

ASIAN DEVELOPMENT BANK

REVIEW OF COST-SHARING LIMITS FOR PROJECT FINANCING AS AN ELEMENT OF ADB'S 1998 GRADUATION POLICY

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ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
DMC	–	developing member country
EBRD	–	European Bank for Reconstruction and Development
FSM	–	Federated States of Micronesia
GNP	–	gross national product
IDA	–	International Development Association
IADB	–	Inter-American Development Bank
IBRD	–	International Bank for Reconstruction and Development
IMF	–	International Monetary Fund
LTSF	–	long-term strategic framework
MDB	–	multilateral development bank
OCR	–	ordinary capital resources
PNG	–	Papua New Guinea
PRC	–	People's Republic of China

NOTE

In this report, \$ refers to US dollars

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I. INTRODUCTION

1. In December 1998, the Board of Directors of the Asian Development Bank (ADB) approved the policy paper, *A Graduation Policy for the Bank's Developing Member Countries*.¹ The 1998 graduation policy included provisions on cost-sharing limits for loan and Technical Assistance operations. The cost-sharing limits refer to the maximum proportion of project costs that ADB may normally finance, which is determined by the classification or country grouping of each developing member country (DMC).

2. This paper focuses on ADB's cost-sharing limits for project loans, taking into consideration similar policies and practices of other multilateral development banks (MDBs). Section II presents the need to review ADB's cost sharing limits. Section III reviews other MDBs' policies on cost-sharing limits that would provide a useful benchmark for determining appropriate cost-sharing limits for ADB. Section IV proposes an upward revision of the cost-sharing limits within the framework of the 1998 graduation policy. Section V contains conclusions and recommendations for the Board's approval.

II. REVIEW OF ADB'S COST-SHARING LIMITS

A. Cost-Sharing Limits under the 1998 Graduation Policy

3. According to ADB's 1998 graduation policy, the maximum proportion of project costs that ADB may normally finance is determined by a DMC's country grouping. ADB's cost-sharing is the ratio of ADB's financing to total project cost inclusive of taxes and duties. The 1998 paper stated that "these limits are not to be applied mechanically, but are to be based on a DMC's performance in domestic resource mobilization, the balance-of-payments situation, and any special circumstances that may prevail. These criteria relate to the economic strength of a DMC, the same principle on which assessment of debt repayment capacity is based." Therefore, the 1998 graduation policy proposed that, in general, country classification should be used when applying cost-sharing limits. The 1998 graduation policy proposed that the existing cost-sharing limits 80% for Group A (ADF [Asian Development Fund]-only), 60% for Group B (ADF-OCR [ordinary capital resources] blend), and 40% for Group C (OCR-only) be retained with modification that a ceiling of 70% be applied to Group B1 (ADF with limited OCR), i.e., if a country graduates from Group A to Group B1, it will also graduate from an 80% cost-sharing limit to a 70% limit.² The 60% cost-sharing limit will apply to Group B2 (OCR with limited ADF). The lower ceilings for countries that are reclassified will be effected in a phased manner, with 5 percentage points reduction per year. Under exceptional circumstances and where justified on country and project considerations, ADB financing may exceed the normal cost-sharing limit. With the approval of the 1998 graduation policy, project cost-sharing limits were well established as an integral part of the graduation framework.

B. DMCs' Graduation Process and Corresponding Changes of Cost-Sharing Limits

4. The 1998 paper introduced a systematic approach for applying the two criteria, i.e., per capita GNP and debt repayment capacity, for the purpose of country classification. The 1998 paper observed that, prior to the introduction of this system, countries had remained in the groups to which they were originally assigned since 1977.³ The 1998 paper set up a graduation

¹ ADB. 1998. *A Graduation Policy for the Bank's Developing Member Countries*. Manila.

² Group B (ADF-OCR blend) was split into two groups: ADF with limited OCR (B1) and OCR with limited ADF (B2) under the 1998 graduation policy.

