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Enhancing Asian Development Bank Support to Middle Income Countries and Ordinary Capital Resources Borrowers

DRAFT

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CDM	–	clean development mechanism
CPF	–	country partnership framework
CSP	–	country strategy and program
DMC	–	developing member country
IADB	–	Inter-American Development Bank
IEI	–	innovation and efficiency initiative
MDB	–	multilateral development bank
MDG	–	Millennium Development Goal
MIC	–	middle-income country
NGO	–	nongovernment organization
OCR	–	ordinary capital resources
PRC	–	People's Republic of China
TA	–	technical assistance

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I. INTRODUCTION

1. **Purpose of the Paper.** This paper synthesizes findings and provisional proposals from a review of operations financed from the Ordinary Capital Resources (OCR) at the Asian Development Bank (ADB). The paper seeks to facilitate further exchanges of views on key issues and proposals. The paper highlights the strategic rationale for ADB's continued engagements in developing member countries (DMCs) eligible for OCR financed operations¹ given the critical role of these countries in the global attainments of the Millennium Development Goals (MDGs) as well as their contribution to global stability. The paper also examines the constraints of ADB's traditional operational approaches, and proposes new approaches better suited to the operational context and needs of clients in the 21st century.

2. **Reasons for Review.** The Asia and Pacific region has been dramatically transformed since the last strategic review of OCR operations (1993). Many OCR borrowers have become active players in the global economy, requiring ADB to reexamine its effectiveness in these countries. Their development process has altered the roles and responsibilities of the national and local governments, public and private entities, non-government organizations (NGOs), civil society, and local communities. To be effective as a development partner, ADB must now have the ability and means to work with a wider range of in-country and external partners such as bilateral and multilateral institutions, and the regional and international business communities.

3. **Structure of the Paper.** The paper has six core sections. Section I explains the purpose and structure of the paper, as well as the concepts and methodologies used. Section II provides the strategic rationale for ADB's continued engagement in OCR countries. Section III examines the challenges that ADB faces in delivering effective OCR operations, including perceptions of client countries. Section IV reviews the experience of external partners. Section V presents ADB's proposed responses to address the identified issues. Section VI concludes with suggested next steps.

4. **Key Definitions.** For the purpose of this paper, "OCR borrowers", "OCR countries", or "Middle Income Countries" (MIC)² are defined as ADB DMCs eligible for OCR operations financing. These include Group B1, Group B2 and Group C countries (see footnote No. 1). The terms "OCR countries" or "MIC" are used interchangeably throughout the report. The latter term has been used widely within the international development community to describe similar initiatives³. "Relevance" refers to the ability (in the context of ADB operations) to relate to

¹ For operational purposes, the graduation policy (ADB. 1998. *A Graduation Policy for the Bank's Developing Member Countries*. Manila.) classifies DMCs into four categories based on per capita gross national product (GNP), debt repayment capacity, and least-developed country status: (i) group A (Asian Development Fund [ADF] only); (ii) groups B1 and B2 (blend countries eligible for a combination of OCR and ADF); (iii) group C (OCR operations only); and (iv) graduates (high-income countries that have graduated from the regular ADB assistance program). The paper focuses primarily on: (i) blend countries: Azerbaijan, Bangladesh, Cook Islands, Indonesia, Marshall Islands, Micronesia, Nauru, Pakistan, Papua New Guinea, Sri Lanka, Tonga, Uzbekistan and Viet Nam; and (ii) countries that borrow only from OCR: Fiji Islands, Kazakhstan, Malaysia, Philippines, Thailand, and Turkmenistan. While the People's Republic of China (PRC) and India are classified as blend countries, their operations have been funded only by OCR.

² The term "country", as used in the context of this paper, refers to a member of ADB and does not imply any view on the part of ADB as to the member's sovereignty or independent status.

³ For example, the World Bank's MIC Strategy (approved in 2004) refers to MICs as countries eligible for financing from the International Bank for Reconstruction and Development (IBRD).

development contexts, opportunities, and challenges in DMCs. “Responsiveness” refers to the ability to meet demands and expectations of DMCs, measured by the quality (how well), timeliness (how fast), and affordability of services. “Effectiveness” refers to the degree of contribution to the development processes and attainments of goals of DMCs.

5. **Methodologies Used.** Global and regional trends were examined through a variety of external and internal economic, thematic, and sector reports. Operations analysis examined operations data⁴, internal task force reports,⁵ and operations evaluation findings. The exercise emphasized consultations with client countries, international and commercial partners, and international and domestic NGOs. Country consultations employed both questionnaire-based surveys and consultation missions. The missions targeted national and local governments as well as a range of development partners (i.e., NGOs, private and commercial sectors, and bilateral development agencies). Other multilateral development banks (MDBs) were consulted closely through the country consultation and the MDBs working group on MICs (para. 52). The paper benefited from extensive interdepartmental collaboration, including resident missions.⁶ Findings were examined with operations and non-operations staff members through group discussions and individual interviews, in addition to the formal interdepartmental and regular Management Committee reviews.

II. WHY SHOULD ADB REMAIN ENGAGED IN OCR CLIENT COUNTRIES?

A. Unprecedented Development Challenges

6. Asia has two faces. Despite remarkable growth rates (averaging 8% annually over the past three decades) and major reduction in the percentage of people living in poverty, inequality has widened rapidly in many client countries. Growing inequality could threaten socioeconomic stability and OCR countries’ ability to sustain further development gains. OCR countries continue to face unprecedented challenges, in sharp contrast to the path of graduate countries which succeeded in reducing poverty relatively smoothly. OCR countries today—including three of the world’s four largest and most populous states—are steering their development process in a globalized economy. Their rapid and large-scale industrialization and urbanization have generated a set of global challenges—heightened demands on energy, competition over natural resources and raw materials, and environmental degradation that make collective regional and global efforts imperative.

⁴ Operations analyses were conducted jointly with the Central Operations Services Office (COSO). The findings were further validated by the independent review of the Operations Evaluation Department (OED) (ADB. 2005. *Annual Report on Loan and Technical Assistance Portfolio Performance for the Year Ending 31 December 2004*. Manila.)

⁵ For example, reports of joint task forces between the Government and the People’s Republic of China (PRC) Resident Mission on accelerating project processing and improving portfolio management.

⁶ Regional departments (RDs), Treasury Department (TD), and Strategy and Policy Department (SPD) administered the questionnaires to eight client countries of which five responded (the PRC, India, Indonesia, Kazakhstan, and Pakistan). Consultation missions visited the PRC, India, Indonesia, Pakistan, and the Philippines (RDs, TD, OED, Private Sector Operations Department (PSOD), and SPD conducted consultations). RDs’ ongoing dialogue with Malaysia and Thailand also provided additional inputs to the exercise. In addition, a symposium was held in Singapore with the private sector sponsored by the Office of Cofinancing Operations (OCO) (June 2005).

7. **Attaining the MDGs.** Asia is home to 63% of the 1.1 billion people in the world living below \$1 a day. In 2002, about 675 million or 62% of the world's poor lived in OCR countries (Figure 1). When using a poverty line of \$2 a day, nearly 70% of the 2.7 billion poor live in OCR countries. With this broader definition, the number of poor actually increased in several OCR countries between 1990 and 2003: India (111 million people), Bangladesh (17 million), Pakistan (13 million), Uzbekistan (14 million), and the Philippines (2 million).

8. Pursuing Non-Income MDGs.

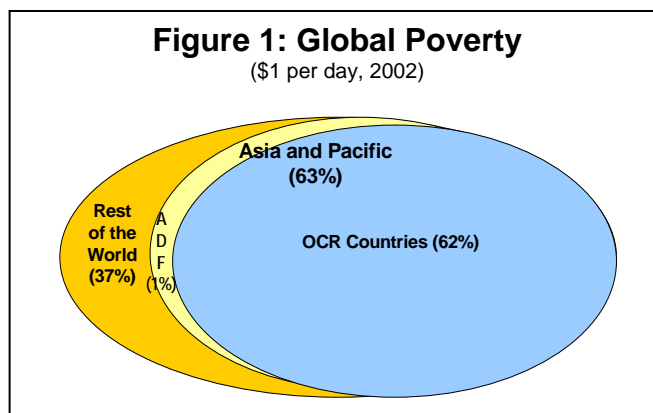
Progress on non-income MDGs in OCR countries has been mixed: 495 million people remain undernourished; 60 children per 1,000 live births die before reaching five years old; 585 million adults are illiterate; 12% of primary school children drop-out of school; gender disparity persists in education and work opportunities; 590 million people do not

have access to safe drinking water; and 1.8 billion people do not have access to sanitation facilities. If current trends continue, the Asia and Pacific region is unlikely to meet the non-income MDG targets.

9. **Investment Climate and Private Sector Development.** Poverty reduction and the MDGs in OCR countries cannot be achieved without sustainable growth and private sector development, both essential to create jobs. Despite robust growth rates, the investment and business climate still needs improvement in many OCR countries. Key challenges include reforms of the economic, fiscal, and taxation policies and regulatory frameworks, which many private firms still perceive as major obstacles to doing business in these countries.⁷

10. **Building Infrastructure and Human Capital.** Reliable physical infrastructure and productive human capital are equally important to establish an enabling investment climate and as sources of growth. Physical infrastructure development alone is estimated to require annual investment in the region of over \$250 billion.⁸ Progressive up-scaling of labor skills and knowledge is a key challenge in fast growing economies. As labor costs increase along with economic growth, OCR economies will also need to enhance their competitiveness beyond low labor cost.

11. **Developing the Domestic Capital Market.** While high liquidity in the global capital market has increased capital flows to some OCR countries, their access to this market remains uneven. As the financial crises in Latin America and in Asia in the 1990s have shown, the global capital market is volatile and pro-cyclical, and can abruptly change the cost and availability of funds for reasons beyond the control of any country. Effective domestic capital markets are



ADF = Asian Development Fund, OCR = ordinary capital resources.

