STATEMENT OF BOARD OF COMMISSIONERS OF THE PORT OF NEW ORLEANS

Discount Rates for Use in the Formulation and Evaluation of Water Resource Projects

The following statement is submitted in behalf of the Board of Commissioners of the Port of New Orleans (an Agency of the State of Louisiana) on the subject of the application of economic criteria and discounting procedures in formulating and evaluating Federal water and related land resource projects. The interest of the Board, based upon its direct responsibilities, obviously is concerned primarily with channel and harbor development projects for the benefit of deep-water navigation. However, the development of the inland waterway system of the Mississippi River and Tributaries which provides a major transportation network connecting the mid-continent area of the Nation to the Port of New Orleans and the Gulf Intracoastal Waterway, as well as other shallow draft channels also are within the Board's area of interest. Furthermore, the safety of the Port and City of New Orleans, as well as the entire State of Louisiana, is dependent upon the Federal works for river flood and hurricane protection.

This Board is gravely concerned with the proposals to increase drastically the discount rate for use in water resources development projects, the effect of which would be to reduce the benefit-ratio ratios on future potential improvements. In the economic analysis of water resource projects, an increase in the interest rate has a double-barrelled effect on the benefit-cost ratio. First, as the interest rate goes up the interest charge on the borrowed money increases and therefore the annual cost increases. Second, the present value or worth of future benefits are drastically reduced as the discount rate increases.

The order of magnitude of the effect of increased discount rates may be shown by the following example. A project having an assumed economic life of 50 years may show a benefit-cost ratio of 1.5 to 1 at 3% interest. If this project has a substantial portion of its benefits accruing in the later years of its life, a higher discount rate will drastically reduce the future benefits. Therefore, an interest rate of 4% will reduce the benefit-cost ratio from 1.5 to 1.2. When the interest rate is increased to 5%, the benefit-cost ratio drops to 1.0; and increasing the interest rate to 6% results in an unfavorable benefit-cost ratio (below unity).

In recent years, relatively few projects reported by the Corps of Engineers for authorization have a benefit-cost ratio in excess of 1.5. The impact of a proposed higher interest rate in evaluating waterway projects therefore becomes readily apparent.

It is noted that the discount rate for use in plan formulation and evaluation of projects for waterway development has been 3¼%; however, the Water Resources Council has announced a proposed new formula for computing rates under which the rate for fiscal 1969 would be 4⅝%, an increase of 1⅜ percentage points. Furthermore, it is indicated by the announced policy of the Water Resources Council that the interest rate shall be subject to recomputation each year, with the provision that the rate shall not be raised or lowered more than one-quarter of one percent per year.

The impact of the proposed increase from 3⅛% to 4⅝% cannot be fully evaluated on the basis of information currently available. However, no doubt this drastic adjustment will affect adversely a number of important projects which are now in the final reporting phase by the Corps of Engineers. Certain of these projects will fall in the category of those having an unfavorable benefit-cost ratio unless corresponding adjustments are made in the evaluation of benefits.

The gradual adjustment of the interest rate for use in cost analyses may be fully justified. However, a sudden increase in the interest rate which is to be applied only to the projects for waterway improvement is discriminatory and prejudicial to the orderly expansion and development of the Nation's water resources.

It is understood that consideration is being given to a radical increase in the interest rate to 7½% and that upwards of 10% to 15% has been advocated.