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. The Role and Functions of the Economic Analysis and Operations Support Division (EREA)
VI. 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 and potential development impact
• To identify and assess potential project risks
Benefits of Doing 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

• Economic, Thematic, and Sector Work (ETSW)
  ▪ What are the binding constraints to growth and poverty reduction?
  ▪ Why should the public sector intervene?

• Country Partnership Strategy (CPS) and Business Plan
  ▪ Why should ADB be involved: To establish the rationale for ADB assistance
  ▪ What instruments should ADB use?

• Project Development (PPTAs and RRPBs)
  ▪ To ensure each project is economically viable, most cost-effective, adds value, and generates results through rigorous project economic analysis.
Country/sector analysis

What is the problem?

Why should Public Sector be involved?

How should public sector be involved?

Technical Options

Physical Constraints

Institutional & Incentive Constraints

Non-Technical Options

Verify Demand/Benefits

Compare Costs and Benefits

Ensure Least Cost Option is Selected
### III. Key Areas of Project Economic Analysis

1. Assess macroeconomic context
2. Assess sector context
3. Assess demand
4. Identify economic rationale
5. Identify project alternatives
6. Identify and compare benefits and costs
7. Assess financial and institutional sustainability
8. Undertake distribution analysis
9. Undertake sensitivity and risk analysis
10. Establish a Project Performance Monitoring System
IV. Highlights of Past Retrospective Reviews of Project Economic Analysis

- Improvements required in the following areas:
  - Demand analysis
  - Analysis of alternatives
  - Quality of quantitative economic analysis
  - Sensitivity and risk analyses
  - Project sustainability analysis
V. What does the Economic Analysis and Operations Support Division of ERD Do?

Office of the Chief Economist

Jong-Wha Lee
Chief Economist

Macroeconomics and Finance Research Division
- Research on short- and medium-term economic prospects
- Research on long term growth

Economic Analysis and Operations Support Division
- Research and analytic work
- Operations advisory services
- Learning programs

Development Indicators and Policy Research Division
- Database development & capacity building
- Public policy research (e.g., labor market studies, investment climate studies, poverty studies)
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

Growth Diagnostics
Identifying Binding Constraints at a Sector/Project Level

Debt Overhang
- Low profitability
  - Low cotton prices
    - Government price controls
- High input costs
  - High costs of financial services
    - Monopolistic pricing and state-price controls on intermediate inputs
  - High cost of transport services
    - High costs of processing services
      - Monopolistic structure of ginning services
        - Inadequate cotton grading system and classification
  - Poor transport
    - Excessive taxes
      - Insecure land tenure
        - Production quotas and restrictions
          - Excessive taxes
            - Insecure land tenure
              - Poor transport
                - High input costs
                  - Monopolistic pricing and state-price controls on intermediate inputs
  - Low productivity
    - Sluggish world demand
      - Adverse weather conditions
        - Poor technology
          - Low farm incentives
            - Poor land quality
              - Salinity and water-logging problems
                - Deteriorating irrigation facilities
                  - Insecure land tenure
                    - Production quotas and restrictions
                      - Insecure land tenure
                        - Poor transport
                          - High input costs
                            - Monopolistic pricing and state-price controls on intermediate inputs