

CAPITAL FORMATION
AND U.S. ECONOMIC PERFORMANCE

Allen Sinai

Three years ago the physical capacity, supply of labor, and financial resources of the U.S. economy were insufficient to satisfy demands. Symptoms of these capital shortages included sharply rising prices, peaks in factory operating rates, increased unfilled orders, long delivery delays, higher wages, low unemployment rates, rapidly accelerating interest rates, widening yield differentials between risky and "safe" financial assets, surging loan demands, decumulation of financial assets, and credit rationing.¹ Indeed, the unprecedented inflation of prices, wages and interest rates was the principal cause of the deep recession that followed.

A by-product of the 1973-75 slump has been a shift from capital "shortages" to surplus with great slack in productive capacity, labor, and financial markets.² However, the recession also induced a low rate

¹As used here, the term "capital" refers to physical capital, human capital and financial capital.

²Utilization rates, whether measured by the Bureau of Economic Analysis or as newly revised by the Federal Reserve Board, are far below peak 1973-74 levels and in a majority of cases are less than the average over 1960 to 1975. Excess supply in the labor market is indicated by a national unemployment rate of 7.5%, compared to the less than 5% of three years ago. Also, the current rate of unemployment, in an expansion that is two years old, exceeds the previous peaks of 7.4% in 1958:2 and 7% in 1962:1. Currently, there is also a large financial surplus; see Sinai (17).

Dr. Sinai is Director of Financial Economics, Data Resources, Inc. and Visiting Associate Professor, Sloan School, Massachusetts Institute of Technology.

of capital formation, especially by business. The failure of business fixed investment to rebound significantly, even in the ensuing recovery, has raised numerous questions about the relationship of capital formation to future economic performance. Among them are:

- 1) will capital formation be adequate to support a full employment level of output in the years ahead, without a resurgence of inflation and subsequent bust?
- 2) what mix of policies would significantly raise capital formation? Should selective business tax incentives be used? Personal tax cuts? Easy money policy? Or, some combination of general monetary and fiscal measures?
- 3) will heavy doses of capital formation provide a large enough increase in productive capacity to ease inflationary pressures on prices and wages?

This study examines the role of capital formation in U.S. economic performance and, in particular, the effects of some alternative sets of policies that could stimulate the formation of capital. The Data Resources, Inc. (DRI) model of the U.S. economy provided the framework for analysis, with computer simulations of economic activity in response to policy changes through 1980.

In brief:

- the present rate of capital formation, broadly defined, is insufficient to achieve full employment. The primary causes are the deep recession of 1973-75, a sluggish economic expansion, caution engendered by the economy's instability over the past decade, and the desire of business to reduce financial risk by restructuring balance sheets. So far,

nonproductive investment, such as spending for pollution abatement equipment, has not been sizeable enough to bear a major responsibility for the weakness in physical capital formation;

- given the current surpluses in productive capacity, labor and finance, aggregate macroeconomic policies can be more effective in raising capital formation than specific business tax incentives.³ Of the policies considered here, a combination of permanent reductions in personal income taxes, minimal growth in Federal government outlays, and easier money would provide the greatest stimulus to capital formation. This "tight fiscal-easy money" approach, in the sense of keeping a tight rein on growth in government spending, would have little cost in terms of additional inflation, even with monetary growth between 8 and 9% per annum in 1977 to 1979;

³Brimmer and Sinai (2) studied the effects of several business tax incentives on capital formation and found significant, but only small impacts. The real case for changes in business taxation rests on grounds other than capital formation; it is to reduce the impact of higher prices on corporate taxes. Inflation reduces the real purchasing power of corporations much as in the case of households. Profits are overstated depending on the method of inventory accounting and historical cost depreciation does not keep pace with replacement costs. Thus, periodic reductions in business taxation may be necessary to prevent an "inflation drag" on corporate spending. This might take the form of indexing depreciation expenses to capital goods prices, a policy suggested by Brimmer and Sinai, or even as reductions in corporate income taxes. Integration of the corporate and personal income tax is also desirable, but on grounds of allocative efficiency. See Fellner-Clarkson-Moore (8) for a good discussion of tax indexation issues; also Tideman and Tucker (20).

- as the economy nears full employment, monetary and fiscal policies must become less stimulative so that growth in aggregate demand slows to balance that of potential supply. Business tax incentives would then provide a more appropriate means for increasing productive capacity further, since improvements in the financial position of business would accompany the additional capital spending. Also, the tax incentives would shift the mix of spending toward business fixed investment and away from other sectors. The share of total GNP in business fixed investment, vis-a-vis other sectors, is really an issue only at full employment;
- the capacity added through aggressive policies to stimulate capital formation can only bring small reductions in the inflation of wages and prices, given the relatively small impact of physical capital formation on potential output. The best insurance against a resurgence of inflation is a gradual approach to full employment with real GNP rising by 5 to 6% for the next few years, rather than any massive program of stimulus designed to increase capital formation.

The paper is organized as follows. The next section reviews the importance of capital formation and presents a simple framework for analyzing the effects of measures to enhance the formation of capital. The analytical model presented helps explain how different policies affect capital outlays, with resulting increases of business, housing, and labor capital. Subsequently, the outlook for capital formation to 1985 is briefly presented, using recent DRI forecasts of the U.S.

economy as a basis. The following section provides the results of computer simulations with the DRI model which show the effects of various policies that could stimulate capital formation. The policies considered are 1) sustained reductions in personal income taxes during 1977, 1978, and 1979; 2) these personal income tax reductions accompanied by accommodative monetary policy; 3) easier money in terms of accelerated M1 growth; 4) personal tax reductions and easier money; 5) personal tax reductions, slowed growth in Federal government spending, and easier money; 6) selective business tax incentives such as the investment tax credit or reductions in corporate profits taxes. The policy sets selected for study, while certainly not exhaustive, are those most likely to benefit capital formation. The variables studied include real GNP; inflation; the unemployment rate; interest rates; real business fixed investment; the tangible physical assets of households including housing, autos, and durables; the tangible physical assets of nonfinancial corporations including plant, equipment, and inventories; the employed labor stock and labor force; capacity utilization, productivity; and potential output. The final section then offers some concluding observations on the relation between capital formation, productive capacity, and inflation.

The Importance of Capital Formation

The recent concern with the pace of capital formation has primarily been focused on the business sector.⁴ One line of reasoning has the capital needs of the U.S. economy so great that adequate financing

⁴See (2), (7), (9), (10), (11), (14), (21), (23) and (25).

will not be forthcoming in the next decade. As a corollary, business fixed investment would be insufficient to create the necessary productive capacity for preventing a recurrence of the shortages that characterized the economy in 1973 and 1974.⁵ Labor productivity and growth in potential output also would be limited. Another serious round of accelerating inflation would result, then a deep recession as policymakers once again applied restrictive measures in order to contain the inflation.

Indeed, as Table 1 and Charts 1 to 4 show, the rate of business capital formation has been quite weak since the recession trough in March 1975. The ratio of business fixed investment to GNP was 9.3% in 1975 and only 9.0% last year.⁶ These figures compare with averages of 9.4% during 1955 to 1964 and 10.1% in 1965 to 1974. The only other years when the proportion of business fixed investment to GNP has been as low or lower were 1930 to 46, 1952 to 54, and 1958 to 64. Furthermore, the upswing in real business fixed investment since the trough of the recession in 1975:1 is the weakest in the postwar period. Real residential construction, on the other hand, has been near average in its expansion.

⁵Vaccara (23) presents the most extreme view. On the basis of a BEA study, she argues that fixed investment must average at least 12% of GNP in the next four years "to assure a 1980 capital stock sufficient to provide for increasing productivity, full employment levels of output, pollution abatement and decreasing dependence on foreign sources of petroleum". Most studies project a necessary ratio of 11.5% for fixed investment to GNP for 1977 to 1980. Sinai and Brinner (19, p. 44) are an exception, finding that ratios within historical ranges can be consistent with a full employment economy by 1981.

⁶These ratios are net of spending for pollution abatement equipment, estimated at 0.4% of nominal GNP in 1975 and 1976.

TABLE 1. Gross Private Domestic Investment:
Historical Profile and DRI Projections*

	(GPDI-PABE)/GNP	GPDI72/GNP72	IFIXNR/GNP	(IFIXNR-PABE)/GNP	IFIXNR72/GNP72	ICR/GNP	ICR72/GNP72	INVCH/GNP	INV72CH/GNP72	PABE/GNP
1953	14.5	13.7	9.4	9.4	9.0	5.0	4.4	0.1	0.2	0.3
1954	14.3	13.5	9.3	9.3	9.0	5.4	4.9	-0.4	-0.4	0.0
1955	17.0	15.0	9.6	9.6	9.4	5.9	5.3	1.5	1.2	0.0
1956	16.8	15.3	10.4	10.4	9.8	5.3	4.7	1.1	0.9	0.3
1957	15.5	14.2	10.5	10.5	9.7	4.7	4.3	0.3	0.2	0.0
1958	13.7	12.8	9.3	9.3	8.7	4.8	4.4	-0.4	-0.3	0.0
1959	15.8	14.2	9.3	9.3	8.7	5.4	5.2	1.1	0.9	0.3
1960	15.0	14.2	9.4	9.4	9.0	4.8	4.7	0.7	0.6	0.3
1961	14.1	13.6	9.0	9.0	8.7	4.7	4.6	0.4	0.4	0.3
1962	15.0	14.6	9.1	9.1	8.9	4.8	4.7	1.1	1.0	0.3
1963	15.1	14.9	9.0	9.0	8.9	5.0	5.1	1.0	0.9	0.0
1964	15.1	15.0	9.4	9.4	9.3	4.8	4.9	0.9	0.8	0.3
1965	16.2	16.1	10.4	10.4	10.3	4.4	4.6	1.4	1.2	0.0
1966	16.4	16.4	10.8	10.8	10.8	3.7	3.8	1.9	1.7	0.0
1967	15.0	15.1	10.3	10.2	10.3	3.5	3.6	1.3	1.2	0.1
1968	14.9	15.1	10.3	10.2	10.3	3.9	4.0	0.9	0.8	0.1
1969	15.4	15.5	10.6	10.4	10.6	4.0	3.9	1.0	1.0	0.2
1970	14.0	14.3	10.2	10.0	10.2	3.6	3.7	0.4	0.4	0.2
1971	14.8	15.0	9.8	9.5	9.7	4.6	4.6	0.6	0.6	0.3
1972	15.6	15.6	10.0	9.6	10.0	5.2	5.2	0.8	0.8	0.3
1973	16.4	16.7	10.4	10.0	10.6	5.0	4.7	1.4	1.3	0.4
1974	14.7	14.9	10.6	10.2	10.6	3.8	3.6	0.8	0.7	0.4
1975	11.6	11.5	9.7	9.3	9.3	3.3	3.1	-1.0	-1.0	0.4
1976	13.6	13.4	9.5	9.0	9.2	3.9	3.6	0.7	0.6	0.4
1977	14.9	13.8	9.5	9.1	9.2	4.3	4.0	0.6	0.5	0.4
1978	14.6	14.3	9.7	9.3	9.4	4.4	4.0	0.9	0.9	0.5
1979	15.0	14.5	10.1	9.6	9.6	4.4	4.0	1.0	0.9	0.5
1980	15.7	15.0	10.5	10.0	9.9	4.6	4.1	1.1	1.0	0.5
1981	15.9	15.2	10.6	10.2	10.1	4.7	4.1	1.0	1.0	0.5
1982	16.5	15.3	10.9	10.4	10.3	4.8	4.2	1.1	1.0	0.4
1983	16.7	15.8	11.1	10.7	10.6	4.8	4.2	1.1	1.1	0.4
1984	16.6	15.8	11.2	10.8	10.7	4.7	4.1	1.0	1.0	0.4
1985	16.3	15.6	11.2	10.8	10.7	4.6	3.9	0.9	0.9	0.4

GNP = Gross National Product
 GNP72 = Gross National Product in Constant Dollars
 ICR = Residential Construction
 ICR72 = Residential Construction in Constant Dollars
 IFIXNR = Fixed Private Nonresidential Investment
 IFIXNR72 = Fixed Private Nonresidential Investment in Constant Dollars
 INV = Change in Business Inventories
 INV72 = Change in Business Inventories in Constant Dollars
 PABE = Pollution Abatement Expenditures by U.S. Business on Capital Account
 Sources: Department of Commerce, Bureau of Economic Analysis, Data Resources, Inc.

* 1977-80 forecasts from DRI Control 2/23/77; 1981-85 figures from long-run projections of March 1977.

CHART 1. Real Business Fixed Investment in Recovery

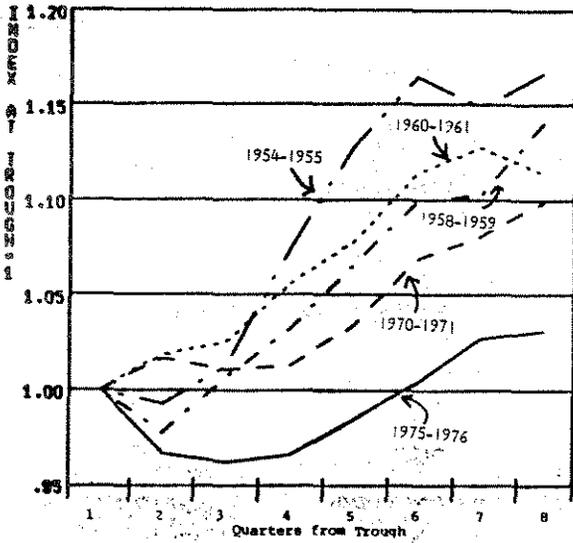


CHART 2. Real Producers' Durable Equipment in Recovery

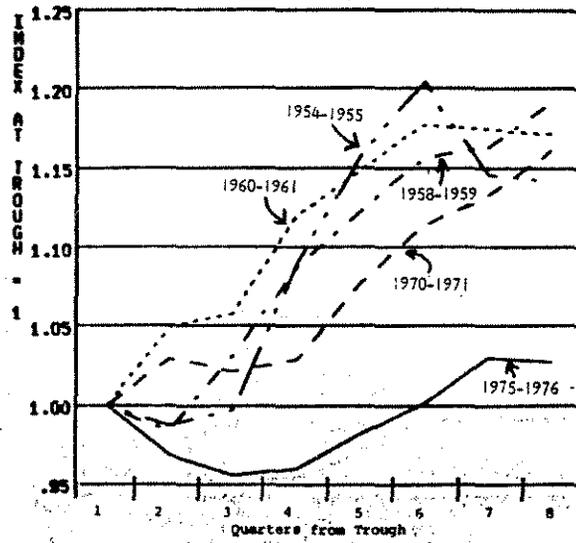


CHART 3. Real Plant Expenditures in Recovery

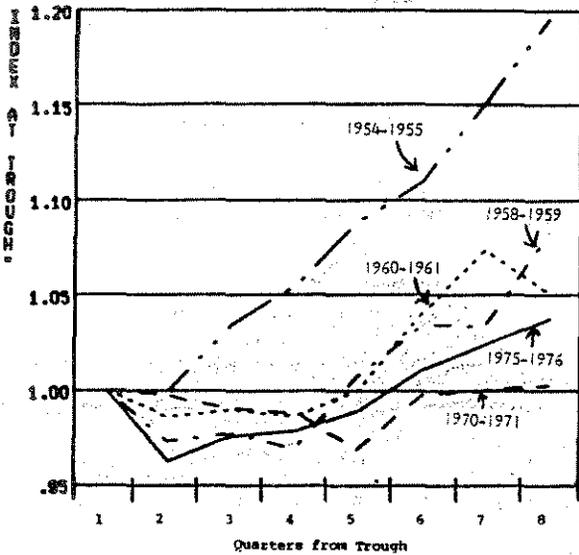
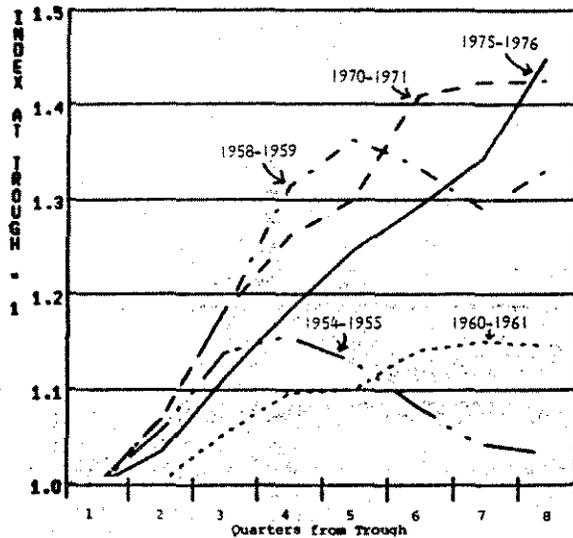


CHART 4. Real Residential Investment in Recovery



Several factors account for the recent poor record of capital formation by business. First, the 1973-75 recession was the most severe of the postwar period. Aggregate demand dropped sharply late in 1974, providing a sudden shock to business' sanguine expectations of future final sales. In addition, this episode, in contrast to others, was characterized by extraordinarily high interest rates, greatly diminished cash flow, and badly deteriorated balance sheets.⁷ Corporate leverage moved dangerously high, debt burdens became overwhelming, the average maturity of outstanding debt shortened considerably, and the ratio of financial assets to short-term liabilities reached a record low. Serious threats of bankruptcy and default arose for many corporations. Debt or equity finance became near impossible to obtain at any cost. Under these conditions, business spending had to be severely cut back.

Second, the expansion has been extremely weak since the 9.2% rise of real GNP in 1976:1. There is considerable slack in the labor market and capacity utilization rates have only slowly recovered, so that much excess capacity remains to be eliminated in relation to the same stage in other expansions. Without the pressure of increased final sales relative to utilization, probably the most important determinant of capital spending, business has had little incentive to invest. Furthermore, fears of continued instability in the economy, similar

⁷For a discussion, see (2), (11), (19), (25). Brimmer and Sinai (2, pp. 288-94) describe how deteriorated financial positions affect business fixed investment in the DRI model of the U.S. economy. A similar view appears in Minsky (13, ch's. 4 to 7).

to the ups and downs of 1965 to 1975, have kept businessmen cautious about commitments to heavy doses of capital outlays.

Finally, an unprecedented restructuring of balance sheets and strengthening of liquidity has prevented business capital outlays from sharply rebounding.⁸ With a resurgence of cash flow relative to capital outlays, business has increased financial assets relative to liabilities, retired a record amount of short-term debt, restructured debt maturities to a longer term, sharply reduced the burden of debt service, and lowered debt-equity ratios for the first time in many years. Much lower inflation and relatively easy monetary policy has helped by reducing interest rates and easing the external risk to balance sheets. The return to this process of corporate "reliquification" in terms of reduced risk, higher credit ratings, reduction of prior claims on income, returns on financial assets, and accumulation of the liquidity to finance future outlays, has far exceeded the expected rate of return on the acquisition of physical assets.

The current weakness in business fixed investment is not without precedent. As noted, similar patterns appeared during the 1930's, early 50's, and in 1958 to 1964. In particular, the 1958 to 1964 experience was characterized by an approach to full employment without any decided rise in the ratio of business fixed investment to GNP. Thus, full employment has not necessarily been precluded in the past because of weakness in business plant and equipment spending. In each case, however,

⁸See Sinai (17).

the process of getting to full employment took many years, and in this sense it can be argued that capital formation was inadequate.

