you refer to the notion of budgetary considerations; that is, if our expenditures exceed our revenues, that this should be an important element in determining whether or not we should have the tax increase in July. I would assume that this would not be the important element.

The important element would be the state of the economy, because clearly if the state of the economy is bad, you are going to have a bigger deficit, and a much worse argument for a tax increase. Therefore, we should not be concerned as far as this particular tax increase is concerned with the budget deficit.

What you should be concerned with is the impact of the tax increase on the economy. If it is soft, we should not have it. And if it is expansionary, as you expect it might be in the second half, we should have it. Is that right?

Mr. Colm. Mr. Chairman, I am delighted to hear you argue this way. That is the way we economists have been arguing for sometime, and we are happy that so much of this so-called new economics has found more response.

But I do think there is a difference between a deficit which is caused by an unexpected increase in expenditures, and a deficit which is the result of a lower income and therefore a fall in revenues.

You are absolutely right, it would be paradoxical or perverse if we have a larger than expected deficit because of a fall in economic activity, then to increase taxes. I mean that was proposed in 1932 and I thought we have learned something since then.

As your statement has indicated, we all have learned a lot since then. But what I am concerned with is that if there is the outlook for defense expenditures much larger than anticipated, then we may need the tax increase, and I think we agreed, at least Mr. Wallich agreed with that, and I am not so much——

Chairman Proxmire. Yes, but even still, Dr. Colm, even if there is a supplemental that comes down and we find that we are off by $5 billion in the Vietnam war, it is the state of the economy it seems to me that must be the determining factor, regardless of the expenditures we have to take into account, whatever impact these expenditures are going to have on the economy. But even if the expenditures are as you say greater than we thought they would be, unless we recognize exclusively, really exclusively the effect of that tax increase and what it is going to do to the economy and what it in terms of inflation and employment, and so forth, is, it seems to me we will be making a serious error. Isn't that correct?

Mr. Colm. I couldn't agree more with your principle, Senator. The point which I would make is we should be concerned not with the state of the economy in June 1967 but what it is likely to be during the next 12 months, and if then—I thought I was rather tolerant with respect to what deficit our economy could absorb. Now with the present defense estimate, we expect a national income account deficit of I think it was something like $6 to $7 billion without a tax increase.

If we now have on top of that a larger than expected increase in defense expenditures, I think we would have to expect some old-fashioned demand inflation during the year——

Chairman Proxmire. It has a tendency to increase demand inflation, there is no question about it. Why should we not wait then until