

Economic Analysis of Public Investment Decisions: Interest Rate Policy and Discounting Analysis

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INTEREST RATE POLICY AND DISCOUNTING ANALYSIS—AN ABSTRACT

In this report, the Subcommittee on Economy in Government presents its conclusions on the application of discounting procedures in Federal Government bureaus and agencies and submits its recommendations on this matter. The subcommittee accepts without qualification the proposition that consistent discounting procedures and appropriate interest rate policy must be adopted throughout the Federal Government if wise and economic investment decisions are to be made. Testimony presented to the subcommittee demonstrated that such consistency is not now present. The subcommittee recommends that no public investment be deemed "economic" or "efficient" if it fails to yield overall benefits which are at least as great as those which the same resources would have produced if left in the private sector. Currently, the rate of return on alternative minimum-risk private spending is at least 5 percent. Indeed, some of the economists appearing before the subcommittee argued for substantially higher interest rates—rates in the 7 to 12 percent range.

On the basis of the testimony presented, the subcommittee recommends that—

1. The Bureau of the Budget insist on the adoption of consistent discounting procedures by all agencies;

2. The Bureau of the Budget, in conjunction with an appropriate Government agency, immediately undertake a study to develop a method for estimating the weighted-average opportunity cost of private spending displaced by Government investment. This method should recognize that the financing of the Federal Government entails a reduction in both private consumption and private investment spending;

3. An appropriate Federal agency undertake the on-going publication of this weighted-average opportunity cost interest rate as guidance to those agencies applying discounting analysis to public investment decisions. This interest rate calculation and publication should be pursuant to and based upon the above-mentioned study;

4. The proposal of the Water Resources Council which ties the interest rate to the yield on Government securities with long terms to maturity be adopted. The subcommittee judges that the yield on long-term Federal Government securities is the lowest possible rate consistent with the minimum-risk opportunity cost of displaced private spending;