Source: World Bank. 2004. *World Development Indicators*. Washington D.C.

⁷ International Finance Corporation. 2005. *Investment Climate Survey*. Washington, D.C.

⁸ ADB, Japan Bank for International Cooperation and World Bank. 2005. *Connecting East Asia: New Framework for Infrastructure*. Washington, DC.

needed to channel untapped domestic savings to investments, and to minimize the countries' vulnerability to fluctuations in global capital markets.

12. **Fostering Regional Cooperation.** OCR countries have important roles to play in fostering regional cooperation. Their decades of development experience make them valuable partners in extrapolating and sharing the wealth of development experience, good practices, lessons learned and future options available within Asia. ADB's continued engagement with OCR client countries is particularly important to ensure a stable, collaborative, and harmonious development in Asia and the Pacific.

B. The International Community has Stakes

13. **Economic Stability in OCR Countries.** In an increasingly interdependent global economy, the international community has a substantial stake in the stability of OCR countries, their policy choices and institutional resilience. OCR countries have attracted significant foreign investments and offer sizable labor, products and services to the global economy. Their social and economic stability contributes to global financial and economic stability. However, as the global experience during the 1990s has amply demonstrated, emerging economies with GNP per capita in the range of \$1,000 to \$3,000 (the lower MIC group) can be particularly volatile. Maximizing their growth potentials and minimizing inequalities warrant durable and concerted support of the international community.

14. **Public Goods and Natural Resources.** OCR countries' social and economic decisions as well as their policies for management of natural resources, environment, and public health affect not only their own people, but also those outside the region. Environmental protection,⁹ efficient use of natural resources and energy, and prevention and management of natural disasters and epidemics (SARS, avian flu) cannot be achieved without cross-border collaboration, and innovative and coordinated measures. OCR client countries have critical roles to play in these undertakings, which will bring benefits to their neighboring ADF countries as well.

C. ADB Services Add Value

15. To help address these challenges, ADB can offer a range of integrated financial intermediary, catalytic, and advisory services in OCR countries. More specifically:

- (i) providing direct financing and equity to both public and private entities, integrated with advisory and analytical services;
- (ii) integrating investment package with measures to raise standards of environmental protection, financial accountability, and procurement;
- (iii) supporting investments which are not commercially viable but economically and socially essential through provision of competitive market lending rates permitted by the Triple A credit rating;
- (iv) fostering regional cooperation by financing cross border operations and facilitating the achievement of common goals and mutual benefits;

⁹ According to the World Bank 2005 Little Green Data Book, the PRC and India together are estimated to account for 17% of global carbon dioxide emissions.

- (v) catalyzing resources from other sources in the regional and international community, including commercial investors through guarantee and risk mitigation services; and
- (vi) dealing with crises by injecting financial resources to governments, supporting rehabilitation of damaged infrastructures, sustaining and restoring basic services, supporting the provision of social safety nets, and supporting regulatory and supervisory capacity to cope with and overcome crises.

16. **Complementing the Capital Market.** These integrated services substantially help client countries. While the global capital market can also support OCR countries' development process, creditors and investors face uncertainty about macroeconomic stability, policy and regulatory frameworks, and political risks. This is the case even in countries that have dramatically deregulated and opened their markets. In such instances, ADB can help catalyze additional resources through guarantee and other risk mitigating measures.

17. **Investing in Public Goods.** These integrated services also help support the objectives of the international community: poverty reduction and attainment of MDGs, human development, environmental protection, financial accountability, and standards of procurement that curtail corruption and promote competition. Longer-term and competitive OCR loans can encourage public investments with high social and economic returns—investments in the financial sector, regulatory and policy framework, environment and natural resources, education, health, and rural infrastructure—that do not yield commercial returns to private agents, and which otherwise might not find a prominent place in national budgets. By supporting equitable growth in open market systems, these investments create an environment that crowd in productive private investment.

18. **Leveraging Development Results.** Technical services linked to lending operations increase the chances of effective implementation. Built around the countries' own commitments to reforms, such integrated approach generates informed and feasible policy choices and builds institutional capabilities. Such arrangements can bring concrete development results to sectors directly supported by ADB—improved institutional capacities, policies and services.

19. **Offering Attractive Financial Terms.** The actual financial terms of OCR loans is determined by various factors. Besides the interest margin over London interbank offered rate (LIBOR), ADB normally charges clients front-end and commitment fees. In some instances, these charges can be waived temporarily (as is the case currently with the front-end fee). Also, public sector borrowers have consistently received the benefits of ADB's sub-LIBOR borrowing costs through rebates. Overall, ADB's pricing of OCR loan charge is competitive compared to other MDBs¹⁰.

III. CHALLENGES TO ADB: EVOLVING WITH THE DYNAMIC REGION

20. To maximize its potential contributions, however, ADB must improve the way it delivers its services to client countries. The diversification, rapid progress and wider financing options available in OCR countries have raised their expectation of ADB.

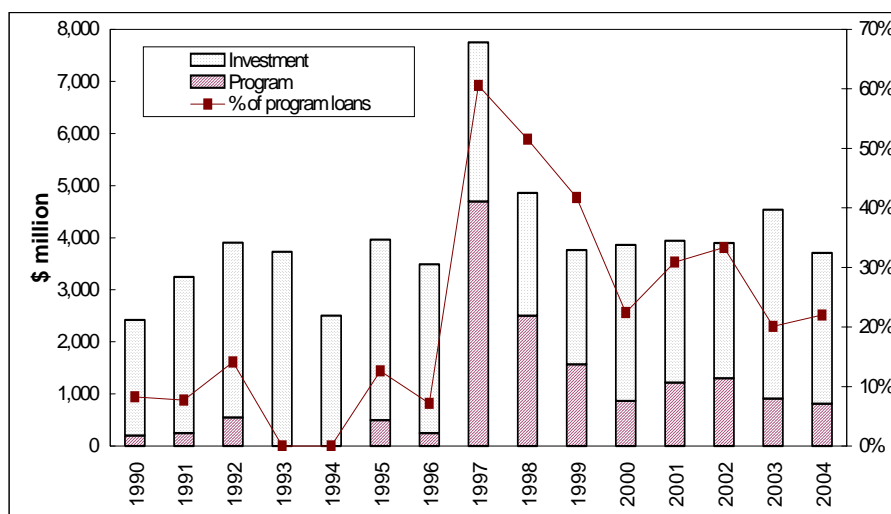
¹⁰ Review of ADB's Loan Charges and Allocation of 2004 Net Income. Presentation Materials for Informal Board Seminar on Financial Matters on 6 March 2006.

A. OCR Operations Over the Past Decade

21. Recent OCR operational data show worrisome trends: (i) flat new approvals; (ii) concentration of new OCR approvals in a few countries and sectors; (iii) slow disbursement of investment loans approved after 2000; (iv) long lead time for release of second/third tranches of program loans; and (v) cancellation of a large portion of approved OCR loans.

22. **Volume of New Approvals.** Since the early 1990s, new OCR approvals for public sector have been relatively constant, at around \$4 billion per year.¹¹ The volume of program loans averaged about \$1 billion a year (25% of the annual new OCR approvals) post crisis, with a corresponding decline in the volume and proportion of investment loans. (Figure 2)

Figure 2: OCR APPROVALS, 1990–2004



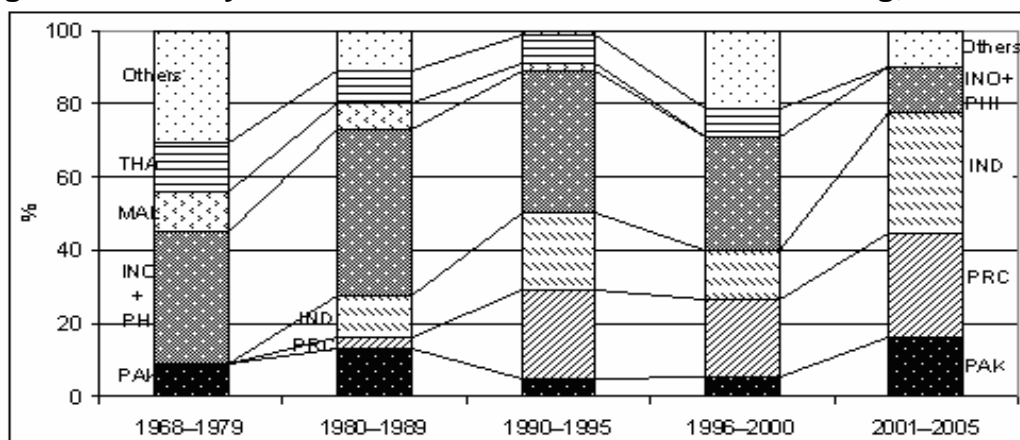
OCR = ordinary capital resources.

Source: ADB. Loan, TA and equity approvals database.

23. **Country Concentration.** Figure 3 shows that new OCR approvals since 2000 have been concentrated primarily in three countries (India, Pakistan, and the People's Republic of China [PRC]). Activities have declined in other client countries affected by the 1997 financial crisis after a set of crisis assistance. There has been no new lending in Malaysia (since 1997) and no new public sector lending in Thailand (since 1999). While discontinuation of OCR operations in Malaysia and Thailand may be a positive outcome of their development achievements, new OCR lending for Indonesia and the Philippines has also diminished significantly.

