USE OF SOCIAL ANALYSIS IN PROJECT APRAISAL

The following notes are concerned with the proposal to incorporate routinely a "social analysis" in the appraisal of Bank projects. The following are the main points made:

(1) The advantages of taking account of the effect of a project on economic growth and some dimensions of income distribution in a single-valued indicator may be small since many other relevant criteria have also to be taken into account.

(2) The proposed methodology is ambiguous regarding whose values distributional weights are supposed to express, and the methods of their derivation are unconvincing.

(3) Assessing the distributional effects of a project is subject to wide margins of error. In practice, social analyses are likely to be methodologically naive and lack an adequate factual basis.

(4) The rationale for using project selection as a means of income distribution is weak in that (a) it may be less cost-effective than conventional methods; and (b) some of the more important costs of redistribution (incentive and political costs) inhere in the redistribution itself and not in the method by which it is accomplished.

The Proposal

The proposed social analysis would specify, by the use of distributional weights, the rate of trade-off between three variables, viz. economic growth and two aspects of income distribution: distribution between savers and spenders (often interpreted as distribution between government and citizens); and distribution among different income classes. Costs and benefits would be thus expressed in units of "socially-weighted dollars", and the summary measure of the project's profitability - its internal rate of return - would be a ratio of socially-weighted dollars per socially-weighted dollar.

I. PROJECTS HAVE MULTIPLE OBJECTIVES

The advantages claimed for the procedure are that the growth-distribution trade-off is made explicitly, and applied routinely and consistently from project to project (in any one country). Even if this is accepted, the advantage may not amount to much, since there are many other desiderata influencing project selection which remain outside the formal optimizing procedure and hence have to be incorporated in the analysis in an *ad hoc* and possibly inconsistent manner. These include other aspects of income distribution - e.g., distribution by age, sex, region, and ethnic group; employment creation; the project's effects on national morale, unity, or prestige; and - to be realistic - its effects on voting in the next election, and/or its appeal to influential elites - intellectual, and otherwise.

To attempt to quantify these variables and specify rates of trade-off between each and every one of them would be absurd and would be seen to be absurd. Even to expand the set of distributional weights to include those dimensions of distribution mentioned above would strain credulity. Project selection must remain a politico-economic art: many of the relevant variables cannot be forced into a single grand optimizing framework. Once this is understood, the advantage of so treating a subset is seen to be marginal - even if the trade-offs within the subset could be quantified in a plausible and convincing manner.

II. WHOSE WEIGHTS?

In the Squire-van der Tak volume there is an ambiguity concerning the derivation of distributional weights. Do they represent the value judgements of the analysist - or his employer (in this case, the Bank) - or are they his interpretation of the value judgements of the government of the country concerned? A recent document[1] states that "the distribution weights ... will reflect the Bank's opinion. However, whenever possible, such weights will be agreed on with the government concerned, and in all cases the weights should be as realistic and relevant in the country context as possible" - which sounds rather like having a bet each way; or perhaps the weights will be arrived at by a process of negotiation and compromise between the Bank and the country. None of these approaches is satisfactory:

(a) Most governments - which are collections of conflicting interest groups and shifting coalitions - simply do not have a well-defined set of preferences which would enable them to articulate a set of distributional weights.

(b) Even if it could, a government would be reluctant to define clearly its distributional trade-offs, for reasons well expressed in the UNIDO *Guidelines for Project Evaluation:*

"... the qualifications of political leadership are many and varied, but for better or worse a grasp of the tools of economics has never been high on the list. Yet without

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1 *Economic Analysis of Projects: Implementation Program*, Issues for Discussion.

> an understanding of the overall methodology of benefit-cost analysis ... it is difficult to imagine that the value judgements necessary for calculation of national parameters [of which distributional weights are an example] could be elicited from the political leadership... The ... most important reason why the political process discourages rather than encourages explicit quantification of political value judgements with respect to the goals underlying calculations of national economic profitability is that political leaders rely on the support of distinct interest groups that are partially (at least) in conflict with one another. In such circumstances ambiguity has obvious advantages. One can hope to appear all things to all men. The corollary is an understandable if deplorable reluctance to take explicit positions that indicate the precise extent to which the political leader values one objective (with its particular lobby) over another objective (with its particular lobby)."

