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D04970

Distr.
LIMITED

ID/WG.150/3
20 February 1973

ORIGINAL: ENGLISH

United Nations Industrial Development Organization

Expert Group Meeting On Uses of National Investment Criteria for Industrial Project Analysis
Washington, D.C., 28-30 March 1973

Comments on the book: Guidelines for Project Evaluation[1]

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id. 73-1099

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1. Introduction

Upon starting to read the book with great expectations and great interest, I had a two-fold aim in mind:

(i) to find some practical guidance in my work in assessing and evaluating various kinds of projects of a public-owned parastatal organization in a developing country;

(ii) to assess the methodology, the suggested ways and means, through an economist's eye as objectively as possible.

As requested by a senior staff member of the United Nations Industrial Development Organization Headquarters in Vienna, Mr. H. Muegge, I am now submitting my views on the study.

2. Title

After having carefully read the voluminous book, I had to conclude that the title was not properly chosen. It should have read:

"Problems of Development Planning and Project Formulation in the Public Sector of Developing Economies".

I have to admit this title tends to be a bit "longish" and not so "eye-catching", but it is my true convincement that it would reflect the contents of the book much more precisely. Such (or similar) title would have helped to avoid misinterpretation.

It is inappropriate to put it in a rank of "guidelines", because it only explains the problems. On the other hand, it has much more to say about the problems of national planning and project formulation than about project evaluation in the true sense of the word.

3. Bibliography

One quick glimpse to the "Selected Bibliography" indicates some cautious warning: the list consists of fourteen publications only and eight of them (57 per cent) refer to the publications of the same authors. I would not say that this kind of "self-reference" is objectionable in principle, but personally I do not like the selective "internal-breeding" approach of explaining and commenting sophisticated theories. I have tried to abreast in reading and digesting the most outstanding items of the world literature on this topic and, therefore, I felt a bit disturbed to find only two or three publications on the list that were familiar to me.

4. Terminology

On page 6 of the Guidelines for Project Evaluation one can read:

> "This volume can be read by non-economists. Indeed it was written with this aim in mind ..."

Unfortunately it was not always easy reading for me; in fact, it was mostly that way. I have checked the book with non-economists (one of them is currently on the payroll of UNIDO) and they confirmed my feelings inasmuch as they had not been successful in "translating" the text for practical use.

The reader is confronted with an array of definitions which are not commonly known. These are the basic terms of the study:

- aggregate consumption
- national economic profitability
- national profits (in other places "national gains")
- aggregate national economic profitability
- aggregate consumption benefits
- direct aggregate consumption costs, etc.

To characterize the book in a general way, one of the most striking features is that one cannot find the phenomena:

- net value added (or "value added")
- gross national product (or "gross domestic product")

anywhere in the 383 pages. How do we define the growth of the national economy in most comprehensive terms, concentrated in a "nutshell"? With the GNP (or GDP)! What is the most important parameter of a project which a Minister (as a politician) wants to know first and with which I (as a professional economist) completely agree? What is the value added? These are the well-known, broadly introduced terms that can be understood easily not only by economists but also by every educated layman, including the politicians.

Page 6 further contains the following:

> "The terms have been defined all along the way, even those that are very familiar to economists."

Which are these terms that sound familiar to the ears of the economists? The "national economic profitability" or the "national profits"? I would hardly agree. Let us have some quotations, all from page 26 only, just as examples:

> "From national profits to national economic profits the translation is not a simple one."

Some lines thereafter:

> "National economic profits are national profits measured in some economic terms";

and immediately thereafter:

> "How we define the term of national economic profitability (NEP) is ultimately not very important".

If we are witnessing the dawn of a newly developed professional slang, I would rather welcome seeing it first in scientific discussions. Later on, if theoretical correctness is proven, let us get it introduced into the mass-scale education and then, and only then, to publicize it for mas consumption. I am very sorry to air my views in that way; however I could not get rid of an odd feeling that this book is more or less a "pilot-plant" of terminology and an approach which sails under the United Nations flag after having obtained the blessing of this highly esteemed body, even though one finds an official note in the Foreword that the views of the authors do not reflect completaly the views of UNIDO Secretariat.

5. <u>Theory</u>

Apart from the terminology and the digestibility of the study, it appears to me that the most serious problems lie in the theoretical approach itself, mostly implicitly hidden, or more or less circumvented. The topics which I am going to point out are the following:

(a) the denial of the importance of the profits and risks in the public sector investments even as a guide for project evaluation;

(b) inadequate presentation of the time-dilemma: confrontation of short-run requirements with long-range strategy;

(c) the use of the indirect, "consumption-approach" instead of the direct one (measured in terms of production and contribution).

<u>ad (a)</u>

Page 84 reads:

> "The need to recover costs through revenues - however crucial in the investment decisions of private enterprise - should pay a decisive role neither in the allocation of public-investment funds nor in the pricing policy of public projects."