Despite the focus of most researchers on capital formation by business, the problem is not limited to that sector. Tangible capital also is found in the household, financial, and government sectors.⁹ The stocks of housing, autos, and durables provide direct utility to households and make household production easier. Even household inventories probably matter for social welfare, if not for the productivity of labor. The equipment and buildings of financial institutions certainly provide an input to the production process. Social overhead capital or infrastructure such as railroads, urban mass transit, and highways is important to maximize economic productivity in the private and public sectors. And lately, the capital necessary for clean air and water, energy independence, and urban repair has attracted attention. Human capital, too, is now generally considered a part of the total capital stock, with spending for maintenance and improvement of labor perhaps as important for productivity as increases of physical capital. But the growth in these forms of capital also has slowed in recent years.

The preoccupation with business capital formation is understandable, since measurement has been concentrated on this category and traditional production theory includes only business capital. But it should be clear that the physical assets of households, labor capital, and social overhead capital are also critical to society's welfare and the productivity of labor. Accordingly, in this paper, concern with capital formation is not limited to the business sector, but includes the stocks of

⁹See Kendrick (12) who presents an exhaustive set of estimates for different types of capital in the U.S. economy.

housing, automobiles, and other durables in the household sector. The induced changes in the labor force and employed stock of labor also are considered. The resulting coverage of capital formation is still limited from a conceptual point of view, but this is only because of the scope of the DRI model.

The case for capital formation can be illustrated with a simplified analytical framework of the U.S. economy. Consider a model of a closed economy that focuses upon the short-run dynamic behavior of households, firms, bank and nonbank financial institutions, the monetary authority, and government. Uses and sources of funds behavior of the various sectors are explicitly recognized.¹⁰ Markets for output; money; non-monetary financial assets; the earning assets of banks; household, business, and government debt; and labor are included. Price inflation depends on wage costs, external elements such as OPEC oil price increases, and demand-pull pressures. Wage inflation depends on inflation expectations, the unemployment rate, and the existing framework of institutions. Employment depends on the demand for labor and real wages. Disequilibrium

¹⁰Funds can be used for acquisitions of physical or financial assets. For example, households purchase houses, autos, and consumer durable goods; but also increase holdings of money, deposits, bonds, or equity. Firms may accumulate inventories, plant, equipment, or labor; but also place funds in various financial assets. Debt repayment and retirements are a use of funds. Financial institutions use funds to acquire loans and investments. The government sector purchases considerable capital and labor. Sources of funds are current new money flows, borrowing, or the sale of assets (a negative use); where new money flows refer to current exogenous sources of funds such as disposable income (households); cash flow (corporations); deposit inflows, adjusted for reserve requirements, and loan repayments (financial institutions); contributions to retirement programs (pension funds); and tax receipts (Federal, state and local governments). Viewing the activity of the various sectors in a uses and sources of funds framework generalizes the more standard macroeconomic analysis that is based on physical asset purchases and current income flow financing. For some discussion of these notions, see Sinai (16) and (18).

is the usual state, with interrelated adjustments of spending and financial behavior as the various sectors move from existing to desired positions in assets and liabilities. Expectations are critical because certainty and perfect foresight are not assumed. Also, the risks of default and bankruptcy are recognized for households, business, and government. Taxes, too, are permitted. A large number of financial markets are assumed to exist for both short- and long-term securities. The demand and supplies of financial assets and liabilities interact to determine the structure of interest rates.

The equations describing this system can be summarized as (underlined variables are exogenous):¹¹

Real Sector

1. $c_t = f_1 [y_t^e; r_s^e; r_l^e; r_e^e; hfa_{t-1}^e; (cl/yd)_{t-1}; (ds/yd)^e; \underline{cs}_t; kc_{t-1}]$
2. $ifixed_t = f_2 [(py/r)^e; (db/cf)^e; \underline{u}^e k_{t-1}; k_{t-1}]$
3. $ires_t = f_3 [r_{mort_t}^e; \Delta mort_{t-1}; \underline{vac}_t^e; \underline{pop}_t; kres_{t-1}]$
4. $inv_t = f_4 [y^e; \underline{delay}^e; \underline{\Delta u}^e; (db/cf)^e; kinv_{t-1}]$
5. $i_t \equiv ifixed_t + ires_t + inv_t$
6. $t_t = f_6(y_t)$

¹¹These equations reflect the structure of the DRI model of the U.S. economy, although not exactly the model generating the simulations presented below. The conceptual framework that determines national income is represented, but some detail is omitted. For example, not all of the variables appear in the equations as specified and many of the exogenous variables are actually endogenous in the DRI model. See Data Resources, Inc. (5) and Eckstein-Green-Sinai (6) for a more complete discussion.

$$7. yd_t \equiv y_t - t_t$$

$$8. g = \underline{g}$$

$$8a) \text{def}_t \equiv \underline{g} - t_t$$

$$8b) \Delta gdebt_t = f_8(\text{def}_t; gdebt_{t-1})$$

$$9. y_t = c_t + i_t + g_t$$

Capital Stock Identities

$$10. kc_t \equiv c_t + \delta_1 kc_{t-1}$$

$$11. k_t \equiv ifixed_t + \delta_2 k_{t-1}$$

$$12. kres_t \equiv ires_t + \delta_3 kres_{t-1}$$

$$13. kinv_t \equiv inv_t + kinv_{t-1}$$

Financial Sector

$$14. md_t = f_{14} [y_t; rs_t^e; rd_t^e; re_t^e; rl_t^e; \Delta gdebt_t; td_{t-1}; usbonds_{t-1}; md_{t-1}]$$

$$15. ms_t = f_{15} (\underline{mb}; rsff_t^e; rloans_t^e; \underline{resreq}; \underline{curratio})$$

$$16. ms_t = md_t = m_t$$

Potential Output

$$17. y^p = f_{17} (nf_t; k_t; T)$$

Employment, Prices and Wages

$$18. n_t^d = f_{18} [y_t^e; k_{t-1}; (w/p)_t^e; (r/p)_t^e; (db/cf)_t^e]$$

$$19. n_t^s = f_{19} [\underline{lf}_t; \underline{pop}_t; \underline{lfpr}; (w/p)_t^e]$$

$$20. \quad n_t^d = n_t^s = n_t$$

$$21. \quad \dot{p}_t = f_{21}[(y_t - y^p); \dot{p}_{\text{struc.}}; \dot{w}_t] \quad \text{if } y_t - y^p > 0, \text{ then } \dot{p}_t > \dot{p}_{\text{struc.}}$$

$$\text{if } y_t - y^p < 0, \text{ then } \dot{p}_t < \dot{p}_{\text{struc.}}$$

$$22. \quad p_t \equiv \dot{p}_t + p_{t-1}$$

$$23. \quad \dot{w}_t = f_{23}[(1/ru)_t; \dot{p}_t^e; w_{t-1}]$$

$$24. \quad w_t \equiv \dot{w}_t + w_{t-1}$$

$$25. \quad ru_t \equiv f_{25} \left[\sum_{i=0}^{-3} (y^p/y)_{t-i} \right]$$

Definitions (superscript e refers to expectations or expected value):

c	=	real consumer expenditures
yd	=	real disposable income
rs	=	short-term interest rate
rl	=	long-term corporate bond rate
re	=	return on corporate stock
hfa	=	real household financial assets
cl	=	consumer installment credit liquidations
ds	=	debt service, defined as a weighted average of outstanding mortgages and consumer credit. The weights are arithmetic averages of the current and past interest rates for each debt instrument
<u>cs</u>	=	consumer sentiment
kc	=	stock of consumer goods
ifixed	=	real business expenditures on plant and equipment
p	=	price level of physical output
y	=	physical output of goods and services
r	=	rental price of capital
db	=	debt burden, defined as a weighted average of outstanding bank loans, commercial paper, and corporate bonds. The

weights are arithmetic averages of the current and past interest rates for each debt instrument.

cf	=	cash flow, after inventory valuation adjustment
<u>u</u>	=	capacity utilization rate
k	=	stock of plant and equipment
ires	=	real residential construction
r_{mort}	=	mortgage rate
mort	=	outstanding mortgages
<u>vac</u>	=	vacancy rate
<u>pop</u>	=	population
kres	=	stock of housing
inv	=	real inventory investment
<u>delay</u>	=	delivery delay, percent of companies reporting slower deliveries
kinv	=	stock of inventories
i	=	real gross private domestic investment
t	=	tax receipts
<u>g</u>	=	real government spending
def	=	Federal budget deficit (NIA basis)
gdebt	=	outstanding issues of Treasury debt
md	=	demand for money
rd	=	effective yield on passbook deposits
td	=	time deposits
usbonds	=	holdings of U.S. Treasury securities by households, firms, and state and local governments
ms	=	supply of money
<u>mb</u>	=	monetary base
rsff	=	Federal funds rate
rloans	=	prime rate on bank loans
<u>resreq</u>	=	reserve requirements on deposits
<u>crratio</u>	=	currency ratio
m	=	MI, narrowly defined stock of money
y^p	=	potential real output
nf	=	full employment
T	=	technology

n^d	=	demand for labor
n^s	=	supply of labor
lf	=	labor force
pop	=	population
$lfpr$	=	labor force participation rate
w	=	level of wages
\dot{p}	=	rate of price inflation
\dot{p}_{struc}	=	structural inflation
\dot{w}	=	rate of wage inflation
ru	=	unemployment rate.

The unexplained endogenous variables in equations (1) to (25) fall into three categories: interest rates (r_s ; r_l ; r_e ; r_{mort} ; r_d ; r_{sff} ; r_{loans}), the rental price of capital r , uses and sources of funds (hfa ; Δ_{mort} ; td ; $usbonds$), and balance sheet indicators of financial instability (cl/yd ; ds/yd ; db/cf). In the DRI model, the interest rates are determined in a segmented market framework where the demands and supplies for a particular instrument, across sectors, interact in stochastic equations. Full explanations of sectoral flows-of-funds, the holdings of financial assets, physical assets and liabilities for households, nonfinancial corporations, commercial banks, savings and loan associations, mutual savings banks, and life insurance companies are provided. This includes hfa , Δ_{mort} , td , $usbonds$, cl/yd , and db/cf . A total of 103 behavioral equations and 99 identities describe the financial system.¹²

¹²There is no need to present such detail here. See (5) for a full description.

The above system generalizes standard macroeconomic analysis to a more realistic framework in several ways. First, the model is dynamic. There are own stock adjustment processes in each of the major expenditure equations; but also interrelated dynamic adjustments in the other assets and liabilities of each sector.¹³

Second, there is considerable disaggregation. The DRI model has 718 equations; 379 behavioral and 339 identities. Some 170 exogenous variables also are included. The breakdown is final GNP demands (176); incomes (31); financial (202); supply, capacity, and operating rates (10); employment, unemployment, and the labor force (10); prices, wages and productivity (81); industry production, investment, capital stock, and employment (208).

Third, expectations play a major role in the economic behavior as modeled. In a world of uncertainty, almost all the right-hand side variables in the equations should be expected values. This is especially true for prices and other signal mechanisms. The formation of expectations is generally adaptive or extrapolative, and current period actual values are eschewed.¹⁴ Explicit survey measures of sentiment (cs) and delivery delays (delay) are used. Thus, distributed lag specifications are pervasive.

¹³See (2) for an example.

¹⁴There have been no attempts yet to incorporate rational expectations into the structure of large-scale econometric models. While the inadequacies of extrapolative methods for projecting expectations are well-known, it is not clear at this time whether implementation of rational expectations, even if possible, will improve upon the current formulations.

Fourth, disequilibrium is the normal state with equilibrium of the system a special case that is never attained. The flows of spending and financial activity describe quarterly behavior, a period that is too short for full equilibrium to be reached. The interrelated adjustments of real and financial activity within each sector, as actual states approach those desired, make disequilibrium dynamics the focus of the analysis. Steady state growth dynamics do not appear until many periods after a shock, but then show numerous familiar characteristics.

Fifth, there are many nonlinearities in the system. These range from ratio variables on the right-hand side of an equation to nonlinear specifications for the effects of capacity utilization, delivery delays, and financial constraints. Numerous on-and-off mechanisms exist and ceilings on variables such as interest rates are specified.

Sixth, there is a very detailed financial system, with explicit modeling of the balance sheets for households, firms, and financial institutions. Government financing is an endogenous result of spending and tax receipts, with effects on interest rates for municipal and U.S. Treasury securities. Interrelations between the spending and financial activities of each sector generate the balance sheet items and measures of bankruptcy or default risk that appear in the main spending equations. Financial markets are imperfect and almost all of the instruments in the portfolios of the various sectors are included in the analysis. Traditional interest rate linkages from finance to real final demands appear, but in addition, there are variables that reflect the supply of funds for markets in disequilibrium (mortgages and housing); recognize the interrelated adjustments of financial assets,

physical assets, and financial liabilities (consumption, investment); and capture the inhibiting costs of balance sheet instability, potential bankruptcy, or debt default on real final demands (consumption, investment and state and local government spending).

Seventh, potential output is endogenous, with changing stocks of labor and capital the major inputs. Given utilization rates and the state of technology, potential output affects the unemployment rate (equation 25); wages through the unemployment rate (equation 23); and price inflation directly via the relation between aggregate demand and supply (equation 21). Thus, business capital formation tends to ease inflation by increasing the capital input to production.

Finally, wage-price interactions heavily reflect inflation expectations. Inflation itself arises from external sources such as OPEC pricing policy, the existing institutional framework, the price setting practices of business, and commodity shortages. Thus, a base rate of inflation, $\dot{p}_{\text{struc.}}$ is assumed to exist at full employment, with deviations about $\dot{p}_{\text{struc.}}$ due to changes in unit labor costs and the relation of aggregate demand to potential output. Capital formation affects inflation to the extent productive capacity is increased.

Equations (1) to (25) can be collapsed to an IS-LM model by removing the dynamic elements; assuming certainty in order to eliminate expectations; treating the financial markets as perfect so there is only a single rate of interest; and eliminating the sectoral portfolio approach to finance. Thus, in a sense the macroeconomic model utilized here is an extension of IS-LM analysis, but its necessary realism makes difficult so simple a categorization.

By tracing through the effects of autonomous shocks to the macroeconomic system that is depicted, the case for capital formation can easily be seen. Consider an autonomous increase of business fixed investment, perhaps because of improved confidence in the stability of policies to emanate from the Administration. Aggregate demand rises, but so does potential output as business capital is formed (equations 11 and 17). Any resulting rise of inflation depends on the relation between actual and potential output (equation 21), and is less than if the rise in aggregate demand were due to another source. With no change in the monetary base, interest rates rise to provide a negative feedback effect on both consumption and investment.¹⁵ The constraining impact of the rates operates directly on consumption, raises the rental price of capital, and increases the debt service charges of households and firms. Higher interest rates also cause a decline in stock prices, a reduction in the market value of household financial assets, and reduced consumption. The higher rental price of capital and debt service burden facing corporations keep business fixed investment lower than under a regime of constant interest rates. Deposit flows to banks and nonbank financial intermediaries diminish with the increase of interest rates, reducing the supply of mortgage money and constraining residential construction. However, the net effect is still higher output; greater rates of investment and consumption; more employment; upward pressures on prices and wages; and increased stocks of consumer durable goods, business capital, and housing. Whether the housing

¹⁵Also state and local government spending.

stock rises or falls depends on the relation between the increased demand for housing and previously existing stock, as manifested in a measure of vacancies.¹⁶ A lower vacancy rate stimulates housing starts, as evidence that the backlog of housing demand is rising. But diminished funds flows lessen the availability of mortgage money as an offset. The increased capital stock of business raises the productivity of labor (equation 18), so there is a rise in the demand for labor.

Thus, the case for capital formation includes 1) increased productive capacity for the economy; 2) an easing of the inflationary pressures from aggregate demand against potential supply; 3) greater productivity of labor and increased employment; 4) and the enlarged purchasing power that goes with slower increases of prices.

Now, by equation (2), business capital formation will occur regardless of the cause of increased output. Thus, any measures to stimulate the economy would promote this type of capital formation. So would changes in tax incentives that affect r , the rental price.¹⁷ However, the relative size of the effects from different policies is uncertain. And, the tangible physical assets of households as well as labor capital also would be affected, but not always in the same direction.

Consider further the effects of several policies on capital formation -- a sustained reduction in personal income taxes; increased

¹⁶See Eckstein, Green, and Sinai (6, pp. 598-602).

¹⁷See Brimmer and Sinai (2).

government spending; easier monetary policy; changes in tax incentives; and a mix of restrained government spending and easier monetary policy. In assessing the effects of these policies, impacts on business, human and housing capital will be examined.

Reductions in personal income taxes raise expected disposable income (yd_t^e) and increase consumption. At the same time the tax reduction increases the deficit (def_t) and Treasury issues of debt ($\Delta gdebt$). The increased issues result in a higher demand for money (equation 14) and, in the absence of accommodating monetary policy, raise interest rates, especially short-term.¹⁸ The resulting rise in national income also increases the demand for money, hence interest rates.

The higher output and higher prices as demand closes on potential output cause an increase of business fixed investment. This enhances capital formation by business, raises capacity, increases productivity, and exerts downward pressure on prices. But the increases in debt service for households and firms as interest rates rise, a higher rental price, and the possible negative feedback effects on the market value of financial assets because of falling stock prices, all act as restraints on the increased spending. In particular, higher money market rates of interest draw funds out of financial institutions, lower the supply of mortgages, and cause a cutback in residential construction. Thus, housing capital would grow more slowly, or even drop, relative to business capital formation. Of course, an accommodating monetary policy could

¹⁸Accommodating monetary policy is defined as maintaining constant nominal interest rates in the face of a change in fiscal policy.

alleviate this problem. The only question is how severe the inflation reaction from an extra monetary stimulus. This is primarily an empirical question, depending on dp/dt when $\dot{y} - \dot{y}^p \neq 0$.¹⁹

In summary, sustained reductions in personal income tax rates increase real output, raise inflation, lower the unemployment rate, and cause a rise of interest rates. Consumption is higher, business fixed investment rises in response to the greater real output, and the rate of capacity utilization moves up. The tangible physical assets of households, including autos and durables, rise from the higher consumer spending. Business capital stock rises higher, too, though not so strongly as in a case where monetary policy is accommodating. The outcome for housing capital is less clear, however, with the positive effects on housing of demand-induced declines in the vacancy rate perhaps more than offsetting a reduced supply of mortgages. Finally, employment is increased because of a rising demand for labor.

A second policy for stimulating capital formation is increased Federal government spending. A higher rate of government expenditures directly affects output, employment, and income. An increase of disposable income stimulates spending on autos, other consumer durables and housing. Business fixed investment and inventory spending rise in response to the stronger utilization of existing capacity causing a rise in replacement spending for plant and equipment (equation 2). Thus, the capital formation of households and business is enhanced.

¹⁹No link of \dot{m} and \dot{p} through expectations is assumed.

However, the benefits of increased government spending are accompanied by some negative feedback effects. Most important are more rapid inflation and higher interest rates. The extent to which prices rise depends on the position of the economy relative to full employment output. The increased inflation restrains spending by reducing purchasing power. The rise in interest rates stems from the financing of a greater Federal government budget deficit and the effects of a worsened inflation. Higher interest rates directly restrain consumption and investment (equations 1 - 4) but also do so indirectly through a worsening of the debt burdens of households and business (equations 1 - 2). Further, higher interest rates tend to reduce stock prices and diminish the real value of household financial assets. Consumer spending is then weaker (equation 1). A higher financial cost of capital also causes a reduction in fixed investment through the rental price of capital goods (equation 2). Finally, higher market rates of interest draw funds out of financial institutions and reduce the supply of mortgages. The mortgage rate rises and a lack of funds causes housing outlays to weaken (equation 3).

The net impact effect from all of these factors, however, would be increased GNP, a higher rate of investment, lower unemployment, and greater capital formation throughout the economy. But the negative feedback effects restrain the beneficial impact of the government sector's expenditures, especially in housing. The closer to full employment of labor and physical capacity, the more substantial the negative impact of rising interest rates and accelerated inflation. In an extreme

situation, the increased expenditures by the government can totally "crowd-out" the gains to the private sector, with no real benefits for overall capital formation. Thus, there is a self-defeating element in using Federal government spending to enhance the capital formation of the private sector.

