

**The uses of cost analysis  
in Early Child Care and  
Development (ECCD) programs**

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## **The uses of cost analysis in Early Child Care and Development (ECCD) programs**

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This paper responds to a felt need for a succinct and user friendly introduction to the basic concepts and uses of cost analysis in the context of ECCD programs. The concepts are basically those found in standard treatments of the economic theory of the firm and of project analysis. Each of the concepts introduced is illustrated with examples bearing on ECCD programs. The paper is intended primarily for non-economists working in the area of Early Child Care and Development (ECCD) who are increasingly challenged to take these concepts into account; for example, to raise money and to illuminate choices among alternative ways of using it to achieve program objectives. While its intent is didactic, the paper is not a “manual” on how to prepare ECCD project proposals, either to the IDB, nor any other funding agency, though we hope it would be useful for such purposes.

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As we all know, the need to invest in ECCD programs in our region is huge, especially in relation with available resources . A recent study estimates that for Latin America and the Caribbean, 58 million children under 15 years of age (almost 60 percent of all children) are poor, and about one third of all children are found in the poorest 20 percent of Households<sup>1</sup>. Roughly, 27 million children under 7 years of age are poor, and a large majority of them (say 75%, or 20 million, as a conservative minimum “guesstimate”) reach school-age without the benefits of having received meaningful developmental attention that would, among other benefits, prepare them for school, during their early childhood. Consequently, most of them can be expected to leave school without the basic skills needed to earn a decent income and escape the destitution into which they were born, thereby perpetuating the cycle of poverty.

## **Why bother with cost analysis of ECCD programs?**

While the financial requirements to address the developmental needs of these children are vast, the availability of financial resources is quite limited, and the competition for funds for social needs is fierce. With the pressure on lending agencies, and by them and governments, to “get the biggest bang for the buck” there is no choice but to improve the economic analysis of projects, and cost analysis is essential for this.

Together with the aim of getting funds for ECCD projects, there are other purposes for which cost analysis is useful.

1) For existing programs and centers:

- a) managerial control of expenditures; and
- b) improvement of efficiency through better allocation of resources.

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<sup>1</sup> van der Gaag, Jacques, and Donald Winkler, “Children of the poor in Latin America and the Caribbean.” June 1996. Paper presented at the World Bank’s Annual Conference on Development in Latin America and the Caribbean. Bogota, Colombia, July 1996.

2) For new or planned programs and establishments:

- a) choosing among competing projects ;
- b) choosing among possible modes of service delivery and scale of operations; and
- c) fund-raising , especially since availability of certain sources of funds is limited by the nature of expenditures; i.e. funding is available for specific types of expenditures and not for others.

### **What are the costs of an ECCD program?**

Costs are the value of resources used by a transformation process that goes on in a system. A system is an interconnected set of diverse parts (“components”--as in a stereo system, or set) subject to a common plan or that serve a common purpose. A system takes an input, or inputs, which it transforms into an output, or outputs.

An ECCD program can be viewed as a system is composed of administrators, caregivers and educators, health personnel, cooks , buildings, materials, food, utilities, transportation , etc. These components are combined and directed by economic and social rules. The common purpose that unites these parts is the provision of services to improve the development of children -- including their physical and psychosocial development. By improving their development, their chances of succeeding in school will increase, thereby decisively improving their life chances.

The child (input) enters the ECCD program (the system) and after a period of time is transformed into a healthier, physically, emotionally and mentally better developed child (output) than if the child had not participated in the program. This has a positive impact not only on the child but

also on families and communities involved as well as in the economy and the larger society for many years to come.<sup>2</sup>

As this transformation system is assembled and put into operation, it incurs costs. The cost of each of the different components of such system is the number of units of this component used in a given period of time, multiplied by its (unit) price. For example, the cost of crayons is the number of crayons used during the period multiplied by the unit price. Similarly, the cost of teachers in the system is the number of teachers (or more precisely, “teacher-time” used during the year) multiplied by their salary. For budgetary reasons, we usually refer to costs on an annual basis.

