As you know, the inventory increase was very large in 1966, far larger than we can expect it to be in 1967. There was $11 billion added to inventories in 1966.

The Council of Economic Advisers expects the 1967 figure to be about half that, but I think even that is optimistic, because we have to have some reversal, some period of using up of those inventories that have been accumulating. So you have something between $5 and $10 billion decline in demand from cessation of inventory buildup.

Finally, another thing that is leveling off is profits—profits and profit margins. The estimates of the Government used in preparing the revenue estimates in the budget, indicated that between calendar 1966 and calendar 1967 there would about about a 1-percent increase in the actual dollar profits. At the same time they are anticipating a 6½-percent increase in the dollar gross national product. This suggests there will be something like a 5- or 5½-percent decline in profit margin, which is the ratio between dollar profits and the dollar volume of business.

Then, if in the middle of the year you impose a 6-percent surcharge on corporation taxes, that would further cut this, and you would have perhaps as much as a 10-percent reduction in profit margins during the year.

This is something that it would be very hard for the economy to adjust to, because profits and profit margins determine the profitability of undertaking various business enterprises, the profitability of hiring people, the profitability of investing in new plant, the profitability of producing goods for various markets. And, when you cut down that profit margin, you have effects on employment, production, and everything else.

This is indicated rather clearly, if you just put profit margins and unemployment rates down in parallel columns. I have done this in a supplementary table. (See p. 798.)

Just to summarize this very quickly, if you will look down the line, you find that the unemployment rate gets below 5 percent when the profit margin rate—this is after-tax profit margins for manufacturers—gets over 5 percent.

Now after 1957, we had a long period in which we couldn't seem to get the unemployment rate down below 5 percent. We all remember that. That is on our mind. And it wasn't until we got profit margins above 5 percent that we began to get the unemployment rate down close to this 4-percent objective.

So reducing profit margins during the coming year might be one of the worst things we could do, if our real effort is to maintain unemployment down at the low level that it has reached.

In 1966, for the first three quarters, the profit margin was 5.6 percent, and if you cut that by about 10 percent, you see you are down close to that limit of 5-percent profit margin, which seems to be about the breaking point where you get unemployment above 4 percent. When you get the profit margin down below 5 percent, you tend to raise unemployment above 4 percent.

These are several factors to which the economy has to adjust in 1967, and it is our opinion that you shouldn't add another factor of adjustment in the form of a 6-percent surcharge on income taxes.

Now, from the point of view of concern about inflation, I think you