

There is only one rate of discount which can bring rational calculations to both sides of the tax-expenditure picture in this way, and that is what I have called the social opportunity cost of public borrowing.

The market price of a product should affect a farmer's production and consumption decisions in the sense that any excess of production over consumption can be sold in the market, and any excess of production over consumption must be bought in the market. Even though for some products the amount bought or sold might be small relative to the farm's production of the product and the family's consumption of it, it is perfectly valid for the farmer to base his production decisions on the market price and for his wife to base the family's consumption plans on the market price.

In just the same way the social opportunity cost of government borrowing can operate to guide taxation and expenditure decisions. It matters not that total borrowing is small relative to taxes and expenditures; what is important is that any extra taxes tend to reduce borrowing and any extra expenditures tend to increase it. The one price that can serve as a guide to both sets of decisions is therefore the opportunity cost of government borrowing.

Let it be noted, too, that the use of the social opportunity cost of government borrowing as a guide to tax and expenditure decisions does not mean that the discount rate is beyond the influence of public policy. Actually, there are two ways in which public policy can influence this rate. First, changes in the rates of tax applicable to the different sectors can change the social opportunity cost of capital obtained at their expense. Thus, a reduction in corporation tax rates would at one and the same time serve to channel more funds into the corporate sector of the economy and also to reduce the opportunity cost of any government funds subsequently obtained at the expense of that sector.

Secondly, to the extent that the social cost of additional tax revenue is judged to be lower/higher than its social yield, increases/decreases in the level of taxation over time can make more/less capital available to the private sector, thus leading to decreases/increases in the market level of interest rates and of private-sector capital yields generally. Thus, though at any point in time the opportunity cost of public borrowing is basically determined by the nature of the then-existing tax and capital-market structures, public policy can be used to influence the way in which this discount rate moves through time, via public decisions concerning both the nature of the tax structure and the overall volume of revenue to be raised through taxation.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Mr. Harberger, do you arrive at any general conclusion on the discount rate level? What ought it to be?

Mr. HARBERGER. Well, the calculation that I made, which admittedly is quite rough—

Chairman PROXMIRE. 10.8 percent?

Mr. HARBERGER. 10.7 percent. I would say that something between 8.5 or 11.5 or 12 would probably represent the plausible range for such an estimate.

Chairman PROXMIRE. As I recall, the Comptroller General, in his analysis, in his concept as you indicated, is somewhat close to yours;