There are other ways of defining costs that could be applied to ECCD programs. For example, instead of the “systems” metaphor chosen here (as in, for example, a stereophonic music system), others have used the metaphor of the “food recipe, or ingredients model” (also called the “resource cost method”), where the elements required for the program are viewed as ingredients (or “inputs”) into the program’s “recipe.” We believe that our way of looking at it provides a clearer view of the central role of the child in the picture<sup>3</sup>. The systems model, moreover, can easily accommodate features of other frameworks, such as a detailed description of the “process”

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<sup>2</sup> Ideally (i.e., in a “perfect” description of an ECCD system) we would like to have precise measurements of the extent of development of the child before entering the system (as an input) and on exiting it (as an output), and to relate the relevant part of such changes to the characteristics of the system. As mentioned later, because the issues relating to the conceptualization and measurement of benefits (or even “effectiveness”) of ECCD programs are quite complex and rather different to those relative to costs, we have focused on the latter in the present paper. Thus, here we simply take the view that factors in the system that carry a cost are presumed to contribute in some way (and to an unspecified extent) to the “development” of the child. In work already underway, we tackle the benefits side of the system, tying the two sides together in practically useful ways and apply the framework to some real life examples of ECCD programs.)

<sup>3</sup> However, as a metaphor, the systems approach has the drawback that it casts the child in an essentially passive role, where she is “operated upon” and “transformed” by the system. Thus the child’s role in her own development, which according to many specialists is an important determinant of outcomes, or “outputs” of ECCD programs, is not explicitly recognized in the systems metaphor. Analytically, however, it is nevertheless possible to handle this notion in the systems approach. For a treatment of costs of early childhood development programs that follows the “ingredients approach”, see: W. Steven Barnett, “Costs and financing of early childhood development programs.” Paper presented at the World Bank conference on *Investing in the future*, April 8-9, 1996 (Revised draft: April 20, 1996.)

characterizing the systems' operations -- as in the ratio of children to teachers or teachers to supervisors; or whether the method for teaching is based on Piaget, or Vygotsky, or Bereiter. While formally the systems approach can also accommodate the specification of multiple inputs and/or outputs, just as in the case of other frameworks, doing so quickly leads to analytic complications that rob the effort of much of its practical value for the purposes of cost analysis that motivate this paper.

## **A typology of costs for ECCD programs**

**Outlay costs + imputable costs = full cost.** Most cost data normally available on ECCD programs are **outlay costs** -- actual financial expenditures paid for by cash, check, or promissory note, registered in accounting records, that include actual expenses for teachers, materials, building maintenance, etc. Outlay costs often leave out components of the system that nevertheless represent a cost to society in making it available and that if the program is to be replicated, it may well have to pay for them as an outlay.

For example, when the local church donates use of a building to an ECCD program, this will normally not show in accounting records as an outlay, but it nevertheless represents a cost to the community in foregoing the opportunity to use that space, for example, to train unemployed youth. Moreover, if the program tries to open a new center in another neighborhood where donated space is unavailable, it would have to rent the space and pay for it directly. And since expanding ECCD systems is a major concern for many of us, this is a very strong reason for reckoning such non-outlay costs of ECCD programs. We refer to these as **imputable costs**. And since imputable costs are by definition excluded from outlay costs, this latter concept is said to be a *narrow* concept of costs. Thus, for many purposes it is useful to have a full accounting of costs ("**full costs**") including both outlay and imputable costs.<sup>4</sup> A table of full costs for an ECCD center would look as follows:

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<sup>4</sup> Often times, certain costs associated with ECCD programs are indeed paid for as outlays and duly recorded, but not by the program itself. For example ministries of education may assign its (duly paid) teachers to an ECCD program with separate accounting. While the cost of these teachers will appear as an outlay cost for the Ministry of Education, it will often not appear as a cost in the books of the ECCD program. This would be a case of imputable cost to the program while being an outlay cost to the Ministry of Education. A recent study of the

**Table 1**

<u>Component</u>	<u>Cost</u>
<i>Personnel</i>	
Administrators	\$
Supervisors	\$
Caregivers	\$
Educators	\$
Nurses	\$
Service workers	\$
Volunteers	\$
<i>Food</i>	\$
<i>Materials</i>	\$
<i>Supplies</i>	\$
<i>Utilities</i>	\$
<i>Rent</i>	\$
<i>Transport</i>	\$
<i>Etc.</i>	\$

