

## EXECUTIVE SUMMARY

Poverty remains the greatest challenge in developing Asia and the Pacific. In countries with access to Asian Development Fund (ADF) assistance, about 100 million people still live in extreme poverty. Progress in achieving the non-income poverty Millennium Development Goals (MDGs) has been mixed. Moreover, new challenges such as rising food prices and climate change threaten to reverse recent gains that have been made. Growth in ADF countries must be accelerated while ensuring that the benefits of such growth are broadly shared. Attaining the levels of growth needed to achieve the MDGs in ADF countries will require considerable investment, with commensurate official development assistance. At the same time, donors are putting greater emphasis on the quality of development assistance, its impact, and partnerships.

Within an evolving aid architecture, ADF continues to focus on supporting the development plans of the poorest countries in the Asia and Pacific region. ADF has a strong track record of financing operations in a number of sectors to help achieve MDG outcomes in eligible developing member countries (DMCs). ADF-financed infrastructure investments contribute to poverty reduction by helping remove major infrastructure bottlenecks that constrain growth and delivery of social services as well as increasing aggregate demand and employment. Support for education, especially access, gender equality, and quality, has been an important priority in ADF operations. ADF has promoted gender equality through various project-specific operations. This has been done directly (such as investment in girls education) and indirectly (such as water supply and sanitation infrastructure). Improving governance is essential to promote efficient delivery of public services. ADF has helped governments improve economic management, governance, and public finance and expenditure management through reforms, as well as financial and other sector programs.

ADF has also played a special role in promoting regional cooperation, especially in the Greater Mekong Subregion and Central Asian Regional Economic Cooperation programs, primarily through cross-border infrastructure projects. These regional projects have helped reduce poverty through more trade and investment, greater employment, and higher incomes in participating countries.

ADB must build on past experiences, and draw on its inherent strengths, while addressing remaining institutional challenges to maximize ADF's development impact. ADB must become a more results-focused organization to succeed in supporting national programs for environmentally sustainable economic growth, inclusive social development, and good governance in the Asia and Pacific region. This will involve mainstreaming managing for development results in ADB and strengthening staff incentives for achieving development outcomes.

A vision of an Asia and Pacific region free of poverty is at the heart of ADB's long-term strategic framework (LTSF). To achieve this goal, ADB will focus assistance on three strategic agendas: inclusive growth, environmentally sustainable growth, and regional integration. These strategic priorities apply to ADF operations as well, with the activities suitably designed to meet the particular circumstances of individual ADF countries. Strategic priorities will be pursued through operations in sectors where ADB has a proven track record and comparative strength, especially infrastructure, environment, and education. At the same time, ADB needs to maintain some flexibility and capacity to selectively deliver quality assistance in a few other sectors to respond to varying country needs. Particularly relevant in this context are sectors such as health, and agriculture and natural resources, which are important for both inclusiveness as well as sustainability of growth.

The LTSF provides the corporate strategy to reshape ADB as a more effective and innovative development institution. The organization must build on the progress made in implementing the reform agenda adopted in 2004. The key elements of further consolidation of reforms will include:

- (i) mainstreaming managing for development results, with increased emphasis on operational quality,
- (ii) reviewing ADB's safeguards framework with a result that reflects strengthened protections,
- (iii) responding better and faster to clients through further decentralization and business process streamlining,
- (iv) transforming to a learning organization,
- (v) reinforcing the effectiveness and independence of the operations evaluation function,
- (vi) implementing the Paris Declaration on aid effectiveness,
- (vii) operating transparently through proactive communications with all stakeholders, and
- (viii) managing human resources better, including further professionalizing human resource management at ADB.

The development challenges in the Asia and Pacific region are considerable, so the demand for ADF remains strong. More than 80% of the ADF X program will be distributed through the performance-based allocation (PBA) formula to direct the limited funds to where they will be used most effectively. Two refinements will be made to the current PBA system. First, the PBA of blend countries (those that also have access to ADB's ordinary capital resources) will be modified to direct more assistance to poorer countries. A threshold of 14% of resources distributed under PBA per country will be set to determine which blend countries will be subject to the modified PBA. The 14% threshold will serve as a "soft cap" because blend countries with PBA greater than the threshold will retain half of the amount above the threshold. Second, the measure of portfolio performance will be revised to reduce the volatility of the ratings and to remove a disincentive to report potential problem projects.

As in ADF IX, 4.5% of the resources distributed under PBA will be earmarked for the Pacific countries. The two postconflict countries—Afghanistan and Timor Leste—will begin the 6-year phaseout period from exceptional postconflict assistance in ADF X. Up to 10% of the ADF program will be earmarked for subregional projects. For every dollar drawn from the subregional pool, each participating country will match it with 50 cents from its PBA. However, the required contributions from biennial PBA will be subject to a 20% ceiling. Beyond that amount, contributions from country PBA will not be mandatory.

The fourth regularized replenishment of the technical assistance special fund (TASF) will be completed in parallel with the ADF X replenishment. Management will develop explicit guidelines and criteria for the allocation of resources in the TASF to go into effect in January 2009. A comprehensive review of the TASF will also be undertaken at the midterm review of ADF X.

The replenishment will cover the 4-year period from 1 January 2009 to 31 December 2012. Donors agreed to a total replenishment size of SDR7.1 billion (\$11.3 billion), which consist of SDR6.9 billion for ADF X and SDR0.2 billion (equivalent to 3% of the total replenishment) for the fourth replenishment of TASF. The replenishment will be financed from

the following sources: (i) SDR2.6 billion from new donor contributions, (ii) SDR4.3 billion internal resources consisting of SDR3.2 billion reflow-based resources and SDR1.1 billion from liquidity drawdown, and (iii) SDR0.2 billion net income transfers from OCR, subject to annual approvals by ADB's Board of Governors. New donor contributions will comprise about 37% of the total replenishment, representing a 13% increase in SDR terms from the level of ADF IX.

The lost reflows from the provision of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative will be accommodated within ADF X resources and will not require specific earmarking of funds for this purpose. This issue will be reviewed in future replenishments. Donors reiterated that financing the costs of HIPC should maximize the use of internal resources of ADB while ensuring the financial integrity of ADB and without compromising the capacity of ADF. The foregone interest payments from the ADF grant framework will also not have a significant impact on ADF X, and like the cost of debt relief, do not require specific earmarking. Donors reiterated the commitment made in ADF IX to finance forgone principal repayments from ADF grants on a pay-as-you-go basis in future replenishments.

To ensure successful implementation of ADF X, it will be necessary to assess ADB's capacity and skill-mix to deliver on ADF X targets. The resource implications of delivering the ADF X program will be discussed with the Board of Directors as part of the annual budgetary process. Moreover, it is imperative to have a sound results framework to measure the performance of ADF X and monitor its implementation. To this end, the results framework being developed to monitor the implementation of ADB's long-term strategic framework forms the basis for the ADF X results framework. ADB will assess and report on progress in implementing ADF program through its annual *Development Effectiveness Review*. Progress on the implementation of ADF X will be reviewed by donors annually on the sidelines of ADB's Annual Meeting. In addition, a comprehensive midterm review of ADF X will be held in fourth quarter 2010.