A third policy to increase capital formation is easier money. An increase in nonborrowed reserves raises the monetary base and the supply of money. The federal funds rate declines and other short-term rates follow a similar pattern, caused by commercial bank arbitrage of assets and nondeposit liabilities to minimize the costs of funding loans. The lower interest rates stimulate consumption and investment. Further, given a slow response of deposit rates at bank and nonbank financial institutions to the easier monetary policy, the returns on these deposits become relatively more attractive to households and businesses than the yields on money market instruments. Funds flow into financial institutions, substantially increasing the supply of mortgage money and raising expenditures on housing. Another effect is a reduction of debt burdens for households and business because of the lower interest rates, higher disposable income, and greater cash flows. The reductions of interest rates are initially associated with higher stock prices and an increased market value of household financial assets. In turn, consumer spending rises even further.

The easier monetary policy will have the net effect of increasing capital formation throughout the economy, in contrast to the policies of reducing personal income taxes or increasing government spending.

The housing stock, stocks of durable consumer goods and cars, and business plant and equipment all rise under the easier monetary policy. So does the employment of labor. The increased capital formation in the business sector leads to a higher potential output. There is an easing of pressure on prices from the increased supply, although to some extent offset by a lower unemployment rate, increased wage inflation, and subsequent cost-push effects.

There are several negative feedback effects associated with the stimulative monetary policy, however. The growing economy will raise inflation as actual output moves closer to potential. This greater inflation will tend to push interest rates higher and also reduce the purchasing power of households and business. The borrowing that is associated with the increased expenditures raises outstanding debt, hence the debt burdens of the various sectors. Of course, these negative feedback effects take time to develop, so that the economy could benefit considerably from the easier monetary policy for a number of quarters.

The main danger of the easier monetary policy approach is the possible resurgence of inflation and high interest rates if economic growth accelerates too rapidly. Another potential problem has to do with the formation of inflation expectations in response to the easier monetary policy, and whether in fact, a temporary speedup in monetary growth will cause a sharp enough rise in inflation expectations to defeat the thrust of the policy. These issues, like many others, are empirical. The results of the policy simulations in the section entitled "Simulation Results" give some quantitative responses.

A fourth policy to stimulate capital formation is through reductions of business taxes. Corporate profits taxes could be reduced, depreciation allowances increased, or the investment tax credit raised. These policies have been analyzed in Brimmer and Sinai (2). Only small impacts on business capital formation were found for these tax incentives unless monetary policy was accommodating. Modest increases in potential output and productivity occurred, but there was no real improvement in inflation. The tax incentives primarily shifted capital formation into the business sector from housing and improved the financial position of business. Thus, it is not clear that business tax incentives would be beneficial overall.

A final possibility is a "tight fiscal-easy money" approach. By tight fiscal policy is not meant decreased expenditures by the Federal government. More realistically, it refers to slower growth in Federal government spending than has been the case in previous years. The "easy money" component of the tight fiscal-easy money policy also does not refer to a radically extreme measure. By easy money is meant a Federal Reserve policy that permits money growth between 8 and 9% per annum, in recognition of the difficulty of reducing the core 5 to 6% inflation in the U.S. economy.²⁰

²⁰The Federal Reserve's long-run targets for monetary growth reflect a set of goals, explicit or implicit, for real economic growth, inflation, and unemployment. However, a target of 5-1/2% growth in M1 (the midpoint of the current long-run target range of the Federal Reserve) implies an inflation rate goal that is unrealistic, given the basic structural inflation that exists in the U.S. economy. This price inflation results from an institutionally determined wage inflation; (Continued...)

In order to highlight the effects of a "tight fiscal-easy money" policy on capital formation, consider an extreme case of reductions in Federal spending and a simultaneous easing of monetary policy. The decline of government expenditures will cause a drop in real output and employment. Consumption, investment, and inventory accumulation would decline via multiplier effects. Potential output would drop but there would be less inflationary pressure with the larger declines in spending relative to supply. The remaining effects would be the opposite of those described for the case of increased government expenditures.

Along with the reduction in Federal government spending would come a smaller budget deficit. The flow of new Treasury issues to the financial markets would drop, with a resulting easing of pressure on short-term interest rates. The lower output and easing of inflationary pressure reduce transactions demands for money, further lowering interest rates. In response, flows-of-funds to financial institutions would rise, mitigating the negative effects on residential construction from the weaker economy by increasing the availability of mortgage money.

20 (Continued) imported inflation, e.g., from OPEC; and the price-setting practices of business, which include rapid markups over short-run rises in costs. The DRI model suggests this "core" rate of inflation to be near 5 or 6%, with no perceptible near-term response to cyclical demand forces. Thus, current monetary growth targets can only result in a weakness of real output and high unemployment rather than sharp reductions in prices. On the other hand, too rapid monetary growth of 10% or more is potentially destabilizing, resembling the Federal Reserve's "stop-go" approach of previous years. Thus, the "easy money" of the "tight fiscal-easy money" policy combination will be taken to mean M1 growth of 8 or 9% per annum.

Most importantly, however, restraint on fiscal policy would enable the Federal Reserve to ease monetary policy. Sustained periods of heavy deficit spending by the Federal Government eventually constrain the monetary policy posture of the Federal Reserve by stimulating the economy too strongly. As a result, monetary policy is often tightened when fiscal policy is stimulative. A stimulative fiscal policy increases pressure on the financial markets directly, but also because of an induced expansion in the private sector. At the same time, a tighter monetary policy intensifies the rise in interest rates. The result has almost always been a credit crunch and recession because of the powerful effects of money and finance on the economy. A "tight fiscal-easy money" approach could lead to an opposite situation.

In the face of restrained growth in Federal Government spending, an easier monetary policy, defined in terms of higher targeted money growth rates, would lower interest rates, reduce debt burden impacts, increase flow-of-funds in markets where rationing occurs, improve the stock market and stimulate housing, consumption, and fixed investment. If sustained, a greater rate of capital formation would occur than under any other policy. Further, with a lower rate of growth in Federal Government spending, Treasury debt issues would comprise a smaller proportion of the total financing in the economy, lessening the chances of "crowding out".

Prospects for Capital Formation

Tables 2 and 3 provide the profile of the current outlook for capital formation over the next decade.²¹ The economy shows steady growth through 1980, the result of a moderately paced but well balanced expansion of real final demands. Real GNP grows at rates above the economy's

TABLE 2. Profile of the Economy to 1985*

	History			Forecast					
	1955-65	1966-75	1976	1977	1978	1979	1980	1976-80	1976-85
Rates of Change (%)									
GNP - Current Dollars	5.9	8.2	11.6	10.9	11.3	10.3	10.4	10.9	9.7
- Constant Dollars	3.8	2.6	6.1	4.8	5.2	4.4	4.5	5.0	4.2
Potential GNP	3.8	3.9	3.4	3.3	3.4	3.3	3.4	3.4	3.2
GNP Deflator	2.0	5.5	5.1	5.8	5.9	5.7	5.7	5.6	5.2
Wholesale Price Index	0.9	6.2	4.6	6.3	6.3	6.3	6.4	6.0	5.2
Average Hourly Earnings	3.6	6.5	7.2	7.1	7.1	7.0	7.2	7.1	7.0
Personal Savings	7.5	12.3	-8.9	11.4	3.9	9.9	12.6	5.8	6.5
Business Savings	5.7	8.8	16.6	11.8	13.0	11.6	11.4	12.9	10.3
Shares of Real Demand (%)									
Consumption/GNP	63.5	62.4	63.8	64.0	63.4	63.1	62.5	63.4	62.4
Business Fixed Investment/GNP	9.6	10.3	9.5	9.5	9.7	10.1	10.5	9.8	10.4
(Excl. Pollution Control Expenditures)	9.6	10.0	9.0	9.1	9.3	9.6	10.0	9.4	10.0
Pollution Control Expenditures/GNP	0.0	0.2	0.4	0.4	0.5	0.5	0.5	0.5	0.4
Residential Construction/GNP	5.0	4.1	3.9	4.3	4.4	4.4	4.6	4.4	4.5
Inventories/GNP	0.8	0.8	0.7	0.6	0.9	1.0	1.1	0.8	0.9
Government Purchases/GNP	20.1	21.9	21.6	21.3	21.1	21.0	20.9	21.2	21.2
Key Indicators of Activity (%)									
Unemployment Rate	5.3	5.0	7.7	7.4	6.4	6.0	5.6	6.6	5.9
Personal Savings Rate	5.8	7.0	6.5	6.5	6.1	6.1	6.3	6.3	6.3
Federal Government Deficit/GNP	-0.1	-1.2	-3.5	-4.0	-2.6	-1.7	-0.8	-2.5	-1.4
State & Local Government Deficit/GNP	-0.1	0.4	0.8	1.3	1.1	0.9	0.5	0.9	0.7
Prime Rate	4.25	7.10	6.84	6.56	7.01	6.55	6.90	6.77	6.55
New High-Grade Corp. Bond Rate	4.24	7.40	8.33	8.25	8.27	7.95	8.36	8.23	8.25

*Based on DRI Control of February 1977 and March 1977 long-run projections.

²¹Projections prior to 1980 are based on DRI analyses of short-run business conditions. The assigned probability to this baseline forecast is 60%. Beyond 1980, the forecasts are based on a balanced, near full employment path for the economy. Such a projection is primarily designed for planning exercises that require stable economic growth as an input, rather than as a "forecast" of expected actual conditions.

potential, although slowing somewhat in 1979-80. Relatively stable fiscal and monetary policies, the absence of any destabilizing external shocks, cautious spending attitudes in the private sector, and constant, although high, inflation rates are the principal determinants of the economy's performance. The greater than average inflation during the period restrains purchasing power, limiting economic growth and reductions in the unemployment rate. In 1980, the various price indices are still rising near 5-1/2 or 6% and the unemployment rate averages 5.6%.

Private sector savings flows are ample to finance the moderate pace of economic activity, especially in the business sector. The share of GNP going to business rises later in the decade, primarily

TABLE 3. Capital and Productivity Items

	Average Percent Changes			
	History			Forecast*
	57-66	67-76	57-76	77-85
Labor Force (Mils. of Persons)	1.3	2.3	1.8	1.6
Labor Force Calculated at Full Employment (Mils. of Persons)	1.4	2.3	1.9	1.6
Real Full Employment Level of GNP (Bils. of 1972 \$'s)	3.6	3.9	3.7	3.2
Gross Capital Stocks (Bils. of 1972 \$'s)				
Nonres. Producers Durable Equipment	4.1	4.9	4.5	4.7
Nonresidential Structures	2.6	2.7	2.7	2.2
Effective Capital Stocks (Bils. of 1972 \$'s)				
Nonres. Producers Durable Equipment	4.1	4.7	4.4	4.6
Nonresidential Structures	2.6	2.6	2.6	2.1
Net Capital Stocks (Bils. of 1972 \$'s)				
Nonres. Producers Durable Equipment	3.8	4.9	4.3	4.9
Nonresidential Structures	3.7	3.1	3.4	2.2
Capital Stock of Housing (Mils. of Units)	NA	1.6	NA	1.8
Capital Stock of Households (Bils. of \$'s)	NA	7.9	NA	8.9
Labor Productivity	3.3	1.8	2.6	2.9

*1977 to 1980 from DRI Control Forecast of February 1977; 1981 to 1985 figures from March 1977 Long Term Trend Forecast.

at the expense of government. Both the ratios of government purchases to GNP and the Federal budget deficit to GNP decline steadily over the next four years as the Carter administration seeks to balance the budget by 1981. The proportion of residential construction to GNP increases as interest rates do not rise enough to cause the severe disintermediation of deposit inflows to financial institutions that could disrupt housing.

Capital formation is not sufficient to achieve full employment of labor by 1980. The gross effective capital stock of producers' durable equipment (excluding the stock of pollution control equipment) shows a 3.9% average rate of growth to 1980, significantly below the high performance 4.7% rate of 1967 to 1976. The stock of plant grows even more slowly, at 1.8% per annum. This compares with a 2.6% average rate of increase from 1967 to 1976. The moderate growth in aggregate demand, slowly rising rates of capacity utilization, a high rental price of capital, and near 6% inflation prevent the kind of investment boom that has typified most business expansions since World War II. A further deterrent is a still high debt service burden as 1980 is approached. Diminished cash flow from eased profits growth, 8 to 9% long-term bond yields, and a rising volume of outstanding debt are responsible. The net capital stocks of plant and equipment behave similarly to the gross concepts, although the high business fixed investment to GNP ratio between 1981 and 1985 raises the average rate of increase to 4.9% for 1977-85, the same as in 1967-76.

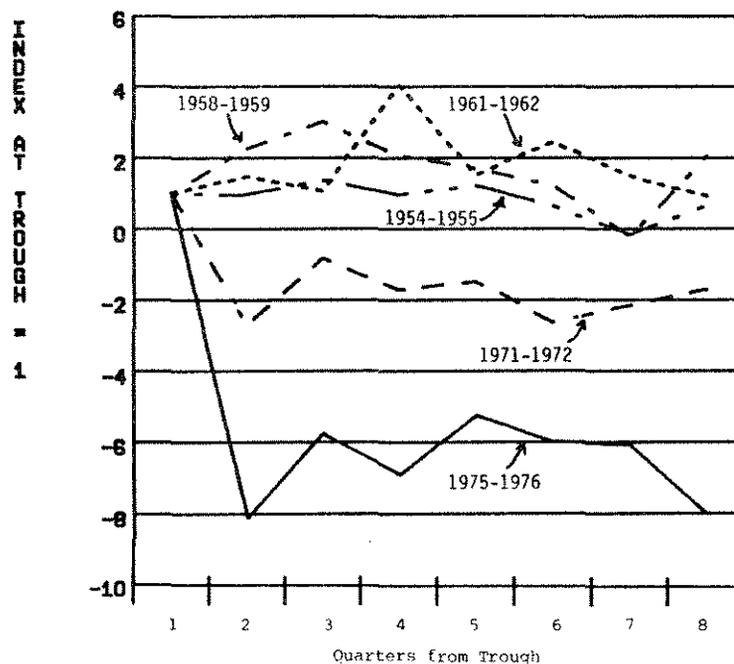
The effects of the slow growth in business capital formation to 1980 are threefold. First, potential output grows slowly, at 3.4%

per annum for the next few years rather than the earlier 3.7%, adding to the pressures for more inflation. Greater inflation lessens real purchasing power, aggregate demand, and hinders the reduction of unemployment. Table 2 shows that the GNP price deflator rises 5.6% per annum from 1976 to 1980. Second, the demand for labor increases less rapidly with a more slowly growing capital stock, so that slack in labor markets remains for a longer period of time. Finally, labor productivity rises less, causing higher unit labor costs and more inflation. All of these effects slow the economy's progress toward full employment.

The rate of capital formation by households is above the average of 1967 to 1976, given steady rises in durable consumer spending and housing. From 1977 to 1980, household physical assets rise by 9.5% a year with concentration in autos and houses. The corresponding figure was 7.5% for 1967 to 1976. Thus, the projections indicate the only real shortfall of capital, at least by historical standards, to be in the business sector. Nevertheless, there exists some more rapid growth rate for the capital stock of households that would cause full employment to be achieved.

What accounts for the insufficient capital formation, especially in the business sector? First, the recession of 1973-75 shook businessmen's expectations of future sales as real GNP dropped more sharply than in any other slowdown since World War II. Further, growth in real final sales since the March 1975 recession trough has been quite moderate relative to similar stages of previous expansions. Chart 5 shows that the rebound in real final sales during the recent expansion has been the weakest of the postwar period. Without the strong "accelerator"

CHART 5. Final Sales Growth (1972 \$'s)
During Postwar Recoveries



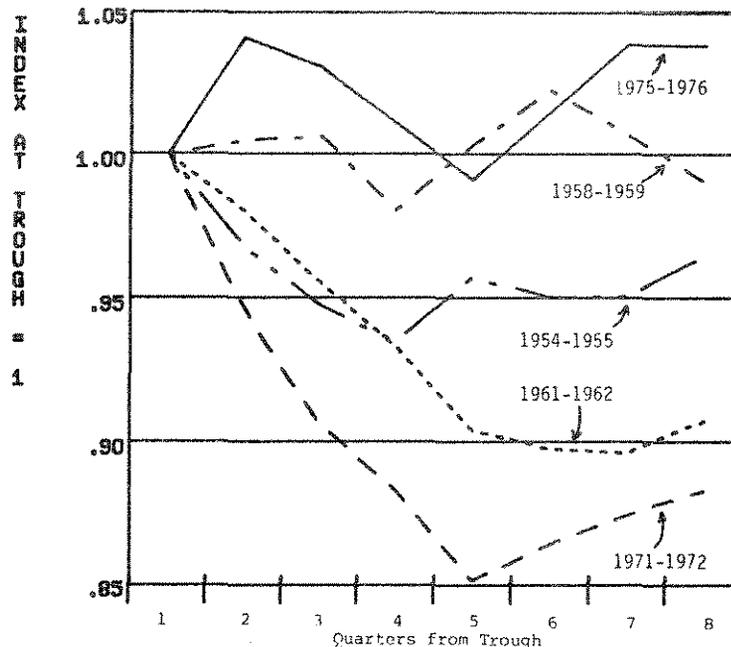
effect from permanent large increases of demand for firms' products, business spending on capital goods has been minimal.

Second, the deep recession left the economy with a considerable degree of underutilized physical capacity. At the trough of the recession in March 1975, the capacity utilization rate for All Manufacturing was 69.6%. The peak of 88%, reached in July 1973, was associated with severe bottlenecks in production. The moderate expansion since 1975 has produced a current rate for All Manufacturing of 80.7%, indicating the existence of considerable slack. Thus, replacement investment, which normally constitutes a large proportion of all new plant and equipment spending, has remained quite low (equation 2).

Third, the rental price of capital, especially for equipment, has remained quite high throughout the current expansion. Chart 6

shows that rises in rental price during similar stages of previous expansions have been smaller than in this episode. The principle reasons

CHART 6. Rental Price of Producers' Durable Equipment During Postwar Recoveries



for this high rental price are 1) increases in the supply price of capital goods that have ranged between 3 and 25.9%; 2) a high average cost of financial capital due to 8 and 9% nominal long-term bond yields and a relatively weak stock market; and 3) the failure to implement major new tax incentives for business.²² Changes in business taxation, including higher tax allowable depreciation rates, shorter lifetimes for capital goods, the investment tax credit, and a lower corporate profits tax rate can have a major effect on rental price. But the only measure

²²Significant business tax legislation was enacted in 1954, 1962, 1965, and 1971.

enacted so far in this episode has been an increase of the investment tax credit to 10% during 1975.

Finally, there has been an unprecedented restructuring of corporate balance sheets since mid-1974, the aftermath of the deteriorated financial position of business that had evolved.²³ Given the huge financial risk generated by balance sheets with top-heavy short-term debt relative to long-term debt, high leverage, a dearth of financial assets relative to short-term liabilities and exceptionally large debt repayment burdens to cash flow, the threat of default and bankruptcy within the business sector has been great. The potential variability in expected earnings created by this situation has proved unacceptable to business, causing increased demands for financial assets, reductions in the desired acquisitions of physical assets, and a decreased rate of debt accumulation. This process, known as reliquification, has proceeded for a much longer period and in a more intensified manner than during any previous postwar expansion. In essence, the returns to business from restructuring balance sheets have exceeded the expected returns from physical asset acquisitions as reduction of financial risk through reliquification have reduced the potential variability of future earnings. As of 1976:4, the process was still occurring, despite the fact that its duration had been twice as long as the typical experience. This desire by business to use funds for purposes other than fixed investment has been a key distinguishing factor of this expansion compared with other postwar business recoveries.

