

IV The Social Cost of Federal Financing

We have seen how the interest rate in the competitive model serves as a price in the capital market, bringing the savings preferences of consumers into consistency with the investment plans of business enterprises. Let us now extend the examination to investment undertaken by government.

Most of the activities of government are devoted to satisfying collective wants, wants which cannot be met through goods and services sold in the market place. Whenever the ballot box and the political process replace market choice, investment decisions will not be made by comparing the rate of return of investments with the market rate of interest.¹ Many of the collective goods produced by public investments are valued qualitatively, precluding computations of the rates of return which underlie private investment decisions. The costs are more specific, however; resources employed in a public undertaking have alternative uses in the production of marketable commodities and will, therefore, have a price which measures their opportunity cost.

This cost cannot be measured directly from the borrowing cost, since the funds are raised by taxation, but within the competitive

¹ Some goods, such as electric power, supplied by government are marketable; others, such as flood control, though nonmarketable, can be valued at prices established in related markets. Yet the fact that the investment decision is made in a political context results in the introduction of other considerations and makes it unlikely that the decision will be made in accordance with the economic principle alone.