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## Social Cost Benefit Analysis - A Study

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### Abstract:

'Profit Maximisation' is no more the any aim of business. It is being felt that business owners, the business should evolve a balance in the interests of employees, customers, suppliers, government and the general public. A business unit owes its very existence to the society by using the society's resources as inputs and by selling the produced goods and services to the society. It is, therefore, necessary that a business should operate within the overall parameters determined by the society. The present study categorically analyses why social cost benefit analysis technique to be introduced, rationality and importance of social cost benefit analysis, indicators of cost benefit analysis and methodology for evaluating social cost and social benefit etc. The study attempts to show that social cost benefit analysis is very much important for evaluating a project whether it is sustainable or not. No business could be allowed to exist if it is detrimental to the interests of the society. Finally the study comes to a conclusion that though social cost benefit analysis has been accepted as an important tool of investment analysis, it is not a precise technique because of its inherent difficulties. In India some companies in private and public sectors have started publishing social reports as supplementary information in the form of Social Income Statements and Social Balance Sheet though there is no legal obligation on companies to do the same.

**Key words:** Social cost, Social benefit, Social Accounting

### 1. Introduction

'Profit Maximisation' is no more the any aim of business. It is being felt that business owners, the business should evolve a balance in the interests of employees, customers, suppliers, government and the general public. A business unit owes its very existence to the society by using the society's resources as inputs and by selling the produced goods and services to the society. It is, therefore, necessary that a business should operate within the overall parameters determined by the society. The society is also to see that such business activities should be undertaken which are beneficial to the society as a whole. Keeping this objective in view, the governments, both in free and controlled economies, enact such appropriate legislation for regulating growth and development of business, which they consider necessary in the overall national interest. For example, in India there are certain fields in which the private sector is not allowed to operate at all, while there are certain areas which have been absolutely reserved for the small sector and still there are areas where both public and private sectors can operate singly or in joint collaboration with each other. The basic philosophy behind this arrangement is that all sectors of the economy, public or private, small or big, should work for the overall good of the society.

### 2. Rationality And Importance

For determining the rationality of investment in any project, whether commercial or a project undertaken for social upliftment as a whole, cost benefit analysis is necessary. The commercial evaluation of a project is concerned only with private costs and benefits and does not take into account the existence of externalities in returns and costs. Such an evaluation, usually, does not coincide with social costs and benefits which need to be evaluated with respect of society's welfare and national objectives. Social cost benefit analysis is the evaluation of investment proposals in terms of their estimated net impact on the economy. It measures the economic, social and environmental costs and benefits to the society expected to arise from the implementation of the projects. The underlying principle is that a project should be accepted only if the total benefits from the project are greater than its total costs.

The importance of the concept of social cost benefit analysis can be followed from the study of a transportation project in U.K, known as 'Victoria Line Project.' On the basis of economic evaluation the project was not acceptable taking 6% cost of capital. However, when the adjustments are made for the social benefits in the form of services provided, the same project was accepted even at 8% cost of capital. Social cost benefit analysis is useful not only for the public sector projects but for private sector also. The Planning

Commission has already decided that in future the feasibility studies for the public sector projects will include an analysis of the social rate of return. In the case of the private sector also, a socially beneficial project may be more easily acceptable to the Government and hence the social cost benefit analysis will be relevant while granting various licences, approvals, subsidies etc. Such projects may also find favour with financial institutions in grant of loans. Moreover, with the present pace of responsibility, ultimately only those organisations are bound to survive which do not go against the interest of the society in general. Hence, social cost benefit evaluation is beneficial for all projects whether in the public or private sectors.

### **3. Indicators Of Social Desirability Of A Project**

The United Nations Industrial Development Organisation (UNIDO) and the Centre for Organisation of Economic Co-operation and Development (COECD) have come with useful publications dealing with the problem of measuring social costs and social benefits. The actual costs of or revenues from the goods and/or services to the organisation do not necessarily reflect the monetary measurement of the cost or benefit to the society. These figures are grossly distorted due to restrictions and controlled imposed by the Government. Hence, a different yardstick has to be used for evaluating a particular payment terms of social cost and sacrifice on the part of the society. Such payments are easily valued at opportunity cost or shadow prices to judge their real impact in terms of cost to society for the purpose of social cost benefit evaluation. It is almost impossible to measure in precise monetary items the real costs and benefits to the society arising from a project. However, a broad judgement may be made about the acceptability or otherwise of a project on social grounds by looking to the different social aspects associated with the project. There are various indicators/criterion which may be used to evaluate the social desirability of a project. Some of the important indicators are discussed below :

### **4. Employment Potential**

In a developing country like India, while labour is surplus, the employment potentiality of a project is an important consideration while determining the social desirability of a project. The project which is labour intensive and has higher employment potential is preferred over the project having lower opportunities to generate employment.

### **5. Output Per Unit Of Capital**

As capital is also scarce in a developing country, capital output ratio becomes an important factor in evaluating the social desirability of a project. The project which gives a higher output per unit of capital employed is given preference over a project which gives a lower output per unit of capital employed.

