

But the real question is whether investment will continue to rise at all this year. The third-quarter 1966 NICB capital appropriations survey showed a 15-percent drop from the second quarter; and the 1,000 largest manufacturing corporations surveyed also indicated that they would make further sharp cuts in appropriations in the fourth quarter.

Because of the momentum in fixed investment expenditures, unfilled orders are still rising, which should keep the producer durable goods industry busy the first half.

But the combination of an expected slower rise in defense orders this year than last year, weakened automobile and other consumer durable sales, the virtual disappearance of mortgage financing as a source of consumer cash flow, the suspension of the investment tax credit, and the emerging squeeze on profits, all argue for a slowdown throughout the year rather than the pattern of slowdown in the first half and upturn in the second.

At best, a leveling off is indicated in the second half compared to the first, with rising consumer spending, construction, and Government spending only moderately exceeding declines in both investment spending and inventory accumulation. The Council's forecast, on the other hand, is based on an expectation that inventories will be run down in the first half while residential construction remains weak; but that in the second half both of these activities will turn upward, along with business fixed investment.

The Council's optimism regarding the second half of this year not only assumes substantial monetary ease and availability of financing early this year, and an extremely fast recovery in construction activity, but it also assumes that there will be no restraint on investment despite an appreciable squeeze on profits from the cost-push pressures that the Council anticipates and the lack of the investment tax credit which will also tend to depress second-half fixed investment spending, especially as projects are deferred into 1968. All of these assumptions are quite questionable.

It makes considerable difference in any economic forecast whether an expected price rise will reflect demand-pull or cost-push forces. In the first instance, continued advances in total real economic output are much more likely than in the latter case. This is because profits will rise if there is demand-pull but will be much less likely to rise if there is cost-push. It is difficult to see in the business sector the basis for the Council's optimism about the second half of 1967. The consumer sector of course, will continue to grow, but not by enough to warrant the Council's expectation of a real growth rate of 4 percent or more this year.

Because of weakness in the business sector, the administration's tax proposal could have the opposite effect of that intended. The impact of higher taxes on shrinking incomes might be such as to lose as much revenue as is gained, even though the proposed increase in social security benefits would, mathematically speaking, about offset the initial tax increase. We are, of course, aware that one reason for the suggested July 1 effective date of the proposed tax increase is to give Congress time to assess the state of the economy at midyear. In this connection we would like to request, respectfully, that this committee seriously consider recommending restoration of the investment tax credit and accelerated depreciation allowances if by midyear it be-