

Introduction to Diagnostics and Diagnostic Frameworks

Bhutan Country Diagnostic Study
Workshop on Diagnostic Approaches

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Outline of the Presentation

- I. Diagnostic Methodology
- II. Application
 - i. From Theory to Practice
 - ii. The Process
- III. Inclusive Growth and Diagnostic Frameworks

I. Diagnostic Methodology for Development Planning

- Why need a new approach to development planning?
 - Disappointments with [Washington Consensus](#)
 - Realization that every country is unique-both in terms of strengths and weaknesses, and also in terms of the constraints that it faces
 - Not all constraints are equally binding and critical.
 - Countries often lack resources to tackle all the constraints simultaneously.
- What do the diagnostics do?
 - Identify the most binding constraints and figure out policy priorities.
- How to identify the most binding constraints?
 - Identify proximate determinants of growth and social development.
 - Figure out which of these are the greatest impediments.
 - Identify the specific distortions behind the impediments.

Washington Consensus

Original Washington Consensus:

1. Fiscal discipline.
2. Reorientation of public expenditures.
3. Tax reform.
4. Financial liberalization.
5. Unified and competitive exchange rates.
6. Trade liberalization.
7. Openness to FDI.
8. Privatization.
9. Deregulation.
10. Secure property rights.

“Augmented” Washington Consensus, 1-10 plus:

11. Corporate governance.
12. Anti-corruption.
13. Flexible labor markets.
14. WTO agreements.
15. Financial codes and standards.
16. “Prudent” capital-account opening.
17. Corner exchange rate regimes.
18. Independent central banks.
19. Social safety nets.
20. Targeted poverty reduction.



What do the diagnostics do?

Washington Consensus Approach applied to health

Common Ailments

- AIDS
- dengue fever
- hepatitis
- high blood pressure
- leptospirosis
- malaria
- rabies
- typhoid fever
- arm fracture
- bullet wound



When a patient is in pain, a good doctor doesn't just give aspirin to ease the pain, the doctor tries to find out more about the patient's history and circumstances, and tries to determine the cause of the pain, or the possible side effects of aspirin before giving it to the patient.

Doctors also recommend a patient to submit to relevant tests to get more information on the patient's condition:

- complete blood count
- routine urinalysis
- routine fecalysis
- electrocardiogram (ECG)
- treadmill stress test
- 2D Echocardiogram
- chest X-ray
- renal sonogram
- ultrasound

What do the diagnostics do?

Similarly, an economic advisor would try to find out what are the constraints to growth (e.g. poor access to finance, inadequate infrastructure, governance, etc.) before determining what strategies (e.g. public expenditure management tools, improving public-private partnership in public infrastructure, etc.) will be best suited to achieve sustained and shared growth.



II. Application– From Theory to Practice

A. Price and Non Price Signals

1. Price Signal - message sent to consumers and producers in the form of a price charged for a commodity; this is seen as indicating a signal for producers to increase supplies and/or consumers to reduce demand.

Searching for price signals: e.g., return to education, interest rates, cost of transport, private health expenditures:

- If low education is a serious problem, returns to skill/education should be high and unemployed skilled people should be low.
- If investment is constrained by savings, interest rates should be high and growth respond to changes in available savings (e.g., inflow of foreign capital).
- If poor transport links are a constraint, there should be bottlenecks and high private cost of transport.
- If poor health is a serious problem, then household expenditures on curative health services will be comparatively high

II. Application– From Theory to Practice

2. Non-price signals - message sent to consumers and producers other than price.

- When a constraint binds, it results in activities designed to get around it:
 - High tax → high informality.
 - Poor legal institutions → high demand for informal mechanisms of conflict resolution and contract enforcement.
 - Constrained access of investors to finance → internalization of finance through business groups, etc.
 - Constrained access of households to finance → thriving money lending business
 - Scarce human capital → high in migration of skilled workers

