

There are other reasons for adhering to our model's assumption. First, the empirical evidence on the relationship between risk-taking and individual welfare is scanty and unconvincing. While people purchase insurance to reduce risk, they also gamble.⁴² Second, and more important, there are two very strong institutional factors in our economy which erode the relationship between high risk and high return. One is the giant corporation which undertakes so many investments that there is much pooling of risks within its own program. The suppliers of the corporation's capital bear only a fraction of the sum of risks of the individual investment projects, and the same is true of the company itself. The other institutional factor is our tax system, which makes risky investments particularly attractive to wealthy individuals, since they usually lead to capital gains rather than ordinary income. With much the largest part of the investable funds made available by personal sources⁴³ coming from taxpayers in the upper brackets, the differential between tax rates on capital gains and on ordinary income promotes the willingness to take risks to such an extent that the difference between the rates of return of risky and secure investments must be much diminished.

Let us briefly consider the cost of capital if risk premiums are treated as prices paid for the factor service of risk-bearing. Lenders are assumed to be rational in this respect, and the risk premium of a loan must be sufficient to compensate for the risk which is taken. On this assumption, a federal loan which displaces a risky private loan and invests the proceeds in a risk-free project would entail a lower social cost than the alternative since there is a reduction in risk-bearing. If we make the bold assumption that all differences in interest rates for the same period are risk premiums, then it might be argued that the true social cost of a risk-free federal investment is the pure interest rate alone—a rate which is probably best approximated by the yield on federal securities with a term equal to the life of the investment.

⁴² Cf. M. Friedman and L. J. Savage, "The Utility Analysis of Choices Involving Risk," *Journal of Political Economy*, August 1948, pp. 279-304; and F. Mosteller and P. Nogee, "An Experimental Measurement of Utility," *ibid.*, October 1951, pp. 371-405.

⁴³ For a full discussion of this point, see J. K. Butters, L. E. Thompson, and L. L. Bollinger, *Effects of Taxation, Investment by Individuals*, (Boston: Gradu-