Benefit-cost analysis

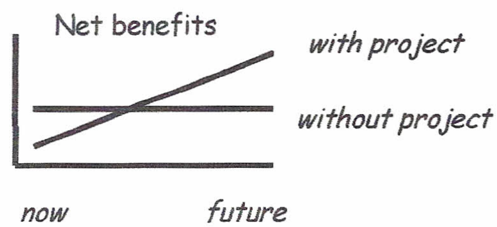
Will a proposal be economic for the long run?

Many action proposals require a front-end investment now, but take a number of years for the benefits to show up. Some examples are:

- A micro-credit program to enable farmers to obtain better animals for breeding.
- A co-op dairy processing plant to provide local milk producers with a market outlet.
- Reforestation and sustainable harvesting of a denuded upland area.
- An educational program to prepare local young people for good off-farm jobs.
- A bus transit system to enable villagers to get to jobs and markets in a nearby city.

While non-financial goals may be much in mind, economic outlays and returns will usually be an important consideration. Will the proposal be financially feasible, without adding to the burdens on taxpayers or other funding sources? Will it pay off as well as other initiatives or approaches that could be considered?

Benefit-cost analysis (BCA) is the projection of required outlays and resulting returns over a period of years. It might cover 20, 30 or more years, according to how long the investment is expected to be productive. Or if leaders are concerned about near-future impacts, BCA might cover only 5 or 10 years. BCA can focus on the impacts on a particular local group involved, such as an individual cooperative, village or farm family. Or it can embrace positive and negative impacts on a broader segment of society, such as a province, watershed or the nation as a whole.



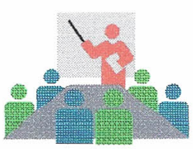
When projecting impacts many years into the future, a procedure called *discounting* is often used to help place near-future and later costs/returns items on a comparable basis. A dollar gained now is worth more than a dollar received 20 years from now; one can be reusing that dollar in other ways. What discount rate to use and, indeed, whether to use discounting at all, is much discussed these days. Some environmentalists and others argue that discounting places long-term investments with delayed benefits at unfair disadvantage.

You yourself may not be a BCA expert. But don't let yourself be overwhelmed if vague or confusing reference is made to BCA. Benefit-cost analysis is not always done correctly. It sometimes neglects non-money considerations. Ask some penetrating questions, such as:

Viewing through whose eyes?

What direct & indirect impacts included?

Looking how many years ahead?



How solid are the benefit-cost estimates?

If discounting used, what rationale?

Any allowance for inflation, delays, etc.?

For more, see the Compounding and Discounting item on this web site.