II. Application– From Theory to Practice

B. Comparative Approaches

1. Bench-marking

- With time periods-high growth episodes vs. low growth episodes
 - If the country, despite poor infrastructure or poor governance, could register a high level of growth in the past; poor infrastructure or governance are not critical
 - If the country could register a high level of economic growth in the past; what has changed since then?
- With other countries (similar but better performing)
 - Indonesia or Philippines vs. Thailand or Malaysia
- Within the country vs. other regions, sectors and industries
 - Faster growing regions with the lagging regions – Coastal China vs. Northwest China
 - Faster growing sectors/industries vs. slow moving ones – textiles in Cambodia vs. agriculture in Cambodia

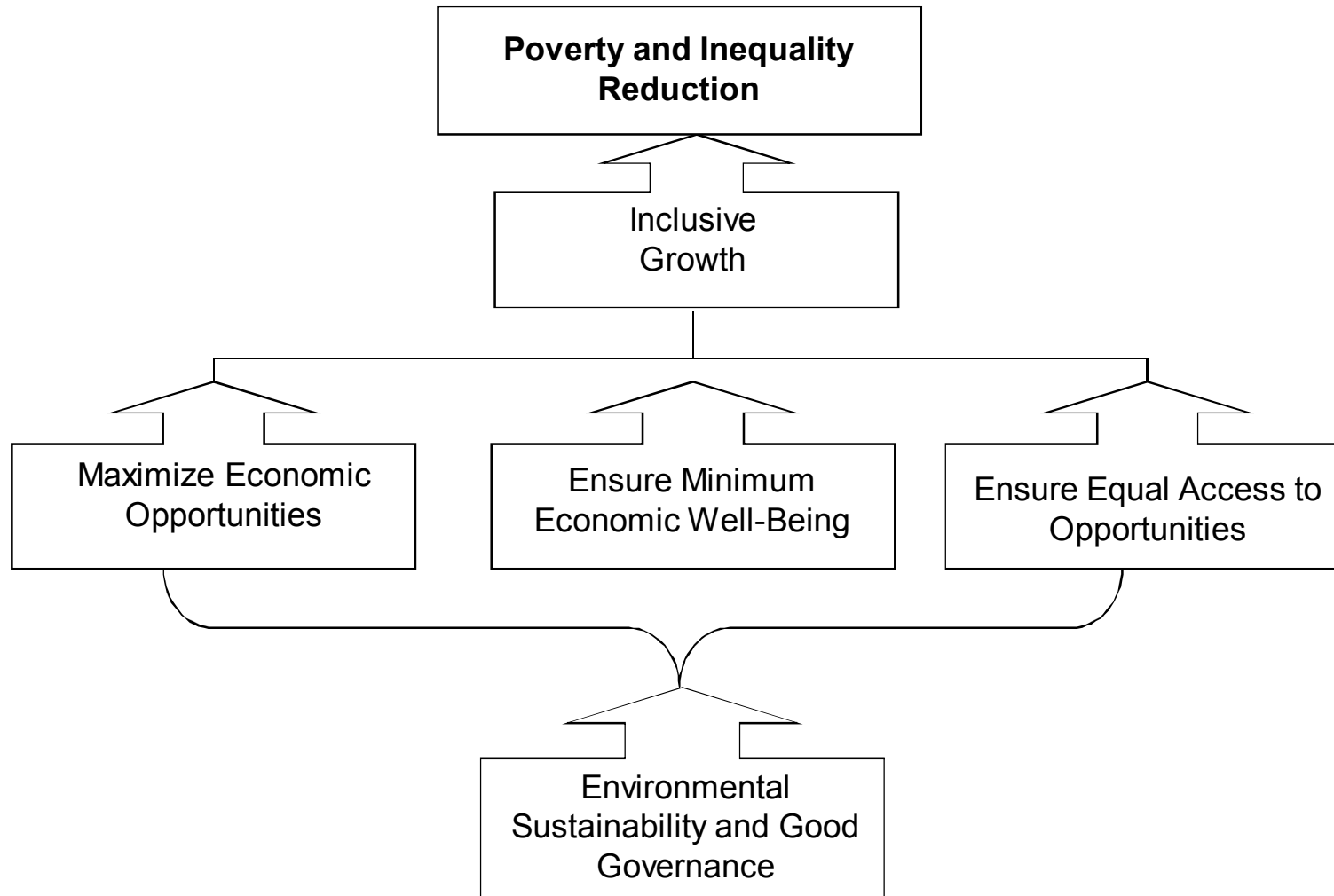
II. Application– From Theory to Practice

