Chairman PROXMIRE. If I could interrupt at that point, Mr. Butler. I am refering to your prepared statement which I thought was very interesting because you have really suggested four proposals: (1) to cut spending sharply; (2) to pass the tax surcharge; (3) to restrict the rise in money and credit; and (4) to reduce our overseas military expenditures. I agree with three out of four with great force, but it is the surtax as far as the balance of payments is concerned that seems to me to be peculiarily unadapted to meeting our problem.

Mr. BUTLER. Well, I do not necessarily insist on the surcharge. I mean if you could do enough through cutting Government spending to get our deficit down to manageable proportions, then I think you would not need the surcharge. I think the important thing in terms of our balance of payments is the rate of inflation which will be necessarily associated with the size of the deficits that we are running and will continue to run unless we take action on cutting spending, raising taxes, or some combination. But it is the size of the deficit that I think is the critical thing.

If you can find ways to cut it down by reducing spending, then I would say that you do not need the surcharge. I am enough of a skeptic about our ability to cut spending that it is my personal belief that you need both, but you need them to reduce the overall deficit, the inflationary pressure that is inevitably generated by this deficit, and its longer term effects on the balance of payments. I think it does not hit the balance of payments very quickly, although there is some evidence in the figures of last year that it had an impact. I think if we could stop the inflation fairly quickly, that we would not suffer permanent damage, but I think if we do not stop it, we will have permanent damage, and it will not take very much longer to lead to this damage.

Looking at the surcharge itself, and there are many ways that one can raise taxes, at the moment I suppose that an across-the-board increase is perhaps the simplest and clearest way to do it. It will have effects in many ways, and in some of the areas you mentioned it will not. I mean I do not think it will have any immediate effect on foreign prices as you indicate.

On the other hand, I think it will, in combination with other measures of reducing the deficit, so reduce overall demand and overall inflation as to have a beneficial effect on our balance of international payment.

Chairman PROXMIRE. Mr. Machlup?

Mr. MACHLUP. Let me first pay you my respects, Senator, for the openmindedness and scholarly attitude with which you invite criticism of your own position. I think this is really most fair, and I bow to you.

But let me then proceed to that criticism. I agree with Jack Behrman about the rate of profit or profitability of American industry, and its effect upon capital movements.

We have had experience with such matters in the past, when we argued for a tax cut in 1963, and in 1964, when we actually cut taxes. Then it was argued that the tax cut would increase American profitability relative to that abroad, and that this would invite capital flows to the United States, which would offset the effects upon the trade balance. This was said by two Presidents and by their Secretary