(c) Attempts to infer the distributional preferences of governments by examining their actions are unconvincing. Since, if only for reasons of practicability, only a selected sub-set of the government's actions and inactions are analyzed, the analysis may be more revealing of the preferences of the analyst than of the government.

These points are acknowledged by Squire and van der Tak: "Governments make decisions every day related to some conception of welfare. Usually, the conception of welfare is not clearly defined; as a result, decisions are often contradictory." (page 49); "... government actions and policies may be misleading guides and may often appear to contradict government statements ... inegalitarian fiscal measures may reflect constraints on fiscal policy rather than a lack of real commitment to objectives of income distribution." (pages 101-102)

The question really has to be faced: Does the Bank wish to appraise projects according to its own value judgements concerning the trade-off between efficiency and some aspects of distribution in each country? If so, how are the value judgements to be made, and how explained and justified to the countries concerned? Or does it wish to make use of each country's value judgements? If so, how does it know that such judgements exist and how are they to be revealed? What if it does not like the government's distributional preference?

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III. DISTRIBUTIONAL EFFECTS DIFFICULT TO ASSESS

Assessing the distributional effects of a project is not easy, and is subject to wide margins of error. Properly done, an analysis of efficiency and distributional effects requires much more information, a higher degree of disaggregation, and a more sophisticated analytical perspective than does an efficiency analysis alone. Anyone with even a passing acquaintance with the public finance literature knows that many aspects of the incidence of taxes and subsidies is controversial, even conceptually - let alone empirically. The same is true of the agricultural economics literature dealing with the effects of such things as fertilizer subsidies, product taxes and subsidies, marketing margins, etc. One cannot expect project analysts to be even modestly expert in these areas. The result is likely to be naive analysis based more on conjecture than fact.

IV. INCOME REDISTRIBUTION VIA PROJECT SELECTION

The rationale for incorporating distribution weights in investment appraisal is to allow more government investment and income redistribution to take place. It is argued that "administrative costs or political pressure, for example, may limit the government's action. Thus, the possibilities of taxing the agricultural sector may be limited by the costs of collection and administration, or the political power of the rich may be sufficient to prevent the government from redistributing incomes to the poor. [C]ountries may also be faced by a fiscal constraint in the sense that the government cannot raise sufficient revenue to achieve its desired level of investment or its desired redistribution of income. The obvious implication is that the government may wish to use project selection as an alternative, additional method of increasing public income or of redistributing income."[2]

The notion that project selection offers an additional and perhaps lower-cost means of redistributing incomes and contributing to government revenue may be plausible insofar as administrative costs are concerned. But even if it is a low-cost method, it is also a rather inaccurate, rough-and-ready method. For example, most projects are geographically specific so that they cannot help poor people generally, but poor people in specific localities. Also, although the benefits may be aimed at particular target groups, the shot is often widely scattered. Cost per dollar redistributed may not therefore be all that low.

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2 This picture of governments being full of good intentions, but being unable to carry them out because of an inability to raise sufficient revenue, is debatable. It could be agreed, *per contra*, that, historically, governments have shown great ingenuity in devising ways of raising revenue, and that lack of reform is as much indicative of lack of will as fiscal powerlessness.

The argument that project selection may be used to circumvent the political and incentive costs of income redistribution is much more dubious. These costs arise from the adverse reactions of individuals and groups to the fact of redistribution. If a group has the political power to prevent further redistribution away from itself by conventional means, why should it permit such a redistribution via project selection? If incentives are blunted by money handouts, will they not also be blunted by receipt of income in kind in the form of government-provided services? For these questions to be dismissed, it must be supposed that the people concerned suffer from "redistribution illusion", whereby they find a redistribution by one means more tolerable than if it were brought about in some other way. While this possibility cannot be ruled out, it seems a weak reed on which to base a policy.

Finally, it seems unlikely that project selection is not already being used to forward various aims other than economic efficiency, including income redistribution - though perhaps not in the dimensions envisaged in the proposed methodology. In these circumstances, the incorporation of distributional weights will involve an opportunity cost, at least in the eyes of the government concerned.