¹¹ Except in 1997 and 1998, when OCR covered substantial crisis operation

Figure 3: Country Distribution of OCR Public Sector Lending, 1968–2005

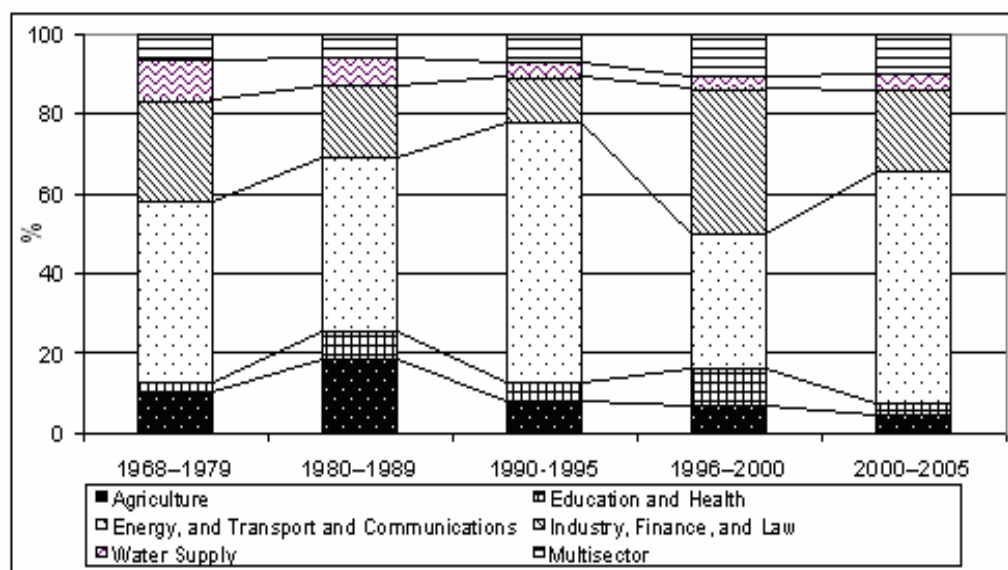


IND = India, INO = Indonesia, MAL = Malaysia, OCR = ordinary capital Resources, PAK = Pakistan, PHI = Philippines, PRC = People's Republic of China, THA = Thailand.

Source: ADB. Loan, TA and equity approvals database.

24. **Sector Concentration.** As illustrated in Figure 4, new OCR approvals since 2000 have concentrated primarily in two sectors (energy and transport, which account for about 60% of total approval). In contrast, in the 1980s and 1990s, OCR operations actively supported agriculture, natural resources, social services, and water supply operations in MICs and countries nearing graduation. These trends may be suggesting declining relevance or responsiveness of ADB services in meeting requirements of operations in these sectors.

Figure 4: Sector Distribution of OCR Public Sector Lending, 1968–2005

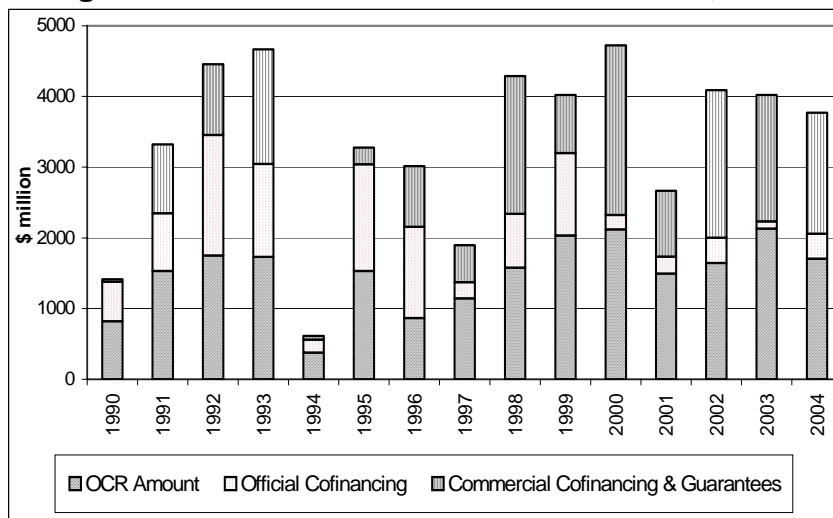


OCR = ordinary capital resources.

Source: ADB. Loan, TA and equity approvals database.

25. **Operations with Private and Commercial Sectors.** Since the mid-1990s, private and commercial entities have become active partners in OCR operations as borrowers and as cofinanciers. Year-by-year fluctuations notwithstanding, new approvals for private sector operations quadrupled from \$138.8 million in 1990 to \$607 million in 2004. In parallel, about \$1.5–\$2.0 billion (50%) of new public and private sector OCR loans have catalyzed additional cofinancing. The commercial sector now shares a major portion of cofinancing for both private and public sector operations, a change from when public entities were ADB’s major cofinanciers. (Figure 5).

Figure 5: OCR LOANS WITH COFINANCING, 1990–2004

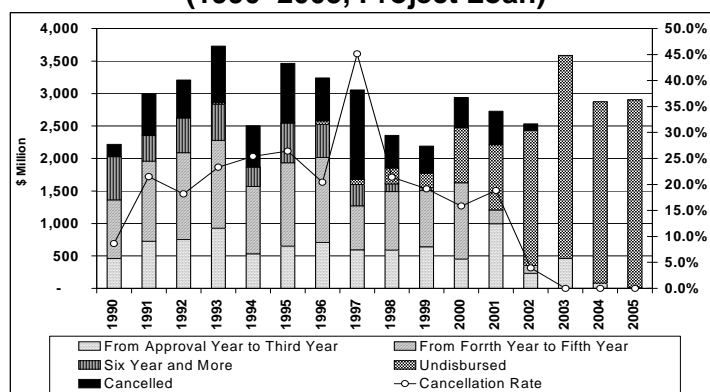


OCR = ordinary capital resources.

Source: ADB. Office of Cofinancing Operations.

26. **Disbursement and Cancellation.** Figure 6 depicts the new annual approvals for investment loans since 1990 (height of each bar represents the total new approvals in the year), and the status of disbursement from the portfolio approved in a given year. Out of about \$17.6 billion OCR investment loans approved in 2000–2005, \$12.7 billion remain undisbursed (checkered area within each bar). The notably positive performance in the PRC masks the large portion of approved loans undisbursed in other countries. A total of \$1.1 billion from the OCR investment loans approved after 2000 and 20–25% of loans approved before 2000 have been cancelled (black area within each bar). The reasons for cancellations included (i) change in financing sources (\$1.33 billion); (ii) change in project scope (\$858 million); (iii) cost underrun (\$795.3 million); and (iv) cleaning up of loans with slow progress (\$486 million).

Figure 6: OCR (Public Sector) Disbursement and Cancellation (1990–2005, Project Loan)



OCR = ordinary capital resources.

Source: ADB. Loan financial information system as of 8 March 2006.

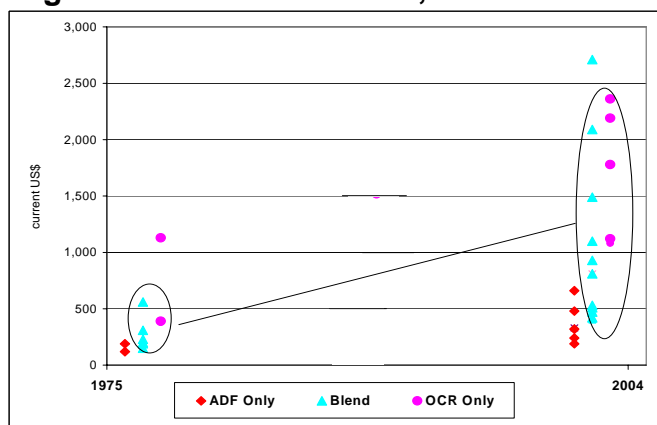
27. **Implications on Development Effectiveness and Results.** While disbursement is not the most reliable indicator of implementation progress, a large proportion of undisbursed loans across countries could mean delayed activities and outputs, and hence lower development effectiveness. Borrowers may also cancel the undisbursed loans to minimize the costs of these commitments

B. Transformation of OCR Client Countries

28. The OCR operational trends described above reflect: (i) changes in the regional and client country contexts; (ii) associated changes in client expectations; and (iii) the growing mismatches between ADB's operational approaches and the dynamic operational context and needs of client countries.

1. Changes in Contexts

29. **Diversified OCR Clients.** ADB deals with a substantially more diverse set of countries today than it did a few decades ago (Figure 7). Transitional economies joined the OCR client group in the 1990s. Some ADF countries have recently started OCR operations for high-revenue-generating investments. If the region's current growth trends continue, more ADF countries will soon access OCR. Yet, despite past successes, some OCR countries continue to be challenged by prolonged debt management problems and limited fiscal space.

Figure 7: GNI PER CAPITA, 1975 AND 2004

ADF = Asian Development Fund, GNI = gross national income, OCR = ordinary capital resources.

Source: World Bank. 2004. World Development Indicators. Washington, DC.

30. **Heterogeneous Operational Contexts.** Diversified clients mean heterogeneous operations contexts and requirements. ADB needs to approach each country differently, based on a profound understanding of its development potentials, challenges, and priorities. Even within the same country, expectations and priorities change over time. Besides regular operations, OCR have also supported a series of emergency operations: post-disaster rehabilitations, financial injections, and social protection during financial crises. In special circumstances, OCR also temporarily supported graduates (e.g., the Republic of Korea during the 1997 Asian financial crisis).

31. **Changing Roles of National and Subnational Governments.** Most OCR client countries, to varied degrees, have decentralized the planning, financing, management and delivery of basic public services to local governments. Needs vary both across and within countries. Increasingly, both national and local governments influence decisions on the use of external financing. In some OCR countries, public investment also involves parliamentary decisions. These circumstances force ADB to take a more demand-driven and flexible approach.

32. **Growing Roles of the Private Sector.** In most OCR countries, the private sector absorbs greater responsibilities for financing, management and delivery of services. This is particularly the case in sectors like transport, energy, and utilities. Government responsibilities are shifting to policy and regulatory functions, inducing changes in the scope of OCR operations in these sectors, and demanding synergy between public and private sector operations.

