

substantially higher than 10 percent reflects a substantial compensation for their riskiness. I believe it is reasonable for us to make at least a modest allowance for risk in our interest rate calculations.

However, I think that in our analysis we should treat the uncertainties explicitly and not merely fold them into a higher target rate of return. This makes it possible for the uncertainties to be judged explicitly by the official responsible for making the decisions.

I would like to give my full support to the establishment of a consistent discount rate policy for evaluating Federal investment, though I recognize the basic discount rate used throughout the Federal Government may not need to be as high as 10 percent.

The issues involved in choosing an appropriate discount rate concept and a correct discount rate are extremely complex, a fact which is borne out both in the economic literature on the subject and in the recent testimony before this committee. The basic point, however, is quite straightforward: The resources used by the Government in its investment projects can also be used productively by private consumers and investors. Whether the Government raises its funds by taxation or by borrowing, some consumers must forgo consumption opportunities which, since they already pass up risk-free investments offering 5 percent interest, must be worth at least 5 percent to them, and some investors must forgo investment opportunities which return 10-20 percent before taxes.

Government agencies should take these opportunity costs into account when calculating the costs of their projects and determining their value to society.

I believe that the rate that is used should not be biased either for or against Government investments.

Adopting a sensible interest rate policy should have two desirable results: *First*, it should lead to a more rational allocation of resources between the private economy and the public sector; *second*, it should encourage the proponents of investment projects to design them specifically to achieve high rates of return.

Discounting should be much more than a mechanical procedure for weighing future costs and benefits. Project designers should recognize that features that do not pay their way in significantly increased benefits or reduced costs should be left out. If they do, the Government will have a menu of much more productive investment alternatives to choose from.

Proper discounting is only one aspect of good analysis, however. If the analyses underlying investment proposals are poorly conceived, or if benefit and cost estimates are faulty, discounting is unlikely to lead to better decisions. As a practical matter, the use of discounting will probably place an even greater premium on competent analysis. If programs must be justified against tougher cost-benefit criteria, great care must be taken to insure that benefit and cost concepts and estimates are sound.

I think this committee is performing a valuable service by surfacing the discounting problem and promoting rational debate on the complex issues involved: I appreciate the opportunity to support the committee's objectives.

Thank you, sir.

Chairman PROXMIER. Thank you, Mr. Enthoven.