

Reclaiming Economic Analysis

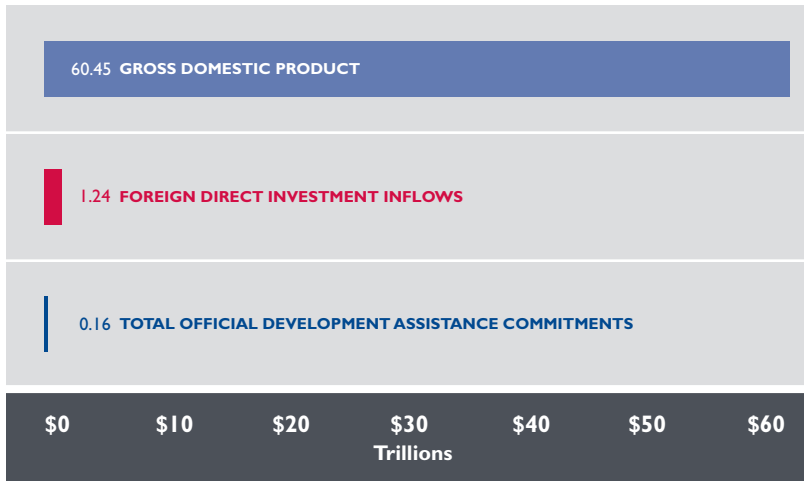
Development assistance has the ability to break open markets, expand trade, improve human capital, and lift the world's most vulnerable from poverty and disease. Foreign aid is, however, a mere drop in the bucket compared to global gross domestic product (GDP) or even foreign direct investment flows. In order for development practitioners—from government bodies like USAID to independent foundations and donors—to truly make a difference, foreign assistance must be used to leverage private-sector funds and open paths to untapped markets.

In the long view of development, decisions made by government practitioners and their private-sector partners today will help determine if developing economies are competitive into the future. The quality and nature of the programming delivered to farmers, firms, and (potential) employees today will determine whether their businesses can be competitive in regional and global markets, hire more and qualified workers, and contribute to the expansion of national GDP over the next decade. But how do development

practitioners accurately forecast needs to ensure that limited foreign assistance is being used in the most efficient and sustainable way—that our programs get the most bang for the buck? One answer is economic analysis.

The tools in the economic analysis toolbox are expanding. We have at our fingertips old workhorses like cost-benefit analysis (CBA) and cost-effectiveness analysis (CEA)—and newer tools, including growth diagnostics and randomized controlled trials. These tools can direct practitioners to the most promising and sustainable paths to development. They ensure that we use scarce funds to benefit the poor by intervening where necessary and leveraging private funds and untapped sources of capital whenever possible. More importantly, in a time of dwindling resources, economic analysis helps to identify sustainable interventions and estimate the optimal amount of assistance needed to achieve results at a project level. Economic analysis can never be a crystal ball that absolutely predicts whether project interventions will be successful, but it does help donors and implementers

WORLD GDP, FDI, AND ODA IN 2010



Development assistance is small compared to total foreign direct investment (FDI) inflows, and just a fraction of world gross domestic product (GDP).

Source: World Bank, UNCTAD, and OECD

make educated decisions about where and how to invest resources.

How Do We Make Our Investments Sustainable?

Cost-benefit analysis is currently the most useful tool for robust project design and sustainability. CBA tallies the costs and benefits of a given activity or investment to determine if the latter outweigh the former for relevant actors (that is, farmers, government, firms) and for the economy as a whole. The tool is data-intensive and requires meaningful collaboration between donor staff (project managers, field experts, economists, and other specialists), government counterparts, implementing partners, and the individuals who eventually benefit. This tool gives us the ability to identify who gains (or loses) from a project and by how much. Moreover, it is a powerful way to consider impacts disaggregated by gender, poverty status, ethnic group, or other characteristics of interest.

Perhaps equally important, agencies like USAID can use CBA to illuminate and improve the sustainability of our investments. This analysis rests on three elements: time, technology, and leveraging the private sector.

Time. CBA structures costs and benefits as flows over time. For a farm- or firm-level activity, this would entail:

- Considering how a project will change farm or firm incomes over the next 5, 10, or 20 years
- Identifying gaps or mismatches between expenditures and revenues
- Predicting when farmers or firms will face a shortfall and need access to credit

CBA helps to determine when a larger grant or loan is necessary to make a project viable, or to set project targets based on realistic adoption rates. As a result, CBA enables us to estimate whether a business assisted through our intervention will be able to compete independently in markets into the future.

Technology. Higher-capacity computers, readily available software tools, and a universe of data sources on the Internet have made CBA a more powerful tool. Analysts can produce models much more quickly and simply than was possible 30 years ago. With the click of a few buttons, it is possible to obtain field data without traveling thousands of miles. With a few more clicks, assumptions shift ever so slightly to calibrate project outputs and impacts. This allows us to isolate the factors that will have the greatest impact on a project's success or failure. For example, by recognizing that seed prices are extremely volatile, we can calculate how that volatility might affect (positively or negatively) a farm-level intervention. As technology improves and increasing volumes of data are publicly available, cost-benefit analyses should become less expensive and faster to produce.

Private sector. The resurgence of CBA aligns with a transformation in development—the recognition of the role and scale of the private sector. As private investment flows dwarf official development assistance, the case for targeted investments by donors such as USAID to leverage and catalyze private investment becomes even stronger. USAID seeks to match funds, or bring business-minded actors into schemes to increase the sustainability of agricultural production. CBA can incorporate the role played by agribusiness firms or private donors and determine just how much donors need to invest to achieve the desired impact. CBA can even identify cases in which there is no need for donor funds at a project level, directing resources toward policy change or investments in a different value chain.

Reclaiming Economic Analysis

USAID, like many donors, embraced CBA throughout the 1960s, '70s, and early '80s. During

the Agency's infancy, renowned economists like Arnold Harberger helped pioneer the application of CBA in project design. The World Bank and, more recently, the Millennium Challenge Corporation have applied CBA insights into their project designs. But in the mid-1980s, the use of CBA withered and was lost from the Agency's toolkit.

USAID began to re-establish CBA several years ago, just as a new emphasis on evidence-based programming, structured project design, and rigorous evaluation re-emerged within the Agency. The Office of Economic Growth began to train economists in CBA in 2010, then the guidance on project design was revised, and a USAID Evaluation Policy followed in 2011. Over the past three years, USAID has trained more than 100 staff and recruited Juan Belt, a retired Foreign Service officer and leading expert in CBA, to push forward these efforts.

The Bureau for Food Security has seized on CBA to improve project design, identify critical variables for monitoring and evaluation, and communicate the impacts of Feed the Future investments. Twenty focus countries are currently using these models to design better, more effective programs and ensure that USAID funds are applied to activities with the greatest possible development impact. Results from models already submitted have allowed USAID field missions to identify exaggerated costs, to recognize that grant sizes were mismatched with recipient needs, and to change the structure of planned partnerships to ensure sustainability.

Moving Beyond Markets

CBA is a powerful tool, but not always appropriate. Costs can almost always be monetized; benefits often cannot. For example, how much is it worth to reduce malaria prevalence by one percent of the population? What is the value of one

acre of rainforest protected? What is the welfare impact of improving care for children and the elderly, and what are the real costs for labor typically provided by women at no charge or non-market rates? The answers to these questions are not straightforward, particularly when markets cannot price the outcome we desire. However, by defining a goal such as preserving rainforests or preventing malaria, we can compare costs to determine which intervention is the most cost effective. Human capital and natural resources are two critical components of markets, and we need to understand the impact of our investments on those resources even if markets cannot (or can only imperfectly) value them.

CEA can be applied to identify the most sustainable interventions for a desired outcome—when an intervention is simply too costly for a host country to maintain after donor support is withdrawn or where lower-cost, more appropriate technologies could be applied. With the power of such insights, we can help countries build their economies, make best use of natural resources, and increase workforce quality so that they may compete in global and regional markets.

Frontiers in CBA/CEA Development

Cost-benefit and cost-effectiveness analysis tools are hardly new; they trace their origins to 19th century France. So how can they be innovative? What's so revolutionary about their application within development agencies? Two issues are at the fore.

First, innovative thinking is needed to analyze interventions where the benefits cannot be counted, much less monetized. Development practitioners struggle with these issues: How do we quantify civic engagement or security? What is a “unit” of democracy? Is there a right way to

count policy reform or private-sector engagement? Certainly rigor is still required to ensure we are making sound investments, and the next frontier in economic analysis will harness CBA and CEA to improve outcomes.

Second, donors should refine CBA and CEA to incorporate emerging development research. For example, as researchers find increasing evidence that gender inequality impedes economic growth, CBA models can be expanded to more precisely estimate the value of investments targeted to poor women. Similar extensions would apply to research on other target beneficiaries, such as youth, the disabled, refugees, or war veterans.

Where Do We Go From Here?

Inspired by the experiences of the Millennium Challenge Corporation, World Bank, and others, USAID has experienced a renaissance in the use of evidence-based programming. The Agency is integrating thoughtful project-design, rigorous cost-benefit and cost-effectiveness analysis, and monitoring and evaluation to ensure that scarce development dollars are well spent to achieve real, meaningful, and sustainable impact.

USAID is making clear what we can achieve when public funds leverage private investment and focus on bringing lasting change to enable the firms, factories, and workers of developing countries to be competitive in markets in the coming decades.

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