Is this likely to persist as an automatic contradiction? If so, perhaps we should make some kind of tentative long-range determination of whether we should be more concerned with our domestic situation vis-a-vis monetary policy or the foreign situation.

Mr. RITTER. I agree completely. Until we get an adequate growth rate and high employment we are going to be faced with this conflict between wanting low interest rates for domestic reasons and high interest rates for international capital flow reasons.

Senator PROXMIRE. When we get that growth and full employment, we will have exactly the opposite situation.

Mr. RITTER. No; then I should think if we do get a high employment economy we can afford high interest rates.

Senator PROXMIRE. Yes; we can. Then there might be reason with regard to flow of capital abroad. Other countries may have adverse balance of payments and losing their capital to us, so we would have reason to lower our interest rates.

Mr. RITTER. I agree. I think we should explore alternative methods of adjustment. That is why I raised the question of flexible exchange rates; to have it automatically move up and down to make dollars more or less expensive to foreigners.

Senator PROXMIRE. I think your suggestion that we need a great deal more research in this area is excellent. I agree. It is very foggy and very indefinite.

Mr. RITTER. It is a shame.

Senator PROXMIRE. I would like to ask one more question of the three members of the panel. When Mr. Martin appeared before the House Banking and Currency Committee earlier he was asked his view on the steps the Federal Reserve would take if the administration and Congress reduce taxes.

The decision will be recommended to us next year. He said this: "In the event the 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 done it already, that I think we must not finance a deficit by bank created funds and that how the deficit is financed is of vital importance and it should be financed out of bona fide savings and not by writing up assets on one side or the other of the bank ledger." Starting with Mr. Sprinkel, what effect will this have on the expansion?

If we have a tax cut of $10 billion, and the Fed sells bonds to make sure that this is not financed by bank created funds, what impact is this going to have on the economy?

Mr. SPRINKLE. As I indicated in my testimony if we can believe that the evidence of the past has some relevance for the present, we would have to conclude, I believe, that if there shall be no monetary expansion; namely, no provision of additional reserves to the banking system, a tax cut would probably provide only a modest stimulus.

I would not want to argue no increase in spending would occur. However, there would not be a substantial or lasting stimulus unless we got some additional money into the system.

This is not to say we can't get too much money into the system. We have done so on numerous occasions in our economic history. It is entirely conceivable to me that 2 years from now we could be in that situation and it could very well result in inflation.

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