³ ADB. 1977. *A Review of Criteria for Lending from Asian Development Fund*. Manila.

process that generally would allow graduation to take place from Group A to Group B1, Group B1 to Group B2, Group B2 to Group C, and graduation from regular ADB assistance. The 1998 paper noted that there would be changes in project cost-sharing limits for the following graduating DMCs: (i) for Bangladesh, Cook Islands, Marshall Islands, the Federated States of Micronesia (FSM), Pakistan, Sri Lanka, Tonga, and Viet Nam, the limit will fall from 80% to 70%; (ii) for the People's Republic of China (PRC) and India, the limit will fall from 80% to 60%; (iii) for Philippines, Thailand, and Uzbekistan, the limit will fall from 60% to 40%; and (iv) for Kazakhstan from 80% to 40%. The prevailing cost-sharing limits prior to the 1998 paper were introduced in 1983.⁴ Under the 1998 graduation framework, four DMCs, Hong Kong, China; the Republic of Korea; Singapore; and Taipei, China; graduated from regular ADB assistance.

C. Changes in the Cost-Sharing Limits: Impact on ADB's Operations

5. It is noted that the 1998 paper brought ADB's country classification system largely in line with that of the World Bank. However, the cost-sharing limits particularly for Group B2 and Group C countries have fallen significantly below that of the World Bank (see Table 2). ADB's stringent cost-sharing limits constrains ADB's country programming and project processing, as well as project implementation (for example, a government under current and midium-term budgetary constraints naturally has an incentive to process or implement a project that requires less counterpart financing). This puts ADB's operations at a disadvantage in serving the needs of its DMCs. It is observed that since 1999, there has been a large number of projects that sought the Board's approval on an exception basis to exceed the cost-sharing limits.⁵

6. The current Group C countries include Fiji Islands; Kazakhstan; Malaysia; Philippines; Thailand; and Uzbekistan. The per capita GNPs of these countries were in 1998 and continue to be much lower than the graduation trigger level of \$5,445 at 1997 prices. Their general economic development level and debt repayment capacity were weaker than those of the four graduating DMCs when the 40% limit was applied to them prior to 1998. Malaysia, Philippines, and Thailand were hard hit by the Asian financial crisis; Kazakhstan and Uzbekistan were hit by the Russian financial crisis. These countries are still recovering from the crises or constrained by strict fiscal positions even for financing national development. The Asian Development Outlook 2002 Update noted that "over the last several years, particularly in East Asia and Southeast Asia, there has been a general tendency toward deteriorating fiscal balances. Rising public debt obligations have accompanied the increased tendency toward deficits."⁶ Consequently, for development financing, the 40% cost-sharing limit puts an undue fiscal burden on these DMCs. Indonesia was a blend borrower prior to the 1998 graduation policy. However, it is well known that the country was severely affected by the Asian financial crisis, with its per capita GNP reduced from \$1,110 in 1998 (at 1997 prices) to \$680 in 2002 (at 2001 prices) and its debt repayment capacity drastically weakened. Similarly, the 60% cost-sharing limit also puts an undue fiscal burden on this country.

D. Evolving Development Agenda and ADB's Portfolio

7. Poverty reduction was declared the overarching goal of ADB in 1999, and ADB's Board approved the poverty reduction strategy later that year.⁷ In March 2001, the ADB Board

⁴ ADB. 1983. *A Review of Lending Foreign Exchange for Local Currency Expenditures on Projects*. Manila.

⁵ Since 1999, 17 project loans were approved by the Board on an exception basis for a higher cost-sharing percentage.

⁶ Source: ADB. 2002. *Asian Development Outlook 2002 Update*. Manila.

⁷ ADB. 1999. *Fighting Poverty in Asia and the Pacific, The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

endorsed the long-term strategic framework (LTSF) of the Asian Development Bank (2001–2015), *Moving the Poverty Reduction Agenda Forward in Asia and the Pacific*.⁸ The LTSF is intended to realize a new vision and mission of ADB.⁹ ADB's operations have been gradually moving from concentration in traditional project financing such as physical infrastructure projects, to a more diversified portfolio with strong emphasis on poverty reduction and social development. These areas of investment often have lower financial rates of returns and higher levels of local currency expenditures, which taken together can put undue pressure on governments' short- and medium-term fiscal positions. In this context, ADB needs to be ready to provide a higher share of financing for poverty reduction and social development projects.

