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The importance of conventions: A critical evaluation of current practice in social cost-benefit analysis

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Structure of session

- Introduction
- Current practice social cost-benefit analysis
- The economics of convention critique
- Q&A

Introduction

- What are **social costs and benefits**?
  - ➢ Economists distinguish them from private costs and benefits
  - ➢ They are the costs/benefits incurred by society as a result of a private transaction
  - ➢ Often called ‘externalities’

Example of a social costs: I buy a packet of cigarettes from a local shop. The price I pay is the **private cost**, and revenue received is the **private benefit**. However, me smoking creates **social costs** (passive smoking affects the health of others).

Example of social benefits: I pay my pharmacist and receive the flu vaccine. I receive **private benefits**, in that I am protected, but I also protect those around me (social benefits).

- Additional importance for public and third sectors!
  - Minimisation of social costs
  - Maximisation of social benefits (policy objectives are social)

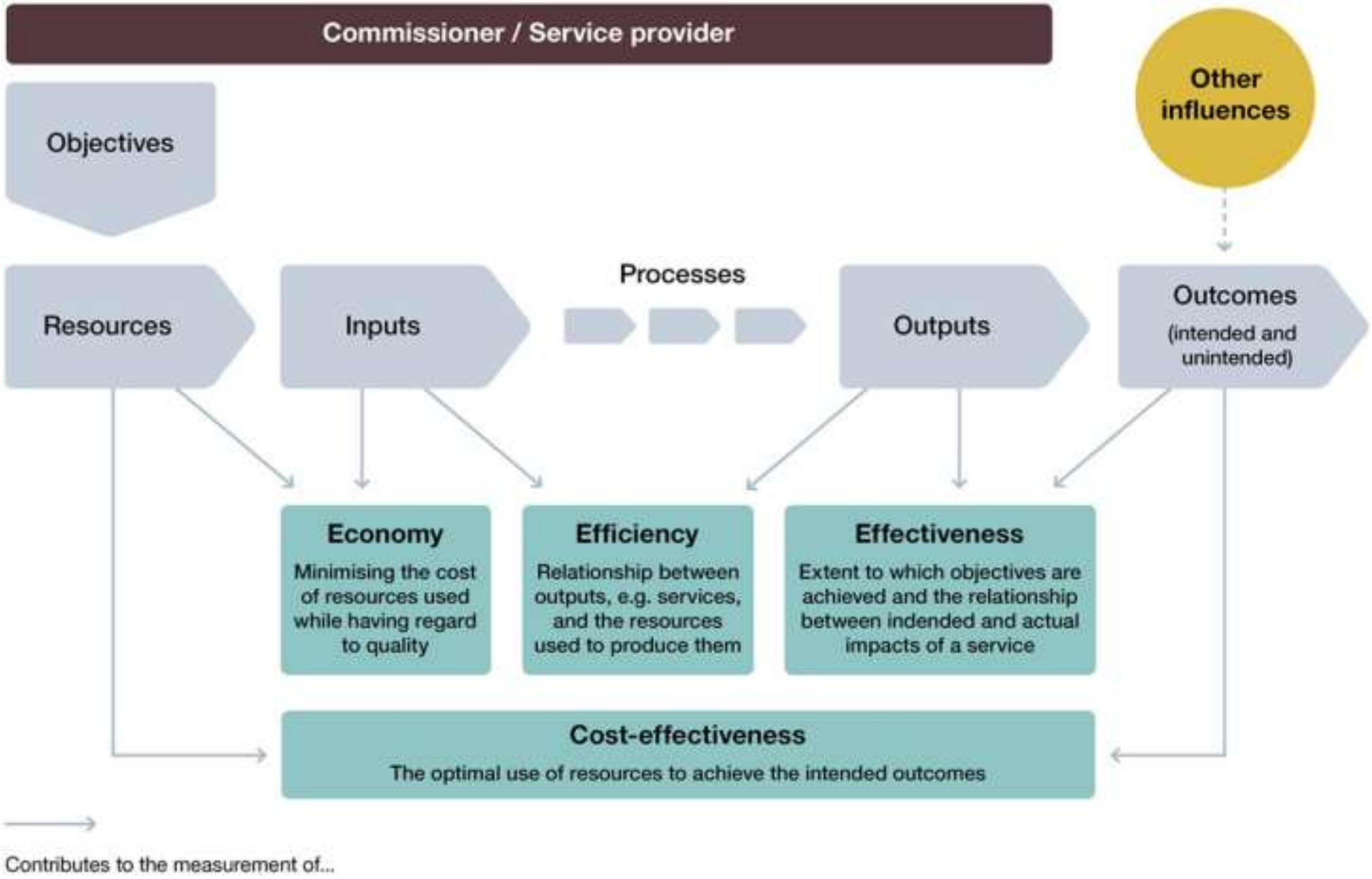
- Why do we need to quantify social costs and benefits?
  - Need to evaluate
  - Need to demonstrate ‘Value for Money’ (especially for National Audit Office)
  - Therefore, we need to give social costs and benefits a financial value (£) – need to quantify them!

