

COST/BENEFIT ANALYSIS AND GLOBAL WARMING

COST /BENEFIT ANALYSIS

As a financial planner I know that many times people look at the benefits of a product or service without looking at the cost. As an example, a person may have a \$500 unexpected repair for his car and conclude he needs to buy a new car. His reasoning is that the continued cost of repairs will ruin him financially. So the person buys a new \$30,000 car to save repairs. Unfortunately, this person has failed to consider the depreciation of a new car, let's say \$5000 in the first year and \$3000 in following years. Also, he has lost the on going interest that could have been earned on the money spent to purchase a car. If I use a 5% interest rate that equals \$1500 per year in lost interest. Together, depreciation and lost interest would pay for a lot of repairs over the cost of a year and yet many people don't seem to be able to put this together. By the way, I am not against new cars. Obviously safety, reliability and enjoyment are big issues. I like a new cars too and actually just bought one. I will probably drive it 10 years. My point is that financially speaking, people ought to analyze the cost and the benefits together on products and services and then make decisions for the right reasons.

GLOBAL WARMING

The discussion of global warming needs to have this same cost/benefit analysis given to it like the personal financial decision I discussed above. I believe that I have read a quite a bit on the subject of global warming and think it would be productive to have a national debate on the subject with experts on both sides of the issue presenting their arguments to the public just like in a presidential debate. Then the public could make up its mind based on these presentations. One of the most recent articles I have read on this subject relates to cost/benefit analysis. This article was in the May 18, 2009 Barron's magazine entitled "Global Warming Is Manageable—If We're Smart" written by Gene Epstein. The article is an interview with Bjorn Lomborg, an author of two books on the subject of global warming. Here are some excerpts from this article, a great deal of which comes from United Nations reports and studies.

According to Lomborg, the world plans to "pay \$180 billion per year for a protocol that could at best reduce the temperature by .3 degrees by the end of the 21st century. The UN estimates that for less than half that amount we could provide clean drinking water, sanitation, and basic health care and education to every single human being on the planet." From a cost/benefit basis this seems to be extremely expensive when comparing the benefits with the cost and alternative benefits.

Epstein believes that global warming is definitely a problem and we should do something but we shouldn't do just anything. Instead we should make smart decisions. According to Epstein fossil fuels are cheap and they make the world rich and good to live in by providing inexpensive heat, light and transportation. Making fossil fuels expensive with taxes and cap and trade etc is bound to fail and have a dramatic negative effect on the economy. Proposed cap and trade is essentially a system of trading permits to emit gases which makes possible immense amounts of "gaming" the system. Instead we should spend money on research and development to make green energy cheap and cost

efficient recognizing that it will be ten to twenty years in the future. If every country put .005% of GDP toward research and development this would generate \$30 billion per year toward this purpose. The way to protect ourselves is not to cripple world economies by “forcing it off fossil fuels before viable alternatives are available.”

According to Lomborg, the UN reports that global warming could cause the sea level to rise between 6 inches and 2 feet in the next 100 years, much less than the 20 feet in 20 years that has been reported. It should be noted that the sea level increased a foot over the last 150 years. Another scare tactic that has been reported is that global warming will cause 400,000 more heat related deaths globally. This is true according to the peer reviewed global estimate published in the Ecological Economies. However, this same report estimates that there will be 1,800,000 fewer cold related deaths globally, a huge net savings in lives, which is normally not mentioned in news reports of impending disaster.

When asked why what Epstein says is so contradictory to what is published in most magazines and papers, he says it is “partly because people don’t read UN reports which confirm what he is saying.” He also says “there is more sizzle in saying the world is coming to an end than there is in saying we have a bit of a problem that we need to solve smartly. The scary stories also appeal to the visceral hatred of materialism harbored by many even when they are materialistic in their own habits.”

In conclusion Epstein says “politicians obviously garner a lot of support by saying we want to save the planet much more than they garner support if they talk about smart, simple policies that might be politically difficult to get through” Some politicians in favor of massive spending toward this issue and taxes on fossil fuels, “ask how we want to be remembered by our kids and grandkids. Well, why would anyone want to be remembered for having spent \$180 billion to do virtually no good a hundred years from now, when less than half that sum could fix virtually all major problems today? With better information, most of us would have no difficulty choosing how we want to be remembered”

Cost/benefit analysis is a good tool for national and international issues as it is for personal finance issues. When you make your next big financial decision I hope you will think through these issues completely.

(Remember every investor’s situation is unique and it is important to review your specific situation with a financial professional.)

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