Economics Briefing 4

Social CBA and SROI

This briefing looks at how to incorporate social considerations into cost-benefit analysis and also presents the theory of Social Return on Investment (SROI), which incorporates 'wellbeing' impacts into the analysis.

Why cost-benefit analysis?

Cost-benefit analysis (CBA) is the predominant tool used in welfare economics in order to assess whether an intervention – be it a project or policy – should be undertaken or not. The criterion for an intervention to be undertaken is that its' benefits outweigh its' costs relative the "status quo" – namely the current prevailing conditions.

In some countries, undertaking a cost-benefit analysis for appraising public projects is mandatory, e.g. US Presidential Executive Order 12291, or HMT guidance in the UK.

The question, however, concerns what is included and excluded in "costs" and "benefits": should we consider solely financial costs and benefits (simple returns on investment)? Or should we consider a wider array of costs and benefits, including those not reflected in the "market" such as environmental and social aspects? Traditional cost-benefit analysis has tended to emphasise the economic costs and benefits, especially because there is often an economic imperative about jobs and growth behind many projects. Social and environmental costs and benefits, despite being of central concern to individuals and communities, are treated as secondary considerations. Progressively, alternatives have developed and have complemented conventional analyses: these include social cost-benefit analysis (Social CBA) and social return on investment (SROI).

What is social CBA?

What is commonly referred to as "social cost-benefit analysis" is an extension of economic cost-benefit analysis adjusted to represent and reflect the full stream of costs borne by,

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and benefits accruing to, society as a whole. Beyond strict economic or financial costs and benefits, any intervention might equally entail both social and environmental costs and benefits. Social CBA aims to insert these into the equation so as to investigate whether an intervention is beneficial to society as a whole. Including social and environmental costs in the equation means that these need to be monetarily valued in order to be compared like-for-like with financial / economic costs and benefits. If all impacts are translated into the same metric, then the condition for a project / intervention to be undertaken is that the sum of economic, social and environmental benefits outweighs the sum of economic, social and environmental costs.

This process entails measuring knock-on (indirect) costs and benefits (positive and negative so-called "externalities"). Three forms of knock on impacts can be distinguished: (1) knock-on impacts which are tangible and have a "market" value (e.g. number of jobs created or destroyed indirectly); (2) knock-on impacts which are tangible but do not necessarily have a market value per se (see: briefing number 3 on valuing nature); (3) knock on impacts which are neither tangible (in an economic sense) nor have a market value: for example well-being or "social capital".

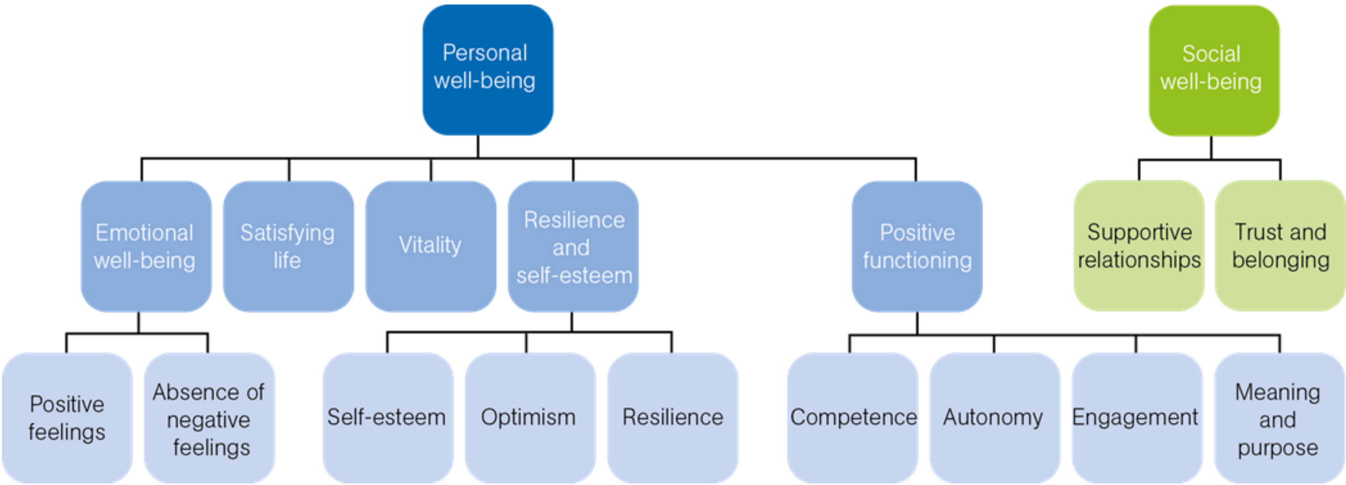
In practice social CBA has often focused on economically tangible knock-on costs and benefits [points (1) and (2)] while disregarding well-being perspectives in economics [point (3)]. This disregard has deep roots: in practice (if not in formally stated theory), conventional economics consider societal wealth (market value, economic) maximization as an end, rather than as a means for achieving well-being. This economic 'truth' has been contested, notably by the Commission on the Measurement of Economic Performance and Social Progress presided by Nobel Laureates Amartya Sen and Joseph Stiglitz[1].

