Session 1.1
Overview of Economic Analysis in ADB Operations

Introductory Course on Economic Analysis of Investment Projects
5-9 July 2010
Outline

I. What Does Economic Analysis Do and Why It Is Important

II. Applying Economic Analysis in ADB Operations

III. 10 Key Areas of Project Economic Analysis

IV. Highlights of Past Economic Analysis Retrospectives

V. Objectives of this Training Course
I. What Does Economic Analysis Do?

- To help identify areas where investment is needed
- To establish the economic rationale for public sector involvement
- To help make the choice among alternative instruments and solutions
- To assess a project’s economic benefits and costs, potential development impact, and potential risks
Benefits of Good Economic Analysis

- Deininger, K. (Does Economic Analysis Improve Quality of Foreign Assistance?)
  - Economic and sector work (ESW) has significant impact on various measures of quality of project; ESW has a systematically positive effect on the quality of lending program
  - ESW help staff design better projects ex ante and improve the quality of projects already in the investment program

- Jenkins, G., (Project Analysis at the World Bank)
  - If the economic appraisal of a project is poorly done prior to approval, the probability that it would perform unsatisfactorily is 7 times higher than that of a project with good economic analysis
II. Applying Economic Analysis in ADB Operations

- At regional level, economic analysis underpins ADB’s corporate strategy and assessment of development outlook.

- At country level, economic, thematic, and sector work (ETSW) provides basis for Country Partnership Strategy
  - What are the binding constraints to growth and poverty reduction in a particular DMC?
  - Why should the public sector intervene?
  - Why should ADB be involved and what instruments to use?

- At project level, economic analysis establishes economic rationale and viability for each project
  - Ensure each project is economically viable, cost-effective, and generates sustained development results
Country/sector analysis

What is the problem?

Why should Public Sector be involved?

How should public sector be involved?

Verify Demand/Benefits

Compare Costs and Benefits

Ensure Least Cost Option is Selected

Technical Options

Physical Constraints

Institutional & Incentive Constraints

Non-Technical Options
### III. Key Areas of Project Economic Analysis

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<td>1.</td>
<td>Assess macroeconomic context</td>
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<td>Assess sector context</td>
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<td>Assess demand</td>
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<td>Identify economic rationale</td>
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<td>Identify project alternatives</td>
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<td>Identify and compare benefits and costs</td>
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<td>Assess financial and institutional sustainability</td>
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<td>Undertake distribution analysis</td>
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<td>Undertake sensitivity and risk analysis</td>
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<td>Establish a Project Performance Monitoring System</td>
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IV. Highlights of Past Retrospective Reviews of Project Economic Analysis

- Improvements required in the following areas:
  - Demand analysis
  - Analysis of alternatives
  - Sensitivity and risk analyses
VI. Objectives of this Training Course

- To introduce concepts/principles of project economic analysis
- To discuss applications of techniques based on guidelines
- To identify key issues in the conduct of project economic analysis
Thank you!
Low Levels of Private Investment and Entrepreneurship

- Low return to economic activity
- High cost of finance

- Low social returns
- Low appropriability

Government failures

- Poor geography
- Bad infrastructure
- Low human capital

Micro risks: property rights, corruption, taxes

Market failures

- Bad international finance
- Bad local finance

Information externalities: “self-discovery”

Coordination externalities

- Macro risks: financial, monetary, fiscal instability
- Low domestic saving
- Poor intermediation

ADB
Debt Overhang

- Low profitability
- Debt legacy on state-owned firms

Low cotton prices

- Government price controls
- Sluggish world demand

Low productivity

- High input costs
- High costs of financial services
- High cost of processing services
- High costs of transport services
- Monopolistic pricing and state-price controls on intermediate inputs

Low farm incentives

- Poor land quality
- Insecure land tenure
- Production quotas and restrictions
- Excessive taxes
- Poor transport

High costs of transport services

- Monopolistic structure of ginning services
- Inadequate cotton grading system and classification