

Economic Analysis Retrospective 2005
Strengthening Quality-at-Entry
of ADB Operations

August 2006

Asian Development Bank

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Printed in the Philippines

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Publication Stock No. 080806

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Abbreviations

ADB	Asian Development Bank
ADF	Asian Development Fund
AFG	Afghanistan
BAN	Bangladesh
CAPE	country assistance performance evaluation
CSP	country strategy and program
DFID	Department for International Development
DMC	developing member country
EIRR	economic internal rate of return
ERD	Economics and Research Department
ETSW	economic, thematic, and sector work
GDP	gross domestic product
IND	India
MLD	Maldives
NPRS	national poverty reduction strategy
OCR	ordinary capital resources
PAK	Pakistan
PPTA	project preparatory technical assistance
PRC	People's Republic of China
RRP	report and recommendation of the President
SPD	Strategy and Policy Department
SRI	Sri Lanka
TA	technical assistance
VIE	Viet Nam

Foreword

This report is the fourth in an annual series of retrospectives prepared by the Economics and Research Department (ERD) to assess the quality of economic analysis as it is applied throughout Asian Development Bank (ADB) operations. Its aim is to help promote the use of rigorous economic analysis by ADB staff in formulating country strategies and programs and in the design of projects to ensure quality-at-entry and achieve greater aid effectiveness. The retrospectives seek to encourage and facilitate learning and knowledge sharing by identifying good practices and the areas that need improvement. It aims to enhance the interface between operations and research, and offer insights to Management.

This retrospective advances the analysis in three important ways. First, on the premise that improving project quality-at-entry starts at the identification stage, it extends its analysis to include both country strategy and program (CSP) papers and reports and recommendations of the President (RRP). Second, on the basis of “what cannot be measured cannot be managed”, it uses a numerical rating system for assessing the quality of economic analysis. Third, and more important, it employs the concept of “binding constraints” to elevate the linkage between shadow prices and distortions that underpin all economic analysis of programs and projects to the country and sector levels. This third point of departure from the previous retrospectives has two particularly attractive benefits. On one hand, it focuses on diagnosing causes of problems—market failures or government failures, the rationale for public sector involvement, and the value-added of ADB interventions. On the other, the diagnostic approach helps enable a seamless transition from country strategy, to country program, to country operations.

Expanding the scope of retrospectives to include both CSPs and RRP stages reflects an upstream shift in the focus of ERD’s operations support. By emphasizing economic analysis in the early stages of ADB’s operational cycle—with a greater emphasis on assistance strategies and programs—it moves from a piecemeal to a more system-wide approach. We hope the findings of this retrospective will provide useful inputs to upgrading the quality of economic analysis for economic, thematic and sector work, and at the CSP and RRP stages. We believe that by doing so, we can achieve a quantum improvement in the quality-at-entry of ADB operations, ultimately strengthening ADB’s aid effectiveness.

This retrospective is a team effort of ERD’s Economic Analysis and Operations Support Division and has benefited from interdepartmental reviews and discussions with the heads of ADB’s regional departments who generally concur with its findings and recommendations.



Ifzal Ali
Chief Economist

Chapter 1

INTRODUCTION



The Economics and Research Department (ERD) of the Asian Development Bank (ADB) prepares annual retrospective reviews to assess the quality of economic analysis applied throughout ADB operations. The aim is to promote the use of rigorous economic analysis in formulating country assistance strategies and programs, and in designing projects to ensure quality-at-entry and achieve greater aid effectiveness. The retrospectives seek to encourage and facilitate learning and knowledge sharing among ADB staff by identifying good practices and areas that need improvement. In particular, the retrospectives attempt to identify systemic, ADB-wide weaknesses in economic analysis that undermine quality-at-entry of ADB operations. The retrospectives also provide a basis for setting ERD's priorities for policy research, analytic work, and operations support advisory services; and offer insights to Management on the stewardship of ADB operations.

The first retrospective (*Economic Analysis in 2002: A Retrospective*) reviewed all reports and recommendations of the President (RRPs) approved by ADB in 2002, covering the key areas of economic analysis as prescribed by ADB's *Guidelines for the Economic Analysis of Projects*. The second retrospective (*Economic Analysis Retrospective: 2003 Update*) continued this assessment and reviewed RRP's approved in 2003. In contrast to the first two, the third retrospective (*Economic Retrospective 2004: Sector Diagnosis in Education*) focused on a single sector and a narrower range of issues. The key findings of the three retrospectives were that (i) there is significant scope for improvement in the quality of economic analysis in ADB operations; and (ii) areas

where improvements are needed most are in the articulation of project rationale, demand analysis, and analysis of alternatives. Findings of the retrospectives were disseminated across ADB to raise awareness and provide feedback on regional departments' efforts to improve project quality-at-entry through strengthening economic analysis.

