

**ASIAN DEVELOPMENT FUND (ADF)  
ADF VIII MIDTERM REVIEW MEETING  
Washington, D.C., 14-15 April 2003**

**IMPLEMENTATION OF ADF VIII: INTEGRATED REPORT**

**Fighting Poverty in Asia**

**Asian Development Bank  
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## ABBREVIATIONS

ADF	–	Asian Development Fund
CGA	–	country governance assessment
CLS	–	Core Labor Standards
CSP	–	country strategy and program
CSPU	–	country strategy and program update
DMC	–	developing member country
EFG	–	External Forum on Gender and Development
GAD	–	gender and development
HIV/AIDS	–	human immunodeficiency virus/acquired immune deficiency syndrome
IDA	–	International Development Association
LTSF	–	Long-Term Strategic Framework
MDB	–	multilateral development bank
MDG	–	Millennium Development Goal
MTS	–	Medium-Term Strategy
NGO	–	nongovernment organization
NPRS	–	national poverty reduction strategy
ODA	–	official development assistance
OED	–	Operations Evaluation Department
PBA	–	performance-based allocation
PDMC	–	Pacific developing member country
PRS	–	Poverty Reduction Strategy
RM	–	resident mission
TA	–	technical assistance
WB	–	World Bank

## GLOSSARY OF SELECTED TERMS

**Country strategy and program (CSP).** The CSP, which is usually prepared every five years in alignment with the country's planning cycle, specifies ADB's country-specific poverty reduction strategy, including sector and thematic priorities, and provides a framework and agreed-upon indicators for country performance review.

**Country strategy and program update (CSPU).** Annual analyses and refinements of the country strategy, including progress against the Millennium Development Goals (MDGs), are encapsulated in each year's CSPU.

**Developing member country (DMC).** ADB has 61 member countries, of which 41 are developing member countries (DMCs) eligible for loans and technical assistance.

**Loan classification system (LCS).** ADB's LCS provides a basis for monitoring implementation of the Poverty Reduction Strategy, and classifies ADB's public sector lending into poverty intervention, core poverty intervention, and other interventions.

**Long-Term Strategic Framework (LTSF).** ADB's Long-Term Strategic Framework, 2001-2015 builds on the PRS and describes the three "pillars" of sustainable economic growth, inclusive social development, and good governance.

**Medium-Term Strategy.** ADB's Medium-Term Strategy (2001-2005) identifies specific priorities for ADB's activities and provides an operational framework for implementation of the first five years of the LTSF.

**Multisector classification.** This refers to a sectoral classification involving a project with two or more sectors and/or subsectors as its objectives, for example agriculture and social infrastructure; finance and industry.

**Multitheme classification.** This refers to a classification of thematic priorities covering two or more themes, for example gender and development, governance, and human development.

**National poverty reduction strategy (NPRS).** ADB supports Government-owned NPRS that originate in participatory processes involving governments, NGOs, civil society, private sector, donors, and other stakeholders.

**Performance-based allocation (PBA).** ADB has adopted the PBA policy to link the allocation of ADF resources to country performance. While the policy requires that a "robust" link between performance and lending be established, it also recognizes that exceptional country circumstances have a legitimate role to play in allocating resources.

**Poverty Reduction Strategy (PRS).** ADB's Poverty Reduction Strategy (PRS), approved in 1999, defines poverty reduction as the ADB's overarching objective. Key principles include (i) a strategic, long-term approach to development; (ii) country ownership and leadership; (iii) strong partnerships among governments, donors, civil society, private sector, and other stakeholders; and (iv) a focus on transparent and measurable development outcomes to reduce poverty.

## CONTENTS

I.	INTRODUCTION	1
	The ADF VIII Midterm Review Reports	1
II.	ADF'S STRATEGIC FRAMEWORK	2
	A. ADF's Experience with Development Effectiveness	2
	B. ADB's Long-Term Strategic Framework and ADF VIII	4
	C. Impact of Recent Events and Changing Development Agenda on ADF VIII	5
III.	HOW ADB CONTINUES THE FIGHT AGAINST POVERTY	5
	A. ADB's Poverty Reduction Operational Cycle	5
	B. The Way Forward	9
IV.	HOW ADB SUPPORTS GOOD GOVERNANCE	10
	A. ADB's Governance Activities	10
	B. The Way Forward	13
V.	HOW ADB SUPPORTS STRONG PERFORMANCE IN THE FIGHT AGAINST POVERTY	15
	A. Overview	15
	B. Implementation Arrangements	15
	C. PBA Assessments	15
	D. PBA Outcomes	16
	E. Emerging Patterns of Lending	16
	F. Country Dialogue and Triggers	17
	G. Disclosure	17
	H. Exceptional Circumstances	17
	I. PDMCs and "Small Economies"	17
	J. Allocation of ADF for Subregional Projects	17
	K. Need for Flexibility	18
	L. The Way Forward	18
VI.	SELECTED POLICIES AND STRATEGIES IN SUPPORT OF POVERTY REDUCTION	19
	A. Overview	19
	B. Gender and Development	19
	C. Environment	21
	D. Core Labor Standards	22
	E. Private Sector Development	22
	F. Infectious Diseases Including HIV/AIDS	24
	G. Drug Control	24
	H. Regional and Subregional Cooperation	24
	I. Internal Governance	25

VII.	MAKING ADB A MORE EFFECTIVE ORGANIZATION AND PARTNER IN DEVELOPMENT	26
	A. ADB and Its Development Partnerships	26
	B. Enhanced Business Processes to Fight Poverty	26
	C. Expanded Resident Mission Role	26
	D. Strengthened Collaboration with Other Donors	27
	E. The Way Forward	28
VIII.	MOBILIZATION, ALLOCATION, AND USE OF ADF VIII RESOURCES IN FIGHTING POVERTY	29
	A. Overview	29
	B. Donor Contributions	29
	C. Allocation and Use of ADF VIII Resources	30
	D. Financial Planning and Management	34
	E. The Way Forward	35
IX.	CONCLUSION	35

## I. INTRODUCTION

### ADF VIII Midterm Review Reports

1. The November 2000 Donors' Report for the Asian Development Fund (ADF) VIII, as adopted by the Board of Directors,<sup>1</sup> requested the Asian Development Bank (ADB) to prepare comprehensive midterm progress reports on implementation of ADF VIII objectives and donor recommendations. The current reports, consisting of this Integrated Report and nine stand-alone reports, fulfill the donors' request to show how ADB is implementing its mission of reducing poverty in the region. This Integrated Report has also been prepared to provide a synthesis of key results, conclusions, and ensuing strategic issues. For reference and full details, Donors may refer to the stand-alone reports.<sup>2</sup>

2. Midway through the ADF VIII period, it is important to ask an overriding question:

How can ADF become more effective in achieving the Millennium Development Goals (MDGs) in the region?

3. In the context of that fundamental question, the key themes and expectations communicated in the ADF VIII Donors' Report revolve around the following major questions.

- First, how can ADB more effectively implement its Poverty Reduction Strategy?
- Second, how can ADB more effectively support "Good Governance"?
- Third, how can ADB adequately link ADF VIII allocations to performance?
- Fourth, how can ADB become a more effective institution and development partner?
- And fifth, how should ADB plan to mobilize additional ADF resources (from internal and external sources) to meet the legitimate priority needs of our ADF borrowers during the remainder of ADF VIII?

4. These questions provide a framework for frank and productive discussions at the ADF VIII Midterm Review Meeting and a basis for donor guidance as we move into the final two years of ADF VIII.

