

Session 1.1

Overview of Economic Analysis in ADB Operations

**Introductory Course on Economic Analysis of
Investment Projects**

5-9 July 2010

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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?

Technical Options

Physical Constraints

Institutional & Incentive Constraints

Non-Technical Options

Verify Demand/
Benefits

Compare Costs and Benefits

Ensure Least Cost Option is Selected

ADB

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
 - 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!



Growth Diagnostics



Low Levels of Private Investment and Entrepreneurship

Low return to economic activity

High cost of finance

Low social returns

Low appropriability

Bad international finance

Bad local finance

Poor geography

Bad infrastructure

Government failures

Market failures

Low human capital

Information externalities: "self-discovery"

Coordination externalities

Micro risks: property rights, corruption, taxes

Macro risks: financial, monetary, fiscal instability

Low domestic saving

Poor intermediation



Identifying Binding Constraints at a Sector/Project Level