²³See Sinai (17).

Another factor affecting business capital formation has been the laws, regulations, and incentives for dealing with pollution control and new, less energy intensive production techniques. While no research yet has been able to clearly identify how much business capital formation is being affected, to some extent productive capacity is being hampered by the substitution of this "non-productive" investment for capacity creating capital spending. So far, however, the proportion of real business fixed investment devoted to pollution abatement equipment has only been near 5%, too small a figure to bear a major responsibility for the overall weakness in capital spending. Potential new programs for energy independence may increase spending for less energy intensive capital goods rather than for new capacity, thus hampering the rate of productive capital formation.

Simulation Results

This section examines the effects on capital formation and U.S. economic performance of several policies that could be used to accelerate the rate of capital formation. The simulations were performed with the Data Resources model of the U.S. economy, beginning in the first quarter of 1977 and ending in the fourth quarter of 1980. The baseline forecast described in Tables 2 and 3 was subjected to various policy shocks, with subsequent solutions of the model producing new time series for the major variables of interest. The amounts of stimulus for the policies were chosen to permit illustration of the effects, rather than as a matter of realism. Comparisons between the alternative policy and baseline solutions provide the differences from which can be determined

the policy impacts. Appendix Tables 8 to 14 contain the details of these simulations.

In what follows, the simulations are described, some of the more interesting results are presented, and supporting evidence for some conclusions about the policies most appropriate for stimulating capital formation are presented.

The policy simulations included:

1. Personal Tax Reductions

A permanent \$5 billion reduction in personal income taxes was assumed for 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. In effect, this simulation assumed that permanent tax reductions are legislated each year to eliminate an "inflation drag" on consumers' purchasing power because of the "bracket" effect on taxes from higher inflation. M1 growth was 7.2% in 1977, 8.2% in 1978, 8% in 1979, and 6.7% in 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

2. Personal Tax Reductions and Accommodating Money

A permanent \$5 billion reduction in personal income taxes was assumed for 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. The distinguishing feature of this simulation from the previous one was the accommodating money. Short-term interest rates were kept constant through the provision of sufficient bank reserves by the central bank. M1 growth was 7.3% in 1977, 8.5% in 1978, 8.8% in 1979, and 7.4% in 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

3. Easier Money

A 1% higher growth in M1 during 1977 and 1978 than in the baseline was assumed. The increased growth was achieved through central bank provision of nonborrowed reserves until the economy's performance generated the desired money growth. The result was M1 growth of 8% in 1977, 8% in 1978, and 7% in both 1979 and 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%. Although this simulation is entitled easier money, the higher monetary growth rates were not so great as to destabilize the economy.

4. Personal Tax Reductions and Easier Money

A permanent \$5 billion in personal income taxes was assumed for 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. M1 growth was permitted to rise 1% above the monetary growth in the "Personal Tax Reductions" simulation during 1977 and 1978, 0.7% higher in 1979, and remained the same in 1980. The M1 growth rates were 8.2%, 9.2%, 8.8%, and 6.7% from 1977 to 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

5. Tight Fiscal and Easier Money

A \$5 billion reduction in military spending was assumed for 1977, then a sustained decrease of \$10 billion from 1978 to 1980. A permanent \$5 billion reduction of personal income taxes occurred in 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. M1 growth was permitted to be 1% above the monetary growth in "Personal Tax Reductions" during 1977 and 1978, 0.7% higher in 1979, but remained the same in 1980. The resulting M1 growth rates were 8.2%,

9.2%, 8.8%, and 6.7% from 1977 to 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

6. Investment Tax Credit

A permanent increase of 2%, from 10 to 12%, in the tax credit for producers' durable equipment, was assumed to begin in 1977:1. Monetary policy was not accommodating; other tax and spending parameters remained the same as in the baseline.

7. Corporate Profits Tax Reductions

A two-stage reduction in the statutory tax rate on corporate profits was assumed. The rate was lowered from 48 to 45% in 1977 and then to 42% in 1978-80. Monetary policy was not accommodating; other tax and spending parameters remained the same as in the baseline.

Table 4 summarizes the effects of the various policies on real GNP, inflation, and the unemployment rate.²⁴ All changes are expressed relative to the baseline solution. The policies that most stimulated the economy involved either more rapid money growth or accommodative monetary policy.

TABLE 4. Policies to Stimulate Capital Formation: Effects on Real GNP, Inflation, and Unemployment*

Simulation No.	Real GNP (% chg.)				Inflation (% chg.)				Unemployment Rate (%)			
	77	78	79	80	77	78	79	80	77	78	79	80
1	0.2	1.2	1.0	-0.6	-	0.1	0.3	0.5	-	-0.3	-0.7	-0.6
2	0.2	1.3	1.5	-0.3	-	0.1	0.4	0.7	-	-0.4	-0.8	-0.9
3	0.5	0.9	0.5	0.1	0.1	0.2	0.3	0.2	-0.1	-0.4	-0.3	-0.3
4	0.7	2.1	0.9	-0.7	0.1	0.3	0.6	0.8	-0.1	-0.7	-1.0	-1.0
5	0.4	1.9	1.1	-0.5	0.1	0.2	0.5	0.7	-	-0.6	-0.9	-0.9
6	0.1	0.1	-	-0.1	-	-	-	-	-	-0.1	-0.1	-
7	-	0.1	-	-0.1	-	-	-	-	-	-	-	-

*Differences Relative to Baseline

²⁴The rate of inflation is for the Implicit GNP Deflator.

The "Personal Tax Reductions and Accommodating Money" simulation (2) was characterized by a sharp rise in real economic growth and sizeable declines in the unemployment rate. However, the inflation rate was accelerated, especially later, reaching a 1:1.3 tradeoff with the unemployment rate by 1980. The higher inflation, its derivative effects on purchasing power and interest rates, and the normal stock adjustment processes of the economy caused real GNP to drop below the baseline by 1980. The "Personal Tax Reductions and Easier Money" scenario (4) had a powerful stimulative impact on economic growth, but also was associated with a large rise of the inflation rate. The effect of the 1 to 2% additions in monetary growth relative to simulation (2) was a much greater early impact on real economic growth and unemployment, with little extra inflation cost (0.1%) by 1980. The "Easier Money" scenario (3) produced steady rises in real economic growth to 1980, with more improvement in unemployment than a worsening of inflation. Maintaining the permanent tax cuts and the same monetary growth as in "Personal Tax Reductions and Easier Money," but restricting government spending (the "Tight Fiscal and Easier Money" solution 4) only reduced real growth slightly (from the 2.1% increase of 1978 to 1.9%). The gain was a more stretched out stimulation of the economy, lasting well into 1980. This occurred because the tighter fiscal policy permitted the central bank to provide more reserves to maintain a given rate of monetary growth.

The simulations highlight the important effects of monetary policy on economic performance. The provision of bank reserves lowers interest rates; raises the flows-of-funds to housing markets; increases

stock prices and the real value of household financial assets to stimulate consumption; reduces the rental price of plant and equipment to stimulate business fixed investment; lowers the debt burdens of households, business, and state and local government to stimulate sectoral spending; and reduces the financial risk of greater expenditures.

The resulting spending increases are not accompanied by much additional borrowing by the private sector until some quarters later, when inflation and sustained expansion cause a deterioration of the internal financial position of households and firms. The "Easier Money" simulation demonstrates that the extra inflation from a moderate relaxation of Fed policy is not great. The greatest acceleration in prices occurs when tax reduction is combined with greater monetary growth than is necessary only for accommodation.

Table 5 summarizes the effects of the seven policy simulations

TABLE 5. Policies to Stimulate Capital Formation: Effects on Capacity Utilization, Federal Budget Deficit, Monetary Growth, and Interest Rates*

Simulation No.	Capac. Util. (%, Mftg.)				Federal Deficit, NIA (\$ Bils.)				M1 Growth (%)			
	77	78	79	80	77	78	79	80	77	78	79	80
1	0.1	1.2	2.1	1.5	-2.5	-15.3	-30.5	-30.5	0.2	1.2	1.1	-0.1
2	0.1	1.3	2.8	2.6	-2.4	-14.1	-24.1	-18.8	0.2	1.4	1.9	0.6
3	0.3	1.9	0.7	1.1	4.2	11.8	9.9	12.9	1.0	1.0	0.2	0.2
4	0.5	3.0	3.2	2.8	1.5	-3.3	-16.1	-14.1	1.2	2.2	2.0	-0.1
5	0.1	2.3	2.8	2.7	4.4	1.9	-10.6	-8.2	1.2	2.2	2.0	-
6	0.1	0.3	0.3	0.1	-1.9	-1.3	-1.3	-2.1	0.1	0.1	-	-
7	-	0.2	0.2	-	-4.8	-10.1	-11.0	-12.5	-	0.1	-	-
		Federal Funds Rate (%)				AAA-Corporate Bonds (%)						
		77	78	79	80	77	78	79	80			
1		.04	.52	1.13	1.22	-.01	.01	.15	.37			
2		-	.01	-.01	.01	-.01	-.03	.09	.39			
3		-1.94	-.24	-2.10	-.63	-.17	.12	-	.15			
4		-1.80	.14	-1.93	.76	-.17	.09	.10	.63			
5		-2.23	-.57	-2.22	-.05	-.24	-.07	-.05	.40			
6		.02	.15	.29	.26	.01	.01	.03	.04			
7		-.01	.06	.23	.30	.01	-.01	-.03	-.03			

*Differences Relative to Baseline

on capacity utilization (All Manufacturing), the Federal budget deficit, monetary growth, the Federal funds rate, and a AAA-equivalent long-term corporate bond yield. The "Personal Tax Reductions and Easier Money" and "Tight Fiscal-Easier Money" solutions speed the economy most rapidly toward full capacity, with increases of the utilization rate for All Manufacturing ranging between 2.3 and 3.2% from 1978 to 1980. The cost to the Federal Government in lost tax revenues is less in the "Tight Fiscal-Easier Money" simulation, with actual declines of the deficit in 1977 and 1978. Only the "Easier Money" solution is associated with continuous reductions in the deficit, as the strong economy and sharply rising inflation increase tax receipts. The extra M1 growth relative to the baseline is the same in both the simulations (4) and (5).

Interest rates are lower in each of the simulations where easier monetary policy is implemented. Rates rise in the solutions where a fiscal stimulus is applied without offsetting monetary policy. Both the short- and long-term rates are lowest in the "Tight Fiscal-Easier Money" solution, as Treasury financing is reduced at the same time the central bank is providing more bank reserves. The Federal funds rate is down anywhere from 5 to 225 basis points as a result of the money growth targets selected in this simulation. The low interest rates have much to do with the strength of the real economy since the effects of monetary policy on expenditures are so wide ranging. The Federal funds rate is particularly volatile as the central bank maneuvers to keep money growth constant at a higher rate.

Table 6 shows the effects of the various policies on capital formation; in particular, business fixed investment, the gross plant and equipment of the business sector, household physical assets, and housing starts. Of the seven policy simulations, the "Tight Fiscal-

TABLE 6. Policies to Stimulate Capital Formation: Effects on Business Fixed Investment; Capital Stocks of Business and Households; Housing*

Simulation No.	Business Fixed Investment (72 \$'s; Bils.)				Gross Plant & Equipment (72 \$'s; Bils.)			
	77	78	79	80	77	78	79	80
1	0.1	0.8	1.7	0.9	-	0.6	2.1	3.3
2	0.1	1.0	2.8	3.1	-	0.7	2.9	6.1
3	0.6	2.6	2.4	2.7	0.3	2.4	4.7	7.0
4	0.6	3.4	4.6	4.4	0.3	2.8	7.0	11.4
5	0.6	3.5	5.3	6.0	0.3	2.9	7.6	13.4
6	0.6	1.9	3.0	3.1	0.3	1.9	4.5	7.3
7	0.7	2.1	2.8	2.7	0.4	2.1	4.7	7.2
	Household Physical Assets (\$ Bils.)				Housing Starts (Mils. of Units)			
	77	78	79	80	77	78	79	80
1	-0.1	11.6	40.2	70.6	.007	.023	.004	-.034
2	-1.0	1.5	30.6	92.5	.010	.063	.133	.115
3	-34.6	43.2	21.0	74.6	.156	.151	.155	.049
4	-32.5	49.9	49.7	189.4	.153	.179	.251	.011
5	-39.9	37.3	48.6	171.6	.191	.240	.317	.058
6	0.3	3.6	6.1	3.9	-	-.008	-.027	-.028
7	-0.6	0.6	4.0	4.1	-.040	-.079	-.089	-.083

*Differences Relative to Baseline

Easier Money" policy has the biggest impact on the capital formation of business and the second greatest effect on household physical assets. The rise in housing starts relative to the baseline is far above the other simulations.

The reasons are straightforward. First, rapid real economic growth and sharp rises in capacity utilization have a major "accelerator" effect on business fixed investment. Plant and equipment spending

is \$5.3 and \$6 billion above the baseline for 1979 and 1980 in the "Tight Fiscal-Easier Money" solution. Second, the lower interest rates reduce debt service charges and the debt burden of corporations, reducing the financial risk that is associated with the acquisition of physical assets. Further, the rental price of capital is decreased because the cost of financial capital drops, favoring the substitution of capital for labor. Third, cash flow is greater with the higher profits of a stronger economy, making purchases of plant and equipment easier. The resulting increases of business fixed investment are translated into a greater stock of gross plant and equipment, so that by 1980 the "Tight Fiscal-Easier Money" simulation gives a cumulated \$24.2 billion rise in business capital formation. The next largest increase is \$21.5 billion under the "Personal Tax Reductions and Easier Money" scenario. Fourth, the low profile of short-term interest rates induces flows-of-funds from households to the major mortgage lenders, as deposits remain an attractive investment compared with other alternatives. The financial intermediaries quickly lend out these funds, given a wide spread between the returns on mortgages and other loans or investments. Housing starts in the "Tight Fiscal-Easier Money" simulation are 25 to 60% greater than in the baseline, far exceeding the differential impact arising from any of the other policies.

How costly is the capital formation under the "Tight Fiscal-Easier Money" policy? Table 4 shows that the extra inflation that is generated ranges between 0.1 and 0.7%, so that M1 growth of between 8 and 9% does not reignite a runaway inflation. The gains include a near 1% reduction of unemployment by 1980, in addition to the new

capital that is accumulated. An equivalent rise in national output that was not accompanied by as much capital formation would be more inflationary, e.g., simulation (4) - the "Personal Tax Reductions and Easier Money" policy.

Finally, Table 7 shows how the various policies affect productivity, the sectoral shares of GNP, and the capital-output ratio.

TABLE 7. Policies to Stimulate Capital Formation: Effects on Productivity, Sector Shares of GNP, and the Capital Output Ratio*

Simulation No.	Labor Productivity (% chg.)				Federal Gov. Share of GNP (%)			
	77	78	79	80	77	78	79	80
1	0.2	1.4	1.3	-0.7	-	-0.3	-0.6	-0.5
2	0.2	1.5	2.0	-0.1	-0.1	-0.4	-0.8	-0.8
3	0.5	2.0	1.3	0.5	-0.2	-0.4	-0.3	-0.4
4	0.6	3.3	0.5	-0.2	-0.2	-0.7	-1.0	-0.9
5	0.2	3.0	0.8	-	-0.4	-1.1	-1.3	-1.3
6	0.1	0.3	0.1	-0.1	-	-	-0.1	-
7	-	0.2	-	-0.2	-	-	-	-
	Real Business Fixed Investment to Real GNP (%)				Capital Output Ratio (1) (%)			
	77	78	79	80	77	78	79	80
1	-.01	-.07	-.10	-.12	-0.2	-1.0	-1.6	-1.1
2	-.01	-.07	-.09	-.07	-0.2	-1.1	-2.0	-1.7
3	-.01	.05	.08	.08	-0.4	-0.9	-0.4	-0.3
4	-.02	-.02	-.03	-	-0.5	-1.9	-2.2	-1.5
5	.01	.04	.06	.13	-0.3	-1.4	-1.9	-1.2
6	.04	.12	.19	.19	-	-	0.1	0.3
7	.05	.14	.19	.18	-	0.1	0.3	0.5

*Differences Relative to Baseline
(1) net capital stock as a proportion of real GNP

Again, the policies that involve accommodating or easier money contribute most to improvement in the variables of concern. Labor productivity is up sharply in the "Personal Tax Reductions and Easier Money" and "Tight Fiscal-Easier Money" solutions, although diminishing subsequent

to 1978. Steady increases appear in the "Easier Money" solution, the result of a sustained period of lower interest rates, higher capital formation, and increased output. The share of Federal government spending to GNP is lower in all the simulations, especially in the "Tight Fiscal-Easier Money" solutions. This declining share for the Federal government frees resources to the private sector, especially late in the decade. Also, Treasury financing is much less with the lower budget deficit. The result is significant increases in the ratio of business fixed investment to GNP. The greatest rises in this ratio occur in the business tax incentive solutions, however, induced by a shift in sectoral shares from housing to business capital formation.

Which policies are most effective in promoting business capital formation? The simulations clearly indicate the program of permanent reductions in personal income taxes, slower growth in Federal Government spending, and easier money in terms of higher targeted rates of growth of M1 has the greatest impact, at least cost, in terms of the economy's goals. Over the four years of the simulation, the gross plant and equipment of business rises by \$24.2 billion in the "Tight Fiscal-Easier Money" scenario. The next largest increase occurs in the "Personal Tax Reduction-Easier Money" solution. All of the other simulations show substantially lower rises in the capital stock of business. In addition, there is a strong rise of housing in the "Tight Fiscal-Easier Money" solution as well, with accumulated increases in housing starts for the four years at 806,000 units, compared with the next largest increase of 594,000 units in the "Personal Tax Reductions and Easier Money" scenario. Also household capital formation is much

larger than in all of the other scenarios. Thus, the "Tight Fiscal-Easier Money" policy has gains in all the forms of capital, with only a moderate rise of inflation as the major cost.

The reasons for the stronger capital formation under the "Tight Fiscal-Easier Money" policy include:

- 1) a sustained period of low interest rates which stimulates consumption, reduces the rental price of plant and equipment to stimulate business fixed investment, and reduces the costs of outstanding debt to minimize financial risk and encourage spending by all sectors;
- 2) increased flows of funds from the household sector to financial intermediaries, who, in turn, make mortgage money available to stimulate housing;
- 3) a reduced share of total economic activity for the Federal Government sector due to the slowed growth in Federal spending. Financial market pressure is eased due to the resulting drop in Treasury financing and a response by the Federal Reserve of more bank reserves.

The trading of an easier monetary policy for a tighter fiscal policy thus appears to offer the greatest potential benefits for capital formation in the U.S. economy.

The business tax incentives provide less aggregative stimulus, because of a much lower impact than accelerator and capacity utilization influences on fixed investment. The tax incentives directly induce some spending on plant and equipment and ease the financial position

of corporations. However, at the same time, the revenue loss to the Federal government is equivalent to an easier fiscal policy; raising pressure on the financial markets, causing increases of interest rates, diminishing the flows-of-funds into housing, and eventually, reducing housing starts.

These last results appear clearly in Tables 6 and 7, where the share of business fixed investment to real GNP rises the most in the tax incentive simulations, but housing starts decline. Thus, the business tax incentives would probably be more appropriate to apply as the economy approached close to full employment, shifting sectoral shares but not exerting much demand pull pressure on the economy. With the considerable slack in the economy that exists at the start of the simulations, the increased national output from the stimulative macro-oriented policies have a major impact on business fixed investment through accelerator effects. Later in the expansion, when there is much less slack, the increased output would be translated into inflation, diminishing the purchasing power and spending of the private sector. Hence, the appropriateness of the permanent tax reductions, easier money, and slowed Federal government spending is particular to the current stage of the business expansion, where there is considerable slack and a large "gap" to be eliminated before severe demand-side inflationary pressures are generated.

