

YIELD OF LONG-TERM TREASURY SECURITIES

On July 26, 1968, the Water Resources Council proposed a new formula for computing the interest rate to be used in the formulation and evaluation of water and related land resource projects. The Water Resources Council proposed that the discount rate be determined as follows:

"The interest rate to be used in plan formulation and evaluation for discounting future benefits and computing costs, or otherwise converting benefits and costs to a common basis, *shall be based upon the average yield during the preceding fiscal year* on interest-bearing marketable securities of the United States which, at the time the computation is made, have terms of 15 years or more remaining to maturity: provided, however, that in no event shall the rate be raised or lowered more than $\frac{1}{4}$ percent in any year." (Underscoring added.)

The Water Resources Council computes the proposed discount rate to be 4 $\frac{5}{8}$ percent and recommends it be used in plan formulation and evaluation of water and related land resource projects during the remainder of fiscal year 1969. It should be noted that the proposed discount rate of 4 $\frac{5}{8}$ percent is based upon the average of bid prices for fiscal year 1966. This contradicts the formula quoted above which provides that the interest rate to be used in fiscal 1969 be based on 1968 yields. The Council adopted the bid prices for fiscal 1966 to meet the needs for a deflated discount rate, since the Federal bond markets for the past two years have reflected rising expectations with regard to inflation.

Although this formula is a substantial improvement over the procedure provided by Senate Document No. 97 and is a step in the right direction, it, too, does not accurately reflect the real cost of long-term borrowing by the United States Treasury. The use of this formula will continue to result in the misallocation of the Nation's resources since the returns in the private sector of the economy are substantially greater than 4 $\frac{5}{8}$ percent.

The Water Resources Council proposes that the current coupon rate of 3 $\frac{1}{4}$ percent be used to evaluate projects which have been authorized by or will be authorized by Congress prior to the close of the second session of the 90th Congress, and where the appropriate state or local governmental agency or agencies have given satisfactory assurances by December 31, 1969, to pay the required non-Federal share of project costs, unless Congress decides otherwise.

The proposal to continue to use the coupon rate of interest (3 $\frac{1}{4}$ %) in evaluating authorized projects, even though no construction has commenced, has no economic merit and will result in the misallocation of the Nation's limited resources. I am confident there are a number of authorized projects with marginal benefit-cost ratios based on an interest rate of 3 $\frac{1}{4}$ percent which could not meet the test of economic efficiency if evaluated on the basis of an interest rate of 4 $\frac{5}{8}$ percent. Moreover, this proposal places the Congress in the position of having to appropriate funds for water and related land resource projects on the basis of a dual standard.

THE SOCIAL RATE OF TIME PREFERENCE

According to this concept, public investments provide benefits to future generations and it is unlikely that the current cost of capital provides the correct interest rate for evaluating public investments. Thus, it is contended that current interest rates do not permit future generations to express their preference and the Government should adjust the current rate downward because of the willingness of present consumers to shift or redistribute income to future generations. There is little evidence to support a finding that people collectively approve the redistribution of income to future generations. Moreover, there are no readily available data for use in computing the social rate of time preference.

If this concept were followed without considering the opportunities foregone in the private sector of the economy, it would result in the misallocation of resources since public investments made on this criteria would displace private investments, for which the returns are much greater. If we are collectively concerned about the well-being of future generations, efforts should be made to stimulate those investments that will result in economic growth, which will obviously increase the well-being of future generations.

OPPORTUNITY COST OF CAPITAL

The opportunity cost of capital is based on the returns foregone in the private sector of the economy since the Government must obtain its capital through taxes or borrowing. In the private sector, the opportunity cost for investors is currently