The objective of this retrospective (Retro 2005) is two-fold. First, it aims to assess whether or not the quality of project economic analysis has improved since the first retrospective. Second, it expands the scope of the review to include the country strategy and program (CSP) papers.

The rationale for reviewing the economic analysis in CSPs stems from the view that country focus, identification of binding development constraints, and linking these constraints to CSPs are at the heart of ADB's ability to improve quality-at-entry.¹

¹ The *Review of the Asian Development Bank's Poverty Reduction Strategy* (ADB 2004d) stressed the centrality of CSPs in determining ADB country assistance and the critical importance of achieving a high standard of analytical rigor in preparing CSPs. It mentioned that an analysis of the new CSPs approved to date shows that this standard had not yet been fully achieved, perhaps because the implementation of new business processes tended to focus more on procedural requirements than on the quality of the final product.

The premise for the change in focus is that improvement of project quality-at-entry starts with improvement in the quality of CSPs.²

The inclusion of CSPs in Retro 2005 is also a reflection of ERD's upstream shift in focus to the earlier stages of the operational cycle. This shift places greater emphasis on the economic analysis of assistance strategies and programs.

Retro 2005 will complement two other ADB retrospective reviews, one recently completed by the Strategy and Policy Department (SPD),³ and the other currently being carried out by a panel created by the President.⁴ A key difference of Retro 2005 from these two is that it has a very specific focus and only examines the contents and quality of economic analysis as applied in ADB operations. The other two reviews either focus on business processes or cover a wider range of subjects and issues.

Retro 2005 reviewed six CSPs approved in 2004–2005 and 49 RRP's approved in 2005. Key findings can be summarized as follows: (i) there is significant scope for improving the quality of economic analysis in ADB operations; (ii) the areas where improvement is needed most in CSPs are in identifying binding constraints to growth and poverty reduction in developing member countries (DMCs), presenting country assessments in an integrated way to tell a coherent development story of a DMC, and demonstrating that country assistance strategies and programs are directly targeted at addressing

country-specific binding development constraints; and (iii) the areas where improvement is needed most in RRP's are in the articulation of a project's economic rationale, demand analysis, and analysis of alternatives.

Three issues should be noted when interpreting the findings of this report. First, although Retro 2005 is limited to examining the final documents of CSPs and RRP's submitted to the Board of Directors—including both main texts and appendixes—it is the culmination of a year-long process of ERD reviews of all CSP- and RRP-related documents, from inception to completion. Second, weaknesses in economic analysis in CSPs and RRP's highlight problems in economic, thematic, and sector work (ETSW) and technical assistance (TA) studies. But some could also be a reflection of a failure to adequately distill the findings of ETSW and TA studies when drafting CSPs and RRP's. Others could stem from the various constraints faced by country teams and project missions in preparing the two documents, or from poor presentation. Investigating the root causes is beyond the scope of this retrospective. Third, Retro 2005 is a retrospective review of the contents and intrinsic quality of economic analysis presented in CSPs and RRP's. It is not a review of whether or not country teams and project missions adhered to ADB business processes and guidelines in preparing these documents.

Retro 2005 argues that weaknesses in economic analysis in CSPs and RRP's raise concerns over whether ADB assistance strategies, programs, and operations in DMCs have a sound basis for ensuring quality-at-entry, which is a necessary condition for achieving maximum development impact. The report suggests several ways to address these weaknesses in economic analysis.

The rest of this report is organized as follows: Chapter II outlines the assessment framework. Chapter III presents findings from the CSP reviews. Chapter IV discusses findings from reviews of investment projects and program loans. Finally, Chapter V summarizes key findings and conclusions.

² The first documented review of project quality-at-entry was undertaken by ADB in 1994 and made a similar assertion. See *Report of the Task Force on Improving Project Quality* (ADB 1994).

³ The *Stocktaking Report of the Results-Based Country Strategy and Program Process* (ADB 2006b) covers seven CSPs approved during 2004–2006. The SPD review focuses on how well CSPs have followed results-based CSP methods and processes as recommended in its *Practice Note on Results-Based Country Strategies and Programs* (ADB 2005d), but not on the intrinsic qualities of the respective CSPs.

⁴ The first biannual assessment of CSPs and loan/technical assistance (TA) projects is currently being conducted by a panel established by the President in early 2006. It covers six CSPs, one regional cooperation strategy and program, and 20% randomly selected loan and TA projects approved during 2004–2005. The assessment is expected to examine a wide range of subjects, quality attributes, and business processes of CSPs and loans/TA projects.