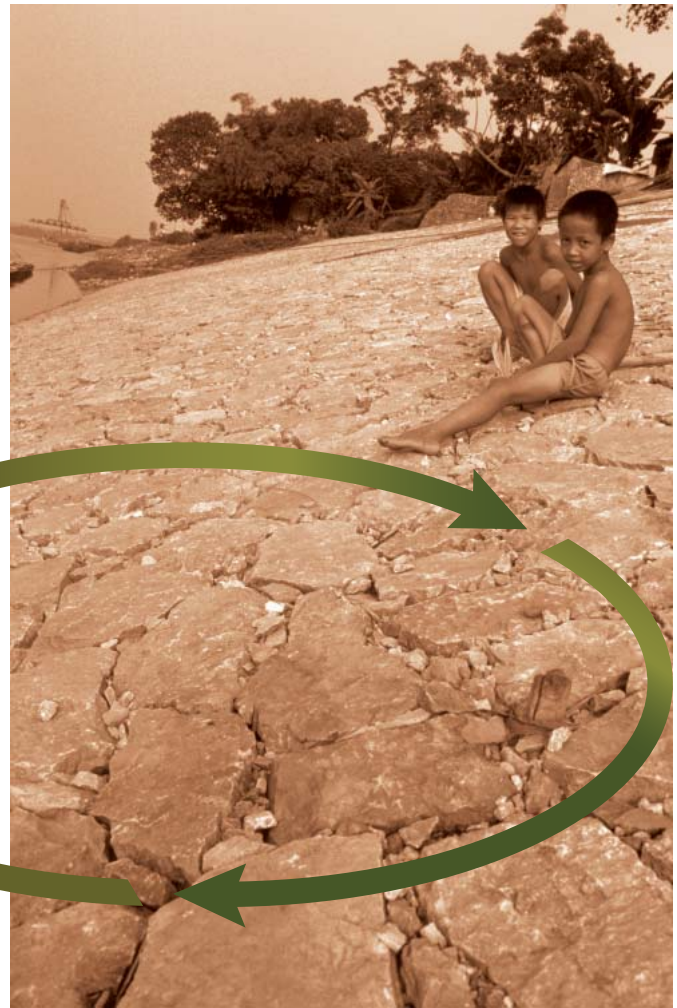


## Chapter 5

### SUMMARY AND CONCLUSIONS



**T**his Retro 2005 reflects three major points of departure from the previous retrospectives. First, on the premise that improvement of project quality-at-entry starts at the identification stage, it extends the coverage to include both CSPs and RRP. Second, on the basis of “what cannot be measured cannot be managed”, it introduces a numerical rating system. Third, and more important, through the introduction of the concept of binding constraints—a concept as old as development economics itself, but gaining renewed attention—the retrospective elevates the linkage between shadow prices and distortions that underpin all economic analysis of projects to the country and sector levels. This third point of departure has two particularly attractive benefits: (i) it focuses attention on a diagnosis of problem causes (market

failures or government failures), the rationale for public sector involvement, and the value-added of ADB interventions; and (ii) the diagnostic approach enables a seamless transition from country strategy to country program to country operations. It is against this analytical framework that the CSPs and RRP were assessed.

#### A. MAJOR FINDINGS

Through a systematic review of economic analysis contained in the six CSPs approved in 2004–2005 and the 49 RRP approved in 2005, Retro 2005 shows that there is significant scope for improving the quality of economic analysis applied in ADB operations. Major areas for improvement are highlighted below.

## Findings on Country Assessments, and Assessments on Government Development Plans and ADB's Past Performance

The most serious weaknesses of country assessments in the CSPs reviewed were, first, a lack of systematic analysis of binding constraints to growth and poverty reduction; second, the often fragmented presentations of economic, thematic, and sector assessments, making it difficult to tell holistic development stories on the concerned DMCs. These problems raise concerns over whether the country assessments provided ADB assistance strategies and programs with sound foundations for achieving maximum development impacts. Some areas for improvement are as follows.

- ❑ Growth assessments should more clearly identify and highlight the drivers of growth and binding constraints to growth, and the analysis of macroeconomic policy issues should be more forward-looking.
- ❑ Poverty assessments should lead to a better understanding of poverty trends and causal factors, country-specific causes of poverty and constraints to poverty reduction, and income inequality.

- ❑ Sector assessments should more systematically diagnose and highlight sector constraints; and cross-cutting thematic assessments should focus more on analyzing how the identified problems constrain growth and poverty reduction.
- ❑ Significant efforts are needed to integrate economic, thematic, and sector assessments in CSPs in order to better present coherent development stories on the countries concerned.