### **6. Value Added Criterion**

The term 'value added' refers to the cost incurred by an organisation such as salaries, wages, interest etc in converting materials into finished products. Thus, the value added by a project can be ascertained by deducting the total value of buying out inputs, such as, raw material, components etc from the total value of production. This criterion is similar to the capital output ratio except that the estimated value added by a project is considered in place of the total value of the output. Under this approach, value added per unit of capital invested is ascertained and the project which gives higher value is preferred to the project which gives a lower value added per unit of capital. It serves as a good indicator as it takes into account the net contribution of an enterprise or project to the national economy. The capital output ratio cannot be used satisfactorily in case of projects which use a high proportion of buying out materials. While evaluating different projects according to social cost benefit analysis technique projects having high 'value added' content are to be ranked high.

### **7. Benefit In Foreign Exchange**

The impacts of the project on the foreign exchange reserves of the country is also good social criterion for accepting or rejecting a project. In a developing country like India, where the foreign exchange position generally remains tight, this an important criterion while making appraisal of a project. For evaluating the project according to this criterion, projects can be ranked according to the net contribution the projects are going to make to the foreign exchange reserves of the country. Projects having greater potentiality in terms of foreign exchange benefits will have priority over other projects.

### **8. Cost Benefit Ratio**

According to this criterion, the projects are evaluated on the basis of total social benefits and costs associated with the projects. Social benefits for this purpose include all economic and non-economic, internal and external benefits which the society is likely to receive from the project. Similarly, the term social cost includes all costs which the society will have to pay whether in monetary terms or otherwise for the project. For evaluating the projects according to this criterion, projects are ranked according to their cost benefit ratios. A project having the most favourable cost benefit ratio is given the highest preference.

The social costs and benefits of a project are ascertained on the basis of 'shadow price'. The shadow price of an input is the real price that would have prevailed had there been no imperfections and externalities in the market.

Social evaluation of cost benefit elements in terms of shadow prices does not give a correct picture unless costs and benefits are adjusted for time factor. This done by using a rate of discount chosen for this purpose, called social rate of discount. The discounted costs and benefits can be compared to evaluate the desirability of a project.

### 9. Methodology For Measurement Of Social Costs And Social Benefits

The methodology for working out social costs and social benefits relating to a project is given below keeping in view the same as suggested by the Centre for Organisation of Economic Corporations and Development (COECD).

### 10. Social Costs

- All financial costs of a project during the construction period and the operational stage should be ascertained be.
- The financial costs so ascertained will have to be converted into social costs. For this purpose, the financial cost, as determined above, should be segregated between cost incurred in terms of foreign currency and cost incurred in terms of local currency.
- The financial cost incurred in terms of foreign currency will be considered as social cost of equivalent amount without any adjustment.
- The local currency will be classified into three categories :
  - Tradeable items costs.
  - Labour costs.
  - Residual items costs.

The computation of social cost of each of the above items is as follows:

- Tradeable Items Costs  
The tradeable items are those items which are dealt in International market. These items include most of the commodities except water and electricity, which can be theoretically traded in the International market. The social costs of tradeable items is determined on the basis of International prices of the commodities concerned.
- Labour Costs  
The computation of social cost of the labour involved in project is done by dividing the labour force into three categories - skilled, semi - skilled and un-skilled. The social cost of each of these three categories is worked out separately by adopting the shadow pricing technique.
- Residual Items Costs  
These include those items which are neither tradeable items nor labour costs. The social cost of these items is ascertained by determining their opportunity cost depending upon the nature of each item of costs.

### 11. Social Benefits

The total value of social benefits from a project is ascertained by determining the total tradeable value of its financial products. In other words, the social benefits from a project can be judged with reference to the import value of such goods or to the detriment which the society suffers in case they are not produced.

The technique for evaluation of social costs and benefits as stated above is merely illustrative. It is not a perfect and precise technique. A lot of research is still to be done. Moreover, the technique does not take into consideration aspects such as happiness, aesthetic, pleasure etc, which are incapable of being quantified. We have, therefore, to go a long way before evolving a suitable satisfactory and generally acceptable technique for conducting social cost benefit analysis.

### 12. Conclusion

In spite of the fact that social cost benefit analysis has been accepted as an important tool of investment analysis, it is not a precise technique because of its inherent difficulties. It is very difficult to identify various social costs and benefits to the society and still more difficult to convert these costs into monetary equivalents. The United Nations Industrial Development Organisation (UNIDO) and the Centre for Organisation of Economic Co-operation and Development (COECD) have published the methodologies for measuring social costs and benefits. But still a lot of research is needed in these directions.

In India, financial statements are prepared under the provisions of the Companies Act, 1956. There is no legal obligation on companies in India to provide details of social costs and benefits while preparing their financial statements. However, some companies in private and public sectors have started publishing social reports as supplementary information in the form of Social Income Statements and Social Balance Sheet.

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