ing this rate. We do, however, caution against the reliance on the observed rates of return in a limited subsector of the private economy as a normative guide to Federal Government interest rate policy. We agree with the Bureau of the Budget's reluctance to "adopt * * * the rate of return on private investment foregone alone because government funds are drawn from both consumption and investment." [35]

However, having advocated a conceptual basis for the public discount rate, the subcommittee notes that a number of subsidiary issues essential for sound discount rate policy remain unresolved. These concern matters such as the following:

1. The role of risk and uncertainty in public investment decisions and interest rate policy;
2. The appropriate interest rate for application to public investments which displace specific private investments; and
3. The treatment of inflationary influences on observed interest rates.

The subcommittee does not presume to define a single correct approach to these issues. A number of suggestions presented to the subcommittee, however, do appear worthy of emphasis.

Nearly all of the witnesses appearing before the subcommittee noted that the estimation of the opportunity cost of displaced private spending by reference to realized private returns builds into the interest rate measurement an average allowance for risk and uncertainty present in the private sector.[36] Use of this rate to evaluate public investments implies that they bear risk and uncertainty characteristics similar to those in the private sector. While this might be an acceptable practice, the subcommittee finds worthy of continued study the suggestion that a basic minimum-risk interest rate be used by the Federal Government and that explicit allowances be made for risk and uncertainty in the benefit and cost estimates of each public investment.[37] The subcommittee notes that, in the judgment of nearly all of the witnesses, the "current yield on long-term Government securities" is the lowest reasonable estimate of this basic minimum-risk rate. We note further that it is on this basis that the Bureau of the Budget and other witnesses support the new interest rate formula proposed by the Water Resources Council. "A long-term riskless rate reflecting a private opportunity cost should not be less than the current yield on Treasury bonds with long terms to maturity." [38]

In the testimony presented to the subcommittee, a number of witnesses addressed the question of the risk and uncertainty present in real investments. They agreed that, while the benefits and costs of all real investments are to some extent risky and uncertain, some undertakings are significantly more venturesome and hazardous than others. If, then, a basic, minimum-risk interest rate is applied to the investment, the estimated streams of benefits and costs should be adjusted to allow for risk and uncertainty. Further, the degree of adjustment should be related to the degree of hazardousness present in the investment.[39] Hence, the benefits of an investment in a hydroelectric project would typically require less adjustment for risk and uncertainty than, say, an investment in an experimental, nuclear power generating facility.

[35] Ibid., pp. 27 and 41–42.
[36] Ibid., pp. 27–28, 67, and 144.
[37] Ibid., p. 28.
[38] Ibid., p. 28.
[39] Ibid., pp. 27–28, 72–73, 77, and 144.