2. Types of evidence
 - a. Direct evidence
 - rates of return, costs, salaries/wages etc.
 - b. Indirect evidence (country or sector specific studies)
 - Analysis (correlation between infrastructure or human capital and growth)
 - Rate of returns for firms delivering a particular product, and regression and correlation results.
 - c. Business Investor feedback
 - Investment climate surveys
 - Enterprise Surveys
 - Global Competitiveness Reports,
 - Doing Business Surveys
 - Governance Perception Indices
 - d. Community feedback
 - Bhutan Living Standards Surveys
 - Bhutan Labor Force Surveys
 - Demographic and Health Surveys
 - Governance Perception Indices

Concept of Inclusive Growth

- Inclusive growth:
 - Growth that not only generates economic opportunities, but also ensures equal access to the opportunities by all members of a society.
- Development strategy based on the inclusive growth concept is anchored on three policy pillars:
 - High and sustainable growth to create economic opportunities.
 - Social inclusion to ensure equal access to the opportunities by all.
 - Social inclusion to ensure equal access to safety nets.

Inclusive Growth Concept



Major Diagnostic Frameworks

Growth Diagnostic Framework

- Identifies proximate determinants of growth.
- Figures out which of those pose the greatest impediments to higher growth.
- Identifies the specific distortions behind the impediments.

Diagnostic Framework for Inclusiveness

- Identifies proximate determinants of people's welfare.
- Figures out which of those post the greatest impediments to improving living standards.
- Identifies the root causes for the impediments.

