

tax surcharge, they are not defended on balance-of-payments grounds, although these now present a better justification than does the domestic outlook.

I believe that the domestic economy will be soft enough, even without a tax increase, to bring some improvement in the current account of the balance of payments. Hence I see no urgency from this point of view for a tax increase.

The situation is very grave. We have lost some of the benefits that price stability has been giving to us. It is useless to say that our prices are rising less rapidly than those of other countries. We are the deficit country. Our prices properly should fall. That is asking too much. They ought to at least remain stable.

To say that we are inflating less than others is saying very little indeed, since at the time we are no longer contributing to balance-of-payments adjustment by keeping the economy under wraps; we are really making no contribution to adjustment at all except by various forms of market intervention, such as the interest equalization tax and a very temporary effect of high interest rates that attracts hot money. All we are doing now is throwing the principal burden of adjustment on the surplus countries. This reflects itself in their refusal to permit us progress toward international monetary reform.

I am concerned about the number of statistical devices we have been using to dress up the balance of payments. I count nine different types of devices in the survey of current business alone, and no doubt there are others. These things conceal the underlying facts without making them any better. It is basically on balance-of-payments grounds I would say that a tax increase can still be supported at this time.

If I, nevertheless, don't support a tax increase now, it is because I see the economy sufficiently soft to achieve most of the benefits that would come from a tax increase, even without one, that is, I see a slackening of imports and improvement of exports.

I also see a continuation of relatively high interest rates, in order to keep the hot money here. That in turn contributes to the prospective weakness of the economy.

Taking these things together, with interest rates not much lower than the present and no tax increase, we would probably be doing, on the inflation and balance-of-payments front, as much as can be done in a year of cost-push inflation. But I do consider the balance of payments a primary source of concern, and I have three proposals to deal with it.

1. Keep short-term interest rates sufficiently high to prevent outflow of short-term funds, but within this constraint seek to making interest rates as low as possible. Low interest rates are better than high.

2. Remove the 25-percent reserve requirement for Federal Reserve notes in order to make our reserve more maneuverable; and

3. Adopt the complex of measures that will be needed to end inflation and resume the improvement in competitiveness. Thank you very much.

Chairman PROXMIRE. Thank you very much, Mr. Wallich, for an excellent statement. I must call attention to the fact you exceeded the time limit by 5 minutes, but I very much appreciate what you have