Session 3.1
Distribution Analysis

Introductory Course on Economic Analysis of Investment Projects
Why Distribution of Project Effects?

- Equity Considerations
  - Who benefits from the project, by how much?
  - Is distribution of effects consistent with project objectives?
  - How do benefits reach target groups?

- Incentive Considerations
  - Who receives, by how much?
  - Who pays, by how much?
Examples of Distribution Analysis

- Understand effects of price changes on stakeholder groups, net benefits of service projects

- Assess effects of foreign resources such as BOT projects with foreign sponsors - net capital flows, host country and foreign investor benefits division

- Assess the distribution of economic and financial costs and benefits, and net benefits between poor groups and other stakeholders

→ Poverty reduction addressed where components effectively reach poor groups
Analytical Focus of Distribution and Poverty Impact Assessment

- Channels of effect: access to employment, markets, resources and assets, services, transfers
- Distribution effects: who receives, who pays
- Time dimensions and directness of effect: short to longer run and direct and indirect effects
- Design implications: mitigation and enhancement measures
Start Distribution Analysis During Sector Work

- Assess without project access to employment, markets, resources and assets, services, transfers
- Assess differences in access by group (such as income) and geographic location
- Identify stakeholder groups that stand to gain or lose by investments
- Assess alternatives that are likely to be effective and sustainable in increasing access, benefit incidence
During Feasibility and Appraisal

- Have the channels of effect been identified to see how costs will be incurred and benefits realized?

- How much are gains/losses from distributing project effects? Do they provide an incentive for response?

- How much is the cost burden to those who will pay? Is the burden acceptable?

- How do targeting/equity considerations affect the overall project performance and returns?

- Can the project and component design be modified and/or complementary measures be taken to enhance impact on target beneficiaries, minimize effect on efficiency?
How Far Can We Take Distribution Analysis?

- Revenue generating projects with quantitative financial/economic analysis
  → quantitative distribution analysis and poverty impact ratio

- Non-revenue generating projects with quantitative benefit analysis
  → quantitative benefit incidence analysis

- Limited quantitative analysis
  → qualitative channel of effect analysis
Stakeholder Groups Analysis

- Owners, operators of project enterprises
- Consumers, users of project outputs
- Goods and service suppliers to the project
- Hired workers, labor for the project
- The government
- Rest of the economy
- Lenders to the project
Distribution Tree: Example From Road Project

Cost Savings

Passenger Vehicles
- Transport Users
  - Private
  - Government
- Owners
  - Private
  - Government

Freight Vehicles
- Transport Users
  - Private
  - Government
- Owners
  - Private
  - Government
Poverty Impact Tree: Example From Road Project

Private Sector Benefits
- Non-Poor
- Poor

Government Benefits
- Transfers to Non-Poor
- Transfers to Poor
Linking Distribution and Poverty Analysis to Cost Benefit Analysis

1. Estimate who gains from the financial flows created by the project
2. Estimate economic costs and benefits relative to financial costs and benefits, i.e., ENPV-FNPV
3. Distribution Analysis: Distribute differences between financial and economic costs and benefits and add these to income changes from project financing
4. Estimate the gains to the poor (PIR)
Example: Water Supply Project

- Project supplies piped water in a small town
- Three main stakeholders
  - Government/economy
  - Construction labor
  - Water consumers
- Consumers pay for water supplied
- Use domestic price numeraire
- Use discount rate of 12% for FPV and EPV
Example: Water Supply Project

Methodology:

1. Identify project stakeholders, for example, water consumers, labor, government, economy.

2. Calculate present value of financial costs and revenues by component and estimate who pays for the project.

3. Calculate present value of economic costs and benefits by component and identify who gains/loses from the differences.

\[
PV(\text{EC}) = PV \text{ financial costs} -/+ \text{ NPV transfers}
\]

\[
PV(\text{EB}) = PV \text{ consumer surplus} + PV \text{ financial revenues} +/- PV \text{ externalities}
\]
Example: Water Supply Project

4. Total project effect is \( \text{ENPV} = \text{FNPV} + (\text{ENPV} - \text{FNPV}) \)
   where ENPV gives addition to national income.

5. Some groups must get both FNPV and the difference between ENPV and PNPV.

6. Some of the groups will be poor.
### Example: Water Supply Project

<table>
<thead>
<tr>
<th>Project Costs and Benefits</th>
<th>FNPV</th>
<th>ENPV</th>
<th>ENPV-FNPV</th>
<th>Consumers</th>
<th>Labor</th>
<th>Government/Economy</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output Benefits</td>
<td>1000</td>
<td>1800</td>
<td>800</td>
<td>800</td>
<td></td>
<td>50</td>
<td>800</td>
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<tr>
<td>Capital Costs</td>
<td>-650</td>
<td>-600</td>
<td>50</td>
<td></td>
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<td></td>
<td>50</td>
</tr>
<tr>
<td>Power Costs</td>
<td>-330</td>
<td>-250</td>
<td>80</td>
<td></td>
<td></td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Labor Costs</td>
<td>-80</td>
<td>-56</td>
<td>24</td>
<td></td>
<td>24</td>
<td></td>
<td>24</td>
</tr>
<tr>
<td>Project Effects</td>
<td>-60</td>
<td>894</td>
<td>954</td>
<td>800</td>
<td>24</td>
<td>130</td>
<td>954</td>
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<tr>
<td>Net Financial Effects</td>
<td>-60</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-60</td>
<td>-60</td>
</tr>
<tr>
<td>Net Economic Effects</td>
<td></td>
<td>894</td>
<td></td>
<td>800</td>
<td>24</td>
<td>70</td>
<td>894</td>
</tr>
</tbody>
</table>

1. Project Financial and Economic Effects

2. Distribution of Project Effects Among Stakeholders
Poverty Impact Ratio

- An extension of distribution analysis with stakeholders further defined by income or other poverty indicators
- Identify the proportion of poor in stakeholder groups
- Calculate the benefits to poor stakeholders
- Calculate the Poverty Impact Ratio (PIR):
  \[ \text{PIR} = \frac{\text{ENPV}_{\text{poor}}}{\text{ENPV}_{\text{total}}} \]
## Example: Water Supply Project

<table>
<thead>
<tr>
<th></th>
<th>Consumers</th>
<th>Labor</th>
<th>Government/Economy</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Economic Effects</strong></td>
<td>800</td>
<td>24</td>
<td>70</td>
<td>894</td>
</tr>
<tr>
<td><strong>Proportion of Poor in Stakeholder Group</strong></td>
<td>0.25</td>
<td>0.33</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td><strong>Benefits to Poor Stakeholders</strong></td>
<td>200</td>
<td>8</td>
<td>35</td>
<td>243</td>
</tr>
<tr>
<td><strong>Poverty Impact Ratio</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>243 / 894 = 0.27</strong></td>
</tr>
</tbody>
</table>
Example: Water Supply Project

- Estimate of 243 gain to poor is a direct effect and there may be an indirect effect due to project financing.
- A subsidy of 60 is required to cover financial costs and must be funded by the government.
- If 35% of this would have gone ultimately as benefits to the poor this is a loss of 21.
- Net gains to the poor are thus $243 - 21 = 222$ \textbf{NOT} 243.
- Indirect effects are very difficult to estimate.
Use Poverty Impact Ratio with Caution

- PIR is a ratio and can be misleading
  - how much NPV actually goes to the poor (absolute poverty impact)
  - how much NPV goes to the poor per project cost (efficiency of poverty impact)
- Highly sensitive to assumptions on proportion of poor in different groups
- If uncertain about proportion of poor, test effect on PIR through sensitivity analysis
Thank you