

in many instances, the limit to a firm's rate of expansion is not set by the diminishing attractiveness of profit opportunities in relation to borrowing costs, but rather by its supply of managerial personnel. The firm undertakes as much investment as its staff can handle successfully. Lintner believes this analysis to be particularly applicable in periods of high employment. In depressions, firms hesitate to borrow for fear of inability to repay, and the relationship between the levels of taxation and of investment becomes much stronger. Since our analysis supposes that a successful stabilization policy precludes depression, we assume that an increase of retained earnings of \$1.00 would lead to only 10¢ of added investment in the firm. A rate of return of 21 per cent, the average rate of return of large corporations in 1955 before taxes,³³ is assumed for the share of the tax cut that would be invested by the firm.

The liquidity of the large firm would be increased by the remaining 90¢ of increased retained earnings. Firms with a significant amount of debt would be able to lower it; firms which raise funds by financing their accounts receivable could reduce this practice; those which are creditors would be able to increase their financial assets—consisting in the case of large corporations primarily of government securities.³⁴ Thus, the major share of the increase of retained earnings would add primarily to that large pool of low-interest, low-risk, relatively liquid capital into which excess corporation funds are channeled, and from which the loans of large corporations, governments, and financial institutions are drawn. An increase in the supply of loanable funds in this market would have several effects. To some extent, interest rates on low-risk securities would fall and the severity of rationing would diminish, leading to some increase of mortgages and perhaps even a small

³³ This figure is derived as follows: 78 per cent of the tax cut goes to manufacturing, 17 per cent to utilities, and 5 per cent to trade. The average rate of return of large corporations in manufacturing was 23.8 per cent (reported in *Quarterly Financial Report for Manufacturing Corporations, Fourth Quarter 1955*, Federal Trade Commission and Securities and Exchange Commission, Washington, April 1956). The rate for utilities was estimated directly from prevalent standards of rate regulation to be equal to 10 per cent. The rate for trade, which is equal to 20 per cent, assumes that it stood in the same ratio to the rate in manufacturing as in 1952. (Figures for 1952 from SEC data.) A weighted average yields our estimate. The concept of rate of return used by the SEC may overstate the actual rate by 1 to 2 per cent.

³⁴ C. E. Silberman, "The Big Corporate Lenders," *Fortune*, August 1956, p. 112.