On government development plans and ADB's past performance, the insufficient attention to identifying binding development constraints in ADB's own country diagnosis raises the question of whether a CSP could make an informed assessment on the government development strategy. The assessment on the feasibility of a government development plan, both in terms of financial and institutional capacities, is another area for improvement. In assessing ADB's past performance, there is a need for more critical analysis of the problems ADB encountered and the challenges it faces at the sector level, and better demonstration of development outcomes and impacts of ADB assistance.

## Findings on ADB Assistance Strategy and Program

For many CSPs reviewed, there was a lack of clear demonstration that country assistance strategies and programs directly target binding development constraints and cater to country-specific needs. This may be partly due to the failure to adequately identify binding constraints in country assessments. This raises questions of whether the assistance strategies of these CSPs were focused enough, whether they have differentiated sufficiently the most urgent needs of each country, and whether they have sound basis for generating maximum development impacts in light of limited ADB resources available to DMCs. This also raises the question of whether the selected sector and thematic areas for ADB intervention and assistance programs designed to implement the strategies could most effectively help DMCs address their development challenges. There were also other weaknesses in articulating assistance programs in several CSPs, as identified below.

- ❑ In some cases, sector constraints were not clearly spelled out, making it difficult to assess the economic rationale of proposed interventions. This could have serious implications for the next stages of ADB's operational cycle—PPTAs and RRP. Many CSPs did not discuss issues of the sequences required to relax binding constraints.
- ❑ Not all the CSPs discussed the general approach to the selection of operational instruments and lending modalities.
- ❑ The assistance programs sometimes did not clearly spell out details of planned interventions, making assistance programs look disconnected from pipelined projects.

## Findings on Economic Analysis of Investment Projects

On economic analysis of investment projects, past successive retrospectives found that the articulation of economic rationale, demand analysis, and alternatives analysis in RRP were the weakest areas among key areas of economic analysis prescribed by ADB's *Guidelines for the Economic Analysis of Projects*. This retrospective found that the three remained the weakest areas of economic analyses in RRP. Specific areas for improvement are as follows.

- ❑ There is a need for improving analysis of rationale for public sector involvement and justification for ADB interventions.
- ❑ Demand analysis was one of the weakest areas of project economic analysis, and this is especially true for agriculture and social sector projects.
- ❑ Alternatives analysis was not presented in many RRP, and there is need for greater efforts in demonstrating the cost effectiveness of proposed project designs.
- ❑ Sustainability analysis needs to improve the discussions on a project's fiscal implications and the government ability to meet financial and institutional requirements for operating projects and maintaining output.
- ❑ In many RRP, sensitivity analysis involved only simple scenarios of project costs and benefits either increasing or decreasing by a percentage.
- ❑ Very few RRP performed risk analysis, and there is a need for greater efforts to ensure that an assessment of risk is part of an economic analysis.
- ❑ For most attributes, more transport, energy, water supply, and sanitation projects were rated as "generally satisfactory" or "fully satisfactory" than agriculture, natural resources, education, and health; regional departments need to make greater efforts to improve economic analysis in social sector and agriculture projects.

## Findings on Economic Analysis of Policy-based Program Loans

On economic analysis of policy-based program loans, although the average score of program loan RRP was higher than that of project and sector loan RRP, there were also weaknesses in economic analysis of policy-based program loans.

- ❑ The justification for ADB involvement should be better explained.
- ❑ There were also weaknesses in the assessments of government reform programs and implementation capacities.
- ❑ Determination and justification of the loan size was the weakest part of the economic analysis of program loans in the RRP reviewed.
- ❑ Analysis of benefits and poverty impacts could be improved by identifying channels through which the benefits and impacts can be achieved.
- ❑ The main weakness in risk assessment was in the discussion of risk mitigation.

## B. STRENGTHENING QUALITY-AT-ENTRY: FUTURE DIRECTIONS

Improving the quality-at-entry of ADB operations hinges on strengthening the quality of economic analysis upstream in ADB's operational cycle.

Getting it right at a very early stage will lead to large payoffs. Based on the findings summarized in the preceding, the following key messages point to the future directions for improving the quality of economic analysis applied in ADB operations.

