

## Chapter 2

### ASSESSMENT FRAMEWORK



#### A. CONCEPTUAL FRAMEWORK

**A**DB achieves its institutional goal of poverty reduction in Asia and the Pacific by promoting economic growth, inclusive social development, and good governance in its DMCs. ADB's effectiveness in achieving this goal depends, first and foremost, on whether it can provide quality services at entry to meet DMCs' development needs and priorities. Quality-at-entry requires ADB to devise relevant and responsive country assistance strategies and programs, and to identify and design economically viable interventions. The CSP and RRP are two key documents in which ADB establishes relevance and responsiveness of its operations and demonstrates economic viability of its specific interventions. The quality of economic analysis helps to determine how well ADB succeeds in these areas.

ADB establishes relevance and responsiveness of its operations in a DMC through a CSP. These involve the following interlinked steps (Table 1):

- (i) Identifying key development challenges and binding constraints to growth and poverty reduction through a broad country diagnosis embedded in ETSW, leading to the identification of areas in need of government interventions (see the following Box on the concept of binding constraints and Appendix 1 on examples of how to identify binding constraints at a country and sector/project level).
- (ii) On the basis of the country diagnosis, critically assessing a government's development plan—or poverty reduction strategy—to determine if it can effectively address the identified development challenges and relax the binding constraints.
- (iii) Assessing ADB's past performance in assisting the DMC to identify lessons on what was done successfully in the past and should be continued, and what was not successful and should be discontinued.
- (iv) Assessing the value-added of ADB operations against other aid agencies operating in the same country, with a view to promoting aid coordination and avoiding duplication.
- (v) Formulating ADB's assistance strategy to complement the government's efforts or pilot-test new ideas and initiatives, including selecting sectors and thematic areas for ADB intervention. This is done on the basis of the development challenges and binding constraints, government development priorities, lessons learned from ADB's past performance, and ADB's value-added identified in the above four steps.
- (vi) Designing ADB's assistance program based on the assistance strategy by identifying specific interventions in each selected sector or thematic area to address the identified constraints.

**Table 1. Key Attributes of Economic Analysis in CSPs and RRP**

Goal	Objective	Attribute of Analysis
<b>CSP</b>		
Establish Relevance and Responsiveness of ADB Operations	<ul style="list-style-type: none"> <li>To identify development challenges and binding constraints to growth and poverty reduction in a DMC</li> </ul>	<ul style="list-style-type: none"> <li>Country diagnosis in terms of economic, thematic, and sector assessments</li> </ul>
	<ul style="list-style-type: none"> <li>To assess the government development plan and implementation capacity in light of the country diagnosis</li> </ul>	<ul style="list-style-type: none"> <li>Assessment of government development plan or poverty reduction strategy</li> </ul>
	<ul style="list-style-type: none"> <li>To identify lessons learned—strengths and weaknesses—from ADB’s past performance in assisting the DMC</li> </ul>	<ul style="list-style-type: none"> <li>Assessment of ADB’s past performance</li> </ul>
	<ul style="list-style-type: none"> <li>To identify assistance activities of other aid agencies to establish the value-added of ADB operations, promote coordination, and avoid duplication</li> </ul>	<ul style="list-style-type: none"> <li>Assessment of donor coordination</li> </ul>
	<ul style="list-style-type: none"> <li>On the basis of the assessments, to formulate ADB’s assistance strategy and program</li> </ul>	<ul style="list-style-type: none"> <li>ADB assistance strategy</li> <li>ADB assistance program</li> </ul>
<b>RRP</b>		
Validate Economic Rationale of ADB Intervention	<ul style="list-style-type: none"> <li>To diagnose problems and identify binding constraints in a targeted sector</li> <li>To establish justification for government intervention</li> <li>To establish justification for ADB assistance</li> </ul>	<ul style="list-style-type: none"> <li>Analysis of economic rationale</li> </ul>
Assess Economic Viability of ADB Intervention	<ul style="list-style-type: none"> <li>To conduct economic analysis of project and sector loans</li> </ul>	<ul style="list-style-type: none"> <li>Demand analysis</li> <li>Alternatives analysis</li> <li>Cost–benefit analysis</li> <li>Sustainability analysis</li> <li>Sensitivity and risk analyses</li> </ul>
	<ul style="list-style-type: none"> <li>To conduct broad economic and policy analysis of program loans</li> </ul>	<ul style="list-style-type: none"> <li>Analysis of government reform plan and capacity</li> <li>Program design</li> <li>Determination of loan size</li> <li>Assessment of benefits and impact of reforms</li> <li>Risk assessment</li> </ul>

Note: Donor coordination is not covered by this Retro 2005.

The CSP, through the cascading steps described above, establishes the relevance and responsiveness of ADB operations in a particular DMC, and also provides an economic rationale for each specific intervention—a policy reform program, an investment project, or a combination of the two. An RRP validates the economic rationale of each intervention established by the CSP, and demonstrates that the intervention is properly designed and economically viable. Validating the economic rationale of specific ADB interventions in an RRP involves

(i) Identifying constraints that the intervention intends to address. This requires a thorough sector diagnosis to identify the binding constraints in the sector.

(ii) Analyzing the rationale for government involvement. The main argument for public sector intervention is to address market failures. However, government failures are also common, so the role of the public sector needs to be carefully assessed.

(iii) Providing justification for ADB involvement. This involves examining whether the proposed project is in line with ADB’s strategic focus and the corresponding instrument and lending modality specified in the CSP, and identifying the value-added expected from the ADB intervention.

