

inflation grounds, is the case for acceleration of corporation tax payments. Whatever the other merits of putting the corporate business community more completely on a current payment basis, the mere fact of acceleration of corporate tax payments can hardly be deemed to be significant for the volume of corporate spending.

The income tax surcharge and the financial markets

One of the arguments advanced on behalf of the surcharge is that, in its absence, Federal borrowing requirements will place extraordinary burdens on financial markets, will send interest rates higher and higher, at the expense of housing, State and local government, and small business expenditures. Last August, the Secretary of the Treasury and the Director of the Bureau of the Budget predicted that failure promptly to enact the tax increase would send "interest rates sky high * * * shutting off the flow of credit to sectors such as the home mortgage market and small businesses." As Dr. Schultze put it, "The recovery in homebuilding from last year's setback would surely be choked off, and indeed, reversed."

Interest rates, to be sure, advanced strongly, particularly in the second half of the year. But residential construction, as already pointed out, also increased strongly through the year, substantially exceeding the Council's forecast. And State and local government outlays also rose more than the CEA had anticipated. Since the end of 1967, parenthetically, the upward movement in yields has slackened. Indeed, many of the rates have been drifting downward, at least into mid-February.

But if the tax increase had been enacted, as requested, would interest rates have risen less? Will its enactment now prevent further increases in interest rates?

The affirmative response is based on the assumption that the reduction in the Treasury's borrowing requirements consequent to a tax increase will not be offset by an increase in credit demands by others. But this, in turn, supposes that households and businesses will respond promptly to the tax increase by curtailing their spending. If this does not prove to be the case, and the burden of my argument is that it won't, then the likely result is an increase in private-sector demand for funds beyond the amounts which would be sought in the absence of the tax increase. In short, the reduction in the Government's financing needs probably would be matched by an increase in the private sector's. In the near term, say over the next year or so, the tax increase may well primarily serve to change the composition of credit demands; it is much less likely to change the total amount of financing sought by any significant amount.

Efforts to justify the tax increase as a means of holding back interest rate increases rest on very shaky theoretical grounds. On the basis of the evidence of the postwar years, the case is just as feeble. Presumably, greater fiscal constraints, either with the same or with a greater degree of monetary ease, should result in reduction in interest rates. By the same token, easier fiscal policy and tighter monetary policy should result in higher interest rates. Using changes in the full-employment surplus as the measure of fiscal constraint, one finds, in fact, that interest rates changed as would be expected on only one occasion in the postwar years when fiscal and monetary policies moved