

that is, it is the cost of long-term borrowing plus forgone taxes or either 7 or 8 percent.

Mr. HARBERGER. That is right.

Chairman PROXMIRE. I take it, Mr. Eckstein, you arrive in that general area, too.

Mr. ECKSTEIN. Yes, Mr. Chairman.

Mr. HARBERGER. My calculation differs from that of the Comptroller General in the particular sense that it takes into account the effects of Government borrowing on sales and excise taxes, and on property taxes. It seems to me that we should not take a narrowly, purely Federal focus in calculating these tax changes. The tax changes really represent what we call in economics external effects of Government borrowing, and if, at the same time as tax revenues are changing for the Federal Government, they are also changing for State and local governments, they should be counted.

Chairman PROXMIRE. Will you spell out what is your rationale for including the tax-forgone item in your calculations?

Mr. HARBERGER. Let me start at another end of the spectrum. If we get government funds, let us say, at the expense of corporate investment with a yield of 15 percent, we might simply take 15 percent as the opportunity cost of those funds, even though the Government is only paying 5 percent on its borrowings. The reason why taxes come into the picture is because the full differences between the 15 percent earned on corporate investment and the 5 percent paid on Government bonds does not represent a true cost to investors. A part of the difference is simply a compensation for the extra risk borne by investors in corporate securities. If the 15-percent yield of corporate investment can be broken down into 5 percentage points of interest—equivalent to that on Government bonds—plus 2 percentage points of risk premium; plus 8 percentage points of taxes, the opportunity cost of Government borrowing at the expense of such investment would be 13—equals 5 plus 8—not 15 percent.

Chairman PROXMIRE. Is this a risk element?

Mr. HARBERGER. It is a risk or taste element on the part of the general public, but it is a genuine cost that is important, I think, or it is relevant to take into account.

Chairman PROXMIRE. That element is wholly gone, absent, from the Government investment?

Mr. HARBERGER. Yes. At least, the risk element is measured by comparing the yields on private securities with those on Government bonds. One need not ask the question, Does the public have some sense of risk concerning Government bonds? The differential we observed in the market is the additional sense of risk that the public has when it compares corporate securities with Government bonds.

Chairman PROXMIRE. You arrive at how big a difference, now?

Mr. HARBERGER. How big a difference in—

Chairman PROXMIRE. Between the Government and corporate bonds.

Mr. HARBERGER. It varies all over the map, Senator.

Chairman PROXMIRE. I know, but overall, in arriving at your calculation of 13 and—

Mr. HARBERGER. What happens is if you were to say in the example I gave that 15 percent is the productivity that capital would have in the corporation, of which 8 is taxes and 7 is the cost of capital to corporations, that compares with, let us say, a 5-percent yield on Govern-