Capital Formation, Productive Capacity, and Prices

A major element in the case for capital formation is the potential beneficial effect on inflation of an increased capital stock. The

mechanism by which capital formation can affect inflation is twofold. First, the construction of badly needed capital would prevent bottlenecks from arising, as was the case in 1973-74. The bottlenecks and shortages in productive capacity for meeting demands was a prime cause of industrial inflation during that period. Second, increased capital formation raises the productivity of labor and increases the potential output of the U.S. economy. Through a reduction in unit labor costs and rise in potential real GNP, aggregate demand pressures on prices would be reduced.

Most of the policies considered for stimulating capital formation have both demand and supply effects with the problem one of creating a balance between demand and supply so that inflation does not rise too rapidly. The aggregative policies in simulations (1) (2) and (5) cause inflation to rise because of a more rapid increase in demand than in supply. But the increase in productive capacity that occurs does serve to mitigate the inflationary pressures created by the macro policies. The business tax incentives do not raise inflation by as much as the general macroeconomic policies. However, the disadvantage is that the overall economic stimulus from these policies is minimal. Thus, the appropriate mix of the two kinds of policies, general macroeconomic stimulus and business tax incentives, depends on the position of the economy relative to full employment. The farther from full employment is the economy the more appropriate would be the macroeconomic policies to stimulate capital formation. But when the economy reaches full employment, it would be more appropriate to rely heavily on the business tax incentives to minimize the inflationary impact of rises in demand.

In all cases, the impact on inflation from increased capital formation is not great because 1) the additional capital that is created is only a small portion of the existing capital stock, and 2) the impact on potential output from a greater rate of capital formation is relatively small. Most production function studies indicate that increases in the quantity and quality of labor have the biggest impact on potential output. The role of increases in the capital stock, although not insignificant, is much less. Therefore, the capacity added through aggressive policies to stimulate capital formation would only bring small reductions in the inflation of wages and prices.

To prevent a resurgence of inflation then, capital formation should not be the principal focus of policy. The best insurance against such a reacceleration would be a gradual approach to full employment, with real GNP rising steadily by 5 to 6% for the next few years. Indeed, growth in real output must slow in later years to insure a "soft landing" at full employment rather than a collision with the capacity ceiling of the economy. Major attempts to reduce inflation through the route of increased capital formation are doomed to failure, if only because the demand-side stimulus required for appreciable increases in capital formation would be too massive and the required size of business tax incentives too great to raise capital formation high enough for significant reductions in prices. Inflation must be attacked in another manner than through policies to raise capital formation. Increased capital formation can help fight inflation, at the margin, by raising productivity and potential output, but should not constitute the major bastion against the still high inflation that remains in the U.S. economy

Appendix: Simulation Results

Description of Simulations:

Personal Tax Reductions: A permanent \$5 billion reduction in personal income taxes was assumed for 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. In effect, this simulation assumed that permanent tax reductions are legislated each year to eliminate an "inflation drag" on consumers' purchasing power because of the "bracket" effect on taxes from higher inflation. M1 growth was 7.2% in 1977, 8.2% in 1978, 8% in 1979, and 6.7% in 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8% and 6.8%.

Personal Tax Reductions and Accommodating Money: A permanent \$5 billion reduction in personal income taxes was assumed for 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. The distinguishing feature of this simulation from the previous one was the accommodating money. Short-term interest rates were kept constant through the provision of sufficient bank reserves by the central bank. M1 growth was 7.3% in 1977, 8.5% in 1978, 8.8% in 1979, and 7.4% in 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

Easier Money: A 1% higher growth in M1 during 1977 and 1978 than in the baseline was assumed. The increased growth was achieved through central bank provision of nonborrowed reserves until the economy's performance generated the desired money growth. The result was M1 growth of 8% in 1977, 8% in 1978, and 7% in both 1979 and 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%. Although this simulation is entitled easier money, the higher monetary growth rates were not so great as to destabilize the economy.

Personal Tax Reductions and Easier Money: A permanent \$5 billion in personal income taxes was assumed for 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. M1 growth was permitted to rise 1% above the monetary growth in the "Personal Tax Reductions" simulation during 1977 and 1978, 0.7% higher in 1979, and remained the same in 1980. The M1 growth rates were 8.2%, 9.2%, 8.8%, and 6.7% from 1977 to 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

Tight Fiscal and Easier Money: A \$5 billion reduction in military spending was assumed for 1977, then a sustained decrease of \$10 billion from 1978 to 1980. A permanent \$5 billion reduction of personal income taxes occurred in 1977:2. There was \$20 billion of additional tax reductions in 1978 and \$25 billion in 1979. M1 growth was permitted to be 1% above the monetary growth in "Personal Tax Reductions" during 1977 and 1978, 0.7% higher in 1979, but remained the same in 1980. The resulting M1 growth rates were 8.2%, 9.2%, 8.8%, and 6.7% from

1977 to 1980. The baseline had corresponding growth rates of 7%, 7%, 6.8%, and 6.8%.

Investment Tax Credit: A permanent increase of 2%, from 10 to 12%, in the tax credit for producers' durable equipment, was assumed to begin in 1977:1. Monetary policy was not accommodating; other tax and spending parameters remained the same as in the baseline.

Corporate Profits Tax Reductions: A two-stage reduction in the statutory tax rate on corporate profits was assumed. The rate was lowered from 48 to 45% in 1977 and then to 42% in 1978-80. Monetary policy was not accommodating; other tax and spending parameters remained the same as in the baseline.

TABLE 8. Capital Formation and U.S. Economic Performance:
"Baseline" and "Personal Tax Reduction" Solutions

	75	76	77	78	79	80
ECONOMY						
FEDERAL GNP (% CHG.)						
BASELINE			4.8	4.7	4.0	4.4
LOWER PERS. TAXES (NON-ACCOM)	1.8	6.1	5.0	5.9	5.1	3.8
DIFF			0.2	1.2	1.0	-0.6
UNEMPLOYMENT RATE (%)						
BASELINE			7.3	6.4	6.1	5.5
LOWER PERS. TAXES (NON-ACCOM)	8.5	7.7	7.3	6.1	5.4	4.9
DIFF			-0.0	-0.3	-0.7	-0.6
INFLATION (% CHG.)						
GNP DEFLATOR						
BASELINE			5.2	5.3	5.1	4.8
LOWER PERS. TAXES (NON-ACCOM)	9.2	5.1	5.2	5.3	5.3	5.3
DIFF			0.0	0.1	0.3	0.5
WPI						
BASELINE			5.0	5.3	5.1	4.9
LOWER PERS. TAXES (NON-ACCOM)	9.3	4.3	5.1	5.6	5.8	5.6
DIFF			0.0	0.3	0.7	0.7
CPI						
BASELINE			5.0	5.2	4.8	4.9
LOWER PERS. TAXES (NON-ACCOM)	9.2	5.7	5.0	5.3	5.2	5.4
DIFF			0.0	0.1	0.3	0.5
AVG. HOURLY EARNINGS						
BASELINE			6.8	6.7	6.6	6.6
LOWER PERS. TAXES (NON-ACCOM)	8.9	7.2	6.8	6.8	6.9	7.2
DIFF			0.0	0.1	0.3	0.5
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASELINE			75.3	77.7	78.7	79.5
LOWER PERS. TAXES (NON-ACCOM)	68.7	72.9	75.4	78.8	80.8	81.0
DIFF			0.1	1.2	2.1	1.5
PRIMARY PROCESSING						
BASELINE			79.6	81.3	82.6	85.0
LOWER PERS. TAXES (NON-ACCOM)	70.2	76.8	79.7	82.7	84.9	86.7
DIFF			0.1	1.3	2.4	1.7
FEDERAL TAX RECEIPTS (\$ BIL.)						
BASELINE			361.0	408.4	455.7	512.2
LOWER PERS. TAXES (NON-ACCOM)	286.5	328.9	358.5	392.7	424.8	482.6
DIFF			-2.5	-15.7	-30.9	-29.6
% DIFF			-0.7	-3.8	-6.8	-5.8
FEDERAL BUDGET SURPLUS (MIA) (\$ BIL.)						
BASELINE			-64.2	-55.7	-45.1	-26.7
LOWER PERS. TAXES (NON-ACCOM)	-71.3	-58.4	-66.7	-71.1	-75.7	-57.1
DIFF			-2.5	-15.3	-30.5	-30.5
% DIFF			-3.9	-27.5	-67.7	-114.3
MONEY AND INTEREST RATES						
NARROW MONEY SUPPLY (M1) (% CHG.)						
BASELINE			7.0	7.0	6.8	6.8
LOWER PERS. TAXES (NON-ACCOM)	4.2	5.1	7.2	8.2	8.0	6.7
DIFF			0.2	1.2	1.1	-0.1
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASELINE			11.0	10.8	11.0	10.6
LOWER PERS. TAXES (NON-ACCOM)	7.7	9.7	11.2	11.3	11.3	10.3
DIFF			0.1	0.5	0.3	-0.3
FEDERAL FUNDS RATE (%)						
BASELINE			5.83	6.22	5.56	6.22
LOWER PERS. TAXES (NON-ACCOM)	5.82	5.05	5.87	6.73	6.69	7.45
DIFF			0.04	0.52	1.13	1.22
3-MONTH TREASURY BILLS (%)						
BASELINE			5.48	5.76	5.34	5.73
LOWER PERS. TAXES (NON-ACCOM)	5.78	5.01	5.52	6.18	6.20	6.62
DIFF			0.04	0.42	0.86	0.89
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASELINE			7.98	8.11	8.03	8.14
LOWER PERS. TAXES (NON-ACCOM)	9.01	8.34	7.97	8.12	8.17	8.51
DIFF			-0.01	0.01	0.15	0.37
VELOCITY (% CHG.)						
BASELINE			3.0	3.0	2.3	2.5
LOWER PERS. TAXES (NON-ACCOM)	2.9	6.2	3.0	3.1	2.5	2.5
DIFF			0.0	0.1	0.2	0.0

TABLE 8. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND POTENTIAL OUTPUT						
PLANT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE	36.7	38.1	40.2	41.8	43.6	46.2
LOWER PERS. TAXES (NON-ACCOM)			40.2	42.0	44.1	46.6
DIFF			0.0	0.2	0.5	0.4
% DIFF			0.1	0.6	1.2	0.9
EQUIPMENT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE	74.7	77.9	83.6	89.5	95.4	103.7
LOWER PERS. TAXES (NON-ACCOM)			83.6	90.1	96.6	104.1
DIFF			0.1	0.6	1.2	0.4
% DIFF			0.1	0.7	1.3	0.4
BUSINESS FIXED INVESTMENT (BILS. OF 1972 \$'S)						
BASELINE	111.4	116.0	123.8	131.3	139.1	149.9
LOWER PERS. TAXES (NON-ACCOM)			123.8	132.1	140.8	150.8
DIFF			0.1	0.8	1.7	0.9
% DIFF			0.1	0.6	1.2	0.6
GROSS PLANT (BILS. OF 1972 \$'S)						
BASELINE	903.7	918.7	935.4	951.5	972.7	993.9
LOWER PERS. TAXES (NON-ACCOM)			935.4	953.7	973.3	995.0
DIFF			0.0	0.2	0.6	1.1
% DIFF			0.0	0.0	0.1	0.1
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASELINE	812.3	839.1	869.8	904.8	943.0	986.7
LOWER PERS. TAXES (NON-ACCOM)			869.8	905.2	944.0	988.9
DIFF			0.0	0.4	1.5	2.2
% DIFF			0.0	0.0	0.2	0.2
HOUSING STARTS (MILLIONS OF UNITS)						
BASELINE	1.163	1.543	1.802	1.795	1.910	2.058
LOWER PERS. TAXES (NON-ACCOM)			1.810	1.818	1.914	2.020
DIFF			0.007	0.023	0.004	-0.034
% DIFF			0.0	1.3	0.2	-1.7
CAPITAL STOCK OF HOMES (MILLIONS OF UNITS)						
BASELINE	74.78	75.69	76.90	78.13	79.42	80.85
LOWER PERS. TAXES (NON-ACCOM)			76.91	78.15	79.45	80.86
DIFF			0.01	0.03	0.04	0.01
% DIFF			0.0	0.0	0.0	0.0
REGISTRATION OF CARS (MILLIONS OF UNITS)						
BASELINE	106.9	110.2	112.9	115.6	118.6	121.6
LOWER PERS. TAXES (NON-ACCOM)			112.9	115.9	119.3	122.6
DIFF			0.0	0.3	0.7	0.8
% DIFF			0.0	0.3	0.6	0.7
CAPITAL STOCK OF HOUSEHOLDS (BILS. OF \$'S)						
BASELINE	3534.6	3868.2	4240.8	4622.9	5009.7	5530.3
LOWER PERS. TAXES (NON-ACCOM)			4240.7	4634.5	5049.9	5600.9
DIFF			-0.1	11.6	40.2	70.6
% DIFF			-0.0	0.3	0.8	1.3
LABOR FORCE (MILLIONS OF PERSONS)						
BASELINE	92.7	94.8	97.1	98.8	100.6	102.3
LOWER PERS. TAXES (NON-ACCOM)			97.1	98.8	100.8	102.7
DIFF			0.0	0.0	0.2	0.4
% DIFF			0.0	0.0	0.2	0.4
AVERAGE PRODUCTIVITY (% CHG.)						
BASELINE	-8.7	8.3	5.7	6.0	4.5	5.8
LOWER PERS. TAXES (NON-ACCOM)			5.9	7.3	5.7	5.1
DIFF			0.2	1.4	1.3	-0.7
POTENTIAL OUTPUT (BILS. OF 1972 \$'S)						
BASELINE	1365.4	1405.9	1447.8	1491.3	1536.9	1584.2
LOWER PERS. TAXES (NON-ACCOM)			1447.8	1491.4	1537.4	1585.2
DIFF			0.0	0.1	0.5	1.0
% DIFF			0.0	0.0	0.0	0.1

TABLE 8. - Continued

	75	76	77	78	79	80
RATIOS						

FEDERAL GOVERNMENT EXPENDITURES						
TO NOMINAL GNP (%)						
BASELINE	23.6	22.9	22.8	22.6	22.3	21.9
LOWER PERS. TAXES (NON-ACCOM)			22.7	22.3	21.7	21.4
DIFF			-0.0	-0.3	-0.6	-0.5
GAP (POTENTIAL LESS ACTUAL GNP)						
(BIL. OF 1972 \$'S)						
BASELINE	173.8	141.0	122.1	103.7	93.3	76.6
LOWER PERS. TAXES (NON-ACCOM)			119.4	85.0	60.0	51.0
DIFF			-2.6	-18.7	-33.3	-25.6
% DIFF			-2.2	-18.1	-35.7	-33.4
GROSS EFFECTIVE CAPITAL						
STOCK TO REAL GNP (%)						
BASELINE	142.0	136.8	133.8	131.3	129.8	128.3
LOWER PERS. TAXES (NON-ACCOM)			133.5	129.6	127.0	126.3
DIFF			-0.3	-1.7	-2.8	-2.0
NET CAPITAL STOCK TO						
REAL GNP (%)						
BASELINE	84.8	81.3	79.3	77.7	76.9	76.2
LOWER PERS. TAXES (NON-ACCOM)			79.1	76.7	75.3	75.1
DIFF			-0.2	-1.0	-1.6	-1.1
GROSS CAPITAL STOCK OF						
POLLUTION ABATEMENT EXPEND.						
TO REAL GNP (%)						
BASELINE	2.3	2.6	2.8	3.1	3.4	3.6
LOWER PERS. TAXES (NON-ACCOM)			2.8	3.1	3.3	3.6
DIFF			-0.0	-0.0	-0.1	-0.1
REAL BUSINESS FIXED INVESTMENT						
TO REAL GNP (%)						
BASELINE	9.35	9.17	9.34	9.46	9.63	9.94
LOWER PERS. TAXES (NON-ACCOM)			9.32	9.39	9.53	9.83
DIFF			-0.01	-0.07	-0.10	-0.12
REAL BUSINESS FIXED INVESTMENT LESS						
POLLUTION ABATEMENT EXPENDS. TO						
REAL GNP (%)						
BASELINE	8.93	8.75	8.91	8.99	9.16	9.48
LOWER PERS. TAXES (NON-ACCOM)			8.90	8.93	9.07	9.37
DIFF			-0.01	-0.06	-0.10	-0.11

TABLE 9. Capital Formation and U.S. Economic Performance:
 "Baseline" and "Personal Tax Reduction with Accommodating Money" Solutions

	75	76	77	78	79	80
ECONOMY						
REAL GNP (% CHG.)						
BASELINE	-1.8	6.1	4.8	4.7	4.0	4.4
LOWER PERS. TAXES (ACCOM)			5.0	6.0	5.6	4.2
DIFF			0.2	1.3	1.5	-0.3
UNEMPLOYMENT RATE (%)						
BASELINE	8.5	7.7	7.3	6.4	6.1	5.5
LOWER PERS. TAXES (ACCOM)			7.3	6.1	5.2	4.6
DIFF			-0.0	-0.4	-0.8	-0.9
INFLATION (% CHG.)						
GNP DEFLATOR						
BASELINE	9.2	5.1	5.2	5.3	5.1	4.8
LOWER PERS. TAXES (ACCOM)			5.2	5.4	5.4	5.6
DIFF			0.0	0.1	0.4	0.7
WPI						
BASELINE	9.3	4.3	5.0	5.3	5.1	4.9
LOWER PERS. TAXES (ACCOM)			5.1	5.6	6.0	6.1
DIFF			0.0	0.4	0.9	1.3
CPI						
BASELINE	9.2	5.7	5.0	5.2	4.8	4.9
LOWER PERS. TAXES (ACCOM)			5.0	5.3	5.3	5.6
DIFF			0.0	0.1	0.4	0.7
AVG. HOURLY EARNINGS						
BASELINE	8.9	7.2	6.8	6.7	6.6	6.6
LOWER PERS. TAXES (ACCOM)			6.8	6.8	6.9	7.4
DIFF			0.0	0.1	0.4	0.7
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASELINE	68.7	72.9	75.3	77.7	78.7	79.5
LOWER PERS. TAXES (ACCOM)			75.4	78.9	81.5	82.2
DIFF			0.1	1.3	2.8	2.6
PRIMARY PROCESSING						
BASELINE	70.2	76.8	79.6	81.3	82.6	85.0
LOWER PERS. TAXES (ACCOM)			79.7	82.8	85.8	88.1
DIFF			0.1	1.5	3.3	3.2
FEDERAL TAX RECEIPTS (\$ BIL.)						
BASELINE	286.5	328.9	361.0	408.4	455.7	512.2
LOWER PERS. TAXES (ACCOM)			354.5	393.9	431.0	494.1
DIFF			-7.5	-14.5	-24.7	-18.1
% DIFF			-0.7	-3.5	-5.4	-3.5
FEDERAL BUDGET SURPLUS (NIA) (\$ BIL.)						
BASELINE	-71.3	-58.4	-60.2	-55.7	-45.1	-26.7
LOWER PERS. TAXES (ACCOM)			-64.6	-69.8	-69.3	-45.5
DIFF			-2.4	-14.1	-24.1	-18.8
% DIFF			-3.8	-25.2	-53.4	-70.5
MONEY AND INTEREST RATES						
NARROW MONEY SUPPLY (M1) (% CHG.)						
BASELINE	4.2	5.1	7.0	7.0	6.8	6.8
LOWER PERS. TAXES (ACCOM)			7.3	8.5	8.8	7.4
DIFF			0.2	1.4	1.9	0.6
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASELINE	7.7	9.7	11.0	10.8	11.0	10.6
LOWER PERS. TAXES (ACCOM)			11.2	11.6	12.2	11.3
DIFF			0.1	0.8	1.2	0.7
FEDERAL FUNDS RATE (%)						
BASELINE	5.82	5.05	5.83	6.22	5.56	6.22
LOWER PERS. TAXES (ACCOM)			5.83	6.22	5.54	6.23
DIFF			-0.00	0.01	-0.01	0.01
3-MONTH TREASURY BILLS (%)						
BASELINE	5.78	5.01	5.48	5.76	5.34	5.73
LOWER PERS. TAXES (ACCOM)			5.49	5.81	5.41	5.82
DIFF			0.01	0.05	0.07	0.09
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASELINE	9.01	8.34	7.98	8.11	8.03	8.14
LOWER PERS. TAXES (ACCOM)			7.97	8.08	8.11	8.53
DIFF			-0.01	-0.03	0.09	0.39
VELOCITY (% CHG.)						
BASELINE	2.9	6.2	3.0	3.0	2.3	2.5
LOWER PERS. TAXES (ACCOM)			3.0	3.0	2.3	2.4
DIFF			0.0	0.0	0.0	-0.1

