

defense and other programs. Our result is meant to apply only to small tax cuts.⁴⁰

The rates of return which we assumed are another possible source of error. Through parts of the analysis, average rates were used to approximate marginal rates of return. Households were assumed to add to their assets in such proportion that the average rate of return of their property incomes would remain constant. For any one firm or household that is not likely to be a good approximation; but for large aggregates the error will be smaller. The typical household will not hold assets in the proportions of the group average; some households will make investments in their own business, others in common stocks, others in real estate—depending upon the experience of the head of the household and the opportunities to which he has access. Additional funds are likely to be put into the household's major form of asset. With the tax cut spread over all households in the income class, the money is likely to be invested proportionately to total holdings.

Similarly, business was assumed to make its additional investments at a rate equal to its average rate of return. In the case of industry, the tax cut is diffused over successful and marginal firms in many fields. This does not rule out a systematic bias between marginal and average rates, but the direction of bias is not clear. On the one hand, extra funds must go into investment opportunities

* We have made no allowance for effects originating in rounds of re-spending subsequent to the economic units on whom the initial impact falls. The increase in disposable income due to a tax reduction will have multiplier effects on the incomes of others, of course, but we have assumed that a correctly managed fiscal and monetary policy offsets these multiplier effects. Nevertheless, the multiplier effects and their policy offsets will lead to some redistribution of income, and it is logically possible that there are systematic differences between the time preferences of the gainers and the losers of this redistribution. This would affect our estimate. But since both the initial repercussions and their offsets are diffused more or less randomly through the economy, it is most unlikely that there will be systematic differences between the two groups in this regard. Further, the similarity of our estimates for different taxes argues that if there are systematic differences in the two groups with regard to important economic characteristics, the effect on the social cost of capital will still be small. For a full discussion of these effects, see A. H. Conrad, "The Multiplier Effects of Redistributive Public Budgets," *Review of Economics and Statistics*, May 1955, pp. 160-73; also see M. Bronfenbrenner, Taro Yamane, and C. H. Lee, "A Study in Redistribution and Consumption," *ibid.*, pp. 149-59.