

Benefit-Cost Analysis

BY AARON STEELMAN

When considering making a purchase, consumers weigh the pros and cons of their decision. For some items, such as a pack of gum, this may not require a lot of thought. But for others, such as education, it may prove quite difficult.

Consider the case of adults deciding whether they should go back to school for another degree. They have to ask themselves a number of questions. Should I return to school at all? If so, which school should I attend? And should I go full time or part time?

The answers to those questions can involve a lot of considerations. The most significant is often pecuniary. Can I afford it? And will the additional degree improve my earning power enough to pay for the time and money I will spend attaining it?

For others, the financial considerations may be less important. Some people return to school knowing that the choice will cost them money, but are willing to do so because it is necessary to switch to a different, more satisfying profession. Even for these people, though, there are difficult issues to consider, such as how attending school will affect the amount of time they can spend with family and friends.

In other words, the specific benefits and costs may differ from person to person but the calculus does not. In the end, everyone hopes to make the “right” choice — that is, the one that results in greater benefits than costs, whatever those may be.

Public-policy analysts often engage in a similar exercise concerning legislative and regulatory proposals. They consider whether a given proposal will yield more benefits than costs — that is, whether it will improve the well-being of society.

Not surprisingly, this analysis is often more complicated than simply taking a notepad, counting up the benefits on one side and the costs on the other, and rendering a verdict. Most fundamentally, it is often difficult to know in advance exactly what effects a proposal will have. But even if the effects are clear, there are vexing ethical issues that must be tackled. For instance, it’s not obvious what time period should be used as a benchmark.

Take environmental proposals. It is possible that, if enacted, some proposals would yield more costs than bene-

fits for current citizens. But for future generations, those proposals could be very beneficial — so beneficial, in fact, as to dwarf the costs imposed on us today. Should we consider the well-being of those people who are not even born yet? Some would say yes, while others would argue no.

In addition, some charge that benefit-cost analysis is simply too cold and calculating to be a useful policy tool. There’s an old saying that you can’t put a price on a human life. But people conducting benefit-cost analyses do it all the time. Consider the case of safety-belt laws. In order to gauge whether these laws pass a benefit-cost analysis it is necessary to provide a numerical estimate of the value of a human life. Such estimates are usually in the \$6 million range. They are arrived at, in part, by looking at the risks that people are

willing to take as they go about their daily business. What’s more, not all lives are valued the same. The Environmental Protection Agency got into hot water recently for using an estimate of \$2.3 million per life for people over 70 years of age, instead of the \$6.1 million figure it used as an across-the-board measure. Some critics say this practice is simply ghastly. But whatever imperfections there may be with benefit-cost analysis, most agree that it is a powerful tool, grounded in sound economics.

In fact, since 1997, Congress has required the Office of Management and Budget (OMB) to provide estimates of the total annual benefits and costs of all federal regulatory programs as well as estimates of individual regulations. In its first report, OMB concluded that there was insufficient evidence to recommend eliminating any specific regulatory programs. Not surprisingly, those “politicians wishing to curb the excesses of social regulation were generally disappointed with the OMB report for not going far enough,” wrote economist Robert Hahn in an article for the *Journal of Economic Perspectives*. Over the past five years, OMB has refined its methodology, and while critics believe much remains to be done, they are generally pleased to see benefit-cost analysis lent the legitimacy they think it deserves.

In the end, difficult ethical issues will always surround benefit-cost analysis. But that doesn’t mean that benefit-cost analysis should be abandoned. It simply means that its limitations must be recognized and readily admitted. **RF**



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