Evaluation has focused on achieving the 3 E's of evaluation:

- **Economy**: minimising the financial cost of resources used or required (inputs) (i.e. spending less);

- **Efficiency**: the relationship between the output from goods or services and the financial resources used to produce them (i.e. spending well); and

- **Effectiveness**: the relationship between the intended and actual results of public spending (outcomes) (i.e. spending wisely).



Source: NAO (2016)

Current practice social cost-benefit analysis

Contingent valuation method (CVM)

CVM “involves eliciting the maximum amount that people are willing to pay for welfare improvements and the minimum that they are willing to accept as compensation for welfare loss, to derive a demand curve for the good in question” (Quah & Toh, 2012. p. 14).

Negative: often vast differences in stated preferences verses revealed preferences.

Hedonic pricing

Hedonic pricing uses price differentials in existing markets as proxies for prices with certain attributes (Quah & Toh, 2012).

For example, if one house is worth £2m with an average ambient noise of 20dB while another is only worth £1m and has an average ambient noise level of 35dB we can ‘price’ a reduction of noise by 15dB as £1m.

Negative: makes strong assumptions about effect of attributes on prices. What about other factors, e.g. air quality?

Shadow pricing

Shadow pricing is a proxy value of a good/service, often defined by what an individual must give up in order to gain an extra unit of the good/service.

For example, the journey time saved by motorists as a result of a new motorway can be quantified using an average hourly wage rate.

Negative: ignores whether good/service is actually what is demanded/needed, e.g. HS2?

Quality-Adjusted Life Year (QALY)

A measure used by health economists to estimate both the quantity and quality of additional years of life.

For example, a new cancer treatment offers a patient an additional 10 years of life in perfect health (a utility of 1, where perfect health has a value of 1 and death has a value of 0). Overall yields 10 years x 1.0 = 10 QALYs.

Negative: difficult to define health utility (expect at 1 or 0)

Life Satisfaction Assessment

Life Satisfaction Assessment evaluates social projects and programmes by how much additional income people would have to have spent to achieve an equivalent gain in life satisfaction (Mulgan, 2010).

Negative: a very new unproven approach and is highly sensitive to what assumptions are made about inputs.

The economics of convention critique

- Conventions are “a regularity in behaviour” (Lewis, 1969. p. 51)

- For example, how to greet friends: a kiss or a handshake, or another example may be what signs signify binding agreement prior to the signing of a contract.

- Such signals also help to distinguish between those who are (or not) part of a given community and worthy of trust which enables collective action to be coordinated.

- Therefore, as a society we are able to solve problems of coordination in situations of uncertainty by following conventions with their associated expectations, and by assuming that such conventions are common knowledge.

Centemeri argues:

“Quantification and objectivity are strictly associated, since historically objectivity emerged in our societies as a fundamental category in the construction and organisation of modern politics, to quantify a knowledge produced according to conventions (rules and procedures) supposed to guarantee impersonality, impartiality and fairness” (2012. p. 1).

However, as Centemeri goes on to argue, such conventions of quantification (or statistical conventions) are not value-free but in fact loaded with the social conventions of those who create them:

"Quantification is guaranteed by 'conventions of quantification' that are the outcome of controversies about the good, or convenient, way to evaluate persons and things, according to desirable social goals aimed at" (Centemeri, 2012. p. 1).

Therefore, according to Centemeri 'conventions of quantification' are underpinned by the moral values and social expectations of those who then decide how to quantify social phenomena.

…So what?!

As a consequence of this process "To quantify is to reshape our world, introducing new entities that are clearly separated from us, and that, once created, have an independent life" (Centemeri, 2012. p. 16).

Once established, a convention of quantification becomes "the 'natural' way to measure a reality" (Centemeri, 2012. p. 17) as these conventions stabilise and ultimately solidify in academic and wider nomenclature.

e.g. What does 'unemployment' mean?

- Common convention: "Someone who doesn't have a job"

- ILO definition (convention of quantification) of 'Unemployment':

- without work, that is, were not in paid employment or self employment during the reference period;

- currently available for work, that is, were available for paid employment or self-employment during the reference period; and

- seeking work, that is, had taken specific steps in a specified recent period to seek paid employment or self-employment.

Conclusion: Consequence for social cost benefit analysis

The economics of convention is important because:

- Whose conventions do we adopt?
- What are the moral convictions driving those meanings?
- Who is to decide the measures/indicators used?

Q&A

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Sources available:

Hill. P. (2017). *The importance of conventions: A Critical Evaluation of Current Practice in Social Cost Benefit Analysis.* APM Research Fund Series. Princes Risborough: Association for Project Management. URL = https://www.apm.org.uk/news/apm-has-launched-its-latest-research-fund-report-the-importance-of-conventions/