

This may seem to be a cumbersome procedure for deriving one number—the opportunity cost applicable to resource development funds. But there is no short cut. With capital coming from many sources, which face widely differing borrowing and lending rates of interest and whose saving and investment decisions are conditioned by altogether different factors, the actual impact of federally financed projects on the economic activities of the other sectors of the economy varies widely. It has been argued, for example, that the true opportunity cost of capital is the rate of return earned on the marginal investments of the most successful private firms, such as DuPont or General Motors, rates which before taxes are in excess of 20 per cent. But this is not the true opportunity cost; reduction of the federal program by \$100 million would not result in expansion of investment by such firms of an equal amount. It has also been argued that the interest rate on long-term government bonds measures the social cost of public capital.⁸ This rate is also inappropriate, because it presupposes that the entire cost of projects is financed out of voluntary bond purchases and that the risks attached to projects are borne by the buyers—two conditions that do not hold. A number of other easily derived rates can be supported by plausible arguments, but in the end the arguments break down. A sector-by-sector approach, assuming a specific incidence of marginal taxation, is far more trustworthy because it corresponds to the actual conditions under which public capital is raised.

Before embarking on our detailed quantitative study, a few precautionary comments should be made about our basic assumptions. We take it as axiomatic that a measure of the social cost of capital which is consistent with an economic efficiency approach must accept the sovereignty of consumers' choice, even in matters of

study, we assume that the fiscal authorities reduce taxes by the appropriate amount, i.e., an amount sufficient to result in the utilization of a bundle of resources equal to the quantity released by the reduction of expenditures. Thus, we assume constancy of effective demand. We also assume that our result is not affected by any redistributions of income attributable to the multiplier effects of the two offsetting changes in the budget.

⁸ The practice of most agencies and the recommendations of Budget Bureau Circular A-47 and of the Sub-Committee on Benefits and Costs of the Federal Interagency River Basin Committee imply this position. See Otto Eckstein, *Water Resource Development: The Economics of Project Evaluation* (Cambridge: Harvard University Press, in press), Chapter IV, for a survey of actual practice.