2. Changes in Client Expectations

33. These contextual changes have generated more diversified and sophisticated client expectations. OCR countries see the need for greater ability and flexibility within ADB to (i) work on more complex issues, and (ii) work with a wider range of in-country partners.

a. Desired Attributes of ADB:

34. Client countries broadly appreciate ADB's past services and see substantial potentials for, and interest in, continuing engagements with ADB. Most cited the continued challenges

(discussed in Section II.A) and emerging opportunities for regional cooperation as two primary reasons for valuing continued engagement with ADB. Most seek the following attributes from ADB:

- (i) **Reciprocal partnership.** Effective partnership needs to be grounded in each country's development visions and strategies, and involve greater reciprocity of experience, knowledge, and cooperation. This is also a necessary foundation to catalyze effective regional cooperation.
- (ii) **Profound regional and country knowledge and high level of expertise.** ADB must have the deepest understanding of the region and individual DMCs and the highest level of expertise. This is essential for country-specific partnership within a vastly diversified region.
- (iii) **Flexibility.** As development in the region has been cyclical and nonlinear, flexible approaches are essential. For example, priority areas (in terms of sectors or thematic areas) for engagement with ADB vary across client countries, reflecting their different development paths, ADB's track-record in each country, economic and fiscal conditions, development strategies, and partnership options. Some countries prefer to focus on physical infrastructure, others on program lending to address fiscal and institutional problems, and on investments in agriculture, natural resources, and social services in less advanced areas. Some would like ADB to continue to focus on the public sector while others prefer an increased emphasis on the private sector such as support to small and medium enterprises.

b. Key Issues

35. Client countries consistently expressed concerns over the deteriorating quality of recent services from ADB. More specifically, OCR countries emphasized that one size does not fit all and that a profound understanding of the country is an essential requirement for an effective partnership. Client concerns can be classified into three broad areas: (i) increased costs, (ii) deteriorating quality of services, and (iii) limited choices of modalities and instruments. The underlying causes are largely internal factors to ADB, pertaining to the framework of OCR operations (i.e., operations policies and guidelines, modalities and instruments, approaches to operations planning and monitoring, among others).

i. Increasing Costs of Doing Business with ADB

36. **Financial Costs.** Some OCR borrowers have raised concerns that the progressive structure of ADB commitment charge is too complex. As a result, borrowers cannot calculate the commitment charge properly and have to depend on ADB's accounting records for maintaining their account. Others have argued that ADB's commitment charge compares quite unfavorably with sister MDBs and therefore should be reduced and/or eliminated altogether. This would help to reduce borrowers' financing costs. For the most part, however, DMCs concerns focused on the rising non-financial costs (or transaction costs) of doing business with ADB.

37. **Slow Responses.** The rapidly changing and dynamic OCR context requires timely decisions and actions from ADB. While recognizing that their own bureaucracies contribute to delays, most OCR client countries are concerned about ADB's slow responses in delivering new

projects and implementing the approved portfolio. The latter is particularly serious as delays translate into additional costs to the borrowers in the form of higher commitment charges.

38. **Complexity and Rigidity.** Clients perceive that ADB's operations policies and strategies have accumulated and contributed to project goal congestion and design complexity. ADB financed projects now have multiple components leading to complex institutional arrangements, increased project costs, and at times, serious implementation problems.

39. **Mismatch of Timeframe.** Each country has its unique economic planning, fiscal and administrative process and timeframes. ADB needs to synchronize its activities with the country's development program cycles, and the pace of local administrative and political processes. Clients feel that the use of a uniform process and timing for country programming and project processing (driven by ADB's fiscal and planning calendar) significantly diminishes the value of discussions, and the quality and validity of country programs and projects.

ii. Deteriorating Quality of Services

40. **Reliance on Consultants.** OCR countries value the integration of lending with knowledge services, especially as it constitutes a sound analytical basis for critical policy, strategic, and technical decisions. However, ADB's knowledge services have been hampered by (i) over-reliance on external consultants, (ii) inflexible guidelines for mobilizing high-caliber consultants, and (iii) long lead time for fielding consultants.

41. **Country Knowledge and Sector Expertise Among ADB Staff.** Most client countries prefer ADB staff members to be more actively engaged as conduits of knowledge transfer, and are concerned about the recent erosion of country knowledge and sector expertise among them. Experienced technical staff with solid understanding of the country is critical for effective long-term partnerships to translate technical assistance (TA), investment and policy support into concrete and successful results.

42. **Stable Assignment of ADB Line Managers and Sector Specialists.** ADB relationship with its clients must be continuous to enable gradual but systematic progress towards development objectives and goals. In this respect, OCR clients require more stable assignments of ADB line managers and sector specialists to country operations. Staff changes are costly. They involve changes in technical approaches and differing interpretation of ADB guidelines.

43. **Consistent Support Across Operational Cycles.** Clients stated that attention across the operational cycle should be more balanced. While ADB is intensely involved during loan processing, its attention to implementation has been minimal. Countries have consistently noted that this is one of ADB's major drawbacks when compared with other development partners.

44. **Country Ownership and Systems.** Clients underscored that sustainable partnership should be built on respect for a country's development vision, strategies, leadership, and capacities. OCR countries must be given the opportunity to lead and own their development processes. Overall, the countries consulted indicated that they prefer simple and realistic project design in congruence with the systems, institutions, and capacities available in-country. New approaches and systems need to be introduced within a realistic timeframe and accompanied by well-sequenced institutional and capacity building.

45. **Policy and Institutional Goals and Conditions.** The long-term engagements of a critical mass of ADB staff members, leading to solid country and sector knowledge, is essential

for realistic design and pace of institutional, policy, and sector reforms. Clients consistently requested for more realistic policy and institutional conditionalities, and exclusion of items involving legislative actions beyond the control of the executive branch of the government.

46. **Mutual Accountability.** Several clients requested mutual accountability for successes and failures. They are especially reluctant to accept sole responsibility for complex programs and projects proposed by ADB. Client countries usually bear the consequences of unrealistic project and program designs, such as managing implementation issues as well as paying charges and fees incurred from delayed or unsuccessful project implementation.

iii. Choices of Modalities and Instruments

47. The current range of instruments available within ADB is not responsive to clients' needs. For example, a single country strategy and program (CSP) process and format apply to all countries, regardless of their contexts. Lending instruments (which were designed primarily for nationally executed infrastructure operations) are less relevant to today's infrastructure operations which are heavily decentralized. These instruments are also not fully responsive to the needs of other sector operations which may require greater flexibility and adaptability during implementation (e.g., agriculture and natural resources, social services, institutional and policy reform). Instruments intended for country operations are applied to regional projects. Although OCR terms and conditions remain attractive to revenue-generating infrastructure operations, they are not fully supportive of investments that are economically and socially viable but have low or negative financial rates of return. Several OCR countries requested for access to softer terms and conditions to support such investments.

C. Underlying Factors

48. Several positive external factors may account for the raised level of expectations among OCR countries. One such factor is the increased capacity that OCR clients have built through decades of rapid development efforts. Another is the high liquidity in the global and regional capital markets that has widened the financing alternatives of OCR countries. As a result, the value of ADB services is being assessed against a wider range of available options. But for the most part, the mismatch between what OCR clients want and what ADB can offer is due to factors internal to ADB. Overall, six groups of factors may be constraining the effectiveness of OCR operations.

- (i) **Proliferation of policies, strategies, and guidelines.** OCR operations are governed by numerous policies, strategies, and guidelines adopted over 40 years. A project is subjected to nine broad policy and procedures areas.¹² These have proliferated in the absence of an institution-wide system to plan and manage policies and strategies. Interpretations and applications of various policies have been inconsistent because responsibilities are dispersed across several departments, increasing internal transaction costs and reiterative business processes. Each project team spends substantial time and effort to coordinate

¹² The ADB Operations Manual (2003) categorizes them under (i) country classification, (ii) sector and thematic policies, (iii) business products and instruments, (iv) partnerships, (v) safeguard policies, (vi) analysis, (vii) financial, (viii) project administration, and (ix) other policies and operational procedures.

with at least seven non-operations departments¹³ overseeing different policy areas. In 2004, a system to coordinate new policy and strategy work was established, but some old policies and strategies need to be retired, and old and new policies made consistent with each other.

- (ii) **Policy applications.** ADB has focused on ex ante and procedure-based compliance during project processing rather than result-oriented support during implementation. Mitigation measures may not always lead to sustainable internalization of policy objectives within the country. They can be more successful and effective if support is maintained throughout project implementation and linked with broader efforts to build the in-country institutional capacity and systems.
- (iii) **Modalities and instruments.** ADB offers fewer modalities and instruments than other MDBs, even though operations coverage and strategic commitments have widened. ADB has introduced four new instruments over the past decade: (a) sector development program modality: a hybrid of policy and investment loans (1996), (b) TA cluster (1997), (c) program cluster loans (1999), and (d) the LIBOR based OCR product (2001). New instruments were also introduced on a pilot testing basis under the innovation and efficiency initiative (IEI) in 2005. Several client countries have requested additional new instruments along with a review/update of current instruments.
- (iv) **Staff and resource distribution.** The dispersion of staff members across multiple operations and non-operations departments has limited ADB's ability to maintain a critical mass of specialists. Frequent formal cross-departmental staff transfers destabilize country and project team assignments. Flexible and informal staff redeployment across work units (e.g., temporary assignment or exchanges of staff between departments) may help stabilize staff assignment and preserve the critical mass of expertise.
- (v) **Institutional and operational performance indicators.** The key operations indicator has been the approval of new loans. Other equally important indicators also influence ADB's institutional effectiveness and overall development effectiveness on the ground. Examples include loan signing and effectivity, disbursement, and progress of the project and program implementation. Use of these indicators, with regular client feedback, could encourage more balanced operations management, realistic resource allocation, and improved services to client countries.
- (vi) **Operations planning and management cycle.** Operations activities at ADB are largely driven by its fiscal calendar. The annualized allocation of loan and TA resources limits the ability of operations units to align their schedules to client countries' planning, fiscal and administrative cycles. It pushes shorter-term operational planning and bunching of loan and TA approvals to the end of ADB's

¹³ Central Operations Services Office, Controller's Department, Economic Research Department, Office of General Counsel, Office of Cofinancing Operations, Regional Sustainable Development Department and Strategy and Policy Department.

fiscal calendar. This results in seasonal overloads in demands for staff time at ADB as well as a mismatch of incentives between ADB and client countries.