E. Refinement Needed to the 1998 Graduation Policy

8. Against this varied background, it is considered necessary and relevant to review the cost-sharing limits under the 1998 graduation policy, taking into consideration similar policies and practices of other MDBs that provide a useful benchmark for determining appropriate cost-sharing limits for ADB.¹⁰

9. It is worth noting that this paper is concerned only with proposed changes to cost-sharing limits for project financing (i.e., only changes in the percentage points for Group B1, Group B2, and Group C countries). All other elements of the existing graduation policy framework are retained. In this context and as per current policy, under exceptional circumstances and where justified on country and project grounds, ADB financing may also exceed the normal cost-sharing limit. A revision of the cost-sharing limits under the graduation framework is to bring ADB's cost-sharing limits in alignment with the level of development in DMCs and with practices of other MDBs.¹¹

III. OTHER MDBs' POLICIES ON COST-SHARING LIMITS

A. The World Bank's Policies on Cost-Sharing Limits

10. Based on the World Bank Operational Manual, Operational Policies OP6.30 and Bank Procedures BP6.30, the World Bank sets cost-sharing ceilings for all its borrowers, including countries eligible for foreign exchange financing only. A country's cost-sharing limit is a function of its ability to mobilize domestic and foreign financial resources and thus is based on its per capita income.

⁸ ADB. 2001. *Moving the Poverty Reduction Agenda Forward in Asia and the Pacific*. Manila.

⁹ Following the approval of ADB's long-term strategic framework in 2001, ADB's core strategic agenda, consonant with the poverty reduction strategy, is sustainable economic growth, inclusive social development, and governance for effective policies and institutions, which will be complemented by three crosscutting themes: promoting the role of the private sector in development, supporting regional cooperation and integration for development, and addressing environmental sustainability.

¹⁰ The Development Committee Communique dated 28 September 2002 stated that "[w]e recognized the need for intensified efforts to harmonize operational policies and procedures of bilateral and multilateral agencies at the institutional and country levels so as to enhance aid effectiveness and efficiency and promote greater ownership by developing countries." Source: Development Committee. 2002. *Development Committee Communique*. Washington D.C..

¹¹ A change in cost-sharing limits for project financing is not directly related to planned level of lending in a DMC. ADB's lending level to a DMC is generally determined by ADB's country strategy and program to the DMC approved by the Board. Decisions on individual project financing by ADB are taken subsequently, within a resource planning framework endorsed by the Management and approved by the Board.

11. The uniform cost-sharing limits applicable to all countries with each of income groups¹² are presented in Table 1.

Table 1: The World Bank Uniform Cost-Sharing Limits

Per Capita Income Group	Per Capita Income (\$)	Cost-Sharing limit (%)
Categories I and II, IDA only	Up to 1,435	90
Categories I and II, IBRD and Blend	Up to 1,435	75
Categories III and IV	1,436-5,185	60
Category V	Over 5,185	50

IBRD = International Bank for Reconstruction Development, IDA = International Development Association.

Source: The World Bank. 2002, 15 August. Operational Manual. BP 6.30. Available: <http://wbln0018.worldbank.org>.

12. Unlike the cost-sharing limits of ADB, those of the World Bank are applicable not to individual projects but to the World Bank's overall lending program for a country (excluding financial intermediary, supplemental, emergency recovery, adjustment, and technical assistance loans). The country limit is applied to a rolling 3-year investment lending program, encompassing 2 prior years and the current year. The World Bank's cost-sharing is the ratio of loan to total project cost net of taxes and duties. The regional vice president establishes country cost-sharing limits on the basis of the income group limits. The country department documents the "country limit" in the country strategy paper. Within the country limits, the country department director determines cost-sharing for individual projects. The country department director may make exceptions to the borrower's minimum 10% cost-sharing for individual projects and may permit cofinancing to substitute for the borrower's contribution. The regional vice president may also approve a temporary increase in the cost-sharing limit for an individual country whose resource situation has become fundamentally more constrained in recent years or whose external situation has deteriorated sharply. Changes in country cost-sharing limits on grounds that are not temporary may be made only with the approval of the Office of the President.

B. The EBRD's Policies on Cost-Sharing Limits

13. The European Bank for Reconstruction and Development (EBRD) has no formal policy on cost-sharing in public sector lending operations, except that EBRD does not finance tax and duty components of projects. As a matter of practice, EBRD sometimes asks its borrowers to fund components that may be best sourced from domestic markets with local currency. Similarly, EBRD often seeks cofinancing from other international finance institutions.

C. The IADB's Policies on Cost-Sharing Limits

14. Inter-American Development Bank (IADB) groups its borrowing member countries on the basis of their relative level of development within the region. Group A contains the more advanced countries, including Argentina, Brazil, Mexico, and Venezuela. Group B contains middle developing countries, including Chile, Colombia, and Peru. Group C contains countries

¹² Income groups of countries are set forth in Annex D of OP 3.10, the World Bank. Available: <http://www1.worldbank.org>.

with insufficient markets, including the Bahamas, Barbados, Costa Rica, Jamaica, Panama, Suriname, Trinidad and Tobago, and Uruguay. Group D contains “the least-developed countries,” including Belize, Bolivia, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Nicaragua, and Paraguay.