Moving a step further: SROI

Social return on investment (SROI) is an adjusted form of social cost-benefit analysis which moves further than conventional analyses. It is strongly grounded in direct stakeholder engagement, to ensure that what matters to the people affected by an intervention is counted and that their voice is recognised and reflected in decision-making. SROI is therefore intended to provide a better evidence framework for how to achieve good lives and human well-being. It also emphasises sustainability by taking a long-term view of outcomes recognising that not doing so can lead to 'false economies'. SROI recognises that economic, environmental and social outcomes are all critical factors in achieving good lives and well-being and should be included in a "triple bottom-line" approach. This means that in addition to economic and environmental costs and benefits, SROI adds social and well-being costs and benefits arising from an intervention. Further information on typical well-being outcomes, impacts and indicators can be found in the National Accounts of Well-Being. Figure 1 on the following page shows an overview of which aspects of personal and social wellbeing are included and evaluated.

[1] See: "Further reading" at the end of the brief for full reference and access to the document

Figure 1: Overview of national accounts of well-being



Well-being indicators may often assess related impacts, but in a different metric. In this sense, they can serve as a complement rather than a substitute for conventional social CBA analyses. For example, a loss of employment can be translated into simple income loss (and resulting loss of tax revenue for the State) but can also be expressed through well-being loss (associated with lower income, but also reduction of personal or community resilience, loss of self-esteem, of optimism etc.). Similarly, the existence of parks or other natural amenities can *in fine* (ultimately) impact on both social and personal well-being via numerous routes – e.g. the feeling of community. Thus, taking a well-being perspective does not negate the importance of economic outcomes, but rather stresses their insufficiency for illustrating the positive and negative impacts of an intervention on society in a holistic manner.

Can we put a monetary tag on social aspects of life and well-being?

As mentioned before, both social CBA and SROI require social and environmental impacts to be translated into monetary terms in order to be compared like-for-like with economic impacts. Putting a monetary tag on non-market goods can be challenging but it is important to recognise that market prices themselves are subjective, variable and inexact. For example, they are often a result of negotiating power rather than, as might be commonly expected, reflective of the real incurred costs. The intention in SROI is to ensure that all material costs and benefits – economic, social and environmental - are assigned an approximate and evidence-based value. Not to do so is effectively to give outcomes like 'strong communities' or 'self-confidence', a value of zero in a key decision-making framework. Nevertheless, difficulties of valuation are a key factor impeding the plain and simple replacement of traditional appraisal and evaluation methods. Whilst briefing 3 was dedicated to methodologies to valuing nature, here we focus on the valuation of social/well-being outcomes.

Overall social valuation has been influenced by environmental valuation: well-being outcomes are valued either in; (1) an

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"instrumental" fashion (i.e. how much an increase of well-being can enhance economic outcomes) or (2) in an intrinsic way (valuing well-being for its own sake). What do these options look like?

- **Option 1**
- Illustratively, these methods can be applied as follows: consider a case whereby an intervention increases the self-esteem of stakeholders. This increase in self-esteem might result in more "tangible" activities such as greater participation to social activities. If using a revealed preference (instrumental) approach, then it would be possible to say that the value of self-esteem can be derived from the value the individual spends (including the value of time) to undertake these social activities. If using a stated preference approach (Willingness-To-Pay WTP or Willingness-To-Accept WTA), on the other hand, we need to account for the intrinsic value of self-esteem, e.g. how much the individuals value an overall increase in self-esteem (beyond observed spending). The revealed preference (RP) approach is more accurate (as it is based on observed behaviour) but will only represent part of the value created. The stated preference (SP) approach can potentially represent the entire value of self-esteem to the individual but is nonetheless based upon hypothetical statements i.e. it assumes that the individual in question is able to conceive and grasp all implications of having a higher self-esteem.
- **Option 2**
- In this case of an intervention which increases self-esteem of stakeholders, for instance, it is possible to ask stakeholders directly how changes they experience as a result of an intervention manifest in their lives, and this can yield helpful information towards approximating a value; if using a revealed preference approach, for example, we could state that an improvement in self-esteem might result in greater social activity, the cost of which can be estimated. This value is just a "proxy" for self-esteem since we only consider one of the results of an increased self-esteem, but is nonetheless accurate since it is based on observed behaviour of the individual in question.

The former option is usually conducted by using WTP or WTA techniques; while the latter requires the use of econometric techniques. In SROI it is also possible to ask stakeholders directly how changes they experience as a result of an intervention manifest in their lives, and this can yield helpful information towards approximating a value; for example an improvement in self-esteem might result in greater social activity, the cost of which can be estimated. In practice however, most analysts use "benefit transfer" – which consists of using values drawn from other studies and apply them in a different context.

What are the implications of social valuation?

Valuing social and well-being outcomes poses three challenges: (1) one of a technical nature; (2) another of an ethical/normative nature; and (3) one in terms of the importance of equity (distribution). Social valuation studies are scarce, which creates a problem when wanting to value well-being outcomes, given that not all well-being outcomes can be valued using robust figures (i.e. drawn from academic research). Similarly the use of very different "proxy" (substitute) figures to "monetize" social outcomes means that the results of different SROIs are hardly comparable: in short, choosing a high or low proxy figure can "inflate" or alternatively "underestimate" social benefits respectively, leading to over or under-claiming.

- From a normative and ethical perspective there is also a question mark over whether we should even try to express social and well-being impacts in market terms (monetary terms). The risk in this case is to "merchandize" well-being by giving an illusion of substitutability between well-being and money; this is because in a cost-benefit framework any well-being benefit can potentially be outweighed by financial or economic costs.

- Although SROI allows you to see the value created or lost for different stakeholder groups, it doesn't extend to systematically adjusting results for distributional consequences. For example, the effect of an intervention which raises households' incomes by an equal amount will be experienced differently according to how rich or poor a household is in the first place. Since we are interested in more than the instrumental effect of an intervention, i.e.: we want to capture the value of the change in life experience, this is an important issue. Assigning a greater value to an increase in income for a poorer family will give this change more weight in a decision, and suggest that more resources should be devoted to it. Since reducing economic inequality is a key issue for society, reflecting such distributional issues in our decision-making frameworks can help shift action towards achieving it.

Further reading

- The International Commission on the Measurement of Economic Performance and Social Progress http://www.stiglitz-sen-fitoussi.fr/documents/rapport_anglais.pdf

- Seven principles for valuing what matters http://neweconomics.org/sites/neweconomics.org/files/Seven_principles_for_measuring_what_matters_1.pdf

- National accounts of well-being http://www.nationalaccountsofwellbeing.org/learn/download-report.html

- A guide to social return on investment http://www.neweconomics.org/sites/neweconomics.org/files/A_guide_to_Social_Return_on_Investment_1.pdf

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The project aims to build socio-economic capacity and cooperation between NGOs and aid their engagement with all sectors using the marine environment.

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