

*First*, the size of the initial change, and the disrupting adjustments to planning programs that it would entail, would be too great.

It was generally felt that a larger increase would be impractical and undesirable. The proposed change, itself, would mean that the benefit-cost ratio of an average long-life capital intensive project of 1.4:1 would be reduced to about 1.0:1.

*Second*, the degree of yearly fluctuation in the discount rate needs to be dampened, not accentuated.

Following the yield rate precisely, up and down, could mean a very substantial change each year in the discount rate. Planning of water projects from first formulation and evaluation, through congressional authorization, to appropriation of construction funds, usually takes 5 or more years. It is usually required by the Bureau of the Budget or the Congress that benefits and costs be recalculated on the basis of the currently applicable discount rate two or more times during these years. If the very substantial effect that marked changes in the discount rate can have upon the benefit-cost ratio of a project makes many projects fluctuate from year to year out of and into the "ball park" of economic acceptability, then the Federal Government's administrative process will be greatly disrupted and made more costly. Also, congressional and public attitudes will become strongly adverse to such an unstable process.

To overcome excessive fluctuation in the discount rate from year to year, the provision was included that the rate would not change, up or down, by more than one-fourth point each year.

*Third*, the discount rate to be used in planning water and related land programs, to be consistent with related provisions in Senate Document 97, should not be based upon a "bond yield rate" that is markedly affected by inflationary or deflationary expectations in the bond market.

No allowance is made for expectations of inflation and deflation in calculating benefits and costs in Senate Document 97. Thus, no discount rate having such expectations built into it should be used, unless, of course, all other prices and costs used in the analysis are also to be adjusted for such expectations.

The actions of the Federal bond market for the past 1 or 2 years clearly have reflected rising expectations with regard to inflation. With the passage of the tax bill, recently, yields on long-term Federal bonds have already declined.

To meet the need for a "deflated" discount rate, the Council's proposal would set the beginning new discount rate at 4½ percent. This rate is based upon the average of bid prices for fiscal year 1966. Also, the provision of no rise or fall in the discount rate of more than one-fourth point each year gives some assurance that the discount rate would not respond inappropriately to expectations of inflation or deflation in the Federal bond market.

In closing this statement, Mr. Chairman, I would like to state again that the attachment to this statement includes the Water Resources Council's proposed regulation. No final decision by the Council, with the approval of the President, has yet been made. The notice that appeared in the Federal Register last Friday has provided all those interested in this matter an opportunity to provide the Council