15. The percentage of the total cost of a project to be financed in foreign exchange that will apply during the period of the Eighth Replenishment Resources are a maximum of 50% for Group A countries, 60% for Group B countries, 70% for Group C countries, and maximum 80% for Group D countries.

16. The percentage may be higher under special circumstances. On the request of the borrower, the levels of financing prescribed for different country groups may be increased by 10 percentage points for poverty-reduction projects, in accordance with the following criteria: (i) the project or program must be geographically targeted to poor beneficiaries, or (ii) a significant majority of the beneficiaries of the project or program are poor. In the case of projects that include cofinancing, such financing may be considered as part of the local contribution. IADB's cost-sharing is the ratio of loan to total project cost inclusive of taxes and duties.

D. A Comparison of Cost-Sharing Limits of ADB, IADB, and the World Bank

17. A list of ADB's borrowers and their cost-sharing limits as per the policies of the ADB and World Bank, are presented in Table 2. A comparison of the IADB's and the World Bank's cost-sharing limits are presented in Table 3. The main conclusions that may be drawn from those comparisons are presented below.

18. On a net of taxes and duties basis, the country cost-sharing limits in the World Bank are higher than the project cost-sharing limits in ADB for all borrowers in Group B2 and Group C categories, and the differences are quite significant for borrowers in Group C category.

19. The World Bank policies on cost-sharing limits are determined largely on per capita income basis (for countries in categories I and II, they were divided into two groups, by IDA-only and the rest) and are on an exclusive of taxes and duties basis.

20. On a net of taxes and duties basis, the project cost-sharing limits in IADB are generally higher than the country cost-sharing limits in the World Bank for individual countries. The IADB's cost-sharing limits are higher than those of the World Bank in IADB's Group B, Group C, and Group D categories, except four countries in the IADB's Group D category where there is basically no difference in cost-sharing limits between the IADB and the World Bank. The differences are very significant for borrowers in IADB's Group C and Group D categories (except the four countries mentioned above). It is further noted that, if per capita GNP is used as an indicator of economic development level, many IADB borrowers are at a relatively higher development level than many DMCs in the Asia and Pacific region. However, the cost-sharing limits of IADB and the World Bank are still quite substantial in these countries with relatively high per capita GNPs and are higher than the cost-sharing limit of borrowers in ADB's group C category.

Table 2: Cost-Sharing Limits of ADB and the World Bank

ADB Borrowers, ^a	Per Capita Income (\$)	Cost-Sharing Limits in ADB, Project Basis, per Graduation Policy (%)	Cost-Sharing Limits in ADB, Project Basis, Net of Taxes and Duties ^b (%)	Cost-Sharing Limits in the World Bank, Country Basis (%)
Group A				
Afghanistan	-	80	89	90
Bhutan	640	80	89	90
Cambodia	270	80	89	90
Kiribati	830	80	89	90
Kyrgyz Rep	280	80	89	90
Lao PDR	310	80	89	90
Maldives	2,040	80	89	60
Mongolia	400	80	89	90
Myanmar	-	80	89	90
Nepal	240	80	89	90
Samoa	1,520	80	89	60
Solomon Is.	580	80	89	90
Tajikistan	160	80	89	90
Vanuatu	1,050	80	89	90
Group B1				
Azerbaijan	650	70	78	75
Bangladesh	370	70	78	90
Marshall Islands	2,190	70	78	60
FSM	2,150	70	78	60
Pakistan	420	70	78	75
Sri Lanka	830	70	78	90
Tonga	1,530	70	78	60
Viet Nam	410	70	78	90
Group B2				
PRC	890	60	67	75
India	460	60	67	75
Indonesia	680	60	67	75
PNG	580	66	67	75
Group C				
Fiji Islands	2,130	40	44	60
Kazakhstan	1,360	40	44	75
Malaysia	3,640	40	44	60
Philippines	1,050	40	44	75
Thailand	1,970	40	44	60
Turkmenistan	950	40	44	75
Uzbekistan	560	40	44	75
Graduate				
Korea, Republic of	9,400	-	-	50

^a Hong Kong, China; Cook Islands; Nauru; Singapore; Taipei, China; and Tuvalu are not included. Cook Islands; Nauru; and Tuvalu are not members of the World Bank.

