

Mr. MODIGLIANI. I think I fundamentally agree with what Professor Chandler has said. The high level of interest rates we have reached now reflect a combination of causes. They reflect a very expansionary fiscal policy. These expenditures were not accompanied by corresponding increases in revenue. It reflects to some extent expectation of rising prices which typically do lead to higher interest rates, because people essentially are willing to borrow at higher rates if they expect to gain from the increases in the prices of the things they buy, or the plant they buy while it is being used.

There are also other factors, however, that contribute to the high interest rates, and I think perhaps people should be more aware of it. I believe that one of the forces that has led to higher interest rates are fiscal incentives such as the investment credit. The investment credit makes it more profitable for firms to acquire equipment, and they are, therefore, willing to pay a higher interest rate because of this higher profitability.

If one were really concerned with trying to reduce interest rates, and I think there is some point to that, one might want to look at the possibility of eliminating some of the incentives that now exist for borrowing at higher rates. In the short run, the tightening of fiscal policy would contribute toward making it possible to at least have no further escalation of interest rates and possibly, by reducing expectations, by changing the mood, to also reduce interest rates.

After all, we do know that every time Congress seems to be close to passing a tax bill, the bond market responds by higher bond prices, lower interest rates. So I think that step would be a helpful step in that direction. Needless to say, I think it is important to act very fast, because the Federal Reserve has been in some sense holding its horses hoping for such passage. And at some point, it just will not be able to hold any longer. So I think time is of the essence, and those steps are not so easily retraceable. So I hope the tax increase will be passed very fast.

Senator JORDAN. And you, too, would go along for selective cuts in spending?

Mr. MODIGLIANI. Oh, absolutely.

Senator JORDAN. Thank you.

Professor Wallich?

Mr. WALLICH. Senator Jordan, I agree with what my predecessors have said and would say very briefly, high interest rates are very largely due to inflation. I would favor as low interest rates as we can get consistent with economic stability. If the Government will stop inflating, interest rates will be a lot lower. As a mild consolation to the farmer who seems to be caught wearing these two millstones, there is the possibility that on the debt he already owes, the true interest rate is substantially reduced by inflation. A four percent price increase means that the real value of his debt in purchasing power is that much less. That does not help him very much, however, if the value of the things he produces is not going up.

It is also possible that the value of the real estate he owns is going up. That would be a compensation.

Senator JORDAN. That has been his only salvation so far. But if he does not sell, he does not realize a capital gain, and he does not wish to sell his property.