

Chapter 12:

Guidelines for Conducting a Constraints Analysis



REDUCING POVERTY THROUGH GROWTH

Guidelines for Conducting a Constraints Analysis

Conducting a Constraints Analysis for use in MCA Compact Development

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Background

The MCC was designed to provide assistance in a manner that promotes economic growth and reduces poverty. To ensure that MCA funds are used to this end, it is essential that newly eligible countries and the MCC share a common understanding of the fundamental issues that impede growth and sustain poverty. Thus, the first step in the proposal development process is for countries to undertake a critical assessment of the conditions in the domestic economy that limit private investment, both foreign and domestic, that will generate economic growth and poverty reduction.

The purpose of this “Constraints Analysis” is to identify the root causes that deter households and firms from making investments of their financial resources, time, effort, or goods that would significantly increase their incomes and economic well-being. The Constraints Analysis is not intended to dictate specific responses to be funded by the MCC, but rather to provide a framework that will help focus domestic deliberations on appropriate programs that will ease those constraints.

Countries will be responsible for undertaking this analysis in a manner that is consistent with the guidance provided by the MCC, preparing a report and discussing the findings with the MCC. These discussions will result in a joint framework, accepted by both MCC and country counterparts, regarding domestic priorities to generate more rapid growth for poverty alleviation.

The constraints identified in this analysis should be fundamental causes rather than symptoms. For example, discussions regarding the root causes of rural poverty often rightly describe “low productivity in rural areas” as a factor related to low incomes; this constraints analysis, however, is intended to identify the core constraints that generate this outcome. Possible fundamental constraints that lead to low productivity in rural areas include poor roads, low levels of human capital, poorly defined property rights, and excessive risk. Similarly, discussions regarding the lack of dynamism within the domestic private sector often lead to the designation of “inadequate access to finance” as the problem, but stop short of identifying the root causes of a financial system unable to deliver private capital efficiently and effectively; possible root causes

might include policies that limit or distort competition in the banking sector, systemic institutional weaknesses within banks that curtail their ability to identify potential borrowers, low domestic savings rates, or macroeconomic phenomena that raise the domestic cost of capital and limit the number of profitable lending opportunities.

In practice, the Constraints Analysis should identify a fairly small number of core impediments to growth¹. It is important that this analysis does not simply produce an exhaustive list of all possible economic concerns, but rather identifies the ones that represent the most binding constraints to growth. Constraints might include, but are not limited to the following:

- inadequate and inefficient investment in critical public goods, such as transportation infrastructure;
- inadequate and inefficient investment in human capital, including health and education services;
- specific government policies that distort or undermine incentives to private sector investment;
- the lack or limited effectiveness of government institutions that are needed to support private economic activity;
- instability in the macroeconomic environment; and
- a country's environmental and geographic realities.

The Constraints Analysis should be undertaken with the understanding that the country's proposal to the MCC – developed through a national consultative process – should focus on reducing or eliminating these core impediments to growth.

¹ While the number of core impediments to growth will vary by country, the CA exercise described here should be recognized as an effort to heighten the focus on the most critical barriers to investment, job creation, and economic growth. Recognizing the need to remain flexible in its guidance to the country CA Team, the MCC suggests that the CA report focus on the 3-6 most important binding constraints.

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The Constraints Analysis represents the first responsibility for eligible countries as they enter into the MCA process. Successfully managing the process should produce a solid foundation for the expeditious development of a proposal that addresses country priorities and is consistent with the MCC's institutional mandate. There are four specific stages to the Constraints Analysis process, which is expected to take 1-3 months:

1. Identification of CA Team Leadership.

The Constraints Analysis will be managed by country experts, and the process cannot begin until the core leadership of the process has been finalized. While countries have the responsibility for identifying a small group of core leaders (ideally between 3-5 members) from any government and non-government institutions (including the private sector), the MCC strongly advises countries to staff this CA leadership team with individuals who possess strong and relevant technical skills and who command broad domestic credibility. Without prejudicing selection, the MCC suggests that appropriate CA leaders might include:

- senior staff from the Ministry of Finance, Planning and/or Trade or the Central Bank;
- senior economists from academia, think tanks and government; and
- leaders from the private sector, including possibly leaders from chambers of commerce and other broad multi-sectoral business membership organizations.

