inflation. As I read the report, the implication is that fiscal policy was not tight enough. I would concur in the view that a tax increase early in 1966 was needed.

With respect to 1967, the Council seems prepared to give up last year's ill-advised attempt to push unemployment substantially below 4 percent. The policies the President recommends would keep unemployment approximately at its present level. I regard this conclusion, painful though it is, as realistic so far as it goes. In fact, it probably does not go far enough. The ultimate distressing lesson that the year 1966 taught us concerning the trade off between unemployment and inflation probably has yet to be spelled out.

The Council is to be commended also on its attitude toward the guideposts on wages and prices. It realizes that, with 3.3-percent inflation, it is not possible to ask labor to abide voluntarily by a 3.2-percent standard. At the same time, the economic truths inherent in the old 3.2-percent standard have been preserved. No new standard in excess of productivity gains has been set that would make labor believe, erroneously, that it could obtain real gains in excess of productivity growth.

Some parts of the report, on the other hand, invite dissent. The economic outlook for 1967, in my judgment, is painted in too glowing colors. The time shape of the outlook, with its expectation of a strong second half, seems particularly questionable. Since this analysis is the basis for a tax-increase recommendation, a forecasting error would be particularly serious.

The balance-of-payments problem is underplayed. If monetary policy were to become as easy as the President apparently would like it to be, large gold losses would have to be anticipated. Little is said about how this dilemma is to be met.

Budget information and budget analysis are seriously defective. On the basis of last year's performance, one can only conclude that the Council of Economic Advisers is not adequately informed by the Defense Department about the outlook for military spending. This seems to have been one reason for the wide underestimate that caused part of our troubles last year. Simultaneously, the administration—and this comment applies even more to the budget than to the Economic Report—is placing almost exclusive reliance upon the NIA budget at a time when the NIA budget has revealed itself to be defective in its appraisal of the economic impact of defense.

I shall now comment in greater detail on these points.

## The Economic Outlook

The Council's estimates of GNP components in 1967 may be considered optimistic on several counts, which however are for the most part within the range of judgment. But the forecast is strongly implausible in one particular: the assumed behavior of inventory. The Council assumes that excessive inventories will be worked off in the first half of 1967 and that inventorying thereafter will return to a normal rate. There is little evidence in past history that inventory adjustments can be completed in two quarters. Given the relative sluggishness of the advance that the Council forecasts, correctly in my view, for the first half of 1967, it is not even certain that much