

In order to ignore the question of whether goods and services are purchased by the government or private spenders, one must assume that borrowing to reallocate resources is an efficient way of reallocating them. In addition, aggregate demand must not increase.

If the government spends the proceeds of its bond issue on real resources while only part of the funds come from household demand for real resources the latter is not true. If funds are raised by taxes, the person taxed has his wealth reduced. The reduced wealth makes it difficult for the taxpayer to borrow to augment his income. It appears that a person who turns in more money in taxes reduces his consumption by more than one who turns in this same additional amount to pay for a bond. A change in income or wealth produced by governmental expenditures may alter spending even if the supply of money is unchanged.

Since the pattern of government demand differs so much from that of household demand, an increase in governmental expenditures requires a major shift of resources. When the government borrows heavily to pay for its expenditures, bond rates may be pushed up enough to cause major alterations in the flow of funds. Some users of credit may get more, while others are fully supplied. In general, the lack of mobility of factors of production limits the effectiveness of high interest rates in reallocating resources. The impediments to accomplishment of such shifts in terms of rigidities, bottlenecks, etc. are significant and cannot be ignored. A tax program may be far more efficient in freeing the type of resources required and in insuring that no large quantities of resources lack demand.