

DETERMINATION OF DISCOUNT RATE

With respect to determination of the rate, one school of thought holds that the rate should be determined by and be equal to the rate paid by the Treasury in borrowing money. Another school of thought holds that the rate should be determined by what is foregone, namely, the return that could have been earned in the private sector of the economy when the decision is made to commit resources to the public sector. Proponents of both views agree that the use of different discount rates has an effect on financial judgments which is similar to charging different prices for, say, identical labor in different programs.

Neither school of thought provides clear guidance on the specific discount rate that should be used. Cost to the Treasury, for example, will vary, depending upon the definition applied, from 3 to 8 percent or more. The average rate of return in the private sector also varies depending upon historical periods selected and upon the weighting of the various segments of the private sector which are used in computing an average.

A discount rate of about 3.2 percent is the cost to the Treasury, if based upon the average rate payable on outstanding United States securities having a maturity of 15 years or more, as prescribed by Senate Document 97 (discussed below).

The rate of return that can be earned in the private sector is estimated by most researchers to be significantly higher than the cost of Government borrowing based on Senate Document 97. According to one researcher, the average rate of return in the private sector amounted to 15.4 percent for manufacturing companies and 4.1 percent for railroads in the years 1961-65.¹ These and other estimates of the same researcher are shown in the following table.

¹Prepared statement of Jacob A. Stockfish, Hearings before the Senate Subcommittee on Economy in Government of the Joint Economic Committee, Ninetieth Congress, on the Planning-Programming-Budgeting System: Progress and Potentials.