator brings the wages up in line with profits broadly speaking, in line with a stable income distribution.

Then the argument of my opponents is well, when that happens, when they have got back to a balance, then here comes along administered prices, and they shoot the price up to maintain the higher profits they had so long as the lag prevailed. And if the administered price is increased in that manner, it then creates an imbalance which again calls upon the escalator to come into action to create a balance again. If now, then administered prices come in, this creates a new imbalance and up goes the spiral.

But I say the trouble there is that when the balance is reestablished by the escalator, administered prices come in and create a new imbalance, and that is the thing that should be opposed rather than the escalator.

Chairman PROXMIRE. We wish there were no administered prices. We wish we had some way of eliminating them.

Mr. HANSEN. Yes.

Chairman PROXMIRE. But in a reasonably short run, it is pretty hard to see how we are going to do that.