IV. EXPERIENCE OF OTHER DEVELOPMENT PARTNERS

49. The trends discussed in Section II.A of the paper are not unique to ADB. In fact, the growing mismatch between client expectations and traditional operational approaches has affected the non-concessional operations of most MDBs, prompting a variety of responses. The growing presence of commercial financiers in the region has also opened a new avenue of partnership for ADB and OCR client countries. The experience and perceptions of these partners are highly relevant to ADB's exploration of new approaches to OCR operations.

A. Multilateral and Regional Development Banks

50. New commitments of non-concessional loans at most MDBs have fluctuated particularly since the late 1990s, and changing expectations of client countries have prompted major updating of operations policies, modalities and instruments across MDBs. The World Bank urged international financing institutions (IFIs) to take "bold actions to accelerate progress towards MDGs" including (i) adopting approaches and instruments to respond to the evolving and differentiated needs of MICs, including further streamlining of conditionality and investment lending; (ii) sharpening the strategic focus and improving the effectiveness of IFI's support for global and regional public goods; and (iii) enhancing operational flexibility to promote the development and use of country systems.¹⁴ Individual MDBs have taken the following actions since 2000:

- (i) The Inter-American Development Bank (IADB) serves the Latin America and Caribbean region which is mainly composed of MICs. Its new lending framework introduced in 2000 consisted of a series of new instruments (19 new instruments had been introduced by 2004) to permit differentiated approaches to country and sector specific requirements. Some instruments carry waivers of IADB policies. IADB has also updated its operational policies and procedures to speed up project approval and reward country performance.
- (ii) The World Bank adopted a MIC strategy and action plan (2004) following an in-depth review that started in 2000. The strategy is comprehensive and aims to (a) reduce transaction costs of delivering new loans; (b) relax eligible items for loan financing; (c) use country systems for procurement, safeguard and fiduciary arrangements; (d) use new approaches to policy lending; and (e) introduce additional financing options during implementation. Initial lessons highlighted the resource intensity of these measures, especially the fast-tracking of approvals which required an experienced country-based team and intense support from headquarters.
- (iii) The African Development Bank (AfDB) MIC strategy (May 2005) covers four policy changes. Among them were: (a) increasing the TA ceiling per project, (b) revising the commitment fee structure, (c) simplifying loan pricing for sovereign borrowers, and (d) reducing the required public disclosure of environmental

¹⁴ World Bank. 2005. *Global Monitoring Report 2005*. Washington, DC.

impact assessment for private sector projects from 120 to 60 days. The strategy has been accompanied by several internal undertakings to systematize and simplify the operations process.

51. The World Bank MIC action plan also recommended the creation of an inter-agency working group to explore approaches, mechanisms, and instruments to support MICs. The meeting of MDB heads (March 2005) endorsed global collaboration but also encouraged regional and country customization of the approach, given the considerable cross-regional and cross-national variations. ADB has been an active proponent of this working group. In September 2005, the heads of multilateral financing institutions continued the discussions and reconfirmed the strategic importance of the institutions' continued engagements with MICs. The subsequent meeting of the MDB senior staff members (in September 2005 during the World Bank's annual meeting) examined operations issues and options. This meeting also validated the applicability of the contextual issues facing OCR operations in Asia to other MDBs, especially the World Bank.

52. At the meeting of MDB heads (February 2006), the presidents agreed to move ahead on two main fronts: (i) conducting joint MDB consultations with client countries in each region over the coming months; and (ii) preparing jointly a policy paper on blending in MIC. In terms of regional consultations, ADB and the World Bank are jointly organizing a consultation meeting with Asian MIC in Manila on 7 April 2006. Preparations for the consultation are well underway. The objectives of the consultation will be to: (i) assess whether the current set of reforms under adoption/implementation by MDBs are sufficient to meet MIC development needs; (ii) identify challenges in implementing the reforms; and (iii) identify areas where policy and procedures may need further adaptation to MIC and MDB needs. As for blending, work is currently underway to explore the possibilities of blending bilateral grant and multilateral lending resources in support of intervention with high poverty incidence, taking into account credit worthiness constraints faced by some borrowers and in providing financing for global public goods. The working group (with the World Bank taking the lead) is currently working on a draft paper to help forge a common approach. The paper will serve as a basis for discussion with interested donors.

B. Private and Commercial Sectors

53. Asia's investment requirements and growth potential represents a strategic opportunity for OCR operations to proactively partner with private and commercial resources. The complementarities are explained below.

- (i) **Advantage of the private sector.** The private sector has substantial capacities to syndicate large amount of funds on its own. It can also conclude transactions much faster than an institution like ADB. The prevailing financial environment in industrialized economies also permits the private sector to offer attractive loan terms and conditions, including maturity of up to 15 years.
- (ii) **Limitations of the private sector.** The private sector can quickly withdraw financing if a project becomes commercially nonviable. A private firm tends not to shoulder the full risks, especially if it lacks country experience or confidence in the investment climate (political risks, premature regulatory framework). Private financiers are generally unwilling to address crises or to invest in public goods that are not commercially viable or do not generate revenue.

- (iii) **Incentives to partner with ADB.** Private and commercial financiers and operators would benefit from partnering with ADB because of its: (a) country and sector experience and knowledge, (b) credit enhancement capacity, (c) permanent presence in the country (e.g., via resident missions), (d) access to and confidence of governments, (e) political risk guarantee, and (f) risk-taking ability (debt and equity).
- (iv) **Expectations of ADB.** Private and commercial financiers and operators value ADB's support for (a) the creation of an attractive investment and business climate, and (b) the design and provision of creative financial solutions to promote investment opportunities in regional and local markets.

V. PROPOSED RESPONSES

A. ADB Poverty Reduction Mandate Remains Relevant in OCR Context

54. OCR countries are different from ADF countries in a number of ways: (i) OCR countries are more diversified and better integrated into the world economy, hence, have a better growth potential; (ii) they have greater physical, financial and human resources for social and anti-poverty programs; and (iii) they have greater institutional and administrative capacity for growth and anti-poverty programs. Yet, despite these differences, poverty and social challenges are still major issues in many OCR countries. Thus, ADB's poverty reduction mandate remains relevant in OCR countries. But in carrying out its mandate, ADB's priorities must be defined in the specific country context. OCR countries vary widely in terms of income, poverty incidence, capital access, and the progress they have made in terms of policy reforms and institution building. ADB support, therefore, needs to be highly customized to the development needs of each country.

55. Broadly speaking, the three pillars of ADB's Poverty Reduction Strategy (PRS)—pro-poor sustainable economic growth, inclusive social development, and good governance—remain relevant to addressing the poverty reduction challenge in OCR countries.

56. **Pro-poor sustainable economic growth.** Empirical evidence demonstrates that robust and sustained pro-poor economic growth is the single most important factor in attaining rapid poverty reduction. This applies to OCR countries as well.

- (i) **Infrastructure.** A large share of ADB operations under the growth pillar in OCR countries consists of infrastructure investment. Although growth and poverty reduction depend on much more than infrastructure investments alone, the contribution of infrastructure to Asia's macroeconomic story (and OCR countries in particular) has been considerable. Yet, there is still much room for improvement and supply needs to keep pace with rapidly increasing demand (i.e., infrastructure needs in East Asia alone are estimated at approximately \$200 billion annually over the next five years).
- (ii) **Private Sector Development and Finance.** As stated in ADB's PSD strategy, development of a strong and dynamic private sector is crucial to long-term economic growth. Given the importance of the private sector in OCR countries, ADB's role should be to catalyze private investment, adding value where private markets cannot. ADB can play several roles vis-à-vis the private sector. First,

ADB should expand and improve its support to policy reforms and institutional development to (i) development and implementation of policy; (ii) regulatory and legal reforms in areas related to public resource and fiscal management; (iii) financial and capital market sector development; (iv) trade and investment; (v) good governance; and (vi) the incorporation of the private sector in key productive areas and public goods and/or services (through privatization program and other modalities). All these measures taken together—those concerning private sector investment and financial sector reform, plus others to improve the structure and operations of domestic capital markets—help countries improve and sustain their access to international capital markets and enhance the role played by commercial finance in enhancing their development. Second, ADB may support actions that will directly crowd in the private sector, such as catalytic financing to the private sector or public-private partnerships.

- (iii) **Regional Cooperation.** Over the last decade, parts of the region have become more integrated because of closer economic and political ties. Internationalization of production has spurred regional trade. Improvements in transportation, coordination, and communication technologies have facilitated cross-border production. Regional economic cooperation can be further increased. This will accelerate economic growth by enlarging the market, exploiting economies of scale, and promoting a better division of labor. Regional cooperation can also spur private sector development, promote peace and stability, and provide greater opportunities to people living close to the borders. Cooperation is also important for providing public goods that address joint constraints such as prevention of communicable diseases and environmental degradation. ADB, as a regional development bank has a strong comparative advantage in providing this kind of support. The recent establishment of the Office of Regional Economic Integration provides a good opportunity to further enhance regional cooperation and integration in the region. ADB's Regional Cooperation and Integration Strategy (currently under preparation) will lay out in greater detail how ADB plans to further intensify its support to regional cooperation in the region.
- (iv) **Environmental Protection.** OCR countries have a large impact on the state of the world environment. Measures to protect the environment raise investment costs considerably, and there is an expectation from OCR and poor countries alike that they be compensated for conservation and abatement measures that are of global interest. Though progress has been made, there is a need for innovative financing and transfer solutions to foster environmental investment of global interest in OCR countries. The Global Environmental Facility provides funding of incremental costs on a grant basis and attracts cofinancing from different sources, including the private sector. By developing a market for emission certificates, the Clean Development Mechanism may eventually transfer significant resources to certain OCR countries. These initiatives (along with others) should be further pursued and/or expanded.

