

Economic Training Series: Introductory Course on Economic Analysis of ADB Operations

Financial and Institutional Sustainability

The views expressed in this presentation are the views of the author/s and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this presentation and accepts no responsibility for any consequence of their use. The countries listed in this presentation do not imply any view on ADB's part as to sovereignty or independent status or necessarily conform to ADB's terminology.



ADB

Economic and Financial Analyses

- **Financial Analysis:** estimating the profits accruing to project operating entity or to project participants

Market Prices → FIRR: Incentives for Project Participants

- **Economic Analysis:** estimating the effects of the project on the national economy

Shadow Prices → EIRR: Consequences of Participants' Decisions for the National Economy

- Difference between FIRR and EIRR

Project Sustainability

- Will project effects last for its economic life?
- **FIRR and EIRR in themselves not a measure of sustainability** – depends on the capacity to sustain net benefits by:
 - meeting recurrent/operating costs
 - sustaining benefit realization
 - meeting intended distribution incidence
 - mitigating risks effectively
 - capacity to implement the project
- Requires consideration of financial, fiscal, institutional, (environmental) implications of projects

Financial and Fiscal Analyses

Three key aspects of financial/fiscal sustainability

- Availability of adequate funds to finance project expenditures
- Recovery of some of the project costs from the project beneficiaries
- Financial incentives necessary to ensure participation in the project
 - Revenue generating projects: **Financial Analysis**
 - Non-revenue generating projects: **Fiscal Analysis**

Revenue Generating Projects

- Revenue generating entity
(power utilities, water utilities, toll roads etc.)
 - Financial performance at the enterprise level
 - Producer incentives from the financial return viewpoint
 - User charges/tariff analysis
 - Subsidy analysis
 - Financial Covenants

→ *Day 4: Financial Analysis (Financial Due Diligence)*
- Other revenue generating projects
(agriculture, irrigation, education, health etc.)

→ Financial & Fiscal Analyses

Non-revenue Generating Projects

- Government budget: the principal fund source to meet investment and operating expenditures
- Public expenditures -> Claims on scarce resources
 - ✓ Are there activities or claims not rationalized?
 - ✓ Do the rationalized priorities have resource support?
 - ✓ How efficiently do the resources get utilized?
 - ✓ How effective in achieving the objectives?
- Making sense of such issues for projects critical with limited resource envelope

Public Expenditure Review (PER)

- Public Expenditure Review:
 - An increasingly available diagnostic tool of national, sector, and regional level expenditures
- Sector PERs:
 - Development problems and binding constraints
 - Existing policies
 - Expenditure priorities (capital and recurrent) management
 - Public institutions versus private deliveries
 - Benefit incidence
- Regional PERs: Decentralization

Medium-term Expenditure Framework (MTEF)

- Linking policy, planning and budgeting over a medium-term
- Matching “resource envelope” and “the current and medium-term costs”
 - fiscal discipline
 - strategic budget allocation
 - : Inter-sectoral and intra-sectoral budget allocation

a simple sector budget estimation and affordability check (without checking the government's priorities or commitment) is not enough!

But, many cases.....

- Fiscal impact of the project on the government budget:

Project costs and future commitments (recurrent costs)
with other ADB projects

→ insignificance on government budget

by assuming the historical trend of the sector budget

Decentralization

- ADB Operations: Increasing support to local governments
 - Overall decentralization policy: governance specialists
 - Local service delivery: sector specialists (..SS, ..AE)
 - A major risk: “isolated” project procedures outside recipient’s decentralized systems → No sustainability!
- ✓ Functional demarcations between levels of government
- ✓ Project fund flow and intergovernmental transfers
- ✓ Local planning and budgeting practices
- ✓ Community and stakeholder involvements
- And, local capacity

Institutional Analysis

- Institutional capacity of EA and IA to implement, operate & maintain the project over its lifetime
 - functions, structure, and capacity
 - institutional capacity:
 - management/administrative capacity
 - technical capacity
 - quantity and quality of staff
 - because implementation delay can lead to increased costs and delayed benefits
 - external influences on the EA and IA
 - e.g. government

But, equality important is more broader.....

