Representative WIDNALL. Thank you very much.

Senator PROXMIRE. I would like to ask the panel to comment on this because this is extremely important. The statement was made before this committee a short time ago by Mr. Martin in response to a question by our chairman, Mr. Patman. The question related to financing the deficit, and Mr. Martin said that—

> In the event a decision is made which further widens or deepens the deficit we are already running, I want to put the Federal Reserve specifically on record that I think we must not finance the deficit by bank-created funds. 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.

Mr. Bell, I want to know whether or not, if Mr. Martin does this, if the Federal Reserve Board does sell bonds to the public under these circumstances to this extent, what would be the effect on the economy? Will it reduce the expansionary impact of the increased deficit one for one? Would it cut it in half? Would it reduce it only a little?

Mr. BELL. It does seem to me, Senator Proxmire, that if you do not finance the deficit in part by new money, you would have to have a larger deficit to get the same economic results. In other words, what I suggested a little while earlier is that the medium position of partly financing it by new money and partly financing out of savings so that the interest rate rise is gradual and does not choke off the expansion would seem to me to be wise and not put us in a very difficult position.

Senator PROXMIRE. What was that again? If you what?

Mr. BELL. If you finance any increased deficit partly out of new money and partly out of existing savings, you can do three things. You can pump enough money in so there is no rise in the interest rate and not call on the existing loan market. You can say, "I will not pump in any money," in which case all of the funds for additional spending must come out of the loan market, bidding the rate of interest up rather sharply. Or you can take a middle monetary fiscal mix and say, "Let us let the interest rate rise with the level of the rise in economic activity." That implies pumping some money in but not enough to keep the interest rate low while the level of activity is rising.

Senator PROXMIRE. As long as you have 5½ percent of the work force out of work, which we have had for 7 months, as long as you have indicators of capacity suggesting that we are operating at about 85 percent with the optimum 90 percent of our plant capacity, why in the world would there be any merit in any restrictive activity until we come closer to fuller utilization of our resources?

The whole point of the tax cut at the time of an unbalanced budget is to stimulate the economy. Why should we undo any part of it with monetary policy?

Mr. BELL. One reason is that you do not want to announce—I have not said that my studies showed that interest rates have no effect; I have said they have a small effect on foreign capital movements—they might have a significantly larger effect if you say you are permanently going to hold your interest rates down for 6 or 9 months or a year.

Senator PROXMIRE. I am not asking for a peg. I say, suppose you decided you would follow a policy of relative ease and sell most of these bonds to the banks until you found you had some inflationary pressures to be concerned about.