(d) The tax proposal is justified if there is a likelihood that expenditures for Vietnam during the latter part of calendar 1967 may be larger than estimated under the policy assumptions made in the Budget.

Under present policy assumptions expenditures for Vietnam may be larger than estimated or they may be smaller, in case of a de-escalation. Actually, it takes more time to deliberate the tax proposal, and to prepare legislation and administrative implementation than to rescind a tax increase. If there is a considerable chance that expenditure may turn out higher than now estimated I think it is advisable to prepare now the tax legislation for enactment (or dropping) at a time when more knowledge is available about the actual financial requirements for war and the course of economic development. For the case of de-escalation a more comprehensive program is needed, which I hope is in process of preparation.

Considering these various aspects, I would recommend that the tax-writing committees of Congress start working along the lines of the President's recommendation. If the forthcoming surveys on business investment intentions should bear out the pessimistic expectations of some observers I would also recommend that consideration be given to an earlier re-instatement of the investment tax credit than provided by present law. I would also recommend that the tax-writing committees plan hearings at a time before the tax increase is to become effective in order to decide whether conditions warrant going ahead with the tax increase. At these hearings representatives of the Government and the Joint Economic Committee should be heard.

2. THE PRICE-WAGE GUIDEPOSTS

Price and wage determinations are made by the parties directly concerned in their particular interest. In a competitive market economy the particular interests of business and labor coincide to a large extent with the general or national interest. In some cases, however, there may be a conflict. This conflict arises because we do not have a fully competitive economic system, neither in business nor in labor. Also, the time lag in the adjustment process is such that relying, for example, on labor market conditions for correcting cost-raising wage settlements would probably require long periods of adjustment and lead to larger and longer-lasting unemployment than are regarded as socially tolerable.

Here we are concerned with the problem of cost-push inflation, which may start with some increase in either the price of the basic raw materials or wage costs.

Some people deny the possibility of a cost-push inflation because in their view no *general* price rise is possible unless money in circulation increases. This in my opinion is a truism but does not explain anything about the causal nexus which sets the price rise into motion. We know there are many events that may give a stimulus to price rise which in order to affect the general price level have to be validated by monetary expansion.

Considering cost-push inflation does not mean that every price rise which is brought about by an increase in costs needs to be translated into an increase in the price level, nor is every such price and cost increase unjustified. Let us assume a union demanded a substantial increase in wage rates, and management grants the increase but at the same time increases the prices of the products—in this case the general public pays the price for the increase in wage rates. If labor in that particular industry had been receiving submarginal wages and had been living below what is considered a decent standard of living, there is justification to raise wages and prices in this industry but to have some other group get a lesser increase in wages and in the standard of living. Let us assume, however, that the industry had before an adequate wage level and demanded an additional increase which would push the cost of production up. If management grants the increase but at the same time increases the prices of their products—in this case an action in the interest of the parties directly concerned would violate the general interest in price stability. The original idea of the guideposts was to establish criteria for identifying wage increases which would be the result of market power and would violate the public interest in reasonable price stability.

The guideposts were formulated on the assumption that demand inflation would be prevented by fiscal and monetary measures. They were only meant to deal with a use of market power in violation of the public interest. Price stability was assumed except for a price rise caused by the exercise of market