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<sup>1</sup> ADB. 2000. *Seventh Replenishment of the Asian Development Fund, ADF VIII Donors' Report: Fighting Poverty in Asia*. Manila.

<sup>2</sup> The ADF VIII Donors' Report requested 11 reports: (i) Implementation of ADB's Poverty Reduction Strategy in ADF Borrowers; (ii) Initial Testing and Application of a Performance-Based Allocation System for ADF Resources in 2001 and 2002; (iii) Implementation of ADB's Governance Action Plan in ADF Borrowers; (iv) Progress in selected policies; (v) Combating Money Laundering; (vi) Strengthening ADB's Evaluation Systems; (vii) Impacts and Results of ADF Operations; (viii) Steps Taken to Strengthen Operational Business Processes, Project Quality and Portfolio Management; (ix) Mobilization, Allocation, and Uses of ADF VIII Resources in 2001 and 2002; (x) Participation of ADF Borrowers in the Heavily Indebted Poor Country Initiative; and (xi) Status of Implementation of Additional Recommendations in the ADF VIII Donors' Report. This Integrated Report provides an overview, and also merges items (iv) and (xi). Thus, there are ten reports. Also provided is a draft joint report by the multilateral development banks (MDBs) on the Update of Progress in MDB Collaboration.

## II. ADF'S STRATEGIC FRAMEWORK

### A. ADF's Experience with Development Effectiveness

5. While detailed data on projects implemented since the inception of ADF VIII are not yet generally available, evaluation results from ADF VI-VII provide insight into the development effectiveness and poverty impact of ADF projects. The following is a brief overview of development results during ADF VI-VII and implications for development effectiveness in current projects.

6. During ADF VI-VII, ADB's development agenda revolved around five strategic development objectives (SDOs): economic growth, human development, poverty reduction, women in development (WID), and environment, which were replaced in 2001 with the single objective of poverty reduction. While evaluation efforts were complicated by the fact that projects were classified as supporting one primary and/or two secondary objectives (i.e., many projects addressed multiple objectives), evaluation results demonstrated good progress:

(i) Economic growth. The economic internal rate of return (EIRR) was calculated for 42 of the 102 completed projects with project completion reports (PCRs) as of December 2002. Projects were split with 21 having EIRRs greater than anticipated at appraisal and 21 below appraisal estimates. One of the leading causes for lower-than-anticipated EIRRs was implementation delays. For nearly all postevaluated projects, delays that were reported reduced the anticipated economic growth impact. Nevertheless, even for projects with lower-than-expected EIRRs, the average was 17.8%, well above the 12% threshold. As of December 2002, 93 economic growth projects had been completed, and 65, ongoing. Among the former, PCRs were available for 72 projects. Of these, 57 were rated generally successful, 14 partly successful, and 1 unsuccessful. Evidence available to date from the PCRs and project performance audit reports (PPARs) generally reflects positive impacts on economic growth. These projects are distributed across all developing member countries (DMCs) and sectors.

(ii) Human development. As of December 2002, 31 human development projects had been completed. PCRs were available for 24 projects, all of them started under ADF VI. Eighteen projects were rated generally successful, five partly successful, and one unsuccessful. One of the biggest changes in the social sectors has been the way projects are designed. After 1995, more attention was given to developing investments in conjunction with sector policies needed to support the investments; that is, projects became broader, addressing more complex issues, often including components that supported sector reforms and involving additional executing or implementing agencies. The initial results show that these types of projects have had greater development impact and a greater probability of sustainability.

(iii) Poverty reduction. Six of 40 poverty reduction projects were complete as of December 2002. Slow disbursement and completion may be due to two factors. The most obvious is that poverty reduction projects may be more complex and, therefore, more difficult to implement than some of the more traditional projects with emphasis on civil works. The former may take longer to implement and require more experience. Implementation support needs to be better designed to accommodate this factor. Second, the lack of experience with such projects may have caused ADB and governments to underestimate implementation difficulties and overestimate the capacity of the executing and implementing agencies.

(iv) Women in development. During ADF VI-VII, projects were required to take WID issues into account in project design. ADF has been particularly important for WID activities supporting all projects with primary WID objectives. One ADF VI primary WID project was completed in 2002. The PCR is scheduled for 2004. Of the eight WID projects evaluated, the PPARs for the remaining seven projects indicate that as of December 2002, one was making highly satisfactory progress, and six satisfactory progress. A full evaluation of the gender and development (GAD) policy is scheduled for 2004. By then, there should be a more solid basis for assessing the impact of the GAD framework.

(v) Environment. During ADF VI-VII, ADB addressed environmental issues through (a) lending for environmental projects, (b) environmental mitigation measures, and (c) technical assistance. As of December 2002, 4 out of the 24 projects with primary environmental objectives had been completed. PCRs are available for two of them; one is rated generally successful and one partly successful. Of the 19 projects under implementation, 16 projects were making satisfactory progress, and 3 were partly satisfactory. ADB strengthened its focus on environmental and social concerns in 1993, and several of ADB's policies addressing these concerns were approved thereafter. Most projects completed under ADF VI-VII have had little adverse or neutral impacts on the environment. Indeed, many of the projects have had positive environmental impacts. Greater public participation has helped enhance the design, operation, and monitoring of mitigation measures. Identification of major project impacts improved as environmental impact assessments and consultations with affected persons were made mandatory.

7. Thirteen policy-based lending (PBL) program loans were approved during ADF VI and 23 during ADF VII, for a total of 36 programs in 9 years, compared with 40 such programs in the prior 23-year ADF period. There were thus more programs per year during ADF VI-VII, but they were for smaller amounts. This may be attributed to more programs for the smaller transition and Pacific economies. Twelve of the 13 ADF VI and 12 of the 23 ADF VII programs were complete by December 2002, with PCRs available for 21 of them (including 1 sector development program). Fourteen were rated generally successful (67%), six partly successful (28%), and one unsuccessful (5%). During the period, program design became more varied, with multiple tranching of conditionalities and introduction of program clusters, and the number of tranche release conditions was being reduced. There continued to be a strong demand for program lending from a range of DMCs.

8. ADB is improving its performance at the project level by measuring achievement against prespecified targets. ADB's current Project Performance Management System (PPMS) was designed in the late 1990s based in part on the outputs of the Task Force on Improving Project Quality<sup>3</sup> and the Working Group on Spring Cleaning.<sup>4</sup> The latter group recommended a one-time "spring cleaning" of the ADB portfolio to cancel slow-moving and inactive projects; in practice, this became an ongoing exercise. Subsequently, the Working Group on ADB Reorganization reinforced the need for a systematic tool to specify, measure, and improve project performance.<sup>5</sup>

<sup>3</sup> ADB. 1994. *Report of the Task Force on Improving Project Quality*. Manila.

<sup>4</sup> ADB. 1999. *Toward Real Portfolio Management: Final Report of the Working Group on Spring Cleaning*. Manila.

<sup>5</sup> ADB. 2001. *Reorganization of the Asian Development Bank*. Manila.

9. The PPMS, which was introduced to enhance project performance through better design and early identification of emerging problems, requires that all projects be grounded in a mandatory project framework that describes projects at five levels: (i) the development goal, (ii) the project purpose, (iii) project outputs, (iv) activities required to produce those outputs, and (v) inputs required for those activities. Each of these dimensions is analyzed in terms of targets and indicators, sources of data, and assumptions and risks. The PPMS provides a solid basis for contributions to research by multilateral development banks (MDBs) and bilateral development agencies on developing methodologies for better measuring, monitoring, and managing of development results.