^b Assuming that taxes and duties average to 10% of total project cost based on data collected from ADB projects approved in 2000 and 2001. A higher percentage of taxes and duties would correspond to a higher cost-sharing limit on a net of taxes and duties basis, and vice versa.

Source: The World Bank. 2002, 15 August. *Operational Policies. OP3.10, Annex D*. Available: <http://www1.worldbank.org>.

Table 3: Cost-Sharing Limits of IADB and the World Bank

IADB Borrowers ^a	Per Capita Income (\$)	Cost-Sharing Limits in IADB, Project Basis ^b (%)	Cost-Sharing Limits in IADB, Project Basis, Net of Taxes and Duties ^c (%)	Cost-Sharing Limits in World Bank, Country Basis (%)
Group A				
Argentina	6,960	50	56	50
Brazil	3,070	50	56	60
Mexico	5,540	50	56	50
Venezuela	4,760	50	56	60
Group B				
Chile	4,350	60	67	60
Colombia	1,910	60	67	60
Peru	2,000	60	67	60
Group C				
Costa Rica	3,930	70	78	60
Jamaica	2,700	70	78	60
Panama	3,290	70	78	60
Suriname	1,690	70	78	60
Trinidad and T.	5,540	70	78	50
Uruguay	5,670	70	78	50
Group D				
Belize	2,910	80	89	60
Bolivia	940	80	89	75
Dominican R.	2,230	80	89	60
Ecuador	1,240	80	89	75
El Salvador	2,050	80	89	60
Guatemala	1,670	80	89	60
Guyana	840	80	89	90
Haiti	480	80	89	90
Honduras	890	80	89	90
Nicaragua	-	80	89	90
Paraguay	1,300	80	89	60

^a Bahamas and Barbados are not members of the World Bank and are not included.

^b On the request of the borrower, the levels of financing prescribed for different country groups may be increased by 10 percentage points for poverty-reduction projects.

^c Assuming that taxes and duties average to 10% of total project cost.

Source: The World Bank. 2002, 15 August. *Operational Policies. OP3.10, Annex D*. Available: <http://www1.worldbank.org>; IADB. 2002, 17 June. *OP-307, Amount of Loan in Foreign Exchange*. Available: <http://www.iadb.org>.

IV. PROPOSED REVISION OF COST-SHARING LIMITS

A. Rationale for Revision of Cost-Sharing Limits

21. It has been noted that there are large differences in cost-sharing limits for Group B2 and Group C countries between ADB and the World Bank. The stringent cost-sharing limits of ADB in these countries have put ADB's operations at a disadvantage in serving the needs of its DMCs. Given its mandate, the World Bank has a full and comprehensive understanding of the macroeconomic and fiscal positions of DMCs and how these may impact a DMC's public expenditure management for development finance. In this context, there are no apparent reasons for such a significant gap in cost-sharing limits between ADB and the World Bank for Group B2 and Group C borrowers.

22. Many DMCs in Group C (and including Indonesia in Group B2) were hard hit by the Asian financial crisis or the Russian financial crisis and are still recovering from the crises. These economies remain weaker than the economies that were formerly classified as Group C, particularly the four graduate economies. It is noted that these economies are constrained by strict fiscal positions over the last several years.

23. Furthermore, the existing cost-sharing limits were basically inherited from the cost-sharing ceilings introduced in 1983. However, over the past two decades, ADB's operations have changed gradually, with increased emphasis on poverty reduction and social development, and, poverty reduction was declared ADB's overarching goal in 1999. Since poverty reduction and social development projects normally have lower financial rates of returns and higher levels of local currency expenditures than other projects, which taken together can put undue pressure on governments' short- and medium-term fiscal positions, ADB needs to be ready to provide a higher share of financing for poverty reduction projects.

24. Thus, ADB needs to revise upward its cost-sharing limits, taking into consideration similar policies and practices of other MDBs.

B. The Proposed Revision

25. It is proposed that ADB's policy on cost-sharing limits be adjusted upward in the context of existing policy, to be generally in alignment with the World Bank's nominal cost-sharing limits, as shown in Table 4.

