

Our quantitative analysis could be presented, with no substantive difference, either as an expansion of investment and a tax increase or as a contraction of investment and a tax cut. It is the change in taxes which is significant; it does not matter whether the public investments would increase existing taxes or prevent a possible reduction. Since the actual tax policy issues have appeared in terms of tax reductions in recent years, we consider the problem from this point of view.

In order to measure the cost of capital for a wide range of taxes, we present two models using different sets of assumptions about the potential tax cuts which are forestalled by the public investments. In Model A, we assume that the personal income tax is reduced in a manner most advantageous to low-income families and that sales taxes are lowered. These tax cuts would primarily boost consumption. Model B consists of a reduction of the personal income tax with emphasis on upper-income brackets, combined with a reduction of the corporation income tax. This model would increase investment.

Throughout the analysis it is assumed that the government runs a successful stabilization policy. This is not to say that full employment and stable price levels prevail constantly, but only that neither major unemployment nor severe inflation is allowed to develop. This assumption accords both with the avowed objectives of the government and with the general setting assumed for federal resource development programs, and it corresponds with the record of recent years. Most of the data for our quantitative analysis are based on the year 1955, a year in which employment was high and prices stable, and the money supply was moderately tight.

In this context, a reduction in a specific government expenditure must be considered an autonomous change that must be offset by some weapon in the arsenal of the stabilizers. It is this reasoning which forces us to derive our estimates of social cost on the basis of specific counteracting fiscal or monetary policies.⁷

⁷ Thus our procedure measures what Musgrave calls the "differential incidence" of expenditures (See R. A. Musgrave, "General Equilibrium Aspects of Incidence Theory," *American Economic Review*, May 1953, pp. 504-17). A reduction of expenditures by \$1.00 may require an offsetting tax cut of less than \$1.00, because the multiplier effects of the former may exceed the effects of tax reduction (see H. C. Wallich, "Income-Generating Effects of a Balanced Budget," *Quarterly Journal of Economics*, 1944, pp. 78-91). In our quantitative