TABLE 9. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND						
POTENTIAL OUTPUT						
PLANT EXPENDITURES						
(BILS. OF 1972 \$'S)						
BASELINE	36.7	38.1	40.2	41.8	43.6	46.2
LOWER PERS. TAXES (ACCOM)			40.2	42.1	44.0	47.0
DIFF			0.0	0.3	0.8	0.8
% DIFF			0.1	0.7	1.7	1.8
EQUIPMENT EXPENDITURES						
(BILS. OF 1972 \$'S)						
BASELINE	74.7	77.9	83.6	89.5	95.4	103.7
LOWER PERS. TAXES (ACCOM)			83.6	90.2	97.0	105.9
DIFF			0.1	0.7	2.0	2.2
% DIFF			0.1	0.8	2.1	2.2
BUSINESS FIXED INVESTMENT						
(BILS. OF 1972 \$'S)						
BASELINE	111.4	116.0	123.8	131.3	139.1	149.9
LOWER PERS. TAXES (ACCOM)			123.8	132.3	141.8	152.9
DIFF			0.1	1.0	2.8	3.1
% DIFF			0.1	0.8	2.0	2.0
GROSS PLANT (BILS. OF 1972 \$'S)						
BASELINE	903.7	918.7	935.4	953.5	972.7	993.9
LOWER PERS. TAXES (ACCOM)			935.4	953.7	973.5	995.6
DIFF			0.0	0.2	0.8	1.7
% DIFF			0.0	0.0	0.1	0.2
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASELINE	612.3	639.1	669.8	704.8	743.0	786.7
LOWER PERS. TAXES (ACCOM)			669.8	705.2	745.1	791.0
DIFF			0.0	0.5	2.1	4.4
% DIFF			0.0	0.1	0.2	0.4
HOUSING STARTS						
(MILLIONS OF UNITS)						
BASELINE	1,163	1,543	1,802	1,795	1,910	2,058
LOWER PERS. TAXES (ACCOM)			1,812	1,857	2,043	2,173
DIFF			0.010	0.063	0.133	0.115
% DIFF			0.5	3.5	7.0	5.6
CAPITAL STOCK OF HOMES						
(MILLIONS OF UNITS)						
BASELINE	74.78	75.69	76.90	78.13	79.42	80.85
LOWER PERS. TAXES (ACCOM)			76.91	78.18	79.58	81.13
DIFF			0.01	0.05	0.16	0.28
% DIFF			0.0	0.1	0.2	0.3
REGISTRATION OF CARS						
(MILLIONS OF UNITS)						
BASELINE	106.9	110.2	112.9	115.6	118.6	121.8
LOWER PERS. TAXES (ACCOM)			112.9	116.0	119.4	122.7
DIFF			0.0	0.3	0.7	0.8
% DIFF			0.0	0.3	0.6	0.7
CAPITAL STOCK OF HOUSEHOLDS						
(BILS. OF \$'S)						
BASELINE	3534.6	3868.2	4240.8	4622.9	5009.7	5530.3
LOWER PERS. TAXES (ACCOM)			4230.9	4624.4	5040.3	5622.8
DIFF			-1.0	1.5	30.6	92.5
% DIFF			-0.0	0.0	0.6	1.7
LABOR FORCE						
(MILLIONS OF PERSONS)						
BASELINE	92.7	90.8	97.1	98.8	100.6	102.3
LOWER PERS. TAXES (ACCOM)			97.1	98.8	100.8	102.8
DIFF			0.0	0.0	0.2	0.5
% DIFF			0.0	0.0	0.2	0.5
AVERAGE PRODUCTIVITY (% CHG.)						
BASELINE	-8.7	8.3	5.7	6.0	4.5	5.8
LOWER PERS. TAXES (ACCOM)			5.9	7.5	6.5	5.8
DIFF			0.2	1.5	2.0	-0.1
POTENTIAL OUTPUT						
(BILS. OF 1972 \$'S)						
BASELINE	1365.0	1405.9	1447.8	1491.3	1536.9	1584.2
LOWER PERS. TAXES (ACCOM)			1447.8	1491.4	1537.6	1585.8
DIFF			0.0	0.1	0.7	1.7
% DIFF			0.0	0.0	0.0	0.1

TABLE 9. - Continued

RATION	75	76	77	78	79	80

FEDERAL GOVERNMENT EXPENDITURES TO NOMINAL GNP (%)						
BASELINE	23,6	22,9	22,8	22,6	22,3	21,9
LOWER PERS. TAXES (ACCOM)			22,7	22,2	21,5	21,1
DIFF			+0,1	-0,4	-0,6	-0,8
GAP (POTENTIAL LESS ACTUAL GNP) (BIL. OF 1972 \$'S)						
BASELINE	173,8	141,0	122,1	103,7	93,3	76,6
LOWER PERS. TAXES (ACCOM)			119,4	83,1	50,9	37,0
DIFF			+2,7	-20,6	-42,4	-39,6
% DIFF			+2,2	-19,9	-45,4	-51,6
GROSS EFFECTIVE CAPITAL STOCK TO REAL GNP (%)						
BASELINE	142,0	136,8	133,8	131,3	129,8	126,3
LOWER PERS. TAXES (ACCOM)			133,5	129,4	126,3	125,3
DIFF			+0,3	-1,9	-3,6	-3,0
NET CAPITAL STOCK TO REAL GNP (%)						
BASELINE	84,8	81,3	79,3	77,7	76,9	76,2
LOWER PERS. TAXES (ACCOM)			79,1	76,6	74,9	74,5
DIFF			+0,2	-1,1	-2,0	-1,7
GROSS CAPITAL STOCK OF POLLUTION ABATEMENT EXPEND. TO REAL GNP (%)						
BASELINE	2,3	2,6	2,8	3,1	3,4	3,6
LOWER PERS. TAXES (ACCOM)			2,8	3,1	3,3	3,6
DIFF			+0,0	+0,0	+0,1	+0,1
REAL BUSINESS FIXED INVESTMENT TO REAL GNP (%)						
BASELINE	9,35	9,17	9,34	9,46	9,63	9,94
LOWER PERS. TAXES (ACCOM)			9,32	9,39	9,54	9,87
DIFF			-0,01	-0,07	-0,09	-0,07
REAL BUSINESS FIXED INVESTMENT LESS POLLUTION ABATEMENT EXPENDS. TO REAL GNP (%)						
BASELINE	8,93	8,75	8,91	8,99	9,16	9,48
LOWER PERS. TAXES (ACCOM)			8,90	8,93	9,08	9,42
DIFF			-0,01	-0,06	-0,08	-0,06

TABLE 10. Capital Formation and U.S. Economic Performance:
"Baseline" and "Easier Money" Solutions

	75	76	77	78	79	80
ECONOMY						

REAL GNP (% CHG.)						
BASELINE	-1.8	6.1	4.8	4.7	4.0	4.4
EASIER MONEY			5.3	5.6	4.5	4.5
DIFF			0.5	0.9	0.5	0.1
UNEMPLOYMENT RATE (%)						
BASELINE	8.5	7.7	7.3	6.4	6.1	5.5
EASIER MONEY			7.2	6.0	5.8	5.2
DIFF			-0.1	-0.4	-0.3	-0.3
INFLATION (% CHG.)						
GNP DEFLATOR						
BASELINE	9.2	5.1	5.2	5.3	5.1	4.8
EASIER MONEY			5.3	5.5	5.3	5.0
DIFF			0.1	0.2	0.3	0.2
WPI						
BASELINE	9.3	4.3	5.0	5.3	5.1	4.9
EASIER MONEY			5.2	6.0	5.3	5.2
DIFF			0.2	0.7	0.2	0.4
CPI						
BASELINE	9.2	5.7	5.0	5.2	4.8	4.9
EASIER MONEY			5.1	5.4	5.1	5.1
DIFF			0.0	0.2	0.2	0.2
AVG. HOURLY EARNINGS						
BASELINE	8.9	7.2	8.8	8.7	8.6	8.6
EASIER MONEY			8.8	8.9	8.8	8.9
DIFF			0.0	0.1	0.2	0.3
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASELINE	68.7	72.9	75.3	77.7	78.7	79.5
EASIER MONEY			75.6	79.5	79.4	80.6
DIFF			0.3	1.9	0.7	1.1
PRIMARY PROCESSING						
BASELINE	70.2	76.8	79.6	81.3	82.6	85.0
EASIER MONEY			80.1	83.7	83.5	86.4
DIFF			0.5	2.4	1.0	1.4
FEDERAL TAX RECEIPTS (\$ BIL.)						
BASELINE	286.5	328.9	361.0	408.4	455.7	512.2
EASIER MONEY			364.9	419.6	465.8	525.2
DIFF			3.9	11.2	10.1	12.9
% DIFF			1.1	2.7	2.2	2.5
FEDERAL BUDGET SURPLUS (NIA) (\$ BIL.)						
BASELINE	-71.3	-58.4	-64.2	-55.7	-45.1	-26.7
EASIER MONEY			-60.1	-43.9	-35.2	-13.7
DIFF			4.2	11.8	9.9	12.9
% DIFF			6.5	21.2	21.9	48.5
MONEY AND INTEREST RATES						

NARROW MONEY SUPPLY (M1) (% CHG.)						
BASELINE	4.2	5.1	7.0	7.0	6.8	6.8
EASIER MONEY			8.0	8.0	7.0	7.0
DIFF			1.0	1.0	0.2	0.2
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASELINE	7.7	9.7	11.0	10.8	11.0	10.6
EASIER MONEY			12.1	12.0	11.7	11.4
DIFF			1.1	1.2	0.7	0.8
FEDERAL FUNDS RATE (%)						
BASELINE	5.82	5.05	5.83	6.22	5.56	6.22
EASIER MONEY			3.90	5.98	3.46	5.59
DIFF			-1.94	-0.24	-2.10	-0.63
3-MONTH TREASURY BILLS (%)						
BASELINE	5.78	5.01	5.48	5.76	5.34	5.73
EASIER MONEY			4.08	5.71	3.85	5.36
DIFF			-1.41	-0.05	-1.49	-0.37
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASELINE	9.01	8.34	7.98	8.11	8.03	8.14
EASIER MONEY			7.81	8.23	8.03	8.29
DIFF			-0.17	0.12	0.00	0.15
VELOCITY (% CHG.)						
BASELINE	2.9	6.2	3.0	3.0	2.3	2.5
EASIER MONEY			2.8	3.1	1.8	2.6
DIFF			-0.4	0.2	-0.5	0.1

TABLE 10. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND						
POTENTIAL OUTPUT						
PLANT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE	36.7	38.1	40.2	41.8	43.6	46.2
EASIER MONEY			40.4	42.3	43.9	46.6
DIFF			0.2	0.5	0.3	0.4
% DIFF			0.4	1.2	0.7	0.6
EQUIPMENT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE	74.7	77.9	83.6	89.5	95.4	103.7
EASIER MONEY			83.9	91.6	97.5	106.1
DIFF			0.4	2.1	2.1	2.4
% DIFF			0.5	2.3	2.2	2.3
BUSINESS FIXED INVESTMENT (BILS. OF 1972 \$'S)						
BASELINE	111.4	116.0	123.8	131.3	139.1	149.9
EASIER MONEY			124.3	133.8	141.4	152.6
DIFF			0.6	2.6	2.4	2.7
% DIFF			0.4	2.0	1.7	1.8
GROSS PLANT (BILS. OF 1972 \$'S)						
BASELINE	903.7	918.7	935.4	953.5	972.7	993.9
EASIER MONEY			935.5	954.0	973.6	995.1
DIFF			0.1	0.6	0.9	1.2
% DIFF			0.0	0.1	0.1	0.1
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASELINE	812.3	839.1	869.8	904.8	943.0	986.7
EASIER MONEY			870.0	906.5	946.8	992.5
DIFF			0.2	1.8	3.8	5.8
% DIFF			0.0	0.2	0.4	0.6
HOUSING STARTS (MILLIONS OF UNITS)						
BASELINE	1,163	1,543	1,802	1,795	1,910	2,058
EASIER MONEY			1,958	1,746	2,065	2,108
DIFF			0,156	0,151	0,155	0,049
% DIFF			8.6	8.4	8.1	2.4
CAPITAL STOCK OF HOMES (MILLIONS OF UNITS)						
BASELINE	74.78	75.69	76.90	78.13	79.42	80.85
EASIER MONEY			76.99	78.41	79.80	81.34
DIFF			0.08	0.28	0.38	0.49
% DIFF			0.1	0.4	0.5	0.6
REGISTRATION OF CARS (MILLIONS OF UNITS)						
BASELINE	106.9	110.2	112.9	115.6	118.6	121.8
EASIER MONEY			112.9	115.7	118.6	121.6
DIFF			0.1	0.1	=0.0	=0.2
% DIFF			0.1	0.1	=0.0	=0.2
CAPITAL STOCK OF HOUSEHOLDS (BILS. OF \$'S)						
BASELINE	3534.6	3868.2	4240.8	4622.9	5009.7	5530.3
EASIER MONEY			4206.2	4666.1	5030.7	5604.9
DIFF			-34.6	43.2	21.0	74.6
% DIFF			=0.8	0.9	0.4	1.3
LABOR FORCE (MILLIONS OF PERSONS)						
BASELINE	92.7	94.8	97.1	98.8	100.6	102.3
EASIER MONEY			97.1	98.9	100.8	102.5
DIFF			0.0	0.1	0.2	0.2
% DIFF			0.0	0.1	0.2	0.2
AVERAGE PRODUCTIVITY (% CHG.)						
BASELINE	-8.7	8.3	5.7	6.0	4.5	5.8
EASIER MONEY			6.2	6.0	5.8	6.4
DIFF			0.5	2.0	1.3	0.5
POTENTIAL OUTPUT (BILS. OF 1972 \$'S)						
BASELINE	1365.4	1405.9	1447.8	1491.3	1536.9	1584.2
EASIER MONEY			1447.8	1491.8	1538.2	1586.2
DIFF			0.0	0.5	1.3	2.1
% DIFF			0.0	0.0	0.1	0.1

TABLE 10. - Continued

RATIOS	75	76	77	78	79	80

FEDERAL GOVERNMENT EXPENDITURES TO NOMINAL GNP (%)						
BASELINE	23.6	22.9	22.8	22.6	22.3	21.9
EASIER MONEY			22.6	22.2	22.0	21.6
DIFF			+0.2	+0.4	+0.3	+0.3
GAP (POTENTIAL LESS ACTUAL GNP) (BIL. OF 1972 \$'S)						
BASELINE	173.8	141.0	122.1	103.7	93.3	76.6
EASIER MONEY			115.2	84.4	81.8	64.0
DIFF			+6.8	+19.3	+11.5	+12.6
% DIFF			+5.6	+18.6	+12.6	+16.4
GROSS EFFECTIVE CAPITAL STOCK TO REAL GNP (%)						
BASELINE	142.0	136.8	133.8	131.3	129.8	128.3
EASIER MONEY			133.1	129.6	124.0	127.5
DIFF			+0.7	+1.7	+0.8	+0.8
NET CAPITAL STOCK TO REAL GNP (%)						
BASELINE	84.8	81.3	79.3	77.7	76.9	76.2
EASIER MONEY			78.9	78.8	76.6	75.9
DIFF			+0.4	+0.9	+0.4	+0.3
GROSS CAPITAL STOCK OF POLLUTION ABATEMENT EXPEND. TO REAL GNP (%)						
BASELINE	2.3	2.6	2.8	3.1	3.4	3.6
EASIER MONEY			2.8	3.1	3.4	3.6
DIFF			+0.0	+0.0	+0.0	+0.0
REAL BUSINESS FIXED INVESTMENT TO REAL GNP (%)						
BASELINE	9.35	9.17	9.34	9.46	9.63	9.94
EASIER MONEY			9.33	9.51	9.71	10.03
DIFF			+0.01	0.05	0.08	0.08
REAL BUSINESS FIXED INVESTMENT LESS POLLUTION ABATEMENT EXPENDS. TO REAL GNP (%)						
BASELINE	8.93	8.75	8.91	8.99	9.16	9.48
EASIER MONEY			8.90	9.05	9.24	9.56
DIFF			+0.00	0.05	0.08	0.09

TABLE 11. Capital Formation and U.S. Economic Performance:
"Baseline" and "Personal Tax Cuts and Easier Money" Solutions

	75	76	77	78	79	80
ECONOMY						

REAL GNP (% CHG.)						
BASELINE	-1.8	6.1	4.8	4.7	4.0	4.4
TAX CUTS & EASY MONEY			5.5	6.8	4.9	3.7
DIFF			0.7	2.1	0.9	-0.7
UNEMPLOYMENT RATE (%)						
BASELINE	8.5	7.7	7.3	6.4	6.1	5.5
TAX CUTS & EASY MONEY			7.2	5.7	5.0	4.5
DIFF			-0.1	-0.7	-1.0	-1.0
INFLATION (% CHG.)						
GNP DEFLATOR						
BASELINE	9.2	5.1	5.2	5.3	5.1	4.8
TAX CUTS & EASY MONEY			5.3	5.6	5.7	5.6
DIFF			0.1	0.3	0.6	0.8
MPI						
BASELINE	9.3	4.3	5.0	5.3	5.1	4.9
TAX CUTS & EASY MONEY			5.2	6.3	6.3	6.3
DIFF			0.2	1.0	1.2	1.4
CPI						
BASELINE	9.2	5.7	5.0	5.2	4.8	4.9
TAX CUTS & EASY MONEY			5.1	5.5	5.5	5.7
DIFF			0.0	0.3	0.6	0.8
AVG. HOURLY EARNINGS						
BASELINE	8.9	7.2	6.8	6.7	6.6	6.6
TAX CUTS & EASY MONEY			6.8	7.0	7.2	7.6
DIFF			0.0	0.2	0.6	1.0
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASELINE	68.7	72.9	75.3	77.7	78.7	79.5
TAX CUTS & EASY MONEY			75.8	80.6	81.9	82.4
DIFF			0.5	3.0	3.2	2.8
PRIMARY PROCESSING						
BASELINE	70.2	76.8	79.6	81.3	82.6	85.0
TAX CUTS & EASY MONEY			80.2	84.9	86.4	88.3
DIFF			0.7	3.6	3.8	3.4
FEDERAL TAX RECEIPTS (\$ BILS.)						
BASELINE	286.5	328.9	361.0	408.4	455.7	512.2
TAX CUTS & EASY MONEY			362.2	434.2	439.3	499.3
DIFF			1.2	4.2	-16.4	-13.0
% DIFF			0.3	-1.0	-3.6	-2.5
FEDERAL BUDGET SURPLUS (NIA) (\$ BILS.)						
BASELINE	-71.3	-58.4	-64.2	-55.7	-45.1	-26.7
TAX CUTS & EASY MONEY			-62.7	-59.6	-61.3	-40.8
DIFF			1.5	-3.3	-16.1	-14.1
% DIFF			2.4	-5.9	-35.7	-52.9
MONEY AND INTEREST RATES						

