

You say, Mr. O'Leary, that in the first quarter you expect a growth in GNP of \$19 billion, second quarter, \$19 billion, and then quite a sharp slowdown. The rise will be only about 70 percent as big in the second half of the year—\$14 billion in the third and \$13 billion in the fourth. In all probability the tax increase won't hit until the third quarter of the year. Most people will agree it should have hit the first of January. It is not going to. It won't hit until after the first of July. On the basis of much of what we have seen in the past, it is unlikely to have much effect, because of the lag in changing consumer-spending patterns.

Under these circumstances, let me start off with Mr. Olsen. Would you still feel that we should go for a 10-percent surtax, rather than emphasize expenditure reductions?

Mr. OLSEN. Well, I still would favor a tax increase, although I must say that my preference is to seek a reduction in expenditures. I must say that the two are not—do not represent alternatives. The reduction in expenditures is an absolute reduction in the level of demand of the economy, whereas in a tax increase, as I indicated, to a great extent it represents a shift of demand from the private sector to the Government. So that actually you can achieve, I think, somewhat more with an expenditure reduction than you can with a tax increase in that respect.

But I do feel that the size of the Federal financing which is implied in the absence of a tax increase, and the propensity of the Federal Reserve to even keel Treasury operations, suggests we have a continued excessive expansion of money in the absence of a tax increase.

Now, I have stated that I believe monetary policy can achieve the same results as the tax increase. What is being sought here is a restraint on the private sector of the economy. And the approach that is being applied now is a gradual slowdown in monetary expansion—I believe it can achieve largely the same effects that would be sought through a tax increase.

However, I do think that given the Vietnamese war, which poses such uncertainties in the sense that all through this period defense expenditures can suddenly balloon, and also the fact that I feel that when fiscal needs are as great as they have become in the last year and a half, that it is desirable to bring this to the attention of taxpayers in the form of a tax increase, rather than to risk, as we have over the past 2 years, to impose not a tax increase, but excessively high rates of inflation on the electorate as the alternative.

If I may take another moment to say another one of the policy problems we face here is that the State Department and the Defense Department are largely looking at an economy which begins at the shores of the United States and moves out, whereas the Commerce Department and the Council of Economic Advisers has been looking at an economy which begins at the shores of the United States and moves inward. And the war in Vietnam has been particularly difficult because it is a war of attrition to a large extent. We have no timetable on its conclusion. It has been—assumptions have been made it will conclude at the end of this fiscal year—the next fiscal year. The ups and downs, the demands of the expenditures there, have raised havoc with economic policymaking in this period of time.