

be put. The way for the Federal Government to assure this result is to adopt in public investment appraisal an interest rate policy which reflects the private sector opportunities foregone.

In opting for this conceptual basis, however, the subcommittee recognizes that the estimation of an interest rate representing the cost of displaced private spending is not a settled matter. In testimony before the subcommittee, three distinct methods for estimating this rate were suggested. Each of these procedures assumes a different method of financing Federal investment and, consequently, each finds a different pattern of private spending displaced. These positions are summarized as follows:

(a) *The opportunity rate of return on private investments.*—In this approach, the public sector would look to the before-tax rate of return on private investment for guidance on interest rate policy. This position presumes that any holder of funds in the private sector has access to investments with this high rate of return and, therefore, this rate has normative significance for social interest rate policy.³⁰

(b) *The opportunity cost of tax-financed investments.*—This approach to interest rate estimation assumes that the Federal Government finances its spending by withdrawing funds from the private sector through taxes. Because the imposition of taxes forces some individuals to forego consumption and other individuals to forego investment, the opportunity cost must reflect some combination of both types of sacrifice.³¹ To calculate this rate then requires that dollars raised in taxes be traced to their ultimate source so that the social returns foregone in these sectors can be estimated. A carefully worked out model for calculating this rate under various taxation assumptions was presented to the subcommittee.³²

(c) *The opportunity cost of public investments financed by borrowing.*—Instead of presuming that the Federal Government obtains investment funds through the tax mechanism, this approach assumes that public investments, like some private investments, are financed through the capital market.³³ The estimation task in this case requires that the dollars borrowed be traced through the economy to ascertain the private activities which are displaced. This approach to opportunity cost estimation was described to the subcommittee as follows:

[To] use private-sector rates of return to obtain the opportunity cost of public funds, what is clearly called for, at least under present institutional arrangements in the capital market, is a weighted average of the rates of return applying in all relevant sectors of the private economy, the weights reflecting the degree to which investment in each sector is estimated to be displaced by public-sector borrowing.³⁴

While advocating the opportunity cost of displaced private spending as a correct conceptual basis for the Government discount rate, the subcommittee does not presume to advocate a precise method for calculat-

³⁰ "The Planning-Programming-Budgeting System: Progress and Potentials," hearings, pp. 133-143.

³¹ "Economic Analysis of Public Investment Decisions * * *," pp. 25, 27, 56, 137, and 143-144.

³² *Ibid.*, pp. 82-134.

³³ *Ibid.*, pp. 57-65.

³⁴ *Ibid.*, p. 58.