Table 4: Proposed Cost-Sharing Limits of ADB

Per Capita Income Group	Cost-Sharing Limit (%)
Group A	80
Group B1	75
Group B2	70
Group C	65

26. It is worth noting that there is no change of cost-sharing limit for Group A countries. Except the only changes in percentage points of cost-sharing limits for Group B1, Group B2, and Group C countries, the existing policy framework, including graduation policy, relating to cost-sharing limits for project financing is retained. As per current policy, under exceptional circumstances and where justified on country and project grounds, ADB financing may also exceed the normal cost-sharing limit.

C. Comparison of the Revised Cost-Sharing Limits with Those of the World Bank

27. Table 5 compares the proposed cost-sharing limits (revised) with those of the World Bank (current).

28. The revised cost-sharing limits will bring ADB's policies on cost-sharing limits in alignment with that of other MDBs and will require minimum changes of ADB's operational procedures.

Table 5: A Comparison of Cost-Sharing Limits of ADB and the World Bank

ADB Borrowers ^a	Per Capita Income (\$)	ADB Revised Cost-Sharing Limits, Project Basis (%)	ADB Revised Cost-Sharing Limits, Project Basis, Net of Taxes and Duties^b (%)	Cost-Sharing Limits in the World Bank, Country Basis (%)
Group A				
Afghanistan	-	80	89	90
Bhutan	640	80	89	90
Cambodia	270	80	89	90
Kiribati	830	80	89	90
Kyrgyz Rep	280	80	89	90
Lao PDR	310	80	89	90
Maldives	2,040	80	89	60
Mongolia	400	80	89	90
Myanmar	-	80	89	90
Nepal	240	80	89	90
Samoa	1,520	80	89	60
Solomon Is.	580	80	89	90
Tajikistan	160	80	89	90
Vanuatu	1,050	80	89	90
Group B1				
Azerbaijan	650	75	83	75
Bangladesh	370	75	83	90
Marshall Islands	2,190	75	83	60
FSM	2,150	75	83	60
Pakistan	420	75	83	75
Sri Lanka	830	75	83	90
Tonga	1,530	75	83	60
Viet Nam	410	75	83	90
Group B2				
PRC	890	70	78	75
India	460	70	78	75
Indonesia	680	70	78	75
PNG	580	70	78	75
Group C				
Fiji Islands	2,130	65	72	60
Kazakhstan	1,360	65	72	75
Malaysia	3,640	65	72	60
Philippines	1,050	65	72	75
Thailand	1,970	65	72	60
Turkmenistan	950	65	72	75
Uzbekistan	560	65	72	75
Graduate				
Korea, Republic of	9,400	-	-	50

^a Hong Kong, China; Cook Islands; Nauru; Singapore; Taipei, China; and Tuvalu are not included. Cook Islands; Nauru; and Tuvalu are not members of the World Bank.

^b Assuming that taxes and duties average to 10% of total project cost.

Source: The World Bank. 2002, 15 August. *Operational Policies. OP3.10, Annex D*. Available: <http://www1.worldbank.org>.

V. CONCLUSIONS AND RECOMMENDATIONS

29. ADB needs to revise upward its cost-sharing limits, taking into consideration similar policies and practices of other MDBs, because (i) many DMCs' in the Asia and Pacific region are still recovering from the Asian financial crisis or the Russian financial crisis and their economies are weaker than prior to the crises, particularly for some Group B2 and Group C countries, and these economies are constrained by tight fiscal positions; (ii) ADB's operations have changed, with increased emphasis on poverty reduction and social development;¹³ and (iii) there are large differences in cost-sharing limits for Group B2 and Group C countries between ADB and the World Bank.

30. Therefore, It is recommended that

- (i) ADB applies cost-sharing limits under the 1998 graduation policy as follows: a cost-sharing limit of 80% for Group A countries,¹⁴ 75% for Group B1 countries, 70% for Group B2 countries, and 65% for Group C countries;
- (ii) the above revised cost-sharing limits will take effective from 1 January 2003 and apply only to new project loans for which formal loan negotiations are completed on or after 1 January 2003.

¹³ Since poverty reduction and social development projects normally have lower financial rates of returns and higher levels of local currency expenditures than other projects, which taken together can put undue pressure on governments' short- and medium-term fiscal positions, ADB needs to be ready to provide a higher share of financing for poverty reduction projects.

¹⁴ As per the Board paper "Review of Afghanistan's Classification under ADB's Graduation Policy" dated 7 June 2002, the cost-sharing limit for loans and TA operations for Afghanistan is waived during the period of 2002–2004.