57. **Inclusive Social Development.** It is generally acknowledged that poverty reduction is more effectively accomplished if a comprehensive program for social development complements policies for accelerating broad-based economic growth. The Asia Pacific region (as a whole) has made tremendous progress in reducing income poverty but still faces challenges with non-income poverty. At current trends, economic growth alone will not be

sufficient to reach the MDGs. OCR operations for social development have sharply declined in recent years mainly because some OCR countries stopped borrowing for social development projects. ADB needs to further investigate why this may be the case. Despite these declining trends, the rationale for ADB intervention in the social sectors remains strong. The non-income dimension of poverty seems to lag behind in the Asia Pacific region, putting into question the likelihood of achieving the non-income MDGs (particularly in the health sector). Education is also extremely important in OCR countries. Globalization is putting a higher premium on competitiveness, requiring many countries to develop more productive but also more flexible and sophisticated labor force. Because of the nature of those social sector goods (like education and health), private sector involvement may be more difficult and therefore organizations like ADB may have an important role to play.

58. **Good Governance.** Good governance is critical to poverty reduction as weak governance hurts the poor disproportionately. Public sector inefficiency, corruption, and waste, leave insufficient resources for basic public services and antipoverty programs. Good governance facilitates participatory, pro-poor policies as well as sound macroeconomic management that encourages economic growth and maintains price stability. Better revenue administration and carefully prioritized and implemented expenditures, particularly for basic services, are essential. Although most OCR countries have undergone political transitions, a number of challenges remain. Some OCR countries still suffer from serious governance deficits including political exclusion, poor representation of citizen's interests, low levels of confidence in state institutions and corruption. Some are struggling to emerge from long periods of conflict. ADB must recognize and help to address these diverse needs. If not, we may miss opportunities to identify and challenge problems which perpetuate poverty, even as income grows.

B. Objectives

59. While the broad framework of the Enhanced-PRS remains relevant in the OCR context, ADB must seek to deliver the following to OCR client countries:

- (i) timely responses throughout the operations cycle, focusing on delivery of results on the ground;
- (ii) high-quality, stable and well-integrated financial and knowledge services; and
- (iii) customized and flexible services with responsive instruments, and coherent alignment of approaches with the countries' own systems (when feasible).

C. Proposed Measures

60. A number of changes are proposed to the OCR operations context at various levels: operations policies and guidelines; modalities and instruments; approaches to operations management; and staff and resource planning and development. Some changes have already been approved by the Board of Directors such as the IEI instruments for pilot-testing¹⁵ and review of supplementary financing policy¹⁶. Others are for consideration by Management or by the Board in 2006 and 2007. This paper provides a broad picture of the proposed measures, while separate papers will detail each measure. These measures are grouped into four areas: (i) reducing the costs of doing business with ADB; (ii) enhancing service quality; (iii) enhancing and

¹⁵ ADB. 2005. *Pilot Financing Instruments and Modalities*. Manila

¹⁶ ADB. 2005. *A Review of the Policy on Supplementary Financing: Addressing Challenges and Broader Needs*. Manila

expanding the range of instruments available; and (iv) adopting responsive operations management, planning and monitoring systems.

1. Reducing the Costs of Doing Business with ADB

61. The first group of measures aims to reduce the costs of doing business with ADB. While some OCR clients have expressed concerns with respect to ADB's commitment fee, the main issue seems to be the rising non-financial (or hidden) transaction costs mainly driven by the plethora of policies and the increasing complexity in their applications which have made ADB operations less attractive. The majority of measures discussed below therefore aim at reducing the transaction costs of doing business with ADB. Various streamlining measures are proposed to permit (i) timely, flexible, and focused country strategies; (ii) new projects with a simple and realistic design; and (iii) effective support to project implementation.

a. Simplifying ADB Commitment Fee Structure

62. The financial terms of ADB's standard instrument are generally at par with those offered by similar institutions. However, some OCR clients have expressed concerns with respect to ADB's commitment fee. The Treasury Department is currently looking into the matter (i.e., how to simplify and/or reduce commitment fees). A separate paper (with a specific proposal for simplifying the commitment fee structure) is expected to be presented to Management and the Board of Directors in the second quarter 2006. The Treasury Department will also be undertaking a review of its LIBOR-based product in 2006 to ensure that it remains attractive and/or competitive to ADB clients.

b. Introducing Greater Flexibility in ADB Programming Cycle

63. Under the CSP reform process currently ongoing, it is proposed that ADB country teams develop annual rolling business plans, identifying specific projects for processing. Delivery of these projects will be undertaken over a more flexible period. The plans would be prepared before ADB's internal budget approval process is completed. Country confirmation missions (normally fielded in the fourth quarter of each financial year after the budget process is completed) would no longer be held. Annual updating of business plans through CSP updates (CSPUs) would also no longer be required. Further details of this proposal are expected to be presented to Management and the Board in the second quarter 2006.

64. A country partnership framework (CPF) is also being pilot-tested in Thailand where (i) a range of analytical work and policy reviews are available, and (ii) systems for formulating and managing development strategies and investment programs are mature. Thailand sees a wider horizon of partnership opportunities with ADB beyond traditional projects, such as the links and synergy between the country and regional operations as well as between private and public sector operations. In this context, a simplified and flexible process may replace the full-fledged CSP. The CPF will define (i) the medium-term scope of partnership between the country and ADB, based on the available analytical work and country's development strategies; and (ii) synergy of private-public sector operations and country-regional operations.

c. Delegating Operational Services and Decisions

65. Greater delegation of operations decisions and accountability permits on-site and timely operations decisions and service delivery. Most of the major OCR countries have well established resident missions with high-quality national staff, and are equipped to absorb more

responsibilities and accountabilities for countries' operations. In 2006, ADB plans to initiate a review of its Resident Missions operations. As part of this exercise, ADB will assess whether there is room to further decentralize its operations.

d. Consolidating and Streamlining Operational Policies and Strategies

66. **Operations Policies and Guidelines.** In line with ADB's commitment to the Paris Declaration,¹⁷ ADB will seek to further update, streamline and consolidate (where possible) operations policies and guidelines to provide (i) greater clarity and consistency across policy items; (ii) realistic and result-oriented approach to their application with a sharper focus on capacity building; and (iii) provisions for the use of country systems where appropriate. Box 1 lists the key strategies/policies under review in ADB.

Box 1: Key Operational Policies and Strategies Under Review

A. Operations Policies and Guidelines

1. Cost Sharing and Eligibility of Expenditures for ADB Financing: A New Approach (approved June 2005)
2. Review of the Policy on Supplementary Financing of Cost Overruns of ADB-Finance Projects (approved in November 2005)
3. Review of ADB's 1998 *Graduation Policy* (2006)
4. Review of TA Management (2006)
5. The Use of Consultants by ADB and Its Borrowers (approved February 2006)
6. Revision of Procurement Guidelines (approved February 2006)
7. Review of ADB's Credit Enhancement and Guarantee Policy (2006)
8. ADB Policy Statement on Environment and Social Safeguards (2006–2007)

B. Operations Strategies

1. Medium-Term Strategy II (IQ 2006)
2. Urban Sector Strategy (2006–2007)
3. Energy Sector Strategy (2006)
4. Transport Strategy (2006)
5. Regional Cooperation and Integration Strategy (2006)

ADB = Asian Development Bank, TA = technical assistance.
Source: ADB. Strategy and Policy Department.

67. For example, ADB's new approach for cost sharing and expenditure eligibility (approved in June 2005) establishes a new policy framework to determine how much, and what ADB can finance under its public sector development programs. The new framework is (i) more closely aligned with the actual expenditures requirement of borrowers, (ii) harmonized with that of other development partners, and (iii) consistent across lending instruments. Simpler and more uniform cost sharing and expenditure eligibility will help reduce transaction costs for borrowers and ADB.

68. **Sector and Thematic Policies and Strategies.** ADB will also seek to streamline thematic and sector policies and/or strategies. Several thematic and sector strategies are

¹⁷ The 2005 Paris Declaration promotes (i) country ownership, leadership, and the use of country systems to foster development effectiveness; (ii) streamlining of operational policies, and (iii) differentiation of approaches to MICs. These principles are relevant to OCR countries with capacities and systems to manage their development process.

currently under review. For example, the review of the safeguard policies currently ongoing is examining mandatory elements across sector and thematic policies, for eventual consolidation into an updated safeguard policy. ADB may also consider retiring several sector policies and/or strategies that have become redundant.

e. **Streamlining the Business Process**

69. **Project Preparation and processing.** There are currently three mandatory milestones for project processing: (i) management review, (ii) loan negotiations, and (iii) Board consideration. The forthcoming paper on CSP and Business Processes will recommend simplified procedures in between these milestones. New approaches will require greater involvement of staff on technical activities, and more flexible use of TAs to help prepare projects.

70. **Project Implementation.** Project implementation process will be streamlined by updates of the guidelines on procurement and consulting services (new guidelines to become effective on 1 April 2006), together with a proposed update of guidelines on disbursement and financial management. The recently approved policy on supplementary financing¹⁸ will ease adjustment of the project costs and design required by the changing operations contexts. Combined with greater efforts to improve portfolio management, these policy provisions will enable more responsive support to project implementation and minimize repetitive clearance processes.

2. **Enhancing Service Quality**

71. The second group of measures aims to enhance service quality and effectiveness, by building and/or maintaining a critical mass of qualified, motivated, and dedicated staff.