10. ADB collaborates with development partners to improve its development effectiveness. ADB formulates its project performance ratings compatible with other MDBs, and significant steps have been taken in that direction. ADB works with the Evaluation Cooperation Group (ECG)<sup>6</sup> of the MDBs to define evaluation criteria (e.g., relevance, efficacy, efficiency, sustainability, and institutional and other development impacts).<sup>7</sup> ADB's ongoing efforts to strengthen its evaluation systems include (i) improving internal evaluation processes, (ii) expanding the role of the Operations Evaluation Department (OED), (iii) actively participating in the MDB ECG, and (iv) strengthening the evaluation process through the creation of the Development Effectiveness Committee (DEC).

## **B. ADB's Long-Term Strategic Framework and ADF VIII**

11. Even with the progress being made in effectively utilizing ADF resources to reduce poverty, over two thirds of the world's poor still reside in Asia. Further, although none of ADB's developing member countries (DMCs) have availed of the Heavily Indebted Poor Country (HIPC) initiative, a number are being closely monitored. Given this stark reality, ADB reassessed its goals and priorities in 1999, leading to a formal commitment to poverty reduction as its overarching objective through the adoption of the Poverty Reduction Strategy (PRS).<sup>8</sup> ADB's Long-Term Strategic Framework, 2001-2015 (LTSF)<sup>9</sup> provides a timely strategic framework, which builds on the PRS utilizing three "pillars" for development: (i) sustainable economic growth; (ii) inclusive social development; and (iii) good governance for effective policies and institutions. ADB's Medium-Term Strategy (2001-2005) (MTS)<sup>10</sup> identifies specific priorities for ADB's activities and provides an operational framework for implementation for the first 5 years of the LTSF. Together, these documents constitute the strategic and operational framework within which ADF VIII has been and is being implemented.

12. Recently embedded into the LTSF are the Millennium Development Goals (MDGs), including their targets and indicators. ADB is incorporating new approaches into operations that build on the MDGs, including the recommendations of the Johannesburg Summit<sup>11</sup> focusing on specific actions consistent with the global development agenda. ADB recognizes that implementing the MDGs in operations requires careful attention to the needs and demands of vulnerable groups, including for example a consistent focus on GAD.

<sup>6</sup> ECG was established in 1996 by the heads of evaluation in five MDBs: African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, and the World Bank Group. The group now includes the International Monetary Fund, and the European Investment Bank also participates.

<sup>7</sup> ADB. 2000. *Guidelines for the Preparation of Project Performance Audit Reports*, page 13. Manila.

<sup>8</sup> ADB. 1999. *Fighting Poverty in Asia and the Pacific: The Poverty Reduction Strategy*. Manila.

<sup>9</sup> ADB. 2002. *Long-Term Strategic Framework of the Asian Development Bank (2001-2015)*. Manila.

<sup>10</sup> ADB. 2001. *Medium-Term Strategy (2001-2005)*. Manila.

<sup>11</sup> Also known as the World Summit on Sustainable Development (WSSD), 2002.

### **C. Impact of Recent Events and Changing Development Agenda on ADF VIII**

13. ADF VIII takes into account the understandings reached at the Monterrey Conference on Financing for Development (March 2002) which declare (i) the need to mobilize financial resources more efficiently, (ii) increase awareness of the importance of development effectiveness as an operational principle, and (iii) recognize the need for increased official development assistance to help poor countries achieve the MDGs. The global development agenda is putting even greater emphasis on issues such as (i) raising productivity through social sector investments focusing on long-term outcomes, (ii) encouraging institutional development, (iii) building capacity in DMCs, (iv) leveraging on strategic partnerships, (v) linking allocations to performance, and (vi) involving the private sector in development issues. All these have implications for ADB's management and effective utilization of limited ADF VIII resources.

## **III. HOW ADB CONTINUES THE FIGHT AGAINST POVERTY**

### **A. ADB's Poverty Reduction Operational Cycle**

#### **Overview**

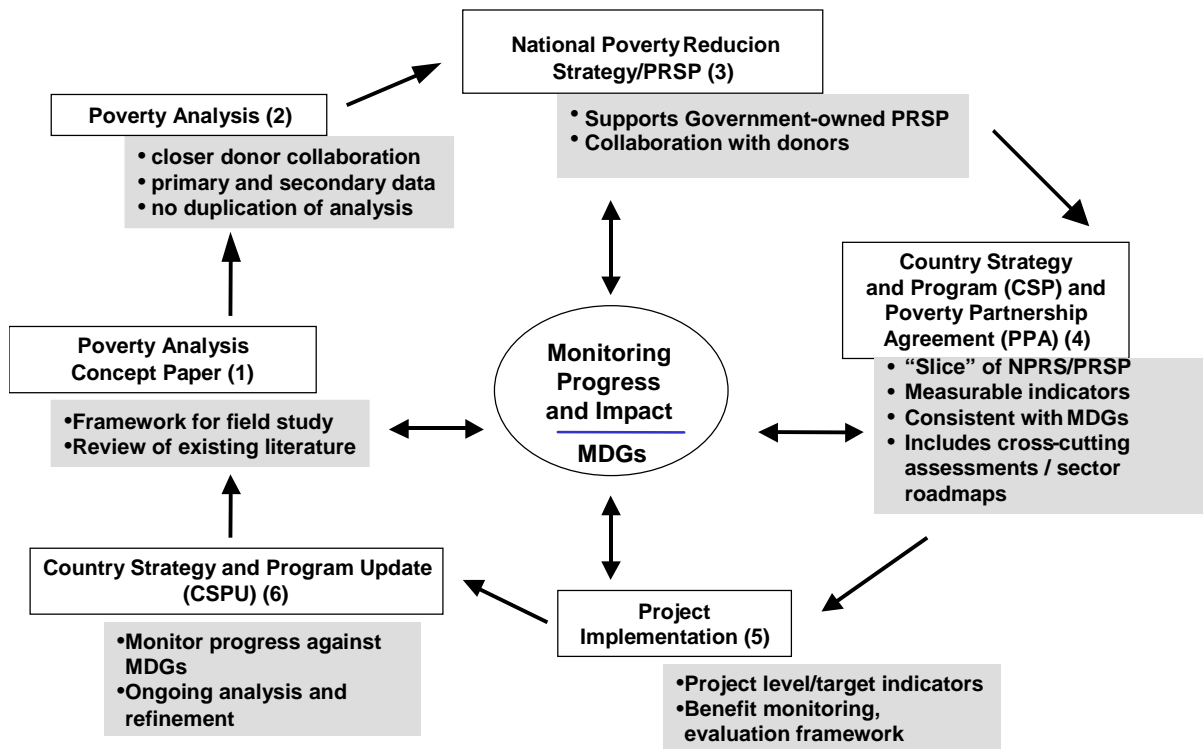
14. The introduction of ADB's PRS in 1999 brought with it recognition that poverty reduction in any particular DMC must be grounded in the specific development challenges and opportunities facing that country. Effective national poverty reduction strategies take into account relevant institutional processes, social and cultural norms, and geographic and resource realities. Thus, ADB collaborates closely with DMC governments, civil society, and other funding agencies to assess, understand, discuss, and interpret poverty from a country-level perspective. For development results to occur, it is important to highlight the strategic approach or process used to create an enabling environment for poverty reduction. This process which lies at the core of ADB operations can be conceptualized in terms of a "Poverty Reduction Operational Cycle."