NARROW MONEY SUPPLY (M1) (% CHG.)						
BASELINE	4.2	5.1	7.0	7.0	6.8	6.8
TAX CUTS & EASY MONEY			8.2	9.2	8.8	6.7
DIFF			1.7	2.2	2.0	-0.1
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASELINE	7.7	9.7	11.0	10.8	11.0	10.6
TAX CUTS & EASY MONEY			12.2	12.6	12.8	11.1
DIFF			1.2	1.8	1.8	0.5
FEDERAL FUNDS RATE (%)						
BASELINE	5.82	5.05	5.83	6.22	5.56	6.22
TAX CUTS & EASY MONEY			4.04	6.36	3.63	6.98
DIFF			-1.80	0.14	-1.93	0.76
3-MONTH TREASURY BILLS (%)						
BASELINE	5.78	5.01	5.48	5.76	5.34	5.73
TAX CUTS & EASY MONEY			4.19	5.94	4.04	6.40
DIFF			-1.29	0.18	-1.30	0.67
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASELINE	9.01	8.34	7.98	8.11	8.03	8.14
TAX CUTS & EASY MONEY			7.81	8.20	8.12	8.76
DIFF			-0.17	0.09	0.10	0.63
VELOCITY (% CHG.)						
BASELINE	2.9	6.2	3.0	3.0	2.3	2.5
TAX CUTS & EASY MONEY			2.7	3.2	1.9	2.7
DIFF			-0.3	0.3	-0.4	0.2

TABLE 11. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND						
POTENTIAL OUTPUT						
PLANT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE	36.7	38.1	40.2	41.8	43.6	46.2
TAX CUTS & EASY MONEY			40.4	42.5	44.6	47.1
DIFF			0.2	0.8	1.0	0.9
% DIFF			0.5	1.8	2.2	2.0
EQUIPMENT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE	74.7	77.9	83.6	89.5	95.4	103.7
TAX CUTS & EASY MONEY			84.0	92.1	99.0	107.1
DIFF			0.4	2.6	3.6	3.4
% DIFF			0.5	2.9	3.8	3.3
BUSINESS FIXED INVESTMENT (BILS. OF 1972 \$'S)						
BASELINE	111.4	116.0	123.8	131.3	139.1	149.9
TAX CUTS & EASY MONEY			124.4	134.6	143.6	154.3
DIFF			0.6	3.4	4.6	4.4
% DIFF			0.5	2.6	3.3	2.9
GROSS PLANT (BILS. OF 1972 \$'S)						
BASELINE	903.7	918.7	935.4	953.5	972.7	993.9
TAX CUTS & EASY MONEY			935.5	954.2	974.3	996.5
DIFF			0.1	0.7	1.6	2.6
% DIFF			0.0	0.1	0.2	0.3
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASELINE	812.3	839.1	869.8	904.8	943.0	986.7
TAX CUTS & EASY MONEY			870.0	906.9	948.4	995.5
DIFF			0.2	2.1	5.4	8.8
% DIFF			0.0	0.2	0.6	0.9
HOUSING STARTS (MILLIONS OF UNITS)						
BASELINE	1.163	1.543	1.802	1.795	1.910	2.058
TAX CUTS & EASY MONEY			1.956	1.973	2.160	2.070
DIFF			0.153	0.179	0.251	0.011
% DIFF			8.5	10.0	13.1	0.6
CAPITAL STOCK OF HOMES (MILLIONS OF UNITS)						
BASELINE	74.78	75.69	76.90	78.13	79.42	80.85
TAX CUTS & EASY MONEY			76.99	78.43	79.90	81.44
DIFF			0.08	0.31	0.48	0.59
% DIFF			0.1	0.4	0.6	0.7
REGISTRATION OF CARS (MILLIONS OF UNITS)						
BASELINE	106.9	110.2	112.9	115.6	118.6	121.8
TAX CUTS & EASY MONEY			113.0	116.1	119.3	122.4
DIFF			0.1	0.4	0.7	0.6
% DIFF			0.1	0.4	0.6	0.5
CAPITAL STOCK OF HOUSEHOLDS (BILS. OF \$'S)						
BASELINE	3534.6	3868.2	4240.8	4622.9	5009.7	5530.3
TAX CUTS & EASY MONEY			4208.3	4672.8	5059.3	5719.7
DIFF			-32.5	49.9	49.7	189.4
% DIFF			-0.8	1.1	1.0	3.4
LABOR FORCE (MILLIONS OF PERSONS)						
BASELINE	92.7	94.8	97.1	98.8	100.6	102.3
TAX CUTS & EASY MONEY			97.1	98.9	101.0	102.9
DIFF			0.0	0.1	0.4	0.6
% DIFF			0.0	0.1	0.4	0.6
AVERAGE PRODUCTIVITY (% CHG.)						
BASELINE	-8.7	8.3	5.7	6.0	4.5	5.8
TAX CUTS & EASY MONEY			6.3	9.3	4.9	5.6
DIFF			0.6	3.3	0.5	-0.2
POTENTIAL OUTPUT (BILS. OF 1972 \$'S)						
BASELINE	1365.4	1405.9	1447.8	1491.3	1536.9	1584.2
TAX CUTS & EASY MONEY			1447.8	1491.2	1538.7	1587.5
DIFF			0.0	0.6	1.8	3.3
% DIFF			0.0	0.0	0.1	0.2

TABLE 11. - Continued

RATIOS	75	76	77	78	79	80
FEDERAL GOVERNMENT EXPENDITURES TO NOMINAL GNP (%)						
BASELINE	23.6	22.9	22.8	22.6	22.3	21.9
TAX CUTS & EASY MONEY			22.6	21.9	21.3	21.0
DIFF			-0.2	-0.7	-1.0	-0.9
GAP (POTENTIAL LESS ACTUAL GAP) (BILLS. OF 1972 \$'S)						
BASELINE	173.8	141.0	122.1	103.7	93.3	76.6
TAX CUTS & EASY MONEY			112.9	66.0	43.2	36.6
DIFF			-9.2	-37.7	-50.1	-40.0
% DIFF			-7.5	-36.4	-53.7	-52.3
GROSS EFFECTIVE CAPITAL STOCK TO REAL GNP (%)						
BASELINE	142.0	136.8	133.8	131.3	129.8	128.3
TAX CUTS & EASY MONEY			132.9	128.0	125.8	125.4
DIFF			-0.9	-3.3	-4.0	-2.9
NET CAPITAL STOCK TO REAL GNP (%)						
BASELINE	84.8	81.3	79.3	77.7	76.9	76.2
TAX CUTS & EASY MONEY			78.7	75.9	74.7	74.8
DIFF			-0.5	-1.9	-2.2	-1.5
GROSS CAPITAL STOCK OF POLLUTION ABATEMENT EXPEND. TO REAL GNP (%)						
BASELINE	2.3	2.6	2.8	3.1	3.4	3.6
TAX CUTS & EASY MONEY			2.8	3.0	3.3	3.6
DIFF			-0.0	-0.1	-0.1	-0.1
REAL BUSINESS FIXED INVESTMENT TO REAL GNP (%)						
BASELINE	9.35	9.17	9.34	9.46	9.63	9.94
TAX CUTS & EASY MONEY			9.32	9.44	9.60	9.95
DIFF			-0.02	-0.02	-0.03	0.00
REAL BUSINESS FIXED INVESTMENT LESS POLLUTION ABATEMENT EXPENDS. TO REAL GNP (%)						
BASELINE	8.93	8.75	8.91	8.99	9.16	9.48
TAX CUTS & EASY MONEY			8.89	8.99	9.14	9.49
DIFF			-0.02	-0.01	-0.02	0.01

TABLE 12. Capital Formation and U.S. Economic Performance:
"Baseline" and "Tight Fiscal and Easier Money" Solutions

	75	76	77	78	79	80
ECONOMY						

REAL GNP (% CHG.)						
BASELINE						
TIGHT FISCAL & EASY MONEY	-1.8	6.1	4.6	4.7	4.0	4.4
DIFF			5.2	6.6	5.1	3.9
			0.4	1.9	1.1	-0.5
UNEMPLOYMENT RATE (%)						
BASELINE	8.5	7.7	7.3	6.4	6.1	5.5
TIGHT FISCAL & EASY MONEY			7.3	5.9	5.2	4.6
DIFF			-0.0	-0.6	-0.9	-0.9
INFLATION (% CHG.)						
GNP DEFLATOR						
BASELINE	9.2	5.1	5.2	5.3	5.1	4.8
TIGHT FISCAL & EASY MONEY			5.2	5.5	5.5	5.5
DIFF			0.1	0.2	0.5	0.7
WPI						
BASELINE	9.3	4.3	5.0	5.3	5.1	4.9
TIGHT FISCAL & EASY MONEY			5.2	6.1	6.0	6.1
DIFF			0.1	0.8	0.9	1.3
CPI						
BASELINE	9.2	5.7	5.0	5.2	4.8	4.9
TIGHT FISCAL & EASY MONEY			5.1	5.4	5.3	5.6
DIFF			0.0	0.2	0.5	0.7
AVG. HOURLY EARNINGS						
BASELINE	8.9	7.2	6.6	6.7	6.6	6.6
TIGHT FISCAL & EASY MONEY			6.8	6.9	7.0	7.4
DIFF			0.0	0.2	0.5	0.8
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASELINE	68.7	72.9	75.3	77.7	78.7	79.5
TIGHT FISCAL & EASY MONEY			75.4	80.0	81.5	82.2
DIFF			0.1	2.3	2.8	2.7
PRIMARY PROCESSING						
BASELINE	70.2	76.8	79.6	81.3	82.6	85.0
TIGHT FISCAL & EASY MONEY			80.1	84.6	86.3	88.4
DIFF			0.5	3.3	3.8	3.5
FEDERAL TAX RECEIPTS (\$ BILLS)						
BASELINE	286.5	328.9	361.0	408.4	455.7	512.2
TIGHT FISCAL & EASY MONEY			360.1	399.2	433.9	493.5
DIFF			-0.9	-9.2	-21.8	-18.7
% DIFF			-0.2	-2.2	-4.8	-3.7
FEDERAL BUDGET SURPLUS (MIA) (\$ BILLS)						
BASELINE	-71.3	+58.4	+64.2	+55.7	+45.1	+26.7
TIGHT FISCAL & EASY MONEY			+59.8	+53.8	+55.8	+34.6
DIFF			4.4	1.9	-10.6	+8.2
% DIFF			6.8	3.5	-23.5	+30.7
MONEY AND INTEREST RATES						

NARROW MONEY SUPPLY (M1) (% CHG.)						
BASELINE	4.2	5.1	7.0	7.0	6.8	6.8
TIGHT FISCAL & EASY MONEY			8.2	9.2	8.8	6.8
DIFF			1.2	2.2	2.0	-0.0
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASELINE	7.7	9.7	11.0	10.8	11.0	10.6
TIGHT FISCAL & EASY MONEY			12.4	12.9	13.0	11.4
DIFF			1.3	2.0	2.0	0.8
FEDERAL FUNDS RATE (%)						
BASELINE	5.82	5.05	5.83	6.22	5.56	6.22
TIGHT FISCAL & EASY MONEY			3.80	5.65	3.33	6.17
DIFF			-2.23	-0.57	-2.22	-0.05
3-MONTH TREASURY HILLS (%)						
BASELINE	5.78	5.01	5.48	5.76	5.34	5.73
TIGHT FISCAL & EASY MONEY			3.86	5.42	3.86	5.82
DIFF			-1.62	-0.34	-1.49	0.09
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASELINE	9.01	8.34	7.98	8.11	8.03	8.14
TIGHT FISCAL & EASY MONEY			7.74	8.04	7.97	8.54
DIFF			-0.24	-0.07	-0.05	0.40
VELOCITY (% CHG.)						
BASELINE	2.9	6.2	3.0	3.0	2.3	2.5
TIGHT FISCAL & EASY MONEY			2.3	2.9	1.9	2.6
DIFF			-0.7	-0.0	-0.4	0.2

TABLE 12. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND						
POTENTIAL OUTPUT						
PLANT EXPENDITURES						
(BILS. OF 1972 \$'S)						
BASELINE	36.7	38.1	40.2	41.8	43.6	46.2
TIGHT FISCAL & EASY MONEY			40.4	42.5	44.6	47.2
DIFF			0.2	0.7	1.0	1.0
% DIFF			0.5	1.8	2.3	2.2
EQUIPMENT EXPENDITURES						
(BILS. OF 1972 \$'S)						
BASELINE	74.7	77.9	83.6	89.5	95.4	103.7
TIGHT FISCAL & EASY MONEY			84.0	92.2	99.8	108.7
DIFF			0.4	2.7	4.3	5.0
% DIFF			0.5	3.1	4.6	4.8
BUSINESS FIXED INVESTMENT						
(BILS. OF 1972 \$'S)						
BASELINE	111.4	116.0	123.8	131.3	139.1	149.0
TIGHT FISCAL & EASY MONEY			124.4	134.8	144.0	155.9
DIFF			0.6	3.5	5.3	6.0
% DIFF			0.5	2.7	3.8	4.0
GROSS PLANT (BILS. OF 1972 \$'S)						
BASELINE	903.7	918.7	935.4	953.5	972.7	993.9
TIGHT FISCAL & EASY MONEY			935.5	954.2	974.3	996.5
DIFF			0.1	0.7	1.6	2.7
% DIFF			0.0	0.1	0.2	0.3
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASELINE	812.3	839.1	869.8	904.8	943.0	986.7
TIGHT FISCAL & EASY MONEY			870.0	907.0	949.0	997.4
DIFF			0.2	2.2	6.0	10.7
% DIFF			0.0	0.2	0.6	1.1
HOUSING STARTS						
(MILLIONS OF UNITS)						
BASELINE	1,163	1,543	1,802	1,795	1,910	2,058
TIGHT FISCAL & EASY MONEY			1,994	2,035	2,227	2,114
DIFF			0,191	0,240	0,317	0,058
% DIFF			10.6	13.4	16.6	2.8
CAPITAL STOCK OF HOMES						
(MILLIONS OF UNITS)						
BASELINE	74.78	75.69	76.90	78.13	79.42	80.85
TIGHT FISCAL & EASY MONEY			77.01	78.51	80.04	81.63
DIFF			0.11	0.38	0.62	0.78
% DIFF			0.1	0.5	0.8	1.0
REGISTRATION OF CARS						
(MILLIONS OF UNITS)						
BASELINE	106.9	110.2	112.9	115.6	118.6	121.8
TIGHT FISCAL & EASY MONEY			112.9	116.0	119.2	122.2
DIFF			0.1	0.4	0.6	0.4
% DIFF			0.1	0.3	0.5	0.4
CAPITAL STOCK OF HOUSEHOLDS						
(BILS. OF \$'S)						
BASELINE	3534.6	3868.2	4200.6	4622.9	5009.7	5530.3
TIGHT FISCAL & EASY MONEY			4200.0	4660.2	5058.3	5701.9
DIFF			-39.0	37.3	48.6	171.6
% DIFF			-0.9	0.8	1.0	3.1
LABOR FORCE						
(MILLIONS OF PERSONS)						
BASELINE	92.7	94.8	97.1	98.8	100.6	102.3
TIGHT FISCAL & EASY MONEY			97.1	98.9	100.9	102.8
DIFF			-0.0	0.1	0.3	0.5
% DIFF			-0.0	0.1	0.3	0.5
AVERAGE PRODUCTIVITY (% CHG.)						
BASELINE	-8.7	8.3	5.7	6.0	4.5	5.8
TIGHT FISCAL & EASY MONEY			5.9	6.9	5.3	5.9
DIFF			0.2	3.0	0.8	0.0
POTENTIAL OUTPUT						
(BILS. OF 1972 \$'S)						
BASELINE	1365.4	1405.9	1447.8	1491.3	1536.9	1584.2
TIGHT FISCAL & EASY MONEY			1447.8	1491.8	1538.9	1588.0
DIFF			0.0	0.6	1.9	3.8
% DIFF			0.0	0.0	0.1	0.2

TABLE 12. - Continued

RATIOS	75	76	77	78	79	80

FEDERAL GOVERNMENT EXPENDITURES TO NOMINAL GNP (%)						
BASELINE	23.6	22.9	22.8	22.6	22.3	21.9
TIGHT FISCAL & EASY MONEY			22.8	21.5	21.0	20.7
DIFF			+0.4	-1.1	-1.3	-1.3
GAP (POTENTIAL LESS ACTUAL GNP) (BIL. OF 1972 \$'S)						
BASELINE	173.8	141.0	122.1	103.7	93.3	76.6
TIGHT FISCAL & EASY MONEY			117.4	78.2	48.7	39.9
DIFF			+4.7	-29.5	-44.6	-36.8
% DIFF			+3.8	-28.5	-47.8	-48.0
GROSS EFFECTIVE CAPITAL STOCK TO REAL GNP (%)						
BASELINE	142.0	136.8	133.8	131.3	129.8	128.3
TIGHT FISCAL & EASY MONEY			133.3	128.7	126.3	125.8
DIFF			+0.5	-2.6	-3.5	-2.5
NET CAPITAL STOCK TO REAL GNP (%)						
BASELINE	84.8	81.3	79.3	77.7	76.9	76.2
TIGHT FISCAL & EASY MONEY			79.0	76.3	75.0	75.0
DIFF			+0.3	+1.4	+1.9	+1.2
GROSS CAPITAL STOCK OF POLLUTION ABATEMENT EXPEND. TO REAL GNP (%)						
BASELINE	2.3	2.6	2.8	3.1	3.4	3.6
TIGHT FISCAL & EASY MONEY			2.8	3.0	3.3	3.6
DIFF			+0.0	+0.1	+0.1	+0.1
REAL BUSINESS FIXED INVESTMENT TO REAL GNP (%)						
BASELINE	9.35	9.17	9.34	9.46	9.63	9.98
TIGHT FISCAL & EASY MONEY			9.35	9.51	9.60	10.07
DIFF			0.01	0.04	0.06	0.13
REAL BUSINESS FIXED INVESTMENT LESS POLLUTION ABATEMENT EXPENDS. TO REAL GNP (%)						
BASELINE	8.93	8.75	8.91	8.99	9.16	9.48
TIGHT FISCAL & EASY MONEY			8.92	9.05	9.23	9.61
DIFF			0.01	0.05	0.07	0.13

TABLE 13. Capital Formation and U.S. Economic Performance:
"Baseline" and "Investment Tax Credit" Solutions

