

STATEMENT OF ASSOCIATION OF AMERICAN RAILROADS

CONSISTENT DISCOUNT PROCEDURE FOR PUBLIC EXPENDITURE ANALYSIS

My name is Burton N. Behling. I am Vice President, Economics and Finance Department, Association of American Railroads (AAR), Washington, D.C. The AAR is a voluntary association and represents railroads accounting for 98 percent of the operating revenues of all linehaul railroads in the United States. I appreciate the opportunity of submitting this statement on behalf of the AAR concerning "Consistent Discount Procedure for Public Expenditure Analysis." This Committee is to be commended for conducting these pioneering hearings. I am confident the hearings will foster improvements in evaluating public investments by focusing attention on the critical role of interest rates used in such analyses.

INTRODUCTION

Historically, there has been no uniform method for computing interest rates for use in evaluating public investments. This deplorable condition has resulted in the misallocation of resources between the public and private sectors of the economy as well as among various public investment undertakings. Moreover, the lack of a uniform interest rate formula makes it almost impossible for the Congress to evaluate the relative economic efficiency of alternative public investments recommended by the various Government Departments.

My statement briefly discusses the following interest rate concepts that have been used or proposed for use in evaluating public investments:

1. Coupon rate on long-term Treasury securities.
2. Yield on long-term Treasury securities.
3. The social rate of time preference.
4. The opportunity cost of capital.
5. Cost of long-term Treasury securities adjusted for taxes forgone.

For the purpose of this statement, the relevancy of the five concepts of interest rates listed above are evaluated on the basis that the appropriate interest rate for use in evaluating public investments should provide the most efficient allocation of the Nation's limited resources between the public and private sectors of the economy as well as between the present and future generations.

I have assumed that the public investment of resources should meet the test of economic efficiency, although recognizing some government programs involving social goals or objectives need not meet this test. However, this does not preclude the use of the discounting procedure for evaluating public expenditures for strictly social goals.

After determining the most relevant interest rate concept for use in evaluating public investments, I have suggested a rate of interest for use by all Government Departments.

COUPON RATE ON LONG-TERM TREASURY SECURITIES

Senate Document No. 97, 87th Congress, 2nd Session, provides that the discount rate for use in evaluating water and related land resource projects be based on the average rate of interest payable by the Treasury on interest-bearing marketable securities of the United States outstanding at the end of the fiscal year preceding such computation which, upon original issue, had terms to maturity of 15 years or more. The application of this formula currently results in an interest rate of $3\frac{1}{4}$ percent for evaluating the costs and benefits of water and related land resource projects.

There is no question that this formula results in understating the real cost of borrowing by the U.S. Treasury. It is equally clear that returns in the private sector are substantially greater than $3\frac{1}{4}$ percent. Consequently, the use of this formula has resulted in the misallocation of the Nation's resources. There is general agreement among economists that an interest rate based on the coupon rate of long-term Treasury securities is not relevant for the purpose of evaluating public investments.