V. APPROACHES TO PROJECT EVALUATION

Since the many different items and considerations relevant to a project appraisal cannot be all incorporated within a grand optimizing framework, the question arises as to how best to organize the requisite information for consideration by decision-makers. The practice that has evolved over the last 30-odd years is to put into one bundle all those items - goods and bads, services and disservices - that are amenable to economic principles of valuation, and to express their net value by means of some summary statistic: net present value, or internal rate of return. Items excluded from the quantitative cost-benefit analysis include some that are conceptually amenable to economic valuation, but incapable of being so valued in practice; and others that cannot be valued meaningfully by reference to objective market phenomena from which consumers' willingness to pay, or opportunity cost in terms of other marketable items, can be inferred. Such items include distributional considerations, which have to be assessed in terms of political value judgements.

To present information concerning a project in the form of (a) its net effect on GDP (which, roughly speaking, is what the "efficiency" analysis tells us); (b) the distribution of costs and benefits among various relevant groups; and (c) its effects on othe relevant variables, is a perfectly legitimate way of proceeding. It corresponds to the way of thinking that says, for example, that country A is wealthier than country B, but has a less egalitarian distribution of income. In the Squire-van der Tak "social" analysis, the information contained in (a) and (b) is combined, with the aid of explicit predetermined weighted factors, into a single composite indicator, expressed in (or based on) units of "socially-weighted dollars". Unlike the dollar values in which "efficiency" analysis is expressed, these socially-weighted dollars and rates of return derived from them, are not related in any obvious way to national accounting dollars. However, there is a natural tendency to think of them as if they were, to the confusion of clear thought.[3]

It is misleading to say of the efficiency analysis that it "is implicitly based on value judgements on growth and equity, viz. (a) the country is growing at an optimal rate; and (b) gains received by all project beneficiencies should receive equal weight". It is simply not concerned with these matters. What it is concerned with is predicting the net effect of the project on the availability of goods and services valued in terms of opportunity costs and willingness to pay. Now to use efficiency criteria as the sole basis for ranking projects may be to make the value judgements quoted above. But again, it may not. For example, to choose projects solely on efficiency criteria may not mean that that decision-maker placed equal distributional weights on all gainers and losers, but rather that he considered that any adverse distributional consequences of the project would be corrected adequately by conventional redistribution mechanisms.

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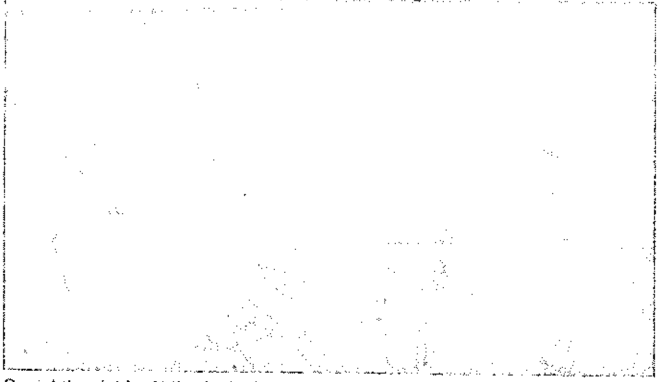
[3] Consider, for example, the discussion (on page 10 of the document cited above) of how the use of "social" analysis could influence project design and raise rates of return. If the average rate of return was raised from 18 per cent to 20 per cent, the gain to a country like Indonesia, with a lending programme of $4 billion supporting projects worth $8 billion, would be about $1.6 billion. "This illustration does point to possibilities of tremendous pay-offs ...", is the conclusion reached.

The changes in project design under discussion would reduce project contributions to GDP, but would alter the distribution of costs and benefits. For example, they might reduce the annual increase in GDP by $0.04 billion, but transfer $0.20 billion from the private to the public sector (where it is deemed to be worth, let us say $0.40 billion) giving a net increase, in social prices, of $0.16 billion. To call this "a tremendous pay-off" is one way of using words, but surely it is apt to be misunderstood. Suppose the transfer was affected by additional sales taxes; could this also be described as a tremendous pay-off?

Consumer Protection B/C



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The weakest link?

