Book Review

Methods of Project Analysis: A Review. By Deepak Lal. Baltimore and London: The Johns Hopkins University Press. 1974. (World Bank Staff Occasional Papers, Number 16.) 53 pp. Price $3.00.

Project analysis is one of the most important and useful forms of applied welfare economics. In a perfectly competitive economy, with no externalities, it boils down to calculation of net present value or internal rate of return to rank the projects. However, when there are distortions in the market, social rankings will differ from the market rankings, because in both the goods and factors markets, prices are no longer the true indicator of the scarcity values. Thus, in order to rank the projects socially, one will have to take account of the distortions present in the economy. Different methods, notably L.M. and U.N.I.D.O., have been suggested to account for these distortions. Besides L.M. and U.N.I.D.O., methods recommended by Bruno and Kruger are worth mentioning. The book under review compares the different methods and concludes that all the methods are basically the same in the sense that if equivalent assumptions are made, they require the same information and social ranking is the same.

The book consists of five sections. First chapter deals with foreign trade distortions, second with distortions in the factor markets, third with income distribution and employment, fourth with debt servicing and balance of Payments, and fifth with second-best problems and Differential Taxation. The most important and interesting discussion is concentrated in the first two chapters.

In the first chapter, two simple numerical examples, one with two tradables (exportable and importable) and the other with three products, out of which two are tradable and the third nontradable, are presented to demonstrate that the two methods are equivalent. The only difference is of numeraire. Whereas L.M. uses foreign currency as numeraire, U.N.I.D.O. uses domestic currency as numeraire. The main difference between the two manuals is that while L.M. assumes that the economy will gradually move to the free trade, U.N.I.D.O. also considers the case of continuing existing government policies.

In the second chapter, methods for calculating social cost of capital and labour are discussed. The difference is again one of numeraire. Whereas

L.M. uses current savings as the numeraire and penalises consumption, the U.N.I.D.O. procedures use present consumption as numeraire and put a premium on savings. However, in practice, the L.M. method is superior to U.N.I.D.O. since the former assumes a finite time period over which the divergence between social value of consumption and savings will disappear and the the latter do not, which lead to value of investment cost to be infinite in some cases. For shadow wage rates, a model incorporating migration cost is presented, and then different methods of evaluating shadow wages are discussed in that context.

Project selection via investment can have a profound effect on the income distribution. Thus the benefits should be appropriately weighted Both the methods are in agreement that the benefits should be weighted, but are silent on how to determine the weights and incorporate them in the analysis. In the next chapter, potential balance of payments problems are discussed. Both the methods suggest that relative prices of traded to non-traded goods should be altered, and then domestic expenditure should be reduced by raising the cut-off rate of return on projects.

Throughout the book, the emphasis had been on the common grounds between the manuals. The review is incomplete since it does not say anything about the assumptions which differ across the manuals and may have crucial impact on the policy prescriptions. Moreover, although L.M. suggests a finite time period, T, over which the divergence between social value of consumption and saving will disappear, yet over this period, they have constant time preference and productivity. If by the time T, time preference should equal the productivity, then the macro parameters must gradually approach each other.

In addition to the errors listed in the errata sheet accompanying the book, several other errors were noted among which the major ones are as follows:

Page 12, line 5 from bottom should read, "cloth= — \$50.00."

Page 12, Footnote line 3 should read "(6 × \$4) labour+...."

Page 15, Footnote 13 line 2, should read,

"BT SER=r $[\Sigma_j \Phi_j (V_j E_j^x) + \Sigma_i \gamma^i \ (- \Psi_i N_i^m)]/B$"

Page 29, Footnote line 2 should read "θ" instead of Y.

This is a very useful survey, albeit incomplete. Those who are engaged in project appraisals should go through this, keeping the reservations in mind and errata in front.

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