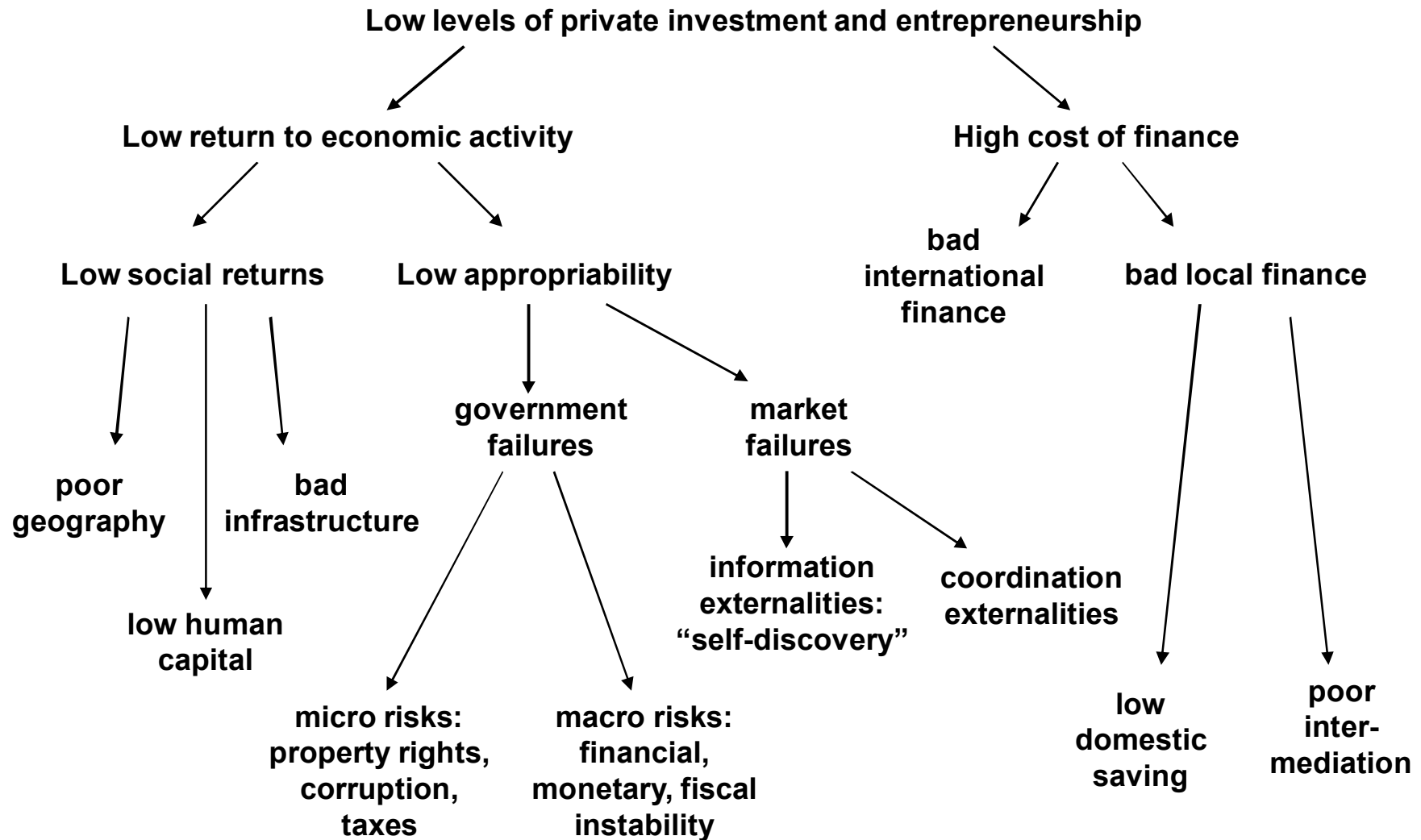
Growth Diagnostic Framework

Growth maybe low because:

Investment is low and entrepreneurship is low

- Cost of finance is high
- Economic returns are low
 - Social returns are low
 - Appropriability is low