Institutional does matter

Fiscal analyses:

→ An implicit assumption: “Money (Budget) does matter”

But, what we learnt was:

→ Weak link between public spending and outcomes

Real problems:

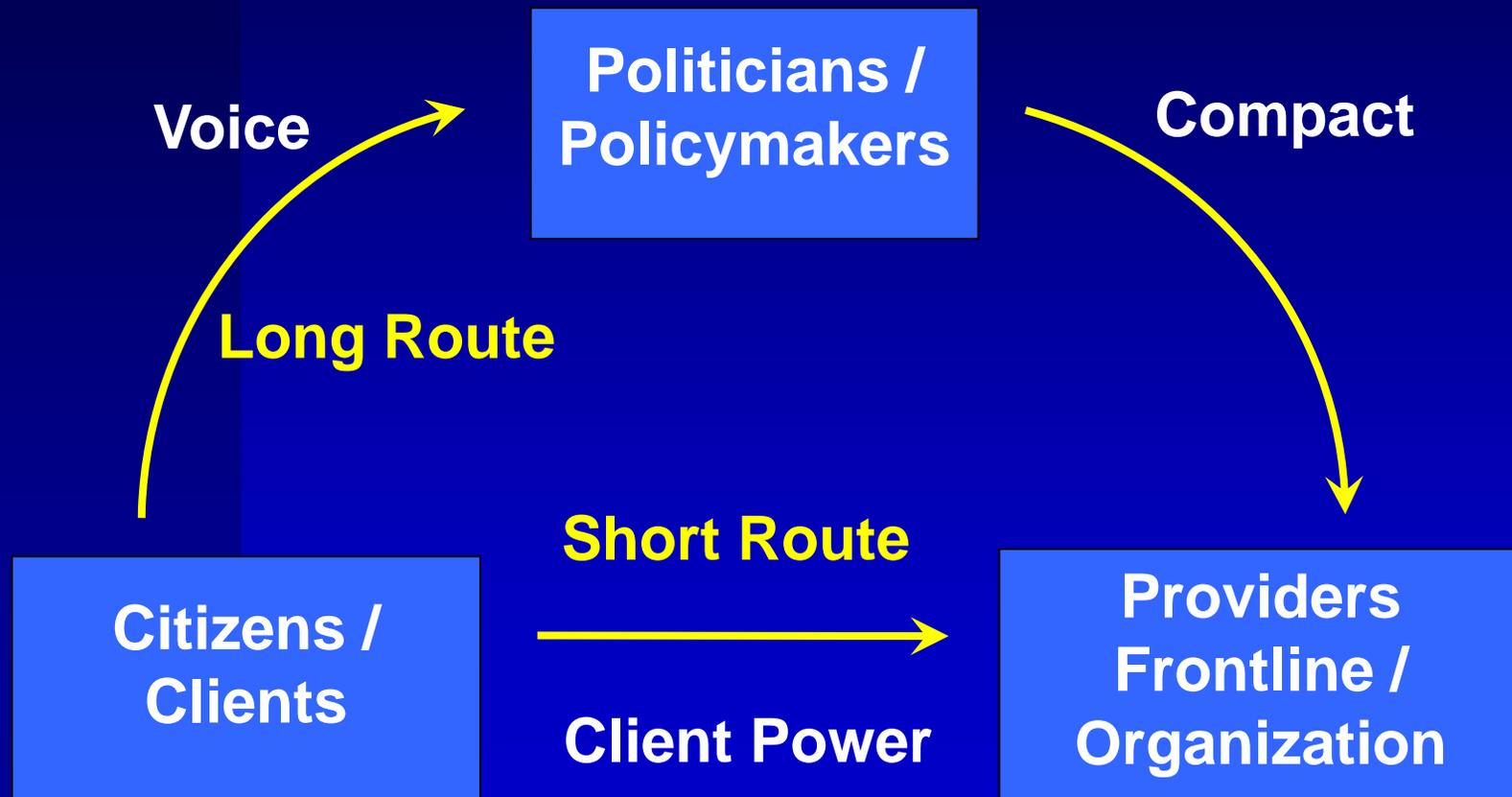
Low service quality: “ghost” doctors and teachers

Fund leakage: insufficient funds at service providers

→ “Money does not matter in a weak institutional contexts”

e.g., WDR 2004 Accountability Chain Approach

Accountability Chains in Public Service Delivery (WDR 2004)



Institutional Failures: Examples

- Lack of capacity – managerial and technical
- Lack of incentives
- Inefficient implementation and/or operations and maintenance in delivering public services
- Cumulative effect of failures of increasing transaction costs on service delivery costs, private profitability
- Inequitable distribution of public expenditure effects - leakages