**Cost can mean different things depending on their use.** Costs can mean different things: to comptrollers costs are for legal and auditing purposes; to administrators costs classifications can be designed to aid them in the different management functions. From a planning and budgeting point

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CURUMIM program to attend 6 to 12 year olds in poverty during off-school hours in the Brazilian state of Minas Gerais, estimates that while the officially reported costs of the program (based on outlays by the program) came to about US\$38/month/child, once the costs of personnel used by the program but paid for by various state secretariats were included, the corresponding unit cost rose 84% to US\$70.

of view, for example, it would make more sense to reclassify the costs of the previous table in accordance to program objectives or functions.

**Table 2**

<i>Component</i>	<i>Cost</i>
Administration	
Personnel	\$
Office supplies	\$
Misc. Workers	\$
Education	
Personnel	\$
Materials	\$
Health Care	
Personnel	\$
Health supplies	\$
Feeding	
Personnel	\$
Food	\$
Materials	\$
Building and facilities	
Amortization (rent)	\$
Maintenance	\$
Service workers	\$
Transportation	\$
Etc.	\$

**Direct and indirect costs.** The classification in Table 2, for example, allows a better determination of the cost of providing particular services included in the program. The table groups together the **direct costs** associated with the service. It also groups the “overhead” or “joint” costs such as central administration. These can then be allocated to each of the services provided as **indirect costs**. This way of classifying costs is also useful for analyzing the cost consequences of expanding particular services or segments of the program.

**How much does a program cost--per child?** Perhaps the most common question on the costs of ECCD programs, and usually the first questions asked by potential funders, is: how much does it cost? In most cases, the interest is not only in the total cost of the program, but also in the cost per child served by the program. The concept of **average unit cost (per child)**, or simply **unit cost**, captures this crucial relation between total cost and the number of children served by the program as a simple ratio of the two (total cost/children served).<sup>5</sup> Among other purposes, the concept of unit cost is essential for assessing how expensive (“high cost”) or economical (“low cost”) a program is relative to another program, to alternative modalities of the program itself, or to some broader norm.<sup>6</sup> Also, estimates of a program’s unit cost generally allows “quick and dirty” estimates of how many more children could be served if resources were increased by a certain amount or similarly, the amount of additional resources that would be needed to increase coverage by a certain number of children.

**Some costs, but not others, will increase when you add children to a center.** Certain cost components, such as rent on buildings, maintenance, and most administrative costs, will not change, or change very little, when children are added to a center operating below “capacity,” and these are called **fixed costs**. Others, such as food, crayons and other consumable materials, and caregiver

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<sup>5</sup> Since there are usually several possible meanings to the term “children served by the program” (e.g., number of children who spend any amount of time, or receive any amount of any particular service provided by the program, in the course of a year--a very inclusive definition; or in contrast, the count of only those children that “graduated” from the program--a very restrictive definition), it is important to have a clear definition of this term when using the concept of average unit cost.

<sup>6</sup> Settling on such a broader norm of unit cost is sometimes a source of tension between funders, on one side, and operators and specialists, on the other. The former are naturally motivated to seek and adopt norms that are, ideally, as broad as the geographical scope of their territory, which among other advantages for funders allows “equitable” funding among clients by allotting the same resources per child across funded projects. Specialists are drawn to much more narrow norms that take into account “local differences.” Since such local differences are enormous, as are the range and characteristics of ECCD services rendered across programs (see section below on “Choosing among ECCD models”), the range of reasonable norms for unit cost in the context of Latin America can easily vary by a factor of 10. For example, the unit cost of the PRONEI program in Peru in 1984 is estimated at \$55 per child per year, while for the “Programa hogares de cuidado diario” in Venezuela in 1978, the corresponding estimate is \$2,500. (Both estimates are expressed in US\$ of 1994 purchasing power. While some methodological issues underlying the comparison render it somewhat imprecise, the order of magnitude of the difference should not be affected.)

salaries (if the ratio of caregivers to children remains fairly constant), will increase as children are added to the center, and are called **variable costs**. This distinction is useful for estimating the budgetary and financing impact of expanding enrolment in a center, and making appropriate provisions.<sup>7</sup>