72. **Building Staff Capacity.** Staff must have technical expertise, combined with balanced international and regional experience, maturity, and interpersonal and intercultural skills in order to work effectively with client countries. Under the framework of the ADB's human resource strategy,¹⁹ skill mixes are being reviewed and technical stream career development explored. Further measures are also required to support a stable assignment of country and project teams. Skills-mix management must be continuous to respond to dynamic operations requirements. This link between skills-mix and operations requirements can be enhanced by integrating the assessment of staff and resource requirements while formulating CPFs, CSPs, and regional cooperation strategies. The new Medium Term Strategy (2006-2008) identifies core operational sectors where ADB will focus its operation and for which it will build up a critical mass of expertise. Staff skills mix will therefore have to be adjusted accordingly.

73. **Optimizing Operational Synergy and Team Work.** Effective services also require synergies among public and private sector and cofinancing operations, as well as regional, subregional and country level operations. Through these synergies, ADB can fully capitalize on the ability to offer a range of public, private, regional, country, lending and non-lending operations. CSPs are the strategic document to do so at the country level (i.e., determining the appropriate menu of lending, non-lending, public versus private interventions). This requires active participation and a partnership among the regional departments, Private Sector Operations Department and other relevant department/offices in the development of the CSPs.

¹⁸ ADB. 2005. A Review of the Policy on Supplementary Financing: Addressing Challenges and Broader Needs. Manila.

¹⁹ ADB. 2004. *Human Resources Strategy*. Manila.

This issue (i.e., how to foster greater synergies across departments) will be addressed under the CSP reform initiative. The draft Regional Cooperation and Integration Strategy (currently under preparation) also proposes a closer alignment between Regional Cooperation Strategy Programs and CSPs.

74. **Capturing Client and Partner Feedback.** Systematic and regular capture of client feedback is needed to objectively measure the progress and effectiveness of service enhancement efforts. Besides the CPF and CSP process, periodic surveys, country and regional level discussion are proposed to capture the broader dimensions of client feedback. In this context, ADB and the World Bank are jointly organizing a consultation meeting with Asian MIC in Manila on 7 April 2006. (See para 52). ADB Department of External Relations (DER) also launched a global perception survey in the first quarter 2006. The survey will poll 700 stakeholders and opinion leaders in 24 countries. Results are expected by the end of the second quarter. The survey will be repeated every three years.

3. Expanding and Enhancing Partnership Instruments

75. The third group of measures aims to provide a range of instruments that are more responsive to the varied nature and needs of operations. Depending on the type of operations, ADB works with different sets of partners: national or local governments, or state-owned, newly privatized, private, non-profit, or non-governmental entities. This section describes instruments to be enhanced or introduced, based on requests made during the country consultations. The list also includes IEI instruments being pilot-tested.

a. Partnering with the Government

76. **Improving Policies and Regulatory Framework.** Program loans support reforms and improvements in the investment climate. In 2006, ADB will examine its program lending policy and program loan instrument, with a particular emphasis on the issue of loan conditionalities.

77. **Building Institutions and Systems.** Effective reforms also require solid policy analysis, institution and capacity building. Enhancements in the TA cluster instrument are proposed under the TA reform agenda to encourage medium-term, flexible and result-oriented services to permit timely and relevant use of technical advice.

78. **Taking a more programmatic approach toward the investment needs of clients.** Through a more programmatic approach, ADB aims to increase its productivity, provide critical mass and continuity and improve quality (through greater attention to implementation and policy dialogue, instead of focusing on repetitive processing tasks). These objectives are addressed under the new Multitranches Financing Facility (MFF). The concept (currently piloted under the IEI) calls for the establishment of a debt financing facility to target (i) discrete, sequential components of large stand alone projects, (ii) slices (or tranches) of sector investment programs over a longer time frame than the current norm, (iii) financial intermediary credit lines, and (iv) guarantees. The MFF facility incorporates features of sector and cluster loans, although with the client and ADB adhering to sounder cash and balance sheet principles.

79. **Protecting Public Goods and Social Services.** Public goods (e.g., environment) and social services involve multiple stakeholders (i.e., local governments, communities, NGOs, bilateral and multilateral agencies) and sector or program-based approach. Possible enhancements of project and sector loan modalities will be considered with a view to permit (i) disbursement through national and local budget for agreed purposes, programs, and

expenditure items; (ii) small-scale pilot-testing to be followed by full-fledged implementation; and (iii) a simple process for engaging NGOs and civil society in implementation. The possibility of introducing softer or blended loans will also be discussed.

80. **Addressing Crises Situations.** A series of recent unprecedented crises showed that readily available sets of financing arrangements for different types of crises situations are needed. Flexible processes for fast reallocation of resources from the existing portfolio are also under consideration.

81. **Fostering Regional Cooperation.** Regional and transborder investments are likely to grow in OCR operations to address common challenges and regional public goods. Given the difficulty of attributing costs and benefits to participating countries, the possibility of creating new and innovative financial arrangements and operational modalities more suitable for transborder operations will be explored.

b. Partner with Subsovereign and Nonsovereign and Private Entities

82. **Direct Lending to Subsovereign and Nonsovereign Entities.** The subsovereign and nonsovereign public sector financing facility (approved on a pilot basis under the IEI) permits ADB to provide loans directly to state-owned enterprises and local governments without guarantee of the national government.

83. **Reducing Currency Mismatch.** Local currency lending (approved on a pilot basis under the IEI) can help minimize currency mismatches between the borrowing and income streams, an important requirement for municipalities, state-owned, and private enterprises.

84. **Mobilizing Commercial Investors and Operators.** Besides providing direct loans and equity, risk mitigation through guarantee instruments can mobilize additional financing from commercial investors and operators. Possible enhancements to the guarantee policy are currently under consideration.

4. Adopt Supportive Operations Planning and Monitoring

85. The last group of measures aims to improve operations planning, management and monitoring practices which are needed to support the first three groups of measures. This group of measures is expected to result in more country and result-focused operations management.

86. **Business and Resource Cycle, Planning and Management.** Three-year allocation of TA resources is being considered to permit greater flexibility for DMCs and operations units to plan and distribute TA activities over the medium term. This will ease the alignment of programming and processing activities with the countries' planning, administrative, and fiscal calendars.

87. **Operations Monitoring.** To measure the responsiveness and effectiveness of OCR operations, a broader range of indicators are being proposed covering: (i) new commitments, (ii) loan signing and effectiveness, (iii) disbursement (volume and ratio), (iv) implementation progress, (v) degree of support to at-risk projects, (vi) outstanding loans, and (vii) repayment. These need to be complemented by more rigorous and systematic country portfolio reviews, regular and mid-term reviews of individual programs and projects, and their timely evaluation, all of which are important means to monitor operations progress and outcomes.

88. **Address Resource Implications.** Updated policies, guidelines, and initiatives do imply startup costs to coordination units, administrative and information technology units, and most important, operational units. Gradual applications of the proposed measures are proposed over a period of three years, starting with carefully managed and monitored pilot-testing in a selected number of countries. Appendix 1 provides an overview and timetable of the proposed activities. The proposed gradual approach seeks to minimize resource intensity, and allow for corrective measures, and more manageable implementation of activities and initiatives. This process will also provide a more reliable basis for realistic resource estimates for expanded applications, and, in turn, will increase the probability of positive outcomes to OCR client countries

89. **Monitor the Progress.** A broad provisional results framework is provided in Appendix 2. More detailed results framework will have to be developed in due course for each of the proposed initiatives and will have to be monitored separately. To do so, supportive information system will be required to permit timely processing and analysis of operations and administrative data. These foundations are needed for more objective monitoring and analysis of operations unit costs, resource allocations, and deployments.

V. CONCLUSION AND NEXT STEPS

90. This paper synthesized key findings from a review of OCR operations and provided a broad framework of proposed measures to enhance ADB support to MIC and OCR borrowers. Based on the feedback received during the consultation meeting, the paper will be finalized and presented to the ADB Board of Directors for endorsement. The outputs of the consultations will also be reflected in a MDB's joint paper on a broader "New partnership for MICs" which will be discussed with bilateral partners at a meeting to be held in the third quarter of 2006, prior to the WB annual meeting. Meanwhile work on specific items and/or measures will continue in parallel as stipulated in Appendix 1.

Appendix 1: Overview and Timetable of Proposed Activities

KEY RESULT AREA/MEASURES	PROPOSED ACTIVITIES	DEPARTMENT RESPONSIBLE	STATUS/REMARKS
1. Reduce the Costs of Doing Business with ADB			
A. Simplify ADB Commitment Fee Structure	a. Proposal for simplifying commitment fee structure	TD	<ul style="list-style-type: none"> To be presented to Management and the Board of Directors for approval in IIQ2006
	b. Review of LIBOR-based loan product	TD	<ul style="list-style-type: none"> To be undertaken in 2006.
B. Introduce greater flexibility in ADB programming cycle	a. CSP reform process	SPD	<ul style="list-style-type: none"> For completion in 2006.
	b. Pilot-Testing of Country Partnership Framework (CPF)	MKRD	<ul style="list-style-type: none"> Concept to be pilot-tested in TRM/MKRD in 2006. Work in Progress.
	c. Application of CPF to other countries	ADB-wide	<ul style="list-style-type: none"> For further discussion.
C. Delegate operational policies and decisions	a. RM policy review	BPMSD/SPD	<ul style="list-style-type: none"> Review to start in IQ 2006. To be completed in 2007.
	b. Reorganization of RSDD	RSDD	<ul style="list-style-type: none"> Approved in September 2005.
D. Consolidate and streamline operational policies, strategies and guidelines	a. Increasing ICB threshold	COSO	<ul style="list-style-type: none"> Approved in October 2004.
	b. Transferring of some responsibilities for processing of consultant contract variations to user departments	COSO	<ul style="list-style-type: none"> Approved in October 2004.
	c. Cost sharing and eligibility of expenditures	RSDD, IEI	<ul style="list-style-type: none"> Approved in August 2005.
	d. Procurement guidelines	COSO	<ul style="list-style-type: none"> Approved in February 2006. To take effect in April 2006
	e. Consulting Services	COSO	<ul style="list-style-type: none"> Approved in February 2006. To take effect in April 2006
	f. Supplementary financing	SPD	<ul style="list-style-type: none"> Revised policy approved in November 2005.
	g. Environment and Safeguard Policy	RSDD	<ul style="list-style-type: none"> Revised policy expected to be submitted for Board approval in IIIQ 2007.

