

There is, however, a somewhat more pessimistic interpretation of the recessionary forces which assumes that during the long recovery period from 1960 to 1965 some imbalance has been developing within the economy. Outlays for fixed business investments (excluding residential construction) in 1965 were 38% above the 1960 level (constant 1958 prices) compared with a 25% increase in consumption. This may suggest a tendency of capacity to be overextended relative to consumption. (This need not be the case, particularly as the level of business investments had been *relatively* low.) The 1966 boom has further added to the discrepancy between the build-up in capital equipment and the increase in personal consumption. Thus, these observers say that some setback in business investments was due sooner or later. In their view, the slowdown in business investment has been aggravated, but not caused, by the restrictive credit policy which was pursued throughout most of 1966. This means that relaxation of credit may not be sufficient to restore the previous long-term rise in business investment.

I personally believe that at this time policies must be formulated on the assumption that either one of these interpretations, or, most likely, a combination of the two may turn out to be right.

III. GOVERNMENT FISCAL AND ECONOMIC POLICIES

1. THE TAX RECOMMENDATIONS

The President's recommendation for a surcharge on individual and corporate income taxes appears justified under the following assumptions.

(a) The proposal for a tax increase improves chances of obtaining approval for economically and socially desirable expenditure programs. (This assumes that there is a choice between a severe cut in the nondefense programs and a tax increase.)

I believe that the relative merits of expenditure programs in contrast with the demerits of additional taxes can be evaluated only in the perspective of long-term goals and priority decisions. Such decisions are in the final analysis a political act. However, the economist can contribute relevant information to aid in making this political decision. While it is always possible and desirable to run any organization with less waste and less expense, I do not believe that, let us say, a \$4 billion cut in expenditures could be made in the 1968 Budget without considerable harm to the nation's longer-range social and economic objectives. In this perspective, contributing to the financing of the Vietnam war by a relatively modest, temporary surcharge on income taxes appears justified to me. I emphasize that this is my personal judgment, which may be only on the borderline of a statement that could be supported by rigorous economic reasoning.

(b) The proposed tax increase is justified if the first of the two alternative interpretations of the current recessionary tendencies discussed before is correct, and a resumption of economic expansion and inflationary pressure is likely to occur in the middle of the year.

My personal feeling concerning the present recessionary tendencies would combine an element of this first interpretation with the somewhat more pessimistic second alternative. I am not convinced that relaxation of credit alone would stimulate resumption of vigorous expansion. Therefore, I believe that some additional arguments in favor of the tax proposal are needed.

(c) The proposed tax increase can be defended on the ground that this is the price to be paid for a considerable relaxation of credit.

I believe that credit restrictions were aggravated because of the conviction of the monetary authorities that the burden of preventing inflation and deterioration of the balance of payments rested mainly on their shoulders. Considering the harmful effect of the credit restrictions on some particularly vulnerable sectors of the domestic economy, e.g. housing, I share the opinion that a better fiscal-monetary mix in the anti-inflation program would be desirable. I do believe that a policy which includes the relatively mild tax increase plus relaxation of credit could about offset each other in their impact on the generation of purchasing power as a whole, with a better balance among component parts. I recognize in this consideration that the relaxation of credit itself has to be appraised not only from the point of view of its effect on the domestic situation but also on the balance of payments.