**Some costs are “lumpy.”** Mainly for financial considerations, it is important to distinguish between **investment costs** and **operating costs**. Investment costs (oftentimes called “capital expenditures” are expenditures “consumed” (or “depreciated”) over a long period of time: buildings, machinery, land, training (“investment in human capital”) etc. They are generally “lumpy” investment in that they require a large commitment of funds up front to put the component in place, they are often available only in a limited number of “sizes” (as in the case of lots on which to build an ECCD center), and once in place, they will continue to contribute to the system over long periods. Operating costs (oftentimes called “recurrent costs”) refer to expenditures incurred for components (i.e., goods and services) consumed during a fiscal period (normally one year), such as salaries , materials, etc. Consequently, investments are often funded from sources different from those that pay for operating costs.<sup>8</sup>

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<sup>7</sup> In a center operating below “**full capacity**”, as more children are added, unit cost will fall because the fixed cost will be spread over more units (i.e., children being served). Once full capacity is reached, further enrolment will result in higher unit cost because of crowding in a limited space, among other reasons, if the quality of the service provided is to be maintained. At full capacity, unit cost will be at a minimum for that center.

A closely related matter is that of “**scale of operations**” and corresponding “scale effects.” The concept of “scale,” however, applies not to comparisons of different enrolment size in a given ECCD center (as in the case of variable and fixed costs), but rather to comparisons between centers of different capacity in terms of children that can be served in each of them. Within a reasonable range of sizes of centers offering similar services, “large” centers operating at full capacity tend to have lower unit costs than “small” centers operating at full capacity. Beyond some point, however, centers become so huge that coordination and communication problems, among other sources of inefficiencies, set in and unit cost at full capacity will be higher than for the centers of optimum size. This is, in effect, the analytical approach that would be taken to determine what would be the size of a center that would be desirable, at least from the economic point of view.

<sup>8</sup> There are other notions of cost recognized in economics that in certain instances may be relevant to ECCD programs. One of these is **implicit costs**, which are those considered too hard or subjective to quantify and do not appear in the **full cost** accounting. Yet, they may be highly relevant and when significantly present, ought to be taken into account, if only qualitatively . For example, the implicit cost of lowering staff salaries to take advantage of a temporary high unemployment situation could be the adverse consequences on the program’s output of less effective work by resentful employees.

**Cost management: discretionary vs. non-discretionary costs.** Another useful cost classifications is one that distinguishes between **discretionary** and **non-discretionary** costs. The distinction turns on the organizational level at which decisions over expenditures are made--e.g., at the ministerial level or by the program's manager. If most of the budget of a manager is predetermined, i.e., the number of teachers or child care givers and their salaries are determined by an administrative center or ministry, there is little that an administrator can do regarding costs besides ensuring that the money is spent for the purpose it was allocated and according to the rules. In this case, from the manager's perspective, the costs are "non-discretionary." Alternatively, when the manager is free to decide how the budget for his operation is to be spent among various cost items, these are called "discretionary." Discretionary costs open possibilities to reduce costs, or extend coverage of the service within the same budget by changing the way in which the service is provided and by whom. Many of the benefits often ascribed to decentralization in the delivery of ECCD services would be reaped through expanding the range of discretionary costs for program and center managers. Similar types of analyses can be made in other areas of expenditure to explore different ways of delivering the same benefits at lower cost, thereby allowing increased coverage within the same budget limits.<sup>9</sup>

## **Putting the typology to work**

Now we turn to some examples of the usefulness of cost analysis based on the various types introduced thus far.

**Fund raising for investment costs.** A potentially rewarding use of the typology is for requesting money from a funding agency which either by choice or statute, will only fund certain types of costs. Agencies such as the multilateral development banks, for example, will normally fund investment but not operating costs. These requests call for carefully segregating investment from

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<sup>9</sup> Another valuable use of cost analysis is as a tool for establishing incentive systems to improve efficiency of ECCD programs, a subject which we hope to treat in the future.

operating costs. Regarding salaries, for example, it is appropriate to distinguish between the salaries of staff concerned with “operating” the programs (e.g., child-minders, cooks, supervisors and their secretaries) and those in the payroll concerned with developing additional facilities or services (e.g., architects, planners, and their secretaries), who should be considered “investment” costs eligible for financing by the multilateral banks. To the extent that establishing and operating experimental, or pilot, centers have the purpose of developing prototypes for program expansion, then all costs related to these activities can be classified as investment costs in the funding request.