15. While ADB provides assistance as requested in these activities, the national poverty reduction strategy (NPRS)/poverty reduction strategy paper (PRSP)<sup>12</sup> must be government-owned if the resulting programs and projects are to be both effective and sustainable. ADB conducts its activities within the context of government priorities and preferences, while at the same time working closely with development partners. Consistent with the global development agenda and the importance of the MDGs, country-specific poverty indicators reflecting the MDGs are increasingly reflected in the NPRS/PRSP and in ADB's country strategy and program (CSP) for each ADF-eligible DMC. The process through which this collaborative process is implemented is shown in Figure 1.

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<sup>12</sup> Denotes national poverty reduction strategy or equivalent, including PRSP.

**Figure 1: ADB's Poverty Reduction Operational Cycle**



### Step 1: Poverty Analysis Concept Paper

16. The concept paper is formulated based on a review of available information and accumulated knowledge about country-specific dimensions of poverty. Reviewing primary and secondary research, the concept paper takes into account the multifaceted nature of poverty in the particular country as well as the regional and subregional context. The concept paper serves as an internal ADB “framing document” that identifies core poverty issues and methods employed in the poverty analysis.

### Step 2: Poverty Analysis

17. Poverty analyses, with government involvement, include extensive analytic work using both quantitative and qualitative methodologies and approaches. In-country, participatory processes contribute to better understanding of the core attributes and determinants of country-specific poverty. ADB encourages government ownership through consultative and participatory processes, including wide-ranging discussions of gender, governance, vulnerable groups, and the effective delivery of basic services, among many other issues. This is accomplished within the context of NPRS/PRSP and existing government processes to ensure that findings of the poverty analysis are disseminated and discussed with a wide range of stakeholders (including government, nongovernment organizations or NGOs, community-based organizations, the private sector, academia, civil society, and other donors).

18. In Sri Lanka, for example, consultations with the poor revealed that they felt that civil conflict and patronage-oriented public policies were major impediments to socioeconomic advancement. Building on an already-existing national poverty framework, the poverty analysis demonstrated that civil conflict, slow growth, regional inequity, weak governance, and flawed policy frameworks were key causes of pervasive and persistent poverty. The analysis endorsed the Government's strategy of restoring peace and building infrastructure and a sound regulatory backbone to link disadvantaged regions to the national economy.

### **Step 3: National Poverty Reduction Strategy/Poverty Reduction Strategy Paper**

19. ADB works with other multilateral organizations (including the World Bank (WB), International Monetary Fund (IMF), and United Nations), bilateral development agencies, and NGOs to assist in the development of government-owned NPRS/PRSPs. ADB is often an integral part of this process, assisting governments in formulating coherent strategies and programs. ADB assistance works within the NPRS/PRSP framework and does not involve the creation of a parallel structure of consultations or working outside existing government processes or institutions. Key principles of the ADB's PRS include (i) a strategic, long-term approach to development; (ii) country ownership and leadership; (iii) strong partnerships among governments, donors, civil society, the private sector, and other stakeholders; and (iv) a focus on transparent and measurable development outcomes to reduce poverty.

### **Step 4: Country Strategy and Program**

20. The strategic basis for ADB's development assistance in its DMCs is the CSP, which is usually prepared every 5 years in alignment with the country's planning cycle. The CSP identifies and describes ADB's distinctive role, focusing on reducing poverty and the development priorities of the client country as defined by the NPRS/PRSP. The CSP determines ADB's country-specific poverty reduction strategy, including sector and thematic priorities (which are translated into specific operations and interventions). For ADF-eligible DMCs, the CSP (in association with the poverty partnership agreement or PPA) also provides a framework and agreed-upon indicators (linked in many instances to MDGs) for country performance review. CSPs include the following:

- (i) **Analytical assessments.** A number of assessments are undertaken as part of the CSP process, each of them grounded in two main assessments: economic growth and poverty analyses. These are bolstered by thematic assessments focusing on the country-specific situation in particular areas such as gender, governance, environment, and private sector (among others).
- (ii) **Sector roadmaps.** These identify short-, medium- and long-term goals and objectives for each sector and are directly linked to possible assistance activities provided by ADB and/or other donors. For example, the Transport Sector Strategy Review in Nepal focused on strategies for connecting poor, remote communities to vibrant market centers.
- (iii) **Selectivity.** ADB concentrates its resources selectively to ensure that complex poverty reduction initiatives are addressed coherently. In several DMCs, the number of sectors in which ADB plans to provide support has been reduced.
- (iv) **Holistic approaches.** Many CSPs now move beyond and across traditional sector boundaries to feature strategic initiatives based on holistic approaches to

poverty reduction. The 2001 CSP for Mongolia, for example, advocates specific programs to reform governance and improve the social protection system as key components of ADB assistance.

- (v) **Participatory and consultative processes.** CSP formulation typically involves extensive participation of DMC stakeholders, including government, civil society and development partners. ADB's new initiative, *ADB-Government-NGO Cooperation: A Framework for Action 2003-2005*, is expected to further promote effective development partnerships at the country, subregional, and regional levels.
- (vi) **Donor collaboration.** Effective collaboration with development partners through identification of ADB's comparative advantages and division of labor among donors is now a key element of CSPs.

21. Box 1 describes this process in Viet Nam, with particular attention to issues of collaboration and harmonization with other development partners.

**Box 1: Donor Collaboration in Support of Viet Nam's National PRS Process**

The process of preparing a national poverty reduction strategy in Viet Nam involved close collaboration between the Government and development organizations. ADB supported extensive consultation, including poverty assessments involving the poor; 2-3 day provincial workshops to discuss the draft strategy; and the creation of a Poverty Task Force. ADB aligned its own CSP in Viet Nam with the Government's 5-year planning cycle and coordinated poverty reduction monitoring with other organizations active in the country. Selectivity was accomplished through ongoing dialogue with Government and development partners; several joint missions have been undertaken to improve coordination and eliminate redundancy. A joint effort at harmonization of procedures among ADB, the Japan Bank for International Cooperation (JBIC), and the World Bank was launched in April 2002 as a country pilot for multilateral financial institution (MFI) harmonization worldwide. Interagency consultations identified the following priority areas for harmonization: (i) procurement, (ii) financial management, (iii) environmental and social safeguards; and (iv) portfolio management. In May 2002, the three institutions made a joint declaration that they would achieve tangible harmonization outcomes within a 1-year period, with significant progress already having been made. Recent activities to support this harmonization have included a regional conference in Hanoi (January 2003) and a High-Level Forum in Rome (February 2003).

**Step 5: Project Implementation**

22. ADB's project implementation is designed to ensure measurable development effectiveness, with key indicators often based directly on the MDGs. ADB continually improves its internal evaluation processes through (i) ongoing efforts to improve *ex ante* performance specification by encouraging better project frameworks and associated documents such as policy and social impact assessment matrices, (ii) using project performance reports to track development objectives during implementation, (iii) improving self-evaluation at project and TA completion through an in-depth review process, (iv) ongoing development and refinement of postevaluation guidelines, (v) developing a more consistent evaluative framework for performance measurement during implementation, and (vi) providing technical assistance and training to DMCs to improve their capacity to monitor the results of projects.

