Diminishing added returns & opportunity costs

How much to invest in a particular line of action?

When making investments or planning programs, often there are options of doing just a little…doing more…doing lots more. It helps to ask *two pivotal questions* about the next increment that you are thinking about:

1) *Will the added benefit be more than offset the added outlay?*
2) *Is this the best way to use this added outlay? Might other uses have higher payoffs?*

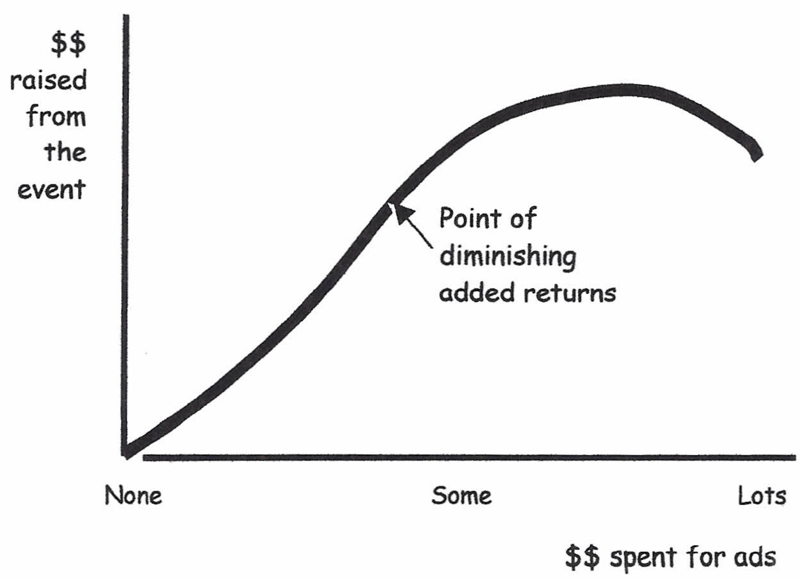
For "benefit" you could substitute any number of tangible and intangible terms—returns, income, food supply, economic payoff, risk reduction, consumer satisfaction, enjoyment, wellbeing, air pollution reduction….

And "outlay" can refer not only to money costs or physical inputs but also to such resources as time, space, group energies, institutional capacity, and political points.

And by "added" I mean the same thing as what economics texts call "incremental" or "marginal."

Diminishing added returns When first investing more inputs into a particular use, you often can expect high added returns. The second increment may also yield a high payoff. But a point is likely to be reached when the added returns start to diminish. One has to consider whether it's worthwhile to put more time and funds into this line of action.

For example, suppose you are sponsoring a folk-music event to raise money for your cause. You are deciding how much publicity to give to this via newspaper and radio ads. Only a couple of ads might not have much impact at all. More ads could have a high payoff in terms of local awareness and interest in the event. Even more ads might enable you to reach and interest people in surrounding communities. But the point could be reached when more ads don't add much to interest. In fact, people could become so tired of hearing about the event that they are "turned off."



Opportunity costs Even if a proposed investment or action has a high likely payoff in its own right, it still may not make sense to go ahead with that. The resources that you have as a farmer, project manager or whoever normally are limited. The more you devote to one use, the less is left for other uses. Maybe one or more of these other uses would have higher payoffs – would bring you closer to your goals. Or one of these other uses might bring the same progress with fewer resources (i.e., more cost-effective). Or another use might carry lower risks or negative side-effects than the initial proposal.

Rational choices So it is that the wise decision-maker thinks about "diminishing added returns" and "opportunity costs" before supporting a proposal to invest more resources in a particular given course of action. She or he raises questions when someone makes statements like "We need to go all the way on this one" or "There is only one way to get this done." She or he presses for solid incremental estimates of what is likely happen via other options as well as the action being proposed.

Here are some other examples of choices where diminishing added returns and opportunity costs may come into play

- A farmer deciding how many times to weed his vegetable plots this year.
- A farmer deciding whether to invest his savings into more cropland.
- A community proposing more tax concessions to attract a particular industry.
- A real estate developer requesting zoning for another new shopping center.
- A highway department proposing to build new roads to ease traffic jams.
- A consultant proposing additional studies of local educational needs.
- An environmental group insisting that an old "brownfield" site be cleaned up to highest residential standards.
- A recreational group pressing for more hectares of a national forest preserve to be opened up for off-the-road vehicles and snow mobiles.
- An anti-trade group pressing for higher and higher protective tariffs.
- A depressed industry pressing for more and more subsidies.