**Targeting fundraising: Grouping costs by likely sources of funding.** The logic of distinguishing between *investment* and *operating costs* in the above example, can be extended to the common situation when there are multiple potential sources of funds, each of which will finance a particular type or types of expenditures. A matrix of a detailed classification of costs as in table 2 by sources of funds can provide a strategy for approaching the different sources of funds.<sup>10</sup>

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<sup>10</sup> In the case of an entire system, Table 2 should also include costs of setting up the program, including training and development of materials, central administration, and monitoring and evaluation, much of which can be counted as *investment costs*, and thus eligible for multilateral bank funding.

**Table 3**

Type of Cost	Funding Source				
	Government	Intl. Agencies	Community	NGOs & other non-profit	Private Sector
a	x	x	x	x	
b	x	x		x	x
n	x		x		x

This way of classifying costs can also be applied to an on-going program to see where the burden of costs actually falls and in relation to what items. This would provide a useful reality - check on assumptions about how much, for example, communities in fact contribute to the program, and thus valuable information for the design of subsequent projects.

**Fundraising: Finding counterpart funds among imputed costs.** Oftentimes funding agencies require counterpart funds from the project sponsors, which might seem as an unreasonable request on reflection that if they had money to begin with they would not be asking for it. The notion of imputed cost can be wielded here to take into account goods and services donated to the program by individuals or entities of any sort. Volunteer labor by family and others in the local community, for example, can be imputed according to the type of labor donated at ongoing wages for that type of labor. The imputed costs are then added to the relevant outlay costs, and the contribution of the local community is thus duly taken into account.

**Is the project feasible?** The criteria of financial feasibility is essential for funding a project. A good cost classification according to subcomponents (along the lines of table 2) provides the basic

framework for a detailed “costing of the project.” Such an exercise often leads to the conclusion that the original goals were overambitious, forcing a reconsideration of the magnitude of the project, the size or richness of the components, or perhaps the modes of delivery of services (see below) until goals, means, and financing are aligned into a viable proposal.

**Choosing among different technologies for providing an ECCD service.** The distinction between fixed and variable costs can help in choosing between alternative methods of providing a service. For example, suppose that the food planned for the program can be prepared by two methods A and B . Alternative A uses a more mechanized system that requires renting a machine at an annual cost of \$50,000 (the **fixed cost**) and a cost of \$1 per additional meal (the **variable cost**). Alternative B is more labor intensive, and uses a simpler machine that rents for only \$10,000 annually, and results in a cost of \$1.2 per additional meal . Which method should be chosen?

We can express the annual cost of providing meals under each alternative as:

$$\text{Cost of A} = \$50,000 + \$1 \times M$$

$$\text{Cost of B} = \$10,000 + \$1.2 \times M$$

If very few meals are needed, Alternative B is clearly preferable because of the saving from renting the cheaper machine. The more meals needed the lesser the advantage of Alternative B and beyond some numbers of meals, Alternative A becomes preferable as the savings from the lower cost of each additional meal keep accumulating. At some point, the costs of providing the meals under each method become even, and thereafter, Alternative A is economically preferable.

Simple algebra reveals what this “break-even” number is:

$$\text{Cost A} = \text{Cost B} = \$50,000 + \$1 \times M = \$10,000 + \$1.2 \times M$$

$$M = 200,000$$

Thus, up to 200,000 meals per year, it pays to use the labor intensive method (B) . If more than 200,000 meals are planned, Alternative A would result in lower total costs for meals.<sup>11</sup>

**Monitoring: Identifying exceptional performers and tracking performance over time.**

In systems composed of many centers or units with similar programs, but each probably operating under different conditions, it is important to know where unit costs vary substantially from the norm, or “typical unit,” and why. Are different components are being used? Are components being used in different proportions? Is the scale of operations different? Are prices paid for the components different? And regardless of the source for the substantially different unit costs, are the differences in cost related to differences in child development outcomes?

