of the Treasury, and several advisers—but, it was palpably wrong. It did not do it in fact, and I think it was a poor argument in theory.

Chairman PROXMIRE. Were you able to isolate that factor? How do you know it was wrong? The balance of payments improved when taxes were cut. He was right then. He must be wrong now.

Mr. MACHLUP. Well, we have seen that capital outflow increased after the tax cut.

Chairman PROXMIRE. But there are always so many elements involved.

Mr. MACHLUP. That is correct; but they said they would expect capital outflow to decline and capital inflow to increase, and we know that on both accounts the opposite took place. American capital had a bigger outflow and foreign capital had a smaller inflow, so we have definitely seen that the argument was at least not supported by the experience that we had soon thereafter. I would say, moreover, that on theoretical grounds the argument was not too strong.

Chairman PROXMIRE. That coincided at the time with a number of other things.

Mr. MACHLUP. I grant you that.

Chairman PROXMIRE. Including the Vietnam escalation, including a tremendous boom in plant and investment here, and so forth.

Mr. MACHLUP. Exactly. The investment boom here ought to have attracted foreign capital according to the argument, but it did not. I would say one should never rely on these supposed probabilities. Take your point about interest rates. The argument that interest rates will rise if we do not get an increase in taxes is correct, but you say, "all the better, the higher interest rates will invite an inflow of capital."

I would say that this would be a help in financing the deficit in the balance of payments for a very short period. We cannot, through short-term variations or differentials of interest rates, reduce the deficit. They may temporarily lead to movements of capital which, however, have no longrun influence on the balance of payments.

Your third point was about the incidence of the tax increase. We know so little about that. We know not enough about whether there will be a shifting of the increased corporate income tax onto the consumer. We do not know. I am doubtful about it, but I could not possibly take a strong position on this question.

Mr. BUTLER. In the short run?

Mr. MACHLUP. In the short run, certainly not. In the long run, shifting would be likely. But now comes the main point against which you argued. You questioned that the tax increase would really cut imports, that it would really cut domestic spending. I cannot see how it could fail to do that. If you take billions of dollars away from individuals and corporations, at least the individuals have no way of recouping that. They cannot all go to loan associations and get all the money that they are paying out as taxes. Hence, the effect upon individuals is practically certain. The effect upon corporations——

Chairman PROXMIRE. At that point, just recall the fact that up until 1966 people had been saving at a rate of about 5.2 percent. Last year they saved at 7.1 percent. If they go part way back to the 5.2—they went back to, say, 6 or even 6.5—it would wipe out virtually all of the diminution in their incomes from the surtax. The surtax would have no deflationary effect.