## **Step 6: Country Strategy and Program Update**

23. Program progress, development effectiveness, and poverty impact are monitored, measured, and managed throughout the operational cycle. Annual analyses and refinements of country strategy are encapsulated in each year's country strategy and program update (CSPU). Planning directions for years 2-4 of the planning cycle are initially specified by Management, followed by a review of the previous year's CSPU (or CSP) and identification of potential changes. A country programming mission holds consultations with DMC stakeholders to review potential changes and refinements. The country team then drafts a CSPU for government clearance, approval by the President, and Board endorsement.

### **B. The Way Forward**

#### **1. Impact of PRS on Country Strategy and Program**

24. Since the adoption of the PRS, CSPs have focused on poverty reduction as the overarching objective and have relied on extensive, country-owned poverty analyses and sector work to develop assistance strategies linked to government-owned NPRSs. Implementation of the PRS has changed the manner in which CSPs are prepared in at least three ways: First, the sector studies underpinning CSPs focus almost entirely on strategies for combating poverty through reforms or investments in a particular sector. Sector development is no longer seen as an end in itself, but is viewed as a tool for combating poverty. Second, as mentioned above, ADB is becoming increasingly more selective in terms of sectors to support, contributing to better poverty focus. Third, several CSPs have incorporated cross-sector strategies to combat poverty.

#### **2. Better Integration of Thematic Assessments in CSPs**

25. While many CSPs/CSPUs to date have effectively incorporated outputs of poverty analysis based on stakeholder participation, cross-cutting themes and assessments still need to be more fully integrated. This requires greater involvement on the part of thematic specialists as early as possible in the formulation of the CSP. This early involvement should ensure that priority thematic areas are fully mainstreamed into the core strategic focus. ADB's reorganization, with its enhanced country focus, provided an important opportunity to address thematic issues within the context of NPRSs. At the same time, the decentralization of the limited number of thematic specialists under the reorganization, and the streamlining of ADB's business processes may lose focus and dilute the mainstreaming of key thematic issues into ADB operations. To prevent this, ADB has established thematic committees to ensure that thematic issues continue to be addressed.

#### **3. Flexibility in Operational Approaches**

26. Experience in the first three years of PRS implementation has demonstrated the complexity of selecting appropriate and effective poverty reduction approaches given the diversity of DMCs. Direct poverty reduction often demands flexible and responsive approaches. For example, results of the poverty analysis may suggest that smaller and more innovative interventions are called for, even if they are more resource-intensive and require more time to implement. Similarly, ADB's commitment to participatory processes sometimes entails a trade-off between efficiency in processing and ensuring that the voices of all stakeholders (especially the poor) are heard. ADB recognizes the existence of such trade-offs and continues to seek out

innovative approaches for balancing transparency and participation on the one hand, and project efficiency and timely processing on the other.

#### **4. Enhancing Participation**

27. Prior to the PRS, ADB's experience with participatory processes (as in the case of other MDBs) was mostly at the project level and of relatively limited scope. Now, however, ADB and its development partners are committed to the use of participatory processes at the national level to craft cohesive NPRS/PRSPs that (i) are government owned, (ii) take into account stakeholders' needs and concerns, (iii) include participatory monitoring and evaluation, and (iv) are designed to be outcome-oriented. ADB's ongoing support of these efforts, if it is to be effective, must be within the context of close collaboration with development partners (including governments, NGO/civil society organizations, MDBs, and other donors).

#### **5. Deepening Donor Collaboration**

28. ADB will continue to deepen its collaboration with both multilateral and bilateral development partners. To support and guide this collaboration, ADB enters into memoranda of understanding (e.g., with the World Bank and the United Nations Development Programme) that provide a platform for long-term cooperation and are supported by ongoing collaborative work to improve operational working relationships and country programming. Particularly important is working together in conducting economic, sector, and thematic work focused on poverty reduction. For example, in many countries ADB works closely with the World Bank and other institutions in undertaking joint poverty analyses, financial sector assessments, and public expenditure reviews, to name a few. ADB will continue to work with its multilateral and bilateral partners to strengthen the alignment of analytical and advisory work at the country level and to build effective working relationships with other agencies in its DMCs.

#### **6. Full Review of Poverty Reduction Strategy**

29. As mandated in the Poverty Reduction Strategy, a full review is to be undertaken after three years of implementation. It is expected that the review will be completed by the fourth quarter of 2003. The review, among other objectives, will highlight development impacts and outcomes of ADB operations in all of the DMCs.

### **IV. HOW ADB SUPPORTS GOOD GOVERNANCE**

#### **A. ADB's Governance Activities**

30. ADB has established good governance as one of the three pillars of its PRS. In support of this priority, a Governance Policy, approved in 1997, and a Medium-Term Action Plan for Promoting Good Governance are providing direction for bringing governance to the top of the development agenda.<sup>13</sup> This chapter provides a brief overview of ADB's focus on encouraging improvements to these basic elements of good governance.

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<sup>13</sup> ADB's *Governance Agenda and Action Plan*, 2002, identifies six major activity areas: (i) enhancing governance quality in DMCs, (ii) elevating good governance to the top of the development agenda, (iii) fighting corruption, (iv) coordinating governance activities, (v) strengthening ADB's capacity for governance operations, and (vi) monitoring implementation of the action plan.

31. The reorganization of ADB and introduction of the new business processes in 2002 brought with it renewed vision and put a priority on supporting governance.<sup>14</sup> To improve its ability to support governance initiatives, ADB has built up its own capacity. Operational support for governance at ADB is now the mandate of Governance, Finance, and Trade divisions within each regional department. ADB now has 17 governance staff, with 3 national governance officers working in resident missions (RMs). These specialists have varied backgrounds and positions, with formal training and experience in fields such as economics, law, political science, development administration, decentralization, and public finance. In addition to these core governance staff, staff with backgrounds in financial management, banking and financial regulation, privatization, corporate regulatory frameworks, participation, and NGOs are doing governance work, including designing and implementing projects with a primary governance classification.

32. The Regional and Sustainable Development Department (RSDD), the organizational focal point for governance, has been mandated to ensure compliance and provide guidance on poverty reduction and safeguard measures. Governance and Regional Cooperation Division chairs the Governance Committee, a group that provides (i) an internal mechanism for sharing information about governance concepts and projects, and (ii) oversight and coherence monitoring for ADB's governance practices. The Governance Network acts as a "professional association" within ADB and meets quarterly, as a thematic link for staff to debate strategic issues and to contribute to knowledge development and dissemination.

#### **1. Donor Collaboration on Harmonization of Procedures and Practices**

33. ADB has made significant inroads in working with other development assistance partners to harmonize its policies, practices, and procedures in order to minimize duplication of efforts to reduce transaction costs and the fragmentation of administrative capacity caused by the multiplicity of donor agency operational policies and procedures. These activities make important contributions to improving good governance for operationalizing and managing development assistance. For example, ADB has worked with the World Bank and the Japan Bank for International Cooperation in Viet Nam to harmonize practices on procurement, financial management, environmental management, involuntary resettlement, portfolio management, and economic and sector work (ESW).<sup>15</sup> ADB has developed accounting standards in DMCs with support from the International Federation of Accountants, and has identified common approaches to environmental assessment and evaluation. ADB undertakes joint Public Expenditure Reviews with the World Bank and often participates in the World Bank's country financial accountability assessments. ADB also actively participates in the MDB Working Group on Financial Management and Analysis. ADB is helping to improve DMC auditing practices by strengthening organizations such as the Asian Organization of Supreme Audit Institutions and the South Pacific Association of Supreme Audit Institutions. Links with bilateral development agencies are also being strengthened in the governance area. ADB and the governments of Canada and Norway have signed agreements to fund the Governance Cooperation Fund, while the United Kingdom's Department for International Development and ADB are establishing a similar collaborative arrangement for mutually supportive objectives in the Pacific.<sup>16</sup>

<sup>14</sup> ADB. 2002. *Business Processes in the Reorganized ADB*. Manila.