In addition to comparing unit costs across centers, it is also valuable to track these costs over time for individual centers and groups of establishments. Significantly rising costs, for example, are a signal to examine the causes and take corrective action whenever possible, while declining unit costs may signify efficiency improvements that could be adopted in other centers. When changing unit costs result from unavoidable changes in the prices of components, the analysis will still be valuable for better budget forecasting and financial planning. This type of analysis is thus essential to maintain or improve the efficiency of the program over time and provide elements for better budgeting.

**Choosing a model of operation.** ECCD services can be offered in different ways: home day care centers, integrated child development centers, preschool formal and non formal , and others. If one could assume that each model is operated efficiently and their child development outcomes are the same, the one with lowest cost should logically be selected. But in general this is not so, and the assumptions of uniformly efficient operations, and especially sameness of outcomes, are not very sensible in the highly diverse world of ECCD. Nevertheless, cost analysis can still shed light on

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<sup>11</sup> If instead of renting the machines, the relevant choice entails buying them, the analysis would then be somewhat more involved by requiring information about the “useful life” of each machine, the scrap value, and the rate of interest. But this would not affect the analysis in terms of the distinction between fixed and variable costs.

choosing among competing models under given circumstances so that scarce resources can do the most good in terms of child development.

Moreover, the types of services offered and the “intensity” with which they are provided vary greatly among ECCD models, and among particular programs within each model. For example, while some programs include health care, early stimulation, and school readiness activities by highly trained personnel, aided by “state of the art” educational toys and materials, in ample and attractive facilities, others barely provide a rough space where children are left for part of the day with an untrained and minimally schooled adult, whose main responsibility is to prevent injury. Regarding “intensity,” some programs may feed the children only a glass of milk per day, while others will include a full and balanced diet. And while some programs keep the children only three or four hours a day, five days a week during school days, others caring for abandoned children will do so around the clock all year round. Presumably, many of the major differences in the types of services received by the child and their intensity will result in differences in outcomes.

Yet another dimension that accounts for a great deal of significant variation in outcomes is the child herself. Within age groups, for example, some programs mainly serve children from communities and households which despite low income, are neither destitute nor dysfunctional, and the children are in reasonably good physical and mental health; others mainly serve “the poorest of the poor” communities, where the opposite conditions prevail. We know that on average, children from the more supportive backgrounds are more likely to thrive in most ECCD programs than those from the more troubled and deprived home environment.

All of these differences among programs undoubtedly pose technical difficulties in identifying the “lower cost” options while taking into account critical differences. However, there are various research techniques that allow reasonable estimates to be made, leading to at least rough rankings

according to “cost-effectiveness” among modes of operation, carrying considerable certainty that the ones at the top are indeed more so than those at the bottom.<sup>12</sup>

This paper has focused on the nature and uses of cost analysis, and on the importance of paying attention to the matter of costs. It did not go into the different techniques and methods available to tackle the various problems that arise in practice of classification, analysis, and estimation of costs. Moreover, as repeatedly mentioned, costs are only one side of the crucial problem of choosing which among possible modes of delivery of ECCD services ought to be adopted or expanded. The other side is benefits, whose operational definitions are more controversial and their measurement more complex. Extending the framework for analyzing costs presented in this paper for analyzing benefits or effectiveness of ECCD programs, and relating the two sides for arriving at cost-effectiveness comparisons for funding and related decisions, remain the task for work in progress.

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<sup>12</sup> Generally, fewer types of services, or services provided in lesser intensity, will result in fewer “benefits” to the child from the program. It is important for decision makers to have reasonable estimates of how much a given amount of cost reduction (or increase) will reduce (increase) the “benefits.” At the macro level, for example, these estimates are needed to make funding decisions entailing the comparison of expected reduction in benefits with the gain from spending the same amount on some other social program also benefiting children. Even if experience shows that final decisions on which programs to fund or where to put additional funding tend to be at least as political as they are technical, good cost estimates introduce a potentially important element of transparency into the decision process that reduces the likelihood of choosing the worst among relevant options. (The quotation marks around “benefits” are a reminder that this paper deliberately eludes the prickly task of defining this term in the context of ECCD programs. Thus the reader is being called upon to supply the meaning here, which also explains why this potentially major use for cost analysis is relegated to a footnote.)