

Book Reviews

Manual of Industrial Project Analysis in Developing Countries, Vol. II by I. M. D. Little and James A. Mirrlees, OECD, Paris, 1969.

The Little-Mirrlees *Manual of Industrial Project Analysis in Developing Countries* is divided into two parts; the first of which is addressed "to the senior administrator or politician, who should understand the broad lines of what is implied by operating a system of social cost-benefit analysis"; and the second "to those who will actually make project evaluations, and teach others how to make them". In fact, the two parts make an integral whole, since the first part of the book raises several broad issues the answers to which are given in the second part. For instance, on page 44 the "senior administrator or politician" is told of the dilemma of the choice between employment-generating and reinvestment-generating projects; . . . a project which employs a lot of labour will get higher marks because it results in a lot of consumption by the poor now. But the incomes generated by such a project will be almost entirely spent. There will, therefore, be little savings generated and so such a project will contribute little to further investment, which, in turn, yields future consumption", while a capital-intensive project with a high reinvestment rate makes a greater contribution to the future, but a smaller one to present welfare. Unless the "senior administrator or politician" is willing to read difficult and often obscure discussions in Part II (Ch. 13) he will have no idea how to go about resolving the dilemma. There is little fear, however, that the nonprofessional reader will get through Part I, not to speak of Part II. To be sure, the authors give a warning that "some of the chapters of Part I may be a little academic for the senior man who has become familiar with economics by practical exposure and does not want to feel that he is going back to school", but they grossly underestimate the gap between the layman's ability to cope with abstract concepts and their own ability to use plain English. I wonder what the intelligent layman is to make of the following passage which occurs on page 41 and which I chose almost at random:

We agree that it is essential that the government set a rate of discount to be used in project analysis, but we do not think this need be, or should be identified with the consumption rate of interest. The reason in brief is that a project gives rise not merely to future consumption but also to future savings and hence investment. As we have seen, the two may not be of equal social value, and therefore a different treatment would

need to be accorded to each of these different benefit streams. This however would be complicated, and it is simpler to revalue each year's consumption in terms of savings (or investment) — and then discount the single combined streams at a rate which is appropriate to investment, a rate which we shall call the accounting rate of interest.

It would be interesting to find out how many of the lay readers understand the nature of the "simpler" solution.

It is a pity that the book is so discouragingly academic for it covers issues which policy-makers should be acquainted with and often are not: the general problem of allocation of scarce resources, the formulation of policy objectives, the relation between planning and project preparation, and the role of protection of industries.

The second part of the book covers virtually the whole area of cost-benefit analysis. It starts with a rapid review of the principles of project appraisal as applied to the private and public sectors and proceeds to a discussion of the accounting (or shadow) price concept to the methodology of calculation of the accounting discount rate, the shadow price of foreign exchange and of labour. There is also a discussion of investment decision under uncertainty and of the evaluation of external effects including the "flowers-and-bees" effect and forward and backward linkages.

Many of the concepts discussed are of crucial importance to social cost-benefit analysis and on several of the topics the authors display robust common-sense. For instance, "external benefits" are all too often used to justify projects the social contribution of which cannot be demonstrated on other grounds. The authors' advice is: do not take externalities into account unless there is very strong evidence why one should do so. Virtually every project has "forward linkages", "backward linkages", "lateral linkages", *etc.*, but since it is almost impossible to calculate the relative magnitude of such effects which, in any case are not likely to be of overwhelming importance, the whole issue is best ignored. The treatment of uncertainty is likewise very sound: instead of using an arbitrary risk discount factor, the authors advise us to compute the expected present social value, and, by using simple examples, they allay our fears that such a calculation might be exceedingly difficult to perform.

The treatment of the accounting discount rate is less successful. The accounting rate of interest is defined (p. 181) as the rate at which acceptable projects just exhaust the investible funds, provided that rate is not lower than that at which society discounts the intertemporal consumption flow. At equilibrium (*i.e.*, in a situation in which society reaches the desired rate of investment) the rate of discount applied to investment (*i.e.*, the future consumption) should equal that used to discount the consumption stream. But if, for whatever reason,

urban labour equals the marginal product of rural labour, ignoring dynamic transfer costs and the costs of urbanization. When all is said and done the shadow wage (at least in the examples given on Pp. 167-168) comes out very close to the actual urban wage rate. One wonders whether rational allocation of the technician's scarce resource (time) justifies the use of the Little-Mirrlees formula.

For all the competence of the authors and the scope of their treatment, the *Manual* is not a good book. There seem to be two reasons for the failure. The first is that the authors attempted to provide practical solutions to problems which are as yet imperfectly understood, and many of their proposed procedures rest on highly controversial reasoning. Secondly, in their effort to reach an audience of laymen and of practical economists, the authors sacrificed rigour for popularity. Unfortunately, a nonrigorous treatment is not necessarily easy to follow. The professional economist is likely to be exasperated by murky passages, and the nonprofessional by the intricacies and mysteriousness of the formulas.

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