<sup>15</sup> Joint Harmonization Report by ADB, JBIC, and WB, November 2002.

<sup>16</sup> The Governance Cooperation Fund (GCF) has been established, and five GCF projects have been selected by the Governance and Capacity Building Committee (GCBC). These are expected to be implemented during 2003.

34. ADB's focus to date has been largely on economic and financial management, particularly (i) strengthening financial and budgetary systems, (ii) enhancing public sector management, (iii) building capacity in key central ministries, (iv) developing corporate regulatory frameworks, and (v) upgrading technical expertise for law making. These activities have become areas of comparative strength and expertise for ADB. Consistent with ADB's emphasis on improving its reach, it is increasingly decentralizing and devolving its governance activities to provincial and other local levels. Box 2 presents an example of ADB's governance practice in Mongolia.

**Box 2: ADB's Governance Support to Mongolia**

While public sector financial efficiency in Mongolia had eroded due to the lack of budgetary discipline, operational efficiency in budgetary bodies was affected by the lack of a proper incentive structure. Recognizing this, the Governance Reform Program was implemented to help establish (i) an efficient public sector financial management system, (ii) a sound public sector accountability system, and (iii) a transparent data and information dissemination system. Performance contracting and merit-based recruitment and promotion procedures have been introduced in pilot agencies. These measures should have a broadening impact, with the Public Sector Management and Financial Law (PSMFL) calling for the adoption of measures to enhance transparency in civil service recruitment and promotion. The PSMFL has triggered a debate on the desired level of autonomy of lower level budgetary bodies. While retaining considerable decentralized decision-making in day-to-day operations, the PSMFL requires local bodies to deliver outputs in accordance with overall policy priorities and performance contracts established by sector ministries and other coordination bodies. These activities have been supported by extension review and participative discussion by stakeholders (including budgetary bodies, provincial-level officials, and political parties).

35. The elements of ADB's Action Plan are being addressed with a series of complementary activities and programs. The following are illustrative activities ADB has undertaken in support of good governance.

## 2. Systematic Governance Assessments

36. To mainstream good governance in its operational activities, ADB includes mandatory country governance assessments (CGAs) as foundation studies for CSPs/CSPUs. Findings and recommendations of CGAs are being used to identify areas of weakness and recommend appropriate interventions to address these, for incorporation into CSPs/CSPUs. A review of the CGA instrument is now being conducted to assess (i) its contribution to improving the quality of CSPs, and (ii) the extent to which DMCs and other development agencies are using findings of CGAs to improve governance.

## 3. Anti-Corruption Initiatives

37. ADB recognizes the importance of reducing corruption as an essential component of good governance. A number of important actions were taken during 2001 and 2002. Selected DMCs (including ADF countries) signed the Anti-Corruption Action Plan for the Asia-Pacific, which had been developed through the ADB-Organization for Economic Cooperation and Development (OECD) Asia-Pacific Initiative for Combating Corruption.<sup>17</sup> ADB has engaged in extensive anticorruption initiatives through policy-based lending and numerous sector and project loans in the South Asia Department (SARD) and the other regional departments (RDs). ADB has also updated the *Guidelines for Financial Governance and Management of Investment Projects* to support accurate assessment of borrowers' financial management capabilities and practices. In 2001, as part of its portfolio management action plan, ADB introduced an

<sup>17</sup> DMCs endorsing the action plan include Bangladesh, Cook Islands, Indonesia, Kyrgyz Republic, Mongolia, Nepal, Pakistan, Papua New Guinea, Samoa, and Vanuatu.

automated project rating system to improve consistency, standardize ratings, and reduce subjectivity of audited accounts and financial statements. ADB has carried out diagnostic studies of accounting and auditing practices in 12 DMCs.<sup>18</sup> The recently updated *Guidelines for Financial Governance and Management of Investment Projects* also has an anticorruption component. ADB continues to closely monitor and investigate allegations of corruption on its projects.

#### **4. Anti-Money Laundering**

38. The ADF Donors' Meeting in September 2000 requested ADB to prepare a policy paper proposing an increased role in anti-money laundering (AML) for ADB. In the context of its mandate to promote good governance, ADB was one of the first multilateral development banks to address the money laundering problem, both directly and indirectly, through regional and country assistance programs. A strategy paper on combating money laundering is expected to be approved by the Board on or before mid-2003.<sup>19</sup> ADB's recent activities in assisting DMCs to combat money laundering have been undertaken within the broader context of its existing policies and strategies to facilitate poverty reduction, promote good governance and act on corruption, and strengthen national financial systems. These activities have been incorporated, as appropriate, as an integral part of ADB's operational programs and country strategies in a limited number of DMCs that have requested assistance in their efforts to combat money laundering.

39. ADB actively collaborates with the Asia/Pacific Group on Money Laundering, a coordinating body for technical assistance and training. Significant support targets 10 countries, including (i) Non-Cooperative Countries and Territories designated by the Financial Action Task Force on Money Laundering (FATF), and (ii) major economies in the region severely affected by the Asian financial crisis. ADB helps increase public awareness of money laundering by highlighting the negative economic effects and serious risks posed to the safety and soundness of financial institutions. Public awareness campaigns target key elements of civil society, including the media, through publicity and outreach programs.

#### **5. Fighting Financial Crimes**

40. The Office of the General Auditor helps ensure that entities and individuals possibly associated with financial crimes and terrorism are precluded from employment, assignments, or business under ADB-financed activities. The MDB Working Group on Anti-Corruption, Governance, and Capacity Building, in which ADB actively participates, meets regularly to coordinate work and share best practices.

### **B. The Way Forward**

#### **1. Improving Governance Assessments**

41. ADB's governance analytic work is increasingly being integrated into CSPs/CSPUs. However, many recent CGAs will take time to filter into CSPs and CSPUs. Recommendations

<sup>18</sup> Azerbaijan, Cambodia, People's Republic of China, Fiji Islands, Mongolia, Marshall Islands, Pakistan, Papua New Guinea, Philippines, Sri Lanka, Uzbekistan, and Viet Nam.

<sup>19</sup> ADB's proposed AML policy has four key elements: (i) assisting DMCs in establishing and implementing effective legal and institutional systems, (ii) increasing collaboration with other international organizations and aid agencies, (iii) strengthening internal controls to safeguard ADB's funds, and (iv) upgrading ADB's staff capacity.

made on increasing governance interventions are beginning to be better documented as standard elements of CSPs/CSPUs. CGAs are clearly articulating areas of need and defining appropriate interventions, but they need to get better at focusing on governance reform opportunities that can disproportionately benefit the poor. Appropriate, well-resourced economic and sector work needs to be carried out to improve the quality at entry of governance loans and provide the basis for informed policy dialogue with DMCs. There is a continuing need for greater collaboration with other development partners and civil societies in DMCs to more effectively provide a holistic understanding of country-specific governance issues.