	75	76	77	78	79	80
ECONOMY						

REAL GNP (% CHG.)						
BASELINE	-1.8	6.1	4.8	4.7	4.0	4.4
INCREASED INVESTMENT TAX CREDIT			4.9	4.8	4.1	4.3
DIFF			0.1	0.1	0.0	-0.1
UNEMPLOYMENT RATE (%)						
BASELINE	8.5	7.7	7.3	6.4	6.1	5.5
INCREASED INVESTMENT TAX CREDIT			7.3	6.4	6.0	5.5
DIFF			-0.0	-0.1	-0.1	-0.0
INFLATION (% CHG.)						
GNP DEFLATOR						
BASELINE	9.2	5.1	5.2	5.3	5.1	4.8
INCREASED INVESTMENT TAX CREDIT			5.2	5.3	5.1	4.8
DIFF			-0.0	-0.0	0.0	0.0
WPI						
BASELINE	9.3	4.3	5.0	5.3	5.1	4.9
INCREASED INVESTMENT TAX CREDIT			5.1	5.3	5.1	4.9
DIFF			0.0	0.0	0.0	0.0
CPI						
BASELINE	9.2	5.7	5.0	5.2	4.8	4.9
INCREASED INVESTMENT TAX CREDIT			5.0	5.2	4.9	4.9
DIFF			0.0	0.0	0.0	0.0
AVG. HOURLY EARNINGS						
BASELINE	8.9	7.2	6.8	6.7	6.6	6.6
INCREASED INVESTMENT TAX CREDIT			6.8	6.7	6.6	6.7
DIFF			0.0	0.0	0.0	0.0
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASELINE	68.7	72.9	75.3	77.7	78.7	79.5
INCREASED INVESTMENT TAX CREDIT			75.4	77.9	79.0	79.7
DIFF			0.1	0.3	0.3	0.1
PRIMARY PROCESSING						
BASELINE	70.2	76.8	79.6	81.3	82.6	85.0
INCREASED INVESTMENT TAX CREDIT			79.6	81.5	82.7	85.0
DIFF			0.0	0.2	0.2	-0.0
FEDERAL TAX RECEIPTS (% BIL.)						
BASELINE	286.5	328.9	361.0	408.4	455.7	512.2
INCREASED INVESTMENT TAX CREDIT			359.1	407.1	454.5	510.4
DIFF			-1.9	-1.3	-1.3	-1.9
% DIFF			-0.5	-0.3	-0.3	-0.4
FEDERAL BUDGET SURPLUS (MIA) (% BIL.)						
BASELINE	-71.3	-58.4	-64.2	-55.7	-45.1	-26.7
INCREASED INVESTMENT TAX CREDIT			-66.1	-57.0	-46.4	-28.8
DIFF			-1.9	-1.3	-1.3	-2.1
% DIFF			-2.9	-2.3	-2.9	-7.9
MONEY AND INTEREST RATES						

NARROW MONEY SUPPLY (M1) (% CHG.)						
BASELINE	4.2	5.1	7.0	7.0	6.8	6.8
INCREASED INVESTMENT TAX CREDIT			7.1	7.1	6.9	6.8
DIFF			0.1	0.1	0.0	-0.0
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASELINE	7.7	9.7	11.0	10.8	11.0	10.6
INCREASED INVESTMENT TAX CREDIT			11.1	10.9	10.9	10.5
DIFF			0.0	0.0	-0.1	-0.1
FEDERAL FUNDS RATE (%)						
BASELINE	5.82	5.05	5.83	6.22	5.56	6.22
INCREASED INVESTMENT TAX CREDIT			5.86	5.37	5.84	6.48
DIFF			0.02	0.15	0.29	0.26
3-MONTH TREASURY BILLS (%)						
BASELINE	5.78	5.01	5.48	5.76	5.34	5.73
INCREASED INVESTMENT TAX CREDIT			5.51	5.87	5.53	5.90
DIFF			0.03	0.11	0.19	0.17
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASELINE	9.01	8.54	7.98	8.11	8.03	8.14
INCREASED INVESTMENT TAX CREDIT			7.99	8.12	8.05	8.18
DIFF			0.01	0.01	0.03	0.04
VELOCITY (% CHG.)						
BASELINE	2.9	6.2	3.0	3.0	2.3	2.5
INCREASED INVESTMENT TAX CREDIT			3.0	3.0	2.3	2.4
DIFF			0.0	0.0	-0.0	-0.1

TABLE 13. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND						
POTENTIAL OUTPUT						
PLANT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE			40.2	41.8	43.6	46.2
INCREASED INVESTMENT TAX CREDIT	36.7	38.1	39.9	41.5	43.4	46.0
DIFF			-0.3	-0.3	-0.2	-0.2
% DIFF			-0.7	-0.7	-0.4	-0.5
EQUIPMENT EXPENDITURES (BILS. OF 1972 \$'S)						
BASELINE			83.6	89.5	95.4	103.7
INCREASED INVESTMENT TAX CREDIT	74.7	77.9	84.4	91.7	98.7	107.1
DIFF			0.9	2.2	3.2	3.4
% DIFF			1.0	2.5	3.4	3.3
BUSINESS FIXED INVESTMENT (BILS. OF 1972 \$'S)						
BASELINE			123.8	131.3	139.1	149.9
INCREASED INVESTMENT TAX CREDIT	111.4	116.0	124.4	133.2	142.1	153.0
DIFF			0.6	1.9	3.0	3.1
% DIFF			0.5	1.5	2.2	2.1
GROSS PLANT (BILS. OF 1972 \$'S)						
BASELINE			935.4	953.5	972.7	993.9
INCREASED INVESTMENT TAX CREDIT	903.7	918.7	935.2	953.0	972.0	993.0
DIFF			-0.2	-0.5	-0.7	-0.9
% DIFF			-0.0	-0.1	-0.1	-0.1
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASELINE			869.8	904.8	943.0	986.7
INCREASED INVESTMENT TAX CREDIT	812.3	839.1	870.3	907.1	948.2	994.9
DIFF			0.5	2.4	5.2	8.2
% DIFF			0.1	0.3	0.6	0.8
HOUSEHOLD STABLES (MILLIONS OF UNITS)						
BASELINE			1,802	1,795	1,910	2,058
INCREASED INVESTMENT TAX CREDIT	1,163	1,563	1,803	1,786	1,883	2,030
DIFF			0.000	-0.008	-0.027	-0.028
% DIFF			0.0	-0.5	-1.4	-1.4
CAPITAL STOCK OF HOMES (MILLIONS OF UNITS)						
BASELINE			76.90	78.13	79.42	80.85
INCREASED INVESTMENT TAX CREDIT	74.78	75.69	76.90	78.12	79.39	80.80
DIFF			0.00	-0.00	-0.03	-0.05
% DIFF			0.0	-0.0	-0.0	-0.1
REGISTRATION OF CARS (MILLIONS OF UNITS)						
BASELINE			112.9	115.6	118.6	121.8
INCREASED INVESTMENT TAX CREDIT	106.9	110.2	112.9	115.6	118.7	121.9
DIFF			0.0	0.0	0.0	0.1
% DIFF			0.0	0.0	0.0	0.0
CAPITAL STOCK OF HOUSEHOLDS (BILS. OF \$'S)						
BASELINE			4240.8	4622.9	5009.7	5530.3
INCREASED INVESTMENT TAX CREDIT	3534.6	3868.2	4241.1	4626.5	5015.8	5534.2
DIFF			0.3	3.6	6.1	3.9
% DIFF			0.0	0.1	0.1	0.1
LABOR FORCE (MILLIONS OF PERSONS)						
BASELINE			97.1	98.8	100.6	102.3
INCREASED INVESTMENT TAX CREDIT	92.7	94.8	97.1	98.8	100.6	102.3
DIFF			0.0	0.0	0.0	0.0
% DIFF			0.0	0.0	0.0	0.0
AVERAGE PRODUCTIVITY (% CHG.)						
BASELINE			5.7	6.0	4.5	5.8
INCREASED INVESTMENT TAX CREDIT	70.7	8.3	5.9	6.2	4.6	5.7
DIFF			0.1	0.3	0.1	-0.1
POTENTIAL OUTPUT (BILS. OF 1972 \$'S)						
BASELINE			1447.8	1491.3	1536.9	1584.2
INCREASED INVESTMENT TAX CREDIT	1365.4	1405.9	1447.8	1491.7	1538.1	1586.3
DIFF			0.0	0.4	1.2	2.1
% DIFF			0.0	0.0	0.1	0.1

TABLE 13. - Continued

	75	76	77	78	79	80
RATIOS						
FEDERAL GOVERNMENT EXPENDITURES TO NOMINAL GNP (%)						
BASELINE	23.6	22.9	22.8	22.6	22.3	21.9
INCREASED INVESTMENT TAX CREDIT			22.8	22.5	22.2	21.9
DIFF			-0.0	-0.0	-0.1	-0.0
GAP (POTENTIAL LESS ACTUAL GAP) (BIL. OF 1972 \$'S)						
BASELINE	173.8	141.0	122.1	103.7	93.3	76.6
INCREASED INVESTMENT TAX CREDIT			121.0	101.2	91.3	76.7
DIFF			-1.1	-2.5	-2.0	0.1
% DIFF			-0.9	-2.4	-2.2	0.1
GROSS EFFECTIVE CAPITAL STOCK TO REAL GNP (%)						
BASELINE	142.0	136.8	133.8	131.3	129.8	128.3
INCREASED INVESTMENT TAX CREDIT			133.7	131.2	129.9	128.6
DIFF			-0.1	-0.1	0.0	0.3
NET CAPITAL STOCK TO REAL GNP (%)						
BASELINE	84.8	81.3	79.3	77.7	76.9	76.2
INCREASED INVESTMENT TAX CREDIT			79.2	77.7	77.0	76.5
DIFF			-0.0	-0.0	0.1	0.3
GROSS CAPITAL STOCK OF POLLUTION ABATEMENT EXPEND. TO REAL GNP (%)						
BASELINE	2.3	2.6	2.8	3.1	3.4	3.6
INCREASED INVESTMENT TAX CREDIT			2.8	3.1	3.4	3.6
DIFF			-0.0	-0.0	-0.0	0.0
REAL BUSINESS FIXED INVESTMENT TO REAL GNP (%)						
BASELINE	9.35	9.17	9.34	9.46	9.63	9.94
INCREASED INVESTMENT TAX CREDIT			9.37	9.58	9.82	10.14
DIFF			0.04	0.12	0.19	0.19
REAL BUSINESS FIXED INVESTMENT LESS POLLUTION ABATEMENT EXPENDS. TO REAL GNP (%)						
BASELINE	8.93	8.75	8.91	8.99	9.16	9.48
INCREASED INVESTMENT TAX CREDIT			8.94	9.11	9.35	9.67
DIFF			0.04	0.12	0.19	0.19

TABLE 14. Capital Formation and U.S. Economic Performance:
"Baseline" and "Corporate Profits Tax Reduction" Solutions

	75	76	77	78	79	80
ECONOMY						

REAL GNP (% CHG.)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	4.8	6.1	4.8	4.7	4.0	4.4
DIFF			0.0	0.1	-0.0	-0.1
UNEMPLOYMENT RATE (%)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	8.5	7.7	7.3	6.4	6.1	5.5
DIFF			-0.0	-0.0	-0.0	0.0
INFLATION (% CHG.)						
GNP DEFLATOR						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	9.2	5.1	5.2	5.3	5.1	4.8
DIFF			-0.0	-0.0	-0.0	-0.0
MPI						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	9.3	4.3	5.0	5.3	5.1	4.9
DIFF			-0.0	-0.0	0.0	-0.0
CPI						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	9.2	5.7	5.0	5.2	4.8	4.9
DIFF			-0.0	0.0	0.0	-0.0
AVG. HOURLY EARNINGS						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	6.9	7.2	6.8	6.7	6.6	6.6
DIFF			-0.0	0.0	0.0	-0.0
CAPACITY UTILIZATION (%)						
ALL MANUFACTURING						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	68.7	72.9	75.3	77.7	78.7	79.5
DIFF			0.0	0.2	0.2	0.0
PRIMARY PROCESSING						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	70.2	76.8	79.6	81.3	82.6	85.0
DIFF			0.0	0.1	0.0	-0.2
FEDERAL TAX RECEIPTS						
(\$ BIL.)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	286.5	328.9	361.0	406.4	455.7	512.2
DIFF			-4.8	-10.1	-11.0	-12.5
% DIFF			-1.3	-2.5	-2.4	-2.4
FEDERAL BUDGET SURPLUS (MIA)						
(\$ BIL.)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	-71.3	-58.4	-64.2	-55.7	-45.1	-26.7
DIFF			-6.0	-6.7	-5.2	-39.6
% DIFF			-0.8	-10.0	-11.1	-12.9
MONEY AND INTEREST RATES						

NARROW MONEY SUPPLY (M1) (% CHG.)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	4.2	5.1	7.0	7.0	6.8	6.8
DIFF			-0.0	0.1	0.0	-0.0
BROAD MONEY SUPPLY (M2) (% CHG.)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	7.7	9.7	11.0	10.8	11.0	10.6
DIFF			0.0	0.0	-0.0	-0.1
FEDERAL FUNDS RATE (%)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	5.82	5.05	5.83	6.22	5.56	6.22
DIFF			-0.01	0.06	0.23	0.30
3-MONTH TREASURY BILLS (%)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	5.78	5.01	5.46	5.76	5.34	5.73
DIFF			0.02	0.08	0.17	0.21
YIELD ON NEW ISSUES OF HIGH-GRADE CORP. BONDS (%)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	9.01	8.34	7.98	8.11	8.03	8.14
DIFF			0.01	-0.01	-0.03	-0.03
VELOCITY (% CHG.)						
BASLINE						
CORPORATE PROFITS TAX REDUCTION	2.9	6.2	3.0	3.0	2.3	2.5
DIFF			0.0	0.0	-0.1	-0.1

TABLE 14. - Continued

	75	76	77	78	79	80
INVESTMENT, CAPITAL FORMATION, AND						
POTENTIAL OUTPUT						
PLANT EXPENDITURES						
(BILS. OF 1972 \$'S)						
BASILINE	36.7	38.1	40.2	41.8	43.6	46.2
CORPORATE PROFITS TAX REDUCTION			40.5	42.3	43.9	46.2
DIFF			0.3	0.5	0.3	0.0
% DIFF			0.7	1.3	0.7	0.1
EQUIPMENT EXPENDITURES						
(BILS. OF 1972 \$'S)						
BASILINE	74.7	77.9	83.6	89.5	95.4	103.7
CORPORATE PROFITS TAX REDUCTION			84.0	91.1	98.0	106.3
DIFF			0.4	1.6	2.5	2.6
% DIFF			0.5	1.8	2.7	2.5
BUSINESS FIXED INVESTMENT						
(BILS. OF 1972 \$'S)						
BASILINE	111.4	116.0	123.8	131.3	139.1	149.9
CORPORATE PROFITS TAX REDUCTION			124.5	133.4	141.9	152.6
DIFF			0.7	2.1	2.8	2.7
% DIFF			0.6	1.6	2.0	1.8
GROSS PLANT (BILS. OF 1972 \$'S)						
BASILINE	903.7	918.7	935.4	953.5	972.7	993.0
CORPORATE PROFITS TAX REDUCTION			934.6	954.2	973.7	994.9
DIFF			0.2	0.7	1.0	1.1
% DIFF			0.0	0.1	0.1	0.1
GROSS EQUIPMENT (BILS. OF 1972 \$'S)						
BASILINE	612.3	639.1	669.8	704.6	743.0	786.7
CORPORATE PROFITS TAX REDUCTION			670.1	706.2	746.7	792.7
DIFF			0.2	1.4	3.7	6.1
% DIFF			0.0	0.2	0.4	0.8
HOUSING STARTS						
(MILLIONS OF UNITS)						
BASILINE	1.163	1.543	1.802	1.795	1.910	2.058
CORPORATE PROFITS TAX REDUCTION			1.767	1.716	1.821	1.975
DIFF			-0.040	-0.079	-0.089	-0.083
% DIFF			-2.2	-4.4	-4.7	-4.0
CAPITAL STOCK OF HOMES						
(MILLIONS OF UNITS)						
BASILINE	74.78	75.69	76.90	78.13	79.42	80.85
CORPORATE PROFITS TAX REDUCTION			76.87	78.03	79.24	80.59
DIFF			-0.03	-0.09	-0.17	-0.26
% DIFF			-0.0	-0.1	-0.2	-0.3
REGISTRATION OF CARS						
(MILLIONS OF UNITS)						
BASILINE	106.9	110.2	112.9	115.6	118.6	121.6
CORPORATE PROFITS TAX REDUCTION			112.9	115.6	118.7	122.0
DIFF			0.0	0.0	0.1	0.2
% DIFF			0.0	0.0	0.1	0.2
CAPITAL STOCK OF HOUSEHOLDS						
(BILS. OF \$'S)						
BASILINE	1534.6	3868.2	4240.8	4622.9	5009.7	5530.3
CORPORATE PROFITS TAX REDUCTION			4240.2	4623.4	5013.7	5534.4
DIFF			-0.6	0.6	4.0	4.1
% DIFF			-0.0	0.0	0.1	0.1
LABOR FORCE						
(MILLIONS OF PERSONS)						
BASILINE	92.7	98.8	97.1	98.8	100.6	102.3
CORPORATE PROFITS TAX REDUCTION			97.1	98.8	100.6	102.3
DIFF			0.0	0.0	0.0	0.0
% DIFF			0.0	0.0	0.0	0.0
AVERAGE PRODUCTIVITY (% CHG.)						
BASILINE	8.7	8.3	5.7	6.0	4.5	5.8
CORPORATE PROFITS TAX REDUCTION			4.6	6.1	4.5	5.7
DIFF			0.0	0.2	0.0	-0.2
POTENTIAL OUTPUT						
(BILS. OF 1972 \$'S)						
BASILINE	1365.0	1405.9	1447.8	1491.3	1536.9	1584.2
CORPORATE PROFITS TAX REDUCTION			1447.8	1491.7	1538.2	1586.3
DIFF			0.1	0.5	1.3	2.1
% DIFF			0.0	0.0	0.1	0.1

TABLE 14. - Continued

	75	76	77	78	79	80
PAYIDS						

FEDERAL GOVERNMENT EXPENDITURES TO NOMINAL GNP (%)						
BASELINE	23.6	22.9	22.8	22.6	22.3	21.9
CORPORATE PROFITS TAX REDUCTION			22.8	22.6	22.3	21.9
DIFF			-0.0	-0.0	-0.0	0.0
GAP (POTENTIAL LESS ACTUAL GNP) (BILS. OF 1972 \$'S)						
BASELINE	173.8	141.0	122.1	103.7	93.3	76.6
CORPORATE PROFITS TAX REDUCTION			121.8	102.8	93.6	79.2
DIFF			-0.3	-0.9	0.3	2.6
% DIFF			-0.2	-0.8	0.4	3.4
GROSS EFFECTIVE CAPITAL STOCK TO REAL GNP (%)						
BASELINE	142.0	136.8	133.8	131.3	129.8	128.3
CORPORATE PROFITS TAX REDUCTION			133.8	131.3	130.1	128.6
DIFF			-0.0	0.0	0.2	0.5
NET CAPITAL STOCK TO REAL GNP (%)						
BASELINE	84.8	81.3	79.3	77.7	76.9	76.2
CORPORATE PROFITS TAX REDUCTION			79.3	77.8	77.2	76.7
DIFF			0.0	0.1	0.3	0.5
GROSS CAPITAL STOCK OF POLLUTION ABATEMENT EXPEND. TO REAL GNP (%)						
BASELINE	2.3	2.6	2.8	3.1	3.4	3.6
CORPORATE PROFITS TAX REDUCTION			2.8	3.1	3.4	3.6
DIFF			-0.0	-0.0	0.0	0.0
REAL BUSINESS FIXED INVESTMENT TO REAL GNP (%)						
BASELINE	9.35	9.17	9.34	9.66	9.63	9.94
CORPORATE PROFITS TAX REDUCTION			9.39	9.60	9.82	10.12
DIFF			0.05	0.14	0.19	0.18
REAL BUSINESS FIXED INVESTMENT LESS POLLUTION ABATEMENT EXPENDS. TO REAL GNP (%)						
BASELINE	8.93	8.75	8.91	8.99	9.16	9.48
CORPORATE PROFITS TAX REDUCTION			8.96	9.14	9.35	9.66
DIFF			0.05	0.14	0.19	0.18

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