

Low interest rates are better than high interest rates in the same sense that lower prices are better than higher prices. We welcome low prices if they reflect a plentiful supply of goods and we welcome low interest rates if they reflect an abundant supply of savings for investment. But if low prices result from insufficient demand for goods they are not a sign of economic health, and neither are low interest rates if they reflect an absence of advantageous opportunities to use capital. And low interest rates are not cause for much satisfaction if they result from excessive expansion of money and credit, thus encouraging inflation at home and weakening the dollar internationally.

The economic program of the Administration might indeed contribute to the lowering of interest rates, but in ways that would yield little gratification. The tax increase might slow down growth and reduce the demand for funds. It, together with guidepost policy, might reduce profit margins and hence the opportunities for using capital profitably. On the other hand, if we assume that these undesirable effects will somehow be avoided, the tax increase will contribute to higher rather than lower increase rates. It will reduce the internal sources of business capital and the savings of individuals, both of which are alternatives to drawing on bank credit. Hence, the tax increase, under these assumed circumstances, would increase the demand for bank credit and thus tend to raise interest rates.

Economic Outlook—1967

In 1967 it is becoming clear that the economy will have to adjust itself to the termination, or reversal, of certain trends which have given it strong support until recently. The developments of this character which can be anticipated are as follows:

1. *A leveling-off of the capital-goods boom.*—Several factors would lead us to expect this trend—which would be a radical shift from the 16% expansion of capital outlays between 1965 and 1966. First, the growth rate of the economy generally will slow down in 1967. This is expected by practically everyone including the CEA and it is probably inevitable. But capital expenditures are, in practice, a means of providing additional facilities for an expanding economy. Hence a slowing of the *rate* of growth can mean an actual decline in the *level* of capital spending.

Second, the suspension of the investment credit and accelerated depreciation will act as a deterrent to capital spending in 1967. This is only beginning to have that effect since much of the spending in the latter part of 1966 was the result of orders placed prior to the suspension date. The investment credit and accelerated depreciation were conceived as normal and permanent parts of the tax system. They were suspended only because it was thought that demand for capital goods would be excessive in 1967. The matter obviously has to be reconsidered. Meanwhile, we list this among the factors which will depress capital spending this year.

Third, the expected reduction of profit margins, to be discussed later, will reduce both the profit incentive and the funds available for capital spending.

Finally, the proposed 6 percent surcharge on income taxes would further depress profit margins, and intensify the problem of maintaining capital expansion. It is surely undesirable to add this on top of all the other factors tending to reduce the level of business capital spending.

Compilations of business plans for capital spending would indicate that 1967 plans exceed actual 1966 levels by a small percentage. But in the last half of 1966 spending fell well below the previously announced plans for that period, as is common close to a turning point. We conclude that a most optimistic assumption would be that business expenditures on fixed investment will be as high as in 1967 as in 1966. This would mean that capital spending would fall below its level as of the last quarter of 1966.

2. *A topping-off of the defense boom.*—This is a matter on which the statistics customarily consulted may be misleading. For that reason we attach a table (Table 1), comparing the trends as measured in various ways. All the figures are derived from the official compilations in the budget document.

Usually we appraise the economic impact of government defense spending in terms of the amount indicated under that head in the national income accounts. As seen on the table, this portrays a continuing upward trend in fiscal 1968. The increase is expected to be about \$12 billion between fiscal 1966 and fiscal 1967, and an additional \$6 billion between fiscal 1967 and fiscal 1968. But the national income accounts record defense spending at the time the goods and services are delivered. Thus it measures the completion of economic activity related