## **2. Monitoring Governance Impacts**

42. It is a challenge to monitor and measure the impact of governance investments. Typical outputs include new and more effective laws and decrees, roadmaps, action plans, or strategies. In most cases, it is difficult to attribute governance impacts to ADB or on other development partner's specific assistance. Nevertheless, it is possible to document a sequence of ADB assistance followed by government decisions that contribute to improved governance. ADB's Economics and Research Department and OED are working to develop methodologies and approaches to more accurately attribute development impact to PBL initiatives. RSDD has approved a series of TA activities on strengthening performance assessment using results-based management approaches in our DMCs.

## **3. Sustainability of Governance Initiatives**

43. ADB is committed to supporting institutional reforms in its DMCs. Engendering lasting reform in public institutions requires both commitment and focus. Progressive reforms are often difficult to sustain without champions in the bureaucracy and at the highest political levels to ensure their success. ADB has made every effort to learn from its experience, but needs to continue to improve its understanding and practice in reinforcing institutional development. Experience has shown that sustainability may be affected by the length of political terms of office and the willingness of new incumbents to continue to support reforms-in-process. Some of the strategies ADB employs include (i) identifying influential groups that benefit from reforms and enlisting their active support, (ii) strengthening public sector oversight bodies and developing accountability mechanisms (including better use of information technology), and (iii) developing more effective channels of communication to ensure wide dissemination of data on public spending and procurement, regulatory activities, and judicial decisions.

## **4. Broadening the Definition of Governance**

44. ADB continues to be aware of the importance of the relationship between non-economic and economic issues in development. This awareness is reflected in a gradual and pragmatic movement to broaden the definition of governance to areas which include anticorruption, legal and judicial reform, AML, procurement practices, and empowering civil society. ADB will continue to help governments to enhance their governance practices through the formulation, implementation, and application of sound laws, policies, and regulations, and through improved management of financial resources. During the remainder of ADF VIII, ADB will build on achievements to date and deepen its efforts to improve governance in the region.

## **5. Working with Development Partners**

45. The MDB Working Group on Anticorruption, Governance, and Capacity Building meets twice a year by videoconference to coordinate and harmonize work and share best practices.

The Group is using a password-protected website to share documents. It is focusing on improved coordination of governance aspects of public sector reform programs, poverty reduction support credits, and PPAs. As described previously, ADB works closely with other MDBs to harmonize financial expenditure assessments and procurement procedures, but it could do more to work in partnership with other international development organizations; to draw on their accumulated knowledge, tools, and instruments; and to harmonize governance-related policies to reduce the burden on governments.

## **V. HOW ADB SUPPORTS STRONG PERFORMANCE IN THE FIGHT AGAINST POVERTY**

### **A. Overview**

46. In March 2001, the Board of Directors approved a policy on the use of performance-based allocation (PBA) for ADF resources.<sup>20</sup> The PBA policy serves the objectives of poverty reduction and broad-based sustainable development by linking the allocation of ADF resources to country performance. Under the PBA policy, each country's performance is assessed in relation to (i) the coherence of its macroeconomic and environmental policies, (ii) the quality of its governance and public sector management, (iii) the degree to which its policies and institutions promote equity and inclusion, and (iv) portfolio quality. Country performance ratings are converted into allocation shares for ADF borrowers using the allocation formula, in which, apart from performance, allocation shares are influenced by average need measured by gross national product (GNP) per capita and country size. While the policy requires that a "robust" link between performance and lending be established, it recognizes that exceptional country circumstances have a legitimate role to play in allocating resources. This chapter provides a summary of key PBA issues.

### **B. Implementation Arrangements**

47. Considerable effort has been expended in establishing a rating system that satisfies credible quality standards that are consistently applied across countries and regions. Quality control is provided through extensive peer review within and across departments and through close oversight by Heads of Regional Departments. The Validation Group has played a crucial role in checking for compliance with the policy and, within the framework of the policy, in making recommendations for improvements in outcomes and in the associated processes. A review of the policy should consider whether current implementation arrangements promote its objectives and ensure adequate accountability for outcomes.

### **C. PBA Assessments**

48. Two rounds of country assessments and allocations under the PBA system have now been completed, with a third round currently under way. A working group, drawn from the regional departments, has taken the lead in designing and coordinating the process and ensuring cross-country consistency. Lending outcomes from the first two rounds of the PBA exercise have been incorporated in the CSPUs for 2002-2004 and 2003-2005, respectively, which have been reviewed and discussed by the Board. Country performance assessments have been discussed with governments, and consensus has been reached on performance criteria ("triggers"). In developing the PBA system, ADB staff consulted extensively with their

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<sup>20</sup> ADB. 2001. *Policy on Performance-Based Allocation for Asian Development Fund Resources*. Manila.

International Development Association (IDA) counterparts in arriving at an allocation framework customized for ADF-eligible DMCs in the Asia and Pacific region.

#### D. PBA Outcomes

49. Performance quintile ratings for the first two PBA exercises are summarized in Box 3. Notwithstanding differences in rating systems and the number of countries eligible for ADF and the IDA, ADF and IDA ratings are within one quintile of each other, with the exception of Bangladesh.<sup>21</sup>

<b>Box 3: 2001-2002 Country Performance Ratings by Quintile</b>		
	<b>2001</b>	<b>2002</b>
<b>First Quintile</b>	Bhutan, Cook Islands, Samoa, Sri Lanka, Tuvalu	Bhutan, Cook Islands, Samoa, Sri Lanka, Tuvalu
<b>Second Quintile</b>	Bangladesh, Kyrgyz Republic, Maldives, Mongolia, Viet Nam	Bangladesh, Kyrgyz Republic, Maldives, Mongolia, Viet Nam
<b>Third Quintile</b>	Cambodia, Indonesia, Kiribati, Lao People's Democratic Republic, Nepal	Cambodia, Indonesia, Kiribati, Nepal, Pakistan
<b>Fourth Quintile</b>	Azerbaijan, Federated States of Micronesia, Pakistan, Papua New Guinea, Tonga	Federated States of Micronesia, Lao PDR, Papua New Guinea, Tonga, Vanuatu
<b>Fifth Quintile</b>	Marshall Islands, Nauru, Solomon Islands, Tajikistan, Vanuatu	Azerbaijan, Marshall Islands, Solomon Islands, Tajikistan

Note: 2001 and 2002 exercise excluded Afghanistan and Myanmar; 2002 exercise also excluded Nauru.

50. The relationship between per capita lending and performance over the first two rounds of the PBA exercise was positive. The estimated elasticity of the response of per capita allocations to differences in country performance ratings was 1.25 (statistically significant). More per capita resources have been allocated to strong than to weak performers notwithstanding the influence of the “small country bias” in the allocation formula and adjustments to moderate abrupt changes from average historical lending levels.<sup>22</sup>

#### E. Emerging Patterns of Lending

51. The PBA system has resulted in a reallocation of resources from countries with small populations to those with larger populations, and from ADF-only recipients to blend countries. The “small country bias” in the allocation formula does not sufficiently capture the historical pattern of resource allocation favoring small countries. Given that ADB's Charter and the policy require that special attention be given to the needs of small countries, and that ADB's Graduation Policy envisions more limited access to ADF resources for blend countries, a review of the policy may wish to consider whether the shift in the pattern of resources being generated by the current PBA system is desirable, and how this should be addressed.

<sup>21</sup> ADB's portfolio in Bangladesh is rated more highly than the World Bank's.

<sup>22</sup> The relationship between per capita allocations and performance is also positive for Pacific DMCS (PDMCs) but less pronounced. The peculiarities of the PDMCs, in which it is not possible to have a loan in every year, mean that the relationship may take more time to establish.

