

had a tax cut and then proceeded to shrink private spending by the same amount by monetary policy, you would simply nullify the tax cut.

Senator PROXMIRE. That is very important. If you have a tax cut and if you sell bonds to the public to absorb all of the increase in monetary supply or the increase in funds that results from a tax cut, you say you would eliminate much of the effect of the tax cut.

Dr. HELLER. I think it is somewhat more complicated than that. If you sell bonds to the public, you will be in part activating idle funds, so that this would not go all the way to offset the effects of the tax cut. The proposition I was stating was one in which the method of financing would increase interest rates so much as to cut back the amount of private spending by the full amount of the tax cut. Then you would nullify the tax cut. But this would be extremely hard to do and would require a highly restrictive monetary policy—one that actually reduced the money supply severely. Of course, it is true that for any given stimulus to the national product, the size of a tax cut would have to be greater the tighter the monetary policy. That is just arithmetic, and I am only too happy to underscore that arithmetical fact.

Going back to the first question, concerning the impact of a tax cut. If we look at this hypothetical set of figures that we put together for a \$6 billion cut in individual tax liabilities—

Senator PROXMIRE. May I just interrupt to put something in the record? I want to put in the record here, Chairman Martin's reply to Chairman Patman on this very question when Chairman Patman asked him what we ought to do to stimulate the economy with a large deficit. Martin said:

I will return to the simple statement I made earlier. In the event a decision is made which widens or further deepens the deficit we are already running, I want to put the Federal Reserve specifically on record this morning, if I have not already, that I think we must not finance the deficit by bank created funds. It should be financed by bona fide savings and not by writing up the funds on one or the other side of the bank's ledger. It would mean that the expansionary effect of the tax cut would be enormously reduced.

Is my observation roughly correct?

Dr. HELLER. As against other methods of financing that would activate bank funds and increase the money supply, there is not any question that this approach would be more restrictive, and would require a larger tax cut for any given result in employment and production.

I believe, as Congressman Curtis mentioned earlier, that this is an area that requires a great deal of additional attention, partly because we don't know all the facts and partly because there is much misunderstanding and misuse of such terms as "real" saving, bank and non-bank funds, activating idle funds, and so forth.

I would hope that our Council and this committee and others would continue to discuss this problem, because it is one of the critical areas of economic policy.

Chairman PATMAN. Will you yield for a brief observation?

Senator PROXMIRE. Yes.

Chairman PATMAN. You are emphasizing bringing out of hiding some idle funds. Don't you think that the amount of such funds would be so small and so insignificant that they would not be a significant factor in our analysis of the monetary problem?