

write off the development bill at 10 percent over a 15-year period. Naturally, then, we are quite interested in aircraft B. However, there are great uncertainties about the cost estimates as well as about the technical risks, and we have to take these uncertainties into account. What this analysis is supposed to do is to encourage the proponents of new aircraft types to design them so that they are as profitable as possible an investment for the Defense Department without sacrificing the capability to meet basic mission requirements.

The best time to encourage this type of work is in the very early stages of an analysis when the alternatives are still being designed.

Mr. Chairman, this concludes the remarks I would like to make.

Chairman PROXMIRE. I wish you would go on for just a few moments and give us your analysis on the supersonic transport.

Mr. LYNN. I am pleased you noticed.

Chairman PROXMIRE. I did. I could not resist it.

Mr. LYNN. We have, of course, had some experience in the past with doing economic analyses of the SST program, because Mr. McNamara was quite deeply involved in the Government committee dealing with that subject. We do not attempt to review or judge the merits of the investment. We attempt merely to do economic analysis of the payoffs of this investment in cash terms, given the very great uncertainties and risks associated with the program. The analyses we show here are, I think, a very good illustration of how difficult it is to take into account all of the uncertainties in arriving at a sensible decision. But I think what we have tried to do is to display the relevant information in a meaningful way so a decisionmaker can focus on it.

For example, there are a variety of estimates of how large the SST market will actually be. There is also the question of what discount rates to use. So we show, for different estimates of the size of the SST market, the present value of the SST investment at discount rates of 5, 10, and 15 percent.

In this way one can look at the question of how the uncertainties about the size of the market affect judgments about the SST program and at how opinions about the right discount rate affect these judgments. As to what the judgments finally are, of course, that involves a great many more considerations than we can encompass in this particular kind of analysis.

Chairman PROXMIRE. You are a diplomat as well as an economist. I shall come back to this in the questioning.

(The prepared statement of Mr. Lynn follows:)

PREPARED STATEMENT OF LAURENCE E. LYNN, JR.

The need for appropriate discounting and interest rate policies in government agencies is now widely recognized, thanks in large part to the Joint Economic Committee. The correct and consistent use of discounting, however, is only one aspect of good analysis. Using the "right" discount rate will not necessarily lead to wiser decisions on government investments if the supporting analyses are poorly conceived and carried out. On the other hand, good program analyses will reflect the appropriate use of discounting procedures in both the design and the evaluation of alternatives.

This paper first discusses an appropriate interest rate policy for use in Federal agencies. Second, the Defense Department's current discounting policies and procedures are described, along with several examples of how discounting has been used in practice in DoD.