## **F. Country Dialogue and Triggers**

52. As implementation of the PBA policy is progressing, CPAs and country-specific triggers are increasingly being discussed with the DMC governments, especially in the context of preparing CSPs and formulating triggers for low, base, and high case scenarios. Further steps need to be taken to enhance the use of the CPAs as a diagnostic tool, to guide country dialogue. A second issue relates to the specification of country specific triggers. Consideration might be given to letting country specific criteria have an expanded role in influencing resource allocation. Finally, the issue of whether high case lending scenarios should be financed through special provisioning or a reduction in allocations to other countries needs to be taken into account. Consideration may be given to establishing contingency fund to allow ADB to accommodate unanticipated needs of DMCs.

## **G. Disclosure**

53. As ADB gains experience, PBA assessments will increasingly become a tool for policy dialogue. ADB has already taken several important steps on disclosure. Starting in 2001, CSPs and CSPUs for ADF-borrowing DMCs contained information on country-specific triggers. A Board information paper on PBA implementation was circulated in May 2002, followed by Board seminars that provided an opportunity for discussion of the PBA process and results, including quintile rankings. As the CPA process develops and the quality of the assessments improves, a review could usefully consider what other information might be publicly disclosed in the interest of promoting the policy's objectives and greater accountability.

## **H. Exceptional Circumstances**

54. In 2001 and 2002, allocations for a small number of countries were made on the basis of exceptional circumstances. Although these decisions have been carefully scrutinized, a framework that clarifies eligibility criteria and the basis on which the assessment of needs should proceed would be helpful. In the design of such a framework, the World Bank's experience, especially in relation to postconflict circumstances, should be considered. A review might also consider how to allocate funding for exceptional circumstances without weakening the link between performance and lending.

## **I. PDMCs and "Small Economies"**

55. Most of the Pacific developing member countries (PDMCs) have very small populations and simple economic structures. To some degree, their economic opportunities are limited by their remoteness. The PDMCs raise unique issues in terms of strategies and programming and pose some challenges for the implementation of a PBA system. Although the PBA system is applied separately to the PDMCs, their smallness and limited absorptive capacity require flexibility. The issue of how this can be achieved without compromising the PBA principles should be considered in the light of past experience.

## **J. Allocation of ADF for Subregional Projects**

56. ADB's Charter mandates ADB to promote regional cooperation and integration. To effectively implement regional cooperation, ADF resources need to be used for this purpose. In accordance with this recommendation, \$125 million was preallocated for subregional projects in

2002. Allocation of ADF for subregional projects presents a challenge. Care needs to be exercised that the allocation does not undermine the link between allocation and performance.

#### **K. Need for Flexibility**

57. As currently implemented, the PBA system allocates resources on a year-by-year basis, 12 months ahead. Three-year allocations are extrapolations of annual allocations and are mainly used for planning and reporting purposes. The ability to bring forward or defer lending within the planning period is limited, which may militate against project quality and effective programming. Rollovers of unutilized allocations have been treated on an exceptional basis. The issue of how a genuine rolling allocation system can be created, and how much discretion should be permitted at a country level in applying resources over the programming period warrants considered review.

#### **L. The Way Forward**

58. In the first two years, the use of unadjusted formula allocations would have led to substantial reallocations of resources from ADF-only to blend countries for reasons largely unrelated to performance. Unchecked, such a reallocation could have proven costly in terms of both project quality and credibility. Abrupt changes in lending levels would have created difficulties for programming and operations in a context where lending pipelines and projects were already in place. It would also be difficult to justify significant reductions in allocations to small, Group A DMCs lacking access to ordinary capital resources (OCR), since ADB's Charter mandates special attention for them. All adjustments to formula-driven allocations are fully governed by ADB's PBA Policy.

59. Given that ADB has had only 2 years of experience with the PBA system, the potential value of PBA as a diagnostic tool to contribute to country dialogue, fine tune strategy, and support effective operations is still developing. In the future, strengthening the link between performance against targets set in country-specific triggers and final allocation will require greater efforts to specify credible country-specific performance criteria and apply them to determine allocations.

60. In the context of country programming, some difficulties have been encountered in explaining year-to-year changes in lending allocations (reflecting in part the impact of unanticipated demands on resources). In particular, ADB has been called on to respond to postconflict reconstruction needs in Afghanistan and Sri Lanka. To the extent that changes in demand cannot be directly accumulated as the basis of performance, the PBA system is at risk of being weakened. In this context, it is possible for countries whose performance ratings improve to experience declining allocation.

61. Although ADB's Charter mandates ADB to promote regional cooperation and integration, allocating ADF for subregional projects has presented a challenge. Care needs to be exercised that the allocation does not undermine the link between allocation and performance. Allocation between regions should be guided by performance indicators and triggers set for subregional cooperation strategies and programs. Among the methodologies under discussion are (i) clearer definitions of what constitutes subregional projects, (ii) support for subregional cooperation projects in the framework of the 3-year subregional cooperation strategy and program, and (iii) a separate allocation mechanism to support subregional projects.

62. Revisions to implementation arrangements are already in place for the 2003 exercise. Although the 2003 exercise is yet to be completed, these revisions will link per capita allocations more tightly to country performance and to the formula. As recommended by the Validation Group, the collar around which actual allocations will now be permitted to depart from recent historical averages has been widened substantially. Consequently, the collar will now determine lending levels in fewer cases, and formula allocations will prevail more often. Also, in those cases where the collar is applied it will now yield lending allocations that are closer to those provided by the formula. Accordingly, the relationship will become more strongly embedded in the system.<sup>23</sup>

63. The formats of CSPs/CSPUs will be reviewed during 2003 with particular attention to the importance of better incorporating PBA results into the strategic planning process. Formulation of triggers will be improved to make them more credible, easily monitored, and realistic. Two other significant developments in 2003 are (i) adoption of the policy on emergency lending, which will help refine the treatment of postconflict and other exceptional circumstances; and (ii) preparation of subregional cooperation strategies and programs to provide a stronger grounding for ADF allocations for subregional cooperation projects.

## **VI. SELECTED POLICIES AND STRATEGIES IN SUPPORT OF POVERTY REDUCTION**

### **A. Overview**

64. While the three pillars of the PRS (sustainable economic growth, inclusive social development, and good governance) provide broad strategic guidance for ADB operations, considerable attention must also be paid to crosscutting and thematic issues. Many ADB projects continue, as they have historically, to focus on the important objective of economic growth. Without sustained economic growth, poor countries lack tax revenues, employment opportunities, and an economic base to lift themselves out of poverty. However, economic growth alone is not sufficient. ADB recognizes that poverty is multidimensional in nature, and that economic growth projects must also take into account issues such as gender and development, environment, and private sector development. The PRS provides a framework and operational structure within which such issues are being addressed, while recognizing that the process of development must and should be driven by coherent, nationally-owned poverty reduction strategies that ADB supports.

65. The earlier chapters of this report have described how ADB implements the PRS operationally (Chapter III), how ADB supports good governance (Chapter IV), and how ADB rewards good performance (Chapter V). This chapter contains concise policy and strategy reviews related to key crosscutting and thematic elements, responding to the Donors' request for separate discussion of these important issues.

### **B. Gender and Development**

66. ADB recognizes that any strategy for poverty reduction in the region requires a concurrent emphasis on gender equality. Following adoption of the Policy on GAD in 1998,<sup>24</sