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THE CURRENT MINIMUM-RISK INTEREST RATE WHICH SHOULD BE USED FOR EVALUATING PUBLIC INVESTMENTS IS AT LEAST 5 PERCENT

As outlined above, estimates of the interest rate for discounting public investments vary with the concept chosen as the appropriate basis for measurement. However, because the evaluation of public investments should accurately reflect the value of private sector alternatives foregone, the appropriate range of estimates is narrowed substantially. The consensus among the experts appearing before the subcommittee could be summarized as follows:

1. If explicit allowance for risk and uncertainty is made in the estimates of benefits and costs, a minimum-risk base interest rate can be used for discounting. In this case, the average current yield on Government securities with long terms remaining to maturity is an appropriate minimum estimate of the opportunity cost of displaced private spending. This rate is currently about 5 percent. The new procedure proposed by the Water Resources Council is consistent with this basic minimum-risk concept and represents a major improvement over past interest rate policy.

2. If specific allowance for risk and uncertainty is not made in the benefit and cost estimates, an average allowance can be incorporated in the base interest rate. In this case, the opportunity cost of displaced private spending, as observed in private capital markets, should be accepted as the base interest rate. As stated above, this rate is estimated as a weighted average of the observed rates of return over the private consumption and investment sectors. Depending on the system of weights adopted, this rate is currently in the 8-10 percent range.