SIGNIFICANCE OF DIFFERING PRACTICES

The fact that some agencies use discounting and some do not will tend to affect adversely the quality of decisions. This is illustrated in the following (hypothetical) cases.

Case A involves a program in an agency that does use discounting. Estimated costs and benefits of this program over its 25-year life are:

Initial investment costs	$12,000,000
Annual operating costs	2,000,000
Annual benefits	3,000,000
Present value of total costs discounted at 4.5 percent	41,656,000
Present value of total benefits discounted at 4.5 percent	44,484,000
Benefit-cost ratio	1.07

Case B involves a program in a different agency which does not use discounting. Estimated costs and benefits of this program over its 25-year life are:

Initial investment costs	$16,000,000
Annual operating costs	1,500,000
Annual benefits	2,500,000
Total costs	53,500,000
Total benefits	62,500,000
Benefit-cost ratio	1.17

On the basis of the benefit-cost ratio, the net value of program A is marginal. To the extent that benefit-cost ratios are considered significant by the decisionmakers, there would be a tendency to prefer program B rather than program A because total undiscounted benefits exceed total costs by a relatively wide margin, even though if program B were subjected to the rate of discount (4.5 percent) used for program A it would be much less attractive than program A (benefit-cost ratio of 0.97 compared with 1.07). Thus, the benefit-cost analyses for programs A and B would, if only the program A analysis used discounting, tend to bring about