Another characteristic remark can be found on page 111: "...the Government can be neutral towards risk....", risks including also uncertainties as taken from page 108: " ..we shall use the terms "risky" and "uncertain" interchangeably".

One can completely agree with the authors in their striving to point out that investment in private business is by far not the same as public investment. They differ very much in complexity even as much as the national economy as a whole (macro-economics) differs from the business-economy (micro-economics). These differences are very well explained. The reader must really highly appreciate the efforts of the authors in explaining the different characters of public investments; there are innumerable economic and social factors that one should take into account additionally to the forward and backward linkage effects within the national economy in comparison with commercial private projects.

However, the authors went too far. I think it is a serious mistake that with the same breath the book practically indicates scrapping completely the profit principle as an unsuitable and useless category in the realm of national project planning. The down-to-earth experience with developing countries should have dictated extreme care and cautiousness. Unfortunately these countries have got many more politicians than trained economists; therefore, this kind of "food for thought" (with the blessing of the United Nations) might open up the flood gates for an economic disaster. In other words, if we were to encourage politicians and top-ranking government officials not to worry about the profit-generating ability of economic projects or to neglect the risks, the "externalities" and imponderable "weights" would consequently appear not only to be relevant but also <u>the</u> deciding factors!

I was astonished to read (page 23), "Externalities are obviously relevant for social choice and provide a sufficient argument for rejecting commercial profitability as a guide to public policy" (sic)! This suggests rejecting profitability even as a pure and humble "guide"! Everything depends on the interpretation and not on the good will (of the authors). If misinterpreted - and there exists a real danger of that - this kind of idea might turn out to be a tinder box in the wrong hands that ultimately wrecks the real core of the economic development.

We also do not have to worry as much about the applied interest and discount rates because page 24 states:

> Even the general public of today (as distinct from policy makers) may feel that for public projects, where all are forced to save simultaneously, a lower rate of discount may be appropriate than would be reflected in the market behaviour of individuals.

Let us continue and see what happens if the project, influenced in a distorted way during the gestation period by these ideas, comes to implementation and starts up operation. Who is to be blamed for the commercial losses? The project planner? The appointed general manager? Definitely not the so-called "Central Planning Organization" and the highly-esteemed politicians. It is not so difficult to foresee the mutual accusations if the project located in region "B" starts generating losses after losing four or five years in the start-up and training (since no infrastructure and skilled labour are available), even if it does contribute very much to the equilibrium of the regional economics and increases the income of a poor region.

Another important problem that also emerges as a consequence of the philosophy outlined in the book is the following: One has to agree that the redistribution process cannot be executed through taxes, budget-allocations, etc., i.e. with the help of economic gears only. But do not take the project allocation issue as one of the main tools of the income redistribution! The book is full of such examples that implicitely suggest this principle. Not a single word has been said that Government must not only conscientiously define the limitations of such actions, but must also provide special funds to cover - at least partly - the extra costs of the infrastructure, must make provisions in future budgets and take suitable measures (tax exemption, subsidies, etc.) to square up the losses primarily in the first years.

National planners and politicians - as human beings - are very much inclined to take decisions that are popular, but they are not always so keen to face the consequences and responsibilities. Therefore, instead of encouraging the CPO's to use the projects as main tools of redistribution, the authors should have pointed cut that this is some kind of "ultima ratio regum" in cases where the economic and financial measures cannot solve the whole problem adequately. The Government and CPO's should have been advised to do everything to minimize the burden of the income redistribution role of economic projects and to make necessary arrangements in the form of budget provisions, taxes or subsidies if the project tends to be commercially unviable for some years to come.

ad (b)

The time dilemma, the confrontation of present gains versus future harvest, is not properly presented in the book. In national planning the most intriguing and basic problem is the pace (timing) of the progress in development. This is, in an ultimately polairzed way:

- rapid development for today (with all the inequalities, gaps and imbalances that this policy should definitely involve) or
- far-reaching aims of a homogenous, balanced economic system (that might require a lot of sacrifices today).

Actually all the economic policies of developing countries reflect some mixture of the above extremes. Unfortunately enough, not all developing countries are in such a lucky position that they can afford to sacrifice today's sparrow for the fat goose of tomorrow. The authors often pointed out that the aim of long-range balance over-rules the short-term tactics and took it for granted that every Government should think this way. It is doubtful that the practically undeterminable "social rate of interest" will automatically bring the solution. In fact it is very desirable that investment policy should not be short-sighted. But not all of the developing countries are in such a fortunate situation with stable social establishments and very permissive and patient societies which allow them to pay off the most important social classes and masses with promises of a bright future as a compensation for the problems of their present well-being. This pivital issue, as referred to on page 105, should have been pointed out much more seriously.

ad (c)

The "consumption-oriented" approach of the authors in purely scientific terms might be justified (since the economic activity concludes in the consumption as the final target) because this consumption triggers off (criginates) and results in an expanded reproduction. Therefore, it might be justified to say, whatever aspect we are going to select could explain theoretically and logically the other side as well.