### Box. Importance of Identifying Country-specific Binding Development Constraints in Preparing a CSP

A country that is underdeveloped or underperforming often faces many distortions. These prevent the best use of resources, keep the economy far below its attainable production frontier, and constrain it from growing and developing. The distortions may be inherent to how certain markets function—such as externalities, public goods, monopoly, information asymmetry, and spillovers. They can also be government-imposed—such as taxes on production, restrictions on trade and market access, and price controls. Or they can be caused by government failures, such as poor economic management, poor governance, and weak institutions. Eliminating such distortions requires government actions. A development or reform strategy should aim to relax the development constraints caused by these distortions.

For a particular country at any particular point of time, some development constraints are binding while some may not be. Among binding constraints, some may have larger shadow prices than others and hence their relaxation would lead to greater development impacts. Given that the total amount of development resources available for the country is often limited, a key challenge for the government and aid agencies in devising the development or country assistance strategy is to identify those binding constraints, prioritize them, and allocate available development resources to relax the binding constraints with the highest shadow prices, thereby achieving the maximum possible efficiency gains and development impact.

In the context of a country strategy and program, a country's binding development constraints are the country-specific conditions and factors—reflecting either *market failures* or *government failures*—that restrict the country from realizing its development potential. At an aggregate level, binding constraints can be of a sectoral nature (e.g., poor financial intermediation, inadequate infrastructure, or energy shortages); or a thematic nature (e.g., poor macroeconomic management, weak governance, or inadequate institutional capacity). At the sector level, binding constraints can mostly be classified into categories such as limited access to financing, low technological capability, a weak policy and regulatory framework, governance issues, or incentive and information problems. Careful diagnosis of the binding constraints to growth and poverty reduction at a country and sector level is one of the most fundamental steps in preparing a CSP, and one of the most important means of ensuring quality-at-entry of ADB assistance strategies, programs, and operations.

The idea of binding constraints is not new, and their importance has long been recognized in development economics literature (Ishikawa 1967, Johansen 1967). The calls for development efforts to target the relaxation of binding constraints in academic and policy discussions in recent years have been partly driven by the failures of the Washington Consensus's laundry list of policy prescriptions to deliver anticipated development results (Hausmann et al. 2005). The importance of identifying binding constraints was highlighted in a recent World Bank study, *Economic Growth in the 1990s: Learning from a Decade of Reform* (World Bank 2005c). The study suggests moving away from formulaic policy making and focusing on country-specific binding constraints through experimentation and learning. The 2004 *Review of the Asian Development Bank's Poverty Reduction Strategy* (ADB 2004d) cited the risk of diverting attention from removing binding constraints to poverty reduction arising from certain business practices at the time.

The need for identifying country-specific binding development constraints in preparing a CSP is in line with recent efforts by the development community to align development assistance with country-specific needs and to focus on development results. This should be an essential part of ADB efforts in searching for greater aid effectiveness.

Appendix 1 illustrates how to identify binding development constraints at the country and sector/project level.

Sources: Ishikawa (1967), Johansen (1967), Hausmann et al. (2005), World Bank (2005c), and ADB (2004d).

Economic viability is a critical requirement for quality-at-entry. For investment projects, assessment of economic viability comprises the following steps:

- (i) Demand analysis. A project that is relevant and responsive and can achieve intended results should be based on a thorough demand analysis, including how demand will be affected by changes in prices, incomes, and other factors.
- (ii) Alternatives analysis. The selected design for a project should be cost-effective. Alternative designs should be assessed to ensure that the selected design meets demand and is the least-cost alternative.
- (iii) Cost–benefit analysis. The economic benefits of the selected alternative need to be identified, quantified, valued, and compared with the economic costs of the undertaking to ensure that benefits sufficiently outweigh costs.
- (iv) Sustainability analysis. For an intervention to achieve its intended results, economic benefits must be sustainable over its lifetime. A financial assessment of the intervention and implementing agency will indicate the intervention’s impact, the financial position of the agency, and its

ability to fund recurrent costs. An assessment of institutional capacity to operate and maintain the intervention is another important indicator of sustainability.<sup>1</sup>

- (v) Sensitivity and risk analyses. Adverse changes in key variables can have an impact on results. Therefore, sensitivity and risk analyses should be conducted to test the robustness of economic viability.

For program loans—often designed to assist DMCs in policy and institutional reforms—establishing economic viability requires a broader economic and policy analysis, including assessments of government reform plans and capacity, program design, fiscal implications and basis of the loan size, benefits and impacts of proposed reforms, and risk assessments.

## B. ASSESSMENT METHOD

The analytical framework outlined above provides a basis for assessing the quality of economic analysis in CSPs and RRP. In addition, a numerical rating system is used, with each attribute of economic analysis (see Table 1), excluding donor coordination, assessed on a scale of 1–4. Specific rating definitions and corresponding scores are presented in Table 2.

**Table 2. Rating Definitions and Scores**

Rating	Score	Definition
Unsatisfactory (US)	1	The attribute concerned is discussed with simple statements but no analysis.
Partially Satisfactory (PS)	2	The attribute concerned is discussed with limited or insufficient analysis.
Generally Satisfactory (GS)	3	The discussion of the attribute concerned meets the minimum standard, i.e., it covers all key aspects with sufficient analysis.
Fully Satisfactory (FS)	4	The discussion of the attribute concerned contains analysis of all key aspects and can be considered as an example of good practice.

<sup>1</sup> The core ADB financial due diligence process covers financial viability and sustainability of projects through financial analysis and financial management assessments.