Note that this short menu of possible leadership candidates is not meant to be exclusive, and countries are welcome to pull from other fields, as well. But the menu highlights the economic nature of this endeavor, and country leadership of the CA process should possess the requisite technical background to *lead* what will undoubtedly be a larger and more diverse CA team.

2. Planning discussion between CA Team Leaders and MCC.

Following the final identification by the country of its CA Team Leaders, a small MCC delegation will meet with them in country to discuss the technical details of

the Constraints Analysis. This discussion will generate a mutually accepted terms of reference for the Constraints Analysis, including a list of questions to be addressed and a non-exhaustive list of materials to be considered. The discussion will also include the CA Team Leaders' list of other potential team members. While the final selection of the CA Team will rest with the CA Team Leaders, MCC representatives may provide input and may suggest additional candidates for consideration. The final list of invited team members should be kept to a manageable size, and while the CA Team Leaders should have some discretion in the composition, it is likely that the group will number somewhere between 10 and 20 members, including the CA Team Leaders.

3. Conduct of Constraint Analysis.

The CA Team Leaders will assemble the CA team to undertake the analysis. The 3-5 day sessions should be scheduled to enable as many of the invited team members to participate as possible, but should not be unduly delayed as a result of scheduling conflicts. The sessions should also be scheduled after sufficient time has been given for the members to review and absorb the relevant background materials. While MCC expects that the full country team will be comprised of country nationals, CA Team Leaders may have grounds to make exceptions, and certainly there would be opportunities for the CA Team to benefit in its deliberations from the use of international resource people. Following the completion of the deliberations, the CA Team Leaders will be responsible for ensuring that a draft report, no more than 20-pages in length, is written and circulated among the CA Team Members (the principal authors may be from the full team, from the leadership, or a consultant or staff tasked specifically with drafting the results). The final draft of the Constraints Analysis need not have full consensus from the team, but should provide an opportunity for Team Members to sign in support or provide a dissenting view on part or all of the CA report, and these views should be provided as an appendix to the report.

4. Development of a Joint Framework.

Following completion of the Constraint Analysis, the MCC team will return for discussions on the findings, and will work with the CA Team to develop a document that establishes a framework to guide the country's development of its MCC proposal. Discussions with the MCC team may lead to a sharpening of focus from the Constraints Analysis (reflecting a difference between issues considered to be core

constraints by the CA Team but considered not pertinent to the development of a proposal by the MCC team) or a broadening of the list of core constraints (reflecting the identification of constraints by the MCC team for consideration in the proposal development process that were not mentioned or downplayed by the CA report).

C. Sources of Information

The results of the Constraints Analysis will need to be driven and carefully supported by data and available studies and evidence. Sources of information to be referenced will include:

- macroeconomic indicators from government agencies and the IMF,
- national and global surveys, including household surveys and studies of the domestic business climate, such as the Doing Business Indicators and the Global Competitiveness Report; and
- recent PRSP documents, or other donor or national strategic assessments recently undertaken.

While the recent and successful completion of such assessments may inform and expedite the Constraints Analysis, the existence of such documents does not eliminate the need to undertake the process as described above.

Constraints analysis should also involve receiving input from key stakeholders. For example, if agriculture is an important sector for the economy, individuals involved in agricultural transport, finance, processing, and marketing should be consulted regarding the difficulties they face. Similarly, if financial intermediation appears to be inefficient, the CA process should be structured to include representatives of private sector financial institutions. Investigation of constraints on foreign investment should involve consultation with current and potential investors. The CA Team, however, will be tasked with analyzing the full information set from all of these sources and ensuring that no narrow private interests are represented as broader public interests within the CA report.