

evaluating public programs is the opportunity cost of capital in the private sector. That is, the discount rate should reflect the rate of return that a given amount of resources employed by the Government could earn in the private sector. This rate, of course, varies over time largely reflecting credit market conditions. The witnesses generally agreed, however, that the opportunity cost of capital in the private sector is at least 10 percent at the present time.

Despite this agreement within the economics profession, the Federal Government at the present time uses a variety of discount rates, the determination of which has little to do with opportunity cost. For example, public works projects undertaken by the Corps of Engineers and the Bureau of Reclamation apply the historical coupon rate at the date of issue of long-term Government securities, or about $3\frac{1}{4}$ percent; many highway projects involving Federal funds use a zero interest rate, and a majority of highway projects which employ positive interest rates utilize discounts which vary from 0.1 percent to 6 percent; poverty program evaluations have used interest rates of both 5 percent and 7 percent.

The lack of a coherent, consistent policy concerning appropriate discount rates has two serious, undesirable results. First, when the Government uses a discount rate lower than the opportunity cost of capital in the private sector, there is a misallocation of resources from the private to the public sector, from a higher return use to a lower return use. Or, on the other hand, if the Government uses a higher rate than that employed in the private sector, there is a misallocation of resources from public to private use. Second, when various Federal agencies use divergent rates, the result is a misordering of priorities. A given resource may be used in a lower return use rather than in a higher return use within the Government.

The alternative to the current system of Government discount rates is the use of a uniform rate throughout all agencies which is equal to the opportunity cost of utilizing the funds in the private sector. Adoption of a uniform discount rate based on opportunity cost would result in the approval of projects whose yields are greater than those which could be earned in the private sector, and the rejection of projects whose benefits are not equal to the private return.

If rates used in evaluating Government projects were raised to reflect economic opportunity costs, unquestionably this would have a profound effect on budget priorities. The current low rate structure has been used to justify many large public works programs to the point where there undoubtedly has been overinvestment in this area. A higher and more realistic discount rate for public works would doubtless lead to increased Government investment in human resource programs. Several recent pilot studies reveal high returns from investment in such activities as education and training. For example, one study showed rates of return in education to range from 11 to 19 percent; another study compared benefit-cost ratios for water resource and Job Corps programs at equivalent interest rates and found that the returns to Job Corps projects were significantly higher than the public works returns; and, finally, one other such study reported a benefit-cost ratio of almost 9 to 1 in an adult education program.

Furthermore, it is important to note that many of the cost-benefit studies of human resource investments attempt to measure only those benefits which accrue directly to the individual and are easily