Growth Diagnostic Framework

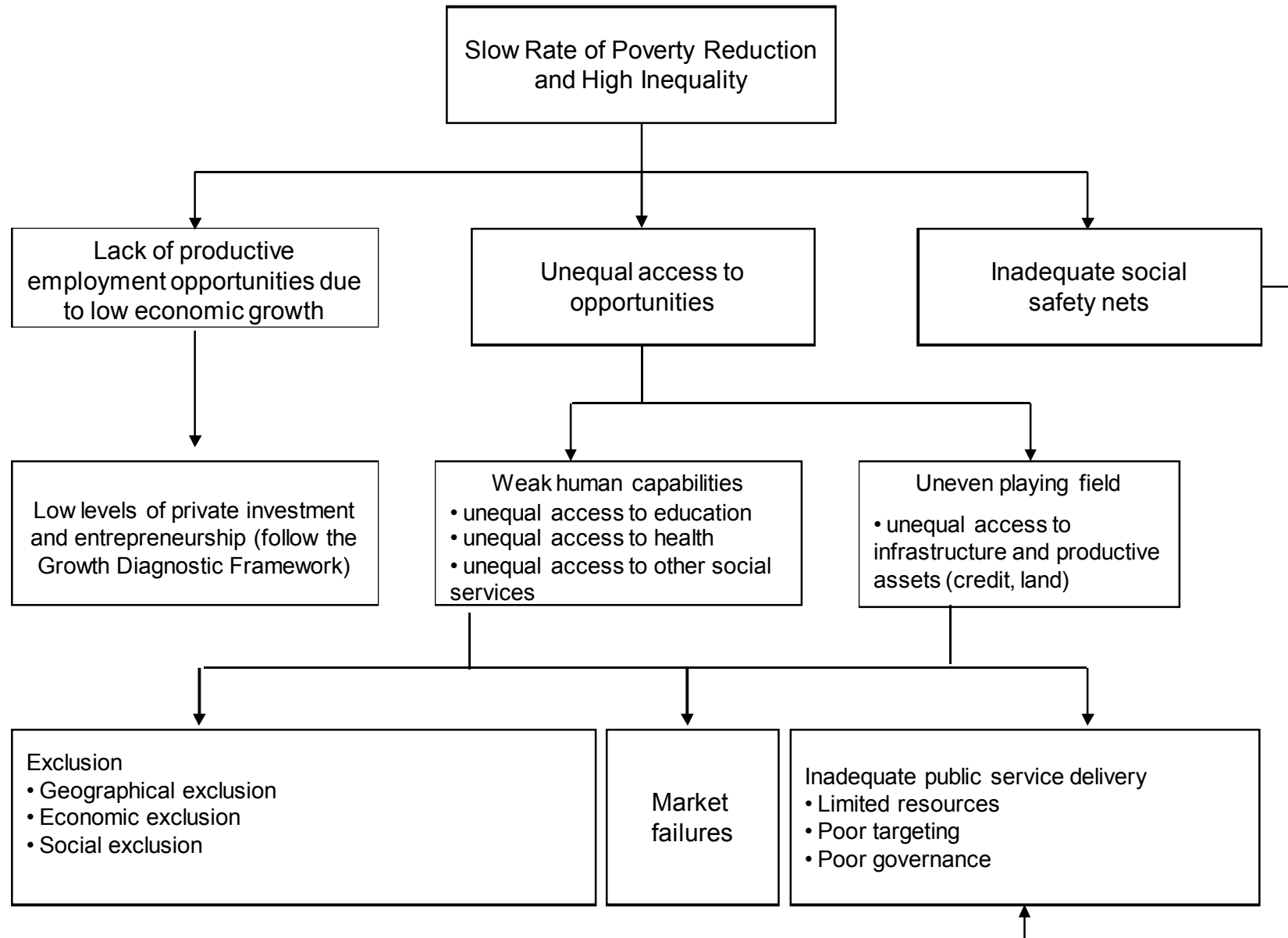


Diagnostic Framework for Inclusiveness

Slow rate of poverty reduction and high inequality may be due to:

- Lack of productive and decent employment opportunities.
- Unequal access to opportunities.
 - Weak human capabilities due to unequal access to education, health care, and/or other social services.
 - Uneven playing fields due to unequal access to infrastructure and/or productive assets (e.g., credit and land)
- Inadequate provision of social safety nets.

Diagnostic Framework for Inclusiveness



Further Readings

Growth Diagnostics

- Slow Growth in Latin America - Common Outcomes, Common Causes (Hausmann and Velasco)
- Doing Growth Diagnostics in Practice-A Mindbook (Hausmann, Klinger, and Wagner)
- Growth Diagnostics (Hausmann, Rodrik and Velasco)
- Trade, FDI, and the Organization of Firms (Helpman)
- Growth Strategies (Rodrik)
- Why We Learn Nothing from Regressing Economic Growth on Policies (Rodrik)
- Why doesn't Latin America grow more, and what can we do about it (Velasco)

Inclusive Growth

- Pro-Poor to Inclusive Growth - Asian Prescriptions. (ADB) ERD Policy Brief Series No.48.
- Inclusive Growth Toward a Prosperous Asia: Policy Implications. (ADB) ERD Working Paper Series No.97.
- Poverty, Inequality, and Inclusive Growth in Asia: Measurement, Policy issues and Country Studies (ADB).

ADB Country Diagnostic Studies

- Philippines: Critical Development Constraints
- Nepal: Critical Development Constraints
- Indonesia: Critical Development Constraints
- Papua New Guinea: Critical Development Constraints (forthcoming)

Thank You

For More Information Visit:

<http://www.adb.org/Projects/Country-Diagnostic-Studies/default.asp>