In this example the difference between the 15 percent rate of return to the displaced investment and the 13.2 percent opportunity cost of capital is equal to the difference of 2.7 percentage points—equals 7.7 minus 5—in the supply price of capital facing the displaced investment and that facing the Government, reduced by one-third to account for lower personal income tax revenues.

The methodology underlying the above calculation is, apart from the treatment of property taxes, essentially identical to that presented by the Comptroller General on pages 25–26 of his report. This brings me to an elaboration of my first point of difference with that report. From the point of view of economic logic, when attempting to measure the cost to the society as a whole of Government borrowing, there is no ground to distinguish whether the taxes foregone on the income from displaced investments would have accrued to the Federal Government or to State and local governments. By focusing on Federal taxes alone, the report unduly narrows its focus. Property tax considerations must enter into any comprehensive measure of the overall opportunity cost of Government borrowing, particularly when property taxes play as important a role in the overall fiscal system as they do in the United States.

The report likewise leaves excise and sales taxes out of consideration, an omission which is harder to understand than that of property taxes since, even apart from highway taxes which might be considered as user charges, the excises by themselves produce some $10 billion per year in revenue to the Federal Government. Of course, State and local sales and excise taxes should also be brought into account; these, which yield considerably more than the Federal excises, further emphasize the importance of incorporating sales and excise taxes into the overall calculation of the opportunity cost of Government borrowing.

To see how the adjustment for sales and excise taxes should be made, assume that the product produced by the displaced investment in the preceding example is subject to sales and excise taxes of 10 percent, and that total costs of sales are distributed as follows:

| | *Percent* |
|---|---|
| Earnings of capital, gross of property, and profit taxes | 20 |
| Earnings of labor, gross of fringe benefits, and social security taxes | 20 |
| Depreciation of capital | 10 |
| Material inputs | 50 |

Sales and excise taxes apply to the total of all these costs, but we need to know what part of such taxes to attribute to the displaced capital investment. On the working hypothesis that materials inputs bear a fixed relationship to total output in the indusry in question, the following formulation holds. Add "Depreciation to earnings of capital," giving a gross of depreciation capital share of 30 percent, in this case. Then allocate the material input share to labor and capital in proportion to their adjusted shares. In this case we thus allocate to capital 20 percent from "Earnings of capital gross of property and profits taxes" plus 10 percent from "Depreciation of capital," plus 30 percent from "Materials." The total is 60 percent, on which sales and excise taxes will have to be paid, say, at a rate of 10 percent. Our figure for the "Earnings of capital gross of property and profits taxes" was $150,000 in the earlier example. This corresponds to 20 percent of total costs. The excise taxes attributable to this additional capital are 10 percent