

deficit by plugging loopholes and raising the revenues that way because, you pointed out, the Federal Reserve, if loopholes are not plugged could simply increase the money supply by an amount necessary to float the additional Treasury borrowing.

Is it really that simple? I would be afraid in the model we put that the Fed, if forced to that act of additional monetary creation, would have created an inflationary overhang which, in a period immediately ahead, on an assumption of an economy just in balance, would cause inflation, and I put it to you that there is an added virtue in loophole plugging in a time like the present when we are at a full employment without inflation situation from the demand standpoint but are facing large budgetary deficits in part brought about by the existence of these tax loopholes.

Would you come back on that?

Mr. SAMUELSON. May I throw you a crumb?

Representative REUSS. I need one.

Mr. SAMUELSON. I think as far as the Gnomes of Zurich are concerned and those people who have a less radical attitude toward the public debt and deficits than has been displayed by most of the witnesses before you, there is a psychological worry about the deficit. Aside from its economic importance, there is a psychological worry about it.

I think \$3 billion of legitimate revenues which we ought to get from anywhere would do something to reduce that psychological worry, and I offer that to you as a special reason for plugging loopholes in this year of high deficit.

Representative REUSS. The Gnomes aside, what about the numbers?

Mr. SAMUELSON. I took the extreme case for classroom simplicity where all of the loophole people who have constructive realization of capital gains have the money at the outset in greenbacks and pay it over in greenbacks. Then I don't see that there is anything more or less inflationary in having the Federal Reserve create those greenbacks anew than to have these greenbacks which were in somebody's hoard coming into circulation and increasing, as you said, inflationary pressure.

But, of course, it is unrealistic for me to assume that this is all going to come out of hoards. So let's actually assume that this is held in so-called locked-in securities, and so forth.

Then I would say that to the degree that these people have to liquidate, have to find a buyer, that you are tightening the capital market.

Now, I don't know how important this is, but Professor Modigliani, my colleague, has been making extensive studies of what determines capital formation—I can remember our chairman once defending his reputation as a craftsman in a congressional debate—and he finds that the behavior of the stock market is an important determinant in his equations for capital formation. Therefore, loophole closing that required forced liquidation which had not been anticipated would be a stock market factor. You would have to send me home to do my homework to work out such effects.

I pray that you not do that, but I would be responsive to your command to weigh the very complicated incidents on the capital market of both sides of the transaction, the Treasury getting the