KEY RESULT AREA/MEASURES	PROPOSED ACTIVITIES	DEPARTMENT RESPONSIBLE	STATUS/REMARKS
	h. Credit enhancement and guarantee policy	OCO	<ul style="list-style-type: none"> Revised policy expected to be submitted for Board approval in IIQ 2006.
	i. Reclassification and retirement of thematic and sector policies	RSDD	<ul style="list-style-type: none"> Ongoing.
	j. Disbursement guidelines	CTL	<ul style="list-style-type: none"> Revised Handbook to be issued by end 2006.
D. Streamline business process	a. Change proposals on CSP and Business process	SPD	<ul style="list-style-type: none"> Informal Board seminar expected during IQ 2006 for change proposals on CSP. Further details on timeframe to be determined after Board seminar.
	b. Application of the streamlined business process	RDs	<ul style="list-style-type: none"> To follow in due course.
2. Enhance Service Quality			
A. Build Staff Capacity	a. HR strategy	BPMSD	<ul style="list-style-type: none"> New HR strategy approved in September 2004.
	b. PDP Implementation	BPMSD and RDs	<ul style="list-style-type: none"> Approved in September 2004 as part of HR strategy. Implementation ongoing. First yearly cycle to be completed by IQ 2006.
	c. Staff skill inventory	BPMSD	<ul style="list-style-type: none"> To be completed by IQ 2006.
	d. Staff skills mix action plan	BPMSD	<ul style="list-style-type: none"> To be finalized in IIQ 2006.
	e. Enhanced separation program approved		<ul style="list-style-type: none"> Board paper approved in May 2005. Implementation proceeding on schedule. Expected date of completion: 30 June 2006.

KEY RESULT AREA/MEASURES	PROPOSED ACTIVITIES	DEPARTMENT RESPONSIBLE	STATUS/REMARKS
	f. Staff development program	BPMSD and RDs	<ul style="list-style-type: none"> • Full review of all learning and development activities bank-wide completed in 2005. • New learning and development unit created in October 2005. • Revamped learning program put in place for 2006.
	a. Private sector development	Task Force	<ul style="list-style-type: none"> • Board information paper circulated in February 2006.
	b. Mainstreaming regional cooperation	OREI, MKRD	<ul style="list-style-type: none"> • New ADB strategy to be presented to Board for discussion in April 2006.
	a. Country Surveys and Consultations	SPD, RDs, TD	<ul style="list-style-type: none"> • For MICs exercise, questionnaire survey for DMCs were conducted in June 2004, and country consultation missions were held in PRC, IND, PAK, PHI and INO during the last quarter of 2004 and early 2005. Joint ADB-WB regional consultations with Asian MICs in Manila in April 2006 .
	b. Regular client surveys	SPD, DER	<ul style="list-style-type: none"> • ADB perception surveys to be launched IQ2006. Surveys to poll 700 stakeholders and opinion leaders in 24 countries. Results expected by end IIQ 2006. Surveys to be repeated every 3 years.
3. Expand and Enhance Partnership Instruments			
A. Introduce new instruments	a. Local currency financing	TD	<ul style="list-style-type: none"> • Board paper approved in August 2005. To be implemented on a pilot-basis for an initial period of 3 years.
	b. Sub-sovereign lending	RSDD, IEI	<ul style="list-style-type: none"> • Board paper approved in August 2005. To be implemented a pilot-basis for an initial period of 3 years.
	c. Multi tranche facility	RSDD, IEI	<ul style="list-style-type: none"> • Board paper approved in August 2005 To be implemented on a pilot-basis for an initial period of 3 years.

KEY RESULT AREA/MEASURES	PROPOSED ACTIVITIES	DEPARTMENT RESPONSIBLE	STATUS/REMARKS
	d. CDM facility	RSDD, IEI	<ul style="list-style-type: none"> • Concept approved in November 2005. Consultation process with various stakeholders to be completed within the first half of 2006. Initial launch planned within 2006.
	e. Public goods and Social Investment Facility	SPD, TD	<ul style="list-style-type: none"> • For further discussion.
B. Improve existing instruments	a. Cluster TA Facility	SPD	<p>To be covered under TA Reform Agenda:</p> <ul style="list-style-type: none"> • Informal Board seminar planned for April 2006 • Board circulation expected by IIIQ 2006.
	b. Program lending	SPD	<ul style="list-style-type: none"> • Background study expected to be completed during the first half of 2006. Further work will depend on the results/decisions taken on the initial study.
	c. Emergency response facility	RSDD, TD	<ul style="list-style-type: none"> • For further discussion.
4. Adopt supportive processes for planning and progress monitoring			
A. Multi-year resource planning	a. TA reform	SPD	<ul style="list-style-type: none"> • Informal Board seminar planned for April 2006. Board circulation expected by IIIQ 2006.
	b. Review of country planning cycles	SPD	<ul style="list-style-type: none"> • To be covered under WPBF process review. SEC-M paper to be presented to Management and the Board of Directors in IIIQ2006.
	c. System for multi-year PF	SPD, TD	

KEY RESULT AREA/MEASURES	PROPOSED ACTIVITIES	DEPARTMENT RESPONSIBLE	STATUS/REMARKS
B. Operational performance and monitoring indicators	a. MfDR	SPD, COSO, TD, CTL, BPMSD	<ul style="list-style-type: none"> • Strategy and action plan to be developed by SPD in consultation with concerned departments/offices in the first half of 2006.

Appendix 2: Provisional Results Framework

Key Results Area	Outputs and/or Outcomes	Key Indicators	Source of Information	Who Monitors	Remarks
1. Cost of doing business with ADB reduced	1. Commitment fee structure simplified and/or reduced	Client satisfaction	Board paper Project document Client feedback	TD; RDs	
	2. Duration of country partnership strategy formulation shortened	Number (no.) of months from CPF initiation to finalization	CPF	RMT; SPD	Targets to be established with each client county at the outset
	3. Project preparation and processing time reduced	No. of months from start of design to effectiveness of new loans	PPIS	RMT; SPD	Targets to be established for each activity within CPF or at the outset of each activity
	4. Timely actions and support to project implementation	No. of days for <ul style="list-style-type: none"> • Consultant fielding for TA and loans • Procurement • Responses to queries • Resolving implementation issues 	CRAM;ICS PCMS PPR	RMT; COSO	Systematic analysis requires automated data processing/reporting system to consolidate data across various data systems within ADB
	5. Schedules of key discussions, missions, and milestones are synchronized with DMC's administrative and political cycles				
		Client satisfaction	Client surveys	RMT; SPD	

BPMSD = Budget, Personnel and Management Services Department, CDM = clean development mechanism, COSO = Central Operations Services Office, CPF = country partnership framework, DER= Department of External Relations, HR = Human resources, ICB = international competitive bidding, IEI = innovation and efficiency initiative, IPF= indicative planning figures, MfDR = Managing for Development Results, MKRD = Mekong Department, NBP = new business processes, OCR = ordinary capital resources, OREI = Office of Regional Economic Integration, RM = resident mission, RSDD = Regional and Sustainable Development Department, SPD = Strategy and Policy Department, TA = technical assistance, TD = Treasurer's Department.
Source: ADB. Strategy and Policy Department.

2. Cost of doing business with ADB reduced	6. Commitment fee structure simplified and/or reduced	Client satisfaction	Board paper Project document Client feedback	TD; RDs	
	7. Duration of country partnership strategy formulation shortened	Number (no.) of months from CPF initiation to finalization	CPF	RMT; SPD	Targets to be established with each client county at the outset
	8. Project preparation and processing time reduced	No. of months from start of design to effectiveness of new loans	PPIS	RMT; SPD	Targets to be established for each activity within CPF or at the outset of each activity
	9. Timely actions and support to project implementation	No. of days for <ul style="list-style-type: none"> • Consultant fielding for TA and loans • Procurement • Responses to queries • Resolving implementation issues 	CRAM;ICS PCMS	RMT; COSO	Systematic analysis requires automated data processing/reporting system to consolidate data across various data systems within ADB
	10. Schedules of key discussions, missions, and milestones are synchronized with DMC's administrative and political cycles			PPR	
		Client satisfaction	Client surveys	RMT; SPD	

<p>3. Quality of ADB services improved</p>	<p>1. Staff has solid country knowledge and relevant sector expertise</p> <p>2. Stable assignment of country and project teams to country operations.</p> <p>3. Simple and realistic project design</p>	<p>Staff profiles and skills inventory</p> <p>Client satisfaction</p>	<p>HR information system</p> <p>Client surveys</p> <p>Project document</p> <p>Project administration memorandum</p>	<p>BPMSD</p> <p>SPD; DER</p> <p>RMT; SPD</p>	
<p>4. Modalities and instruments are made relevant to the operational nature and responsive to the key partner</p>	<p>ADB has operationalized and client countries are satisfied with enhanced/newly introduced</p> <ul style="list-style-type: none"> • Investment loan modalities • Program loan modalities • TA cluster • IEI instruments • CDM facility 	<p>No. of new or enhanced instruments offered</p> <p>No. of new or enhanced instruments used</p> <p>Client satisfaction on the modalities/instruments offered</p>	<p>Board documents</p> <p>PPIS</p> <p>Client surveys</p>	<p>SPD</p> <p>SPD; DER</p>	