### Improving the Quality of Economic Analysis Applied in ADB Operations

- ❑ Improving the quality of economic analysis in CSPs starts with strengthening ADB's ETSW. The adoption of a diagnostic approach in ETSW requires a change in mindset when analyzing development problems and focusing on the identification of binding constraints to growth and poverty reduction in DMCs (see Appendix 1 for examples of how to identify binding constraints).<sup>1</sup>
- ❑ Key ETSW findings need to be carefully distilled and presented in final CSPs in an integrated and coherent manner.
- ❑ Insights emerging from ADB's diagnostic economic analysis should be the basis for critically assessing a government's development plan and program.
- ❑ Strengths and weaknesses emerging from ADB's past performance in a DMC combined with the above diagnostics should determine the contours of the country assistance strategy.
- ❑ Country assistance strategies and programs targeted more directly at assisting DMCs in relaxing binding development constraints will clearly establish ADB's development role in a DMC.<sup>2</sup>
- ❑ Ensuring quality-at-entry of ADB operations requires good economic analysis in CSPs as well as in RRP. Analysis of economic rationale for a project emanates from linking ADB intervention to the relaxation of binding constraints identified in the CSP; the demand analysis provides the basis for valuing the output stream resulting from relaxing the constraint; the alternative analysis strengthens the adoption of the least-cost option; and the sensitivity and risk analyses are the basis for identifying mitigating measures to reduce risks at the project, sector, and country levels. All of these are areas for future improvement.

<sup>1</sup> A diagnostic of ADB's approach and system for producing ETSW can help strengthen the process. The diagnostic could clarify, among others, the following issues: (i) Has ADB committed enough resources to producing ETSW? (ii) Does the system give adequate incentives to staff to produce quality ETSW products? (iii) Has senior Management given sufficient attention and adequate oversight to ETSW? (iv) Is the existing ADB business process conducive to producing quality ETSW? (v) What can ADB learn from other development partners in ETSW? ETSW is the central part of World Bank's country and sector analysis, absorbing approximately 75% of World Bank resources devoted to preparing new lending. The World Bank estimated that \$1 spent on ETSW on average yields between \$12 and \$15 of development impact (see Deininger et al. 1998).

<sup>2</sup> Earlier ADB efforts to identify binding constraints to growth and poverty reduction, such as those by Pacific Department and SPD, are noted. See Duncan and Pollard (2002).

## C. POSSIBLE RESPONSES

### **Economics and Research Department: Reorienting Its Approach to Advisory Services**

- ❑ Strengthen its research and analytical work, focusing on pilot growth diagnostic studies in selected DMCs
- ❑ Undertake focused economic analysis retrospective reviews of ADB operations
- ❑ Develop and improve economic analysis methodologies and act as a focal point/resource center for such methodological issues
- ❑ Offer learning programs on the economic analysis of projects and programs to ADB staff

Economic analysis retrospectives are targeted at ERD staff, regional departments, and Management. ERD's responses will focus on strengthening its efforts to bridge literature with operations and bringing knowledge distilled from operations to literature. In this regard, ERD is in the process of reorienting its advisory services toward providing quality support at earlier stages in the operational cycle. This reorientation is an outcome of previous retrospectives of economic analysis, which indicated that ERD's advisory services are likely to be most useful at the CSP and PPTA stages when missions have the greatest potential to respond. ERD will support this reorientation process through the following actions.

ERD will continue to review and comment on key ADB operational documents, with a particular focus on CSP initiating papers, CSPs, and TA papers. The comments on draft RRP's will focus on key issues identified in CSP and TA papers. Through this reorientation, ERD aims to develop a more constructive relationship with regional departments, with a view to contributing more effectively in improving quality-at-entry of ADB operations.

ERD's country-specific studies on binding development constraints and their sequential relaxation should be complemented by similar sector studies. The lessons learned and insights gained would be very useful in preparing sector road maps with good and bad practices identified as applicable to sectors in countries at similar stages of development. In this regard, the Regional and Sustainable Development Department would have an important role to play.

Retro 2005 highlights the importance of the knowledge and analytical content of CSPs for

informed decision-making. The distillation in a CSP of the knowledge and experience gained in working with a DMC enables ADB to take a view and, on that basis, adopt certain positions with respect to the DMC. The subsequent policy dialogue would be pivotal in shaping ADB strategy, program, and operations. The insights from Retro 2005 indicate the directions of introspection and action that the regional departments might wish to consider in order to strengthen ADB's relevance and responsiveness to both bolster quality-at-entry and demonstrate ADB's uniqueness and distinctiveness. While Retro 2005 identifies directions for improvements, it is for the regional departments to determine their plan of action.

Management is sensitized to the major shortcomings in economic analysis of ADB operations, and the implications for establishing relevance and responsiveness at the strategy and program stage, and economic viability at the project level. This information is relevant in Management's decision-making on strengthening their stewardship over ADB operations.

Retro 2005 has expanded the scope of economic analysis to include both CSPs and RRP's. In doing so, it has initiated a fundamental shift in terms of moving from a piecemeal to a systems approach, where each component is explicitly linked to other components in a cascading manner. It is hoped that the findings of Retro 2005 could be used as a basis to undertake major changes in applying economic analysis at the ETSW, CSP, and RRP stages, in order to achieve a quantum improvement in the quality-at-entry of ADB operations. In turn, this should contribute toward strengthening ADB aid effectiveness.