I am persuaded, moreover, that Europe, where growth outside of France is slowed down, needs lower rates. To hold U.S. interest rates high for the sake of the balance of payments would be a double error. It would not help the balance of payments much, and it would wrongly tighten interest rates in Europe, as in the United States.

The Importance of the International Capital Market in the World Economy

The Economic Report of the President recommends an increase in the interest equalization tax and the Report of the Council of Economic Advisers on pages 189 and 190 provides the analytical basis of that recommendation. A much stronger statement of this position, however, was set forth by Gov. Sherman J. Maisel of the Federal Reserve System in a speech at Portland, Oreg., on February 1, 1967. He argued that capital movements from the United States are excessive because they are inadequately taxed, and that we should apply a tax like the interest equalization tax to all capital outflows, not just the bonds and long-term bank loans now subject to interest equalization tax, varying the level of the tax to regulate capital movements in ways required by domestic goals, and particularly the appropriate mix of monetary and fiscal policy. I must respectfully disagree on all counts.

First with respect to the inadequate taxation of foreign investment. Governor Maisel, I take it, regards the tax credit on corporate income taxes paid abroad as a subsidy to foreign investment. Without taking up the question of taxing retained earnings abroad after adjustment for the tax credit, which is only a small issue in Europe where corporate income taxes are on the whole at the U.S. level, but where I incline to agree with the Kennedy administration's position in the revenue proposals for 1962, I infer that Governor Maisel wants it both ways. It seems unlikely that he wants to shift from tax on income produced to one on income received, which would require the United States as well as other countries to give up corporate income on foreign-owned firms within their borders and hardly seems practical. He must then believe in double taxation, which implies that foreign-earned income is somehow inferior to domestically earned income and should be discriminated against. This comes close to an isolationist position. Does he want to collect a national income tax on profits earned on imports, as well as the income tax we now collect on profits on exports, putting a special tariff on all imports because their producers do not pay U.S. income taxes? Admittedly, the question of how to share taxation between jurisdictions is a complex one, but most analysts have abandoned the position that the solution is to reduce or eliminate international transactions through double taxation.

Second, with respect to increasing the interest equalization tax and extending it to all foreign lending. The argument of the Council that the interest equalization tax has been successful is not compelling. It stopped lending through new bond issues in New York, but the capital outflow changed to other channels, first bank lending, then direct investment, and then the Canadian gap, the pension fund