This is correct in the case of national (macro-economic) planning when all the warps and wefts of the national fabric are at hand. The disturbing thing for me is that we are now discussing development projects that are bound to contribute directly to the production (as a treasure box of consumption) and afterwards only secondarily (heavily involving a whole array of other economic and political means and tools) affect the consumer. What makes it necessary, therefore, to choose the indirect approach (which the authors call direct) that does away with well-known phenomena such as GNP, GDP, growth rate, etc? That remains unexplained through the first hundred pages of the book. On page 101 we have the first clarification:

> In the Guidelines we have preferred the approach of directly weighing the contribution to consumption at each period of time (thereby taking into account the growth rates indirectly) rather than directly attaching weights to growth rates (thereby indirectly taking into account the actual levels of consumption).

That is fair enough. The authors preferred this approach. But, at least to start with, the uninitiated reader should have been provided with more familiar terms; for example, it could have read: "On the square one", i.e. on the basis of such common terms like value added or GNP. Apart from the fact that this offers a simpler, easier-to-understand explanation in many aspects, this production approach would have been more logical and "direct" way for project planners and evaluators

On page 100 one finds:

> It might be noted that we have left out a number of specific objectives that are often thought to be important....the objective of maximization of growth and the objective of self-reliance in foreign trade.

But what is the justification for having just scrapped (or exterminated) these important terms without trying to explain more clearly to the "non-economist" laymen how to derive the sequence of thought from the growth maximization objective to the so-called "aggregate consumption objective" and how these two differ from each other. I think this problem is not as simple as the authors contend (page 100, after the above-mentioned quotation):

> The objective of economic growth...is taken very seriously indeed but it is already reflected in the aggregate consumption objective

I must confess I was not convinced and felt as though I had been paid off with a blunt statement which I cannot accept as scientific proof.

On page 110 the footnote explains (but why only at the end?):

> We use "aggregate consumption" and "national income" synonymously here. National income will consist of the country's total consumption and its total investment (revalued at the shadow price of investment to make it comparable to consumption).

To the untrained, this might create a very unarticulated tune: How could one particular sort of "consumption" contain elements of capital formation like savings and direct investments? Why did the authors feel the need to replace the well-known term "national income" with new and sometimes unfortunate expressions? The reader finds these stumbling blocks that are used in different contexts on practically every page.

I am afraid that the proposed method, if rigidly applied, would create a peculiar deadlock. The entire scope of all national (public as well as private) projects is definitely needed to establish shadow prices for capital, wages, foreign exchange, etc. The suggested "bottom-up" approach, therefore, seems not only very reasonable, but also essential, since it is true that one cannot expect politicians or CPO's to "dream up" shadow prices overnight. This, however, practically requires arrays of completely elaborated projects at the very planning moment, ready for implementation if approved; that, however, is the Achilles tendon in the logic since one cannot expect to have such arrays of projects.

Thus we have a variation of the chicken-egg problem which cannot be solved with a "one-way road", regardless if one is working "top-bottom"-wise or vice versa. This is a continuous self-refining process, similar to figure 9 on page 119 of the Guidelines. One can expect only to have a handful of really important and completely elaborated new projects at one time and perhaps a large number of project ideas which those responsible for national planning should influence by clearly defining national policies and priorities in a quantified way as expressed in the form of shadow prices and national weights. These quantified policy indicators, however, should be based on experience gained from the parameters of those sectors of the entire national economy already in operation rather than derived by using a large number of new development projects and the "bottom-up" method. Here we have real national planning exercise in the most comprehensive sense of the word, not just simply project formulation and evaluation. Thus the problems of overall national planning were confused with project planning and evaluation. The duties and responsibilities of the central planning authorities have been generally overlooked and circumvented, and the enormous task of establishing the practical values of the national weights and shadow prices has been put mainly on the shoulders of the project planners and evaluators.

6. Some Closing Remarks

Part III of the Guidelines I found less objectionable. Apart from the fact that these chapters used the same questionalbe terms, the definition of the shadow prices and social values (investment, discount rate, wages, foreign exchange and the investment co-ordination) was quite interesting reading with broad scopes in a theoretically sound presentation with only a handful of debatable points. The main question is very well put on page 238:

> Our approach to benefit-cost analysis is in a way paradoxical. Rejecting the basic premises of a theory of economics designed to demonstrate the virtues of laissez-faire, we go on to adopt the principal tool of that theory: marginal analysis.

True.

As a director of development of the biggest parastatal institution of a developing country (which claims control of over half of the whole industry) and as a practical businessman, project planner and evaluator, I could easily dispense with this book. As an Associate Professor of Economics (in national planning) I would say that it was one of the most interesting and intriguing books that I have read. My thanks to the authors for this very challenging and interesting ride.

[redacted]

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