I HAVE taken a good deal of interest in the recent correspondence on the mediocre response of VW brakes. Having owned a Scirocco TS Automatic for almost five years — after an Alfa Romeo Guilia TI and a Fiat 124 Sports, both fitted with over-sensitive servos, I was also rather unhappy with the brakes. They demanded a constant awareness of the braking time-lag.

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I have driven an assorted range of cars for almost fifty years, and the Scirocco (my first German-made car) is the most satisfactory of the lot — still running on the original Michelin tyres after 50,000 miles. The detailed design/engineering solutions are of an extremely high standard for a mass production car, with no compromise on cost savings, which is rather surprising.

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Must Germans belt up?

I HAVE just returned from a trip to the Continent and I was astonished to be told by a solicitor in West Germany that the seatbelt legislation was abolished there after some years in force. The reason was, according to his information, the severity of internal injuries caused by seatbelts and no reduction in accident injuries generally.

Would you, please, try to confirm this information and, if true, publish the facts? I had my first seatbelts fitted 30 years ago.

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East Molesey
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You have undoubtedly been misinformed. Since 1975 it has been compulsory to belt-up when travelling in the front seat of a car in West Germany. However, there is no fine or punishment for not belting-up, though insurance companies do reduce injury payouts to non-belt-wearers and the German Parliament regularly debates whether it is time to introduce a fine or some other penalty. It is compulsory for rear seatbelts to be fitted to cars sold in Germany but it isn't compulsory for the rear seat occupants to use them — DW

Which-doctors

WITH THE publication of another car reliability league table, I notice that once again the *Which?* hunt is on.

I can allow — just about — that the Consumers' Association does a good job in examining utilitarian criteria for the purchase of many products, but there's a grave danger that we, and they, get their judgements out of focus.

I include "them" because one of their spokesmen, in a radio interview, actually had the temerity to suggest that people should not buy unreliable cars. What arrogance! What a myopic view of the motivations, and satisfactions, that come from the purchase of anything — cars included! One might as well choose a spouse on the basis of his or her medical case history.

If we all lived in a world ruled by functional criteria alone, presumably nobody would travel first class on trains (second class passengers arrive just as late) and we should always eschew fillet steak in favour of chewing shin of beef or scrag-end of mutton because they're so much cheaper.

You will notice I did not say "so much better value". Value is what people are prepared to pay for what they want. If they buy what they don't want, however reliable it may be, that's very bad value indeed.

According to the Which-doctors, value for money — or the lack of it — has everything to do with turgid things like keeping the garage man at bay. Rubbish!

The plain fact is I wouldn't be seen alive in a Datsun Sunny. I can't bear the name for one thing. And I don't apologise at all for the fact that this is just as important to me as twenty other factors, including reliability.

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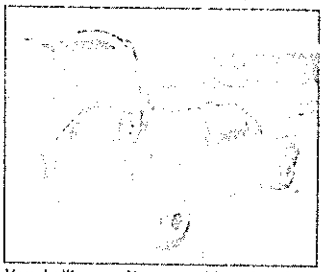

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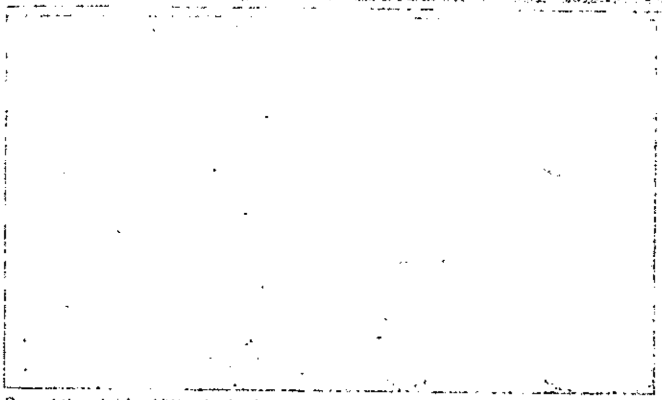

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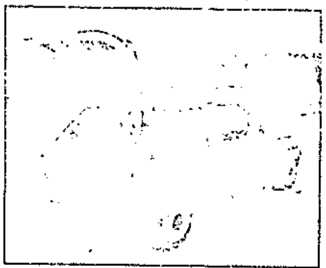

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