



Improving the Effectiveness of Economic Growth Programs

The objective of the Programming for Growth series has been to provide a concise explanation of the value and effectiveness of USAID's economic growth (EG) programs. The main conclusions from the series are as follows:

- **EG programs are vitally important for the development objectives of U.S. foreign policy.** Rapid economic growth can transform living standards within a single lifetime. Even moderate growth has enormous cumulative effects on social well-being over time. And without growth, disadvantaged people in poor countries will continue to languish in poverty. Economic growth also plays a major role in improving food security, reducing conflict risk, and enhancing economic and personal freedom.
- **Many of USAID's EG programs have been highly successful.** Compelling evidence shows that many EG programs have improved key policies and institutions, stimulated private sector development, and spurred broad-based development in many countries—benefiting millions of people and yielding high returns on the aid dollar.
- **USAID needs to strongly support programs that promote inclusive growth.** A development strategy that balances strong support for EG programs along with programs that aid the poor directly can have the greatest impact on poverty and well-being.
- **USAID needs more systematic and rigorous approaches to data collection and program evaluation.** Although some project

documents provide valuable evidence on program effectiveness, USAID needs better mechanisms for screening projects, evaluating results and impacts, and managing this knowledge to strengthen institutional learning to improve program design.

The present paper synthesizes lessons from the briefing notes, that USAID's EG officers may find useful guidance for strengthening the design of EG programs and improving the measurability of results.¹ First it outlines observations from the Programming for Growth series that relate to designing EG programs for maximum benefit. Then it summarizes observations relating to the measurement of benefits.

DESIGNING EG PROGRAMS FOR MAXIMUM BENEFIT

1. Although the private sector is the main engine of growth, government has an essential role to play in establishing the foundation for private investment and private initiative to flourish. The fundamental requirements include strengthening economic institutions, ensuring macroeconomic stability, relying on markets to allocate resources, reforming the business environment, opening to trade and investment, and developing sound and efficient financial institutions.
2. Successful interventions have to be country-owned and country-tailored. EG officers play a critical role in this through collaboration with government officials and

This guidance note is part of a series produced for the EGAT Bureau at USAID as a contribution to the recurrent debate on development priorities. Each note in the Programming for Growth series examines a topic relating to the value and effectiveness of USAID's economic growth programs. All the titles in the series are listed on the last page of this note.

- stakeholders, diagnosis of key constraints on growth, and assessment of institutional and political conditions, in order to design interventions that are responsive to local priorities.
3. Promoting economic growth is an art, not a science. Economists have no cookie-cutter formula for producing rapid and broad-based growth. “Best practices” can guide project design, but no single recipe can be applied mechanically to different contexts. Each country’s economic structure, political currents, culture, and history matter in determining the appropriate prescriptions and the sequencing of reforms.
 4. EG programs are most successful when the country’s leaders and stakeholders champion the interventions and want them to succeed at least as much as the donor agencies do. Ensuring ownership requires identifying current or potential stakeholders for reform, and listening carefully to their concerns and ideas. The *process* of shaping interventions to country conditions can make the difference between success and failure.
 5. To maximize benefits from the use of tax dollars, EG programming should be strategic and catalytic, focusing on a small set of constraints that most limit economic growth in the host country. The best EG programs are designed to address reforms or innovations that can produce transformational effects benefiting large numbers of people or even entire economies. Programs involving policy reform and institutional capacity building may yield benefits that accrue to businesses, workers, and families throughout the country. In the same vein, an ideal private sector development program will deliver benefits that multiply spontaneously as entrepreneurs take advantage of new opportunities.
 6. In countries that lack stable and effective institutions to support private sector investment and market development, EG programs have to focus, when possible, on establishing these fundamentals—without falling into the trap of unsustainable “institution-building” that lacks a foundation of local support.
 7. In addition to collaboration with host-country leaders and stakeholders, effective project design also requires effective coordination with other donors and investors (official and otherwise). Indeed, collaboration with multilateral finance institutions, other donors, foundations, the private sector, and NGOs can provide mechanisms for leveraging the impact of USAID funding.
 8. Incentives matter: Growth results from innumerable decisions of businesses and households that are steered by incentives, which in turn are shaped by market opportunities, government policies, and legal and regulatory institutions. Noneconomic incentives and cultural values also influence market behavior. EG officers need to understand how incentives and traditions work in a particular society to achieve the best results in promoting growth.
 9. Adaptability is essential for success. In setting priorities, designing programs, and implementing reforms, governments and donors require the capacity to learn from experience and adapt to changing conditions, as well as a willingness to test alternative approaches.
 10. Expanding the economic participation of women boosts productivity and incomes. Women provide half the potential labor force and half the pool of talent in any country. They are essential contributors to economic growth.
 11. Although quick wins are always important, it is essential to think deeply about long-term effects in designing EG interventions. The best programs produce sustainable benefits that spread and grow over time.
 12. EG programs can also deliver enormous benefits by helping host countries prevent economic crisis or build resilience to economic shocks through improved economic and financial management—even though the benefits in this case (namely, bad things that don’t happen) may be invisible.
 13. Leadership for growth requires effective public communication. Accordingly, activities to promote transparency and public information are important elements for successful EG programs.
 14. Measures to promote inclusiveness and empowerment reinforce measures to promote economic growth, and vice versa. The former create buy-in and legitimacy for successive stages of reform, which, in turn, spur further growth that helps to pay for social policies.
 15. Measures to promote private sector development should aim at stimulating efficient and competitive investments and should leverage private sector resources when possible. Investments that depend on subsidies or protection usually work at cross purposes to the ultimate goal of sustainable development, even if they elicit a positive investment response in the short run.²

MEASURING EG PROGRAM BENEFITS

1. In recent years, EG evaluations have typically focused on assessing project management, client satisfaction, and the achievement of outputs and intermediate results (IRs) relative to targets established in the project monitoring plan. Very few evaluations have made a serious attempt to gauge the development impact of the activities.
2. This leaves unanswered vital questions about the extent to which various projects are truly effective in achieving the intended development outcomes and whether the benefits are sufficient to justify the cost. The importance of these questions is self-evident. Hence, impact evaluations should be conducted far more widely and more rigorously.
3. An *impact* evaluation provides a quantitative answer to the question: “What difference did this program make?” This involves comparing changes in key indicators observed with the program with an estimate of the changes that most likely would have occurred anyway—the counterfactual. Before-and-after numbers do not show impact (except in special cases where “no change” happens to be the plausible counterfactual).
4. An *economic impact* evaluation focuses on measuring the economic benefit to people of the host country from a particular intervention or policy measure, in terms of net income gains. With this standard yardstick, benefits can be compared across different programs and weighed against project costs to determine whether a particular intervention is a good investment of aid funds. See Box I.
5. Economic impact is most readily measured for projects that help particular groups of enterprises to increase incomes and create jobs by improving productivity, overcoming constraints on growth, upgrading product quality, developing new products, and penetrating new markets.
6. By incorporating baseline data collection activities in the project design, economic impact assessments can often be conducted for EG programs that support economic policy and regulatory reforms in partner countries, which are otherwise difficult to evaluate.
7. One widely accepted approach for applying a common yardstick to different types of aid projects or activities is to estimate the respective economic costs and benefits and then express the net benefits in terms of the rate of return

BOX I

The Concept of Economic Impact

To understand the concept of economic impact, suppose that one of USAID’s economic growth programs records an increase of \$50 million per year in exports by project-supported businesses, involving 1,000 new jobs that pay an average of \$2,000 per year. Suppose, too, that these numbers are properly measured relative to a plausible estimate of the trend in exports that would have occurred without the program intervention (the counterfactual). In this example, the net economic benefit to the host country is not \$50 million and certainly not \$50 million plus $1,000 \times \$2,000$ of wage income (since this would double-count payments to labor, which are already part of the export sales price).

To measure the addition to income one must take into account, among other things, what the invested funds and the workers could have earned in other uses (opportunity cost), as well as the share of added income that may accrue to foreign owners rather than nationals of the host country.

Notice, too, that net benefits recur each year and may even grow over time. The impact calculation must include the present value of this stream of benefits and costs by discounting future values, taking into account the time value of money (because a dollar in the hand today is worth more than a dollar years hence). Discounting is usually based on the rate of return that could be earned on alternative uses of capital in the host country.

- on the investment or a benefit-cost ratio. This analysis can be used to determine whether a project or activity justifies the resource cost, and also for comparisons across alternative uses of budget funds. As far as possible, EG officers should use benefit-cost analysis or rate-of-return analysis for assessing and comparing EG programs. The present practice of measuring performance in terms of the “F” indicators falls far short of providing a meaningful scorecard for judging the development effectiveness of the EG portfolio (see Briefing Note 5).
8. These methods can and should be applied (again, when possible) both to ex ante analysis in the course of designing EG projects, and to ex post impact evaluation.
 9. EG officers should be familiar with MCC standards for assessing results. The MCC routinely conducts an ex ante eco-

conomic analysis of each major project component, as well as an ex post impact evaluation, using the most rigorous methods, wherever possible. The ex ante analysis then feeds into the monitoring plan for each compact, to track progress in terms of the parameters used to justify the investment. See <http://www.mcc.gov/pages/results>. Similar practices should be applied as far as possible to USAID projects.

- I0. The ex ante economic analysis is only as good as the assumptions used to estimate costs and benefits. But using this tool has the virtue of making the assumptions explicit and subject to scrutiny. At the MCC, this analysis has many times had an immediate payoff in showing where changes are needed in the program design to justify the investment.
- I1. Realistically, a rigorous economic analysis or impact evaluation is often not possible because of data weakness or the cost and time involved. This is especially so for EG projects involving policy reform and institutional capacity building—even though these activities may ultimately have the largest impact of all.
- I2. When it is difficult to place an economic value on program benefits, a useful alternative is to apply *cost-effectiveness analysis*. This analysis compares the cost of various approaches for achieving a given objective, such as improving access to finance for SMEs, modernizing a budget management system, or improving revenue performance. This metric, however, cannot be compared across programs with different objectives.
- I3. IR indicators have long been the main source of information on project performance at USAID. IR indicators can provide compelling evidence of development effectiveness if the indicators are well chosen within a clear causal model linking activities to outcomes, such as the Logical Framework matrix. If IRs are not linked clearly to objectives, then even accurate numbers may reveal little or nothing about progress toward achieving programmatic objectives.
- I4. Most EG projects involve multiple components covering activities that generate different outputs and outcomes.

It is often possible to estimate economic benefits or cost reductions for a *subset* of results and outcomes sufficient to provide compelling evidence of strong and sustainable development effects of the project as a whole. This is even true for projects focusing on policy reform or institutional capacity building.

- I5. In designing and managing a project, EG officers should look for ways to include activities that are likely to create measureable economic benefits as well as data development activities (such as baseline and follow-on surveys) to provide a quantitative foundation for a benefit-cost analysis.
- I6. Even a relatively simple and low-cost analysis of the benefits and costs can be used ex ante to weed out projects or project elements that are not worthwhile, and ex post for impact evaluation. Having a rough estimate of the benefits and costs—based on plausible, defensible, and conservative assumptions—is much more useful than having no estimate at all.
- I7. To evaluate impact, there are various ways to establish a counterfactual, ranging from rigorous methods to plausible approximations. For example, measured changes that occur in conjunction with the project can be compared with changes
 - Achieved by a statistically valid control group through a randomized trial, when possible—the “gold standard” for impact evaluation;
 - Estimated from quasiexperimental econometric techniques applied to sample data;
 - Defined by an established trend, taking into account changes in overall economic conditions; or
 - Inferred from developments in a similar parallel market (such as exports or sales in sectors not benefiting from project support).

NOTES

1 This paper represents the views of Nathan Associates Inc. The content is not to be construed as representing views of USAID or the Bureau. For the latter, see USAID (2008) *Securing the Future: A Strategy or Economic Growth*; USAID (2007), *Policy Reform Lessons Learned*; and USAID (2008), *Guide to Economic Growth in Post-Conflict Countries*.

2 Subsidies or protection can create a situation in which the opportunity cost of inputs actually exceeds the economic value of the outputs for particular activities (such as an agricultural value chain). Domestic resource cost analysis is a tool that can be used to determine whether this situation exists. The analysis can also identify policy, infrastructure and other constraints that increase resource costs.

The Programming for Growth Series

Overview

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1. Economic growth as a goal of U.S. Foreign Assistance
2. The critical role of economic growth
3. Growth, poverty, and well-being
4. Reforming policies and institutions to foster economic growth
5. Measuring effectiveness to improve effectiveness

Briefing Notes on USAID's Economic Growth Programs, with Case Studies

6. Linking people and food: The role of economic growth programs in achieving food security
7. Postconflict programming for growth
8. Economic impact
9. Intermediate results
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BRIEFING NOTES CAN BE READ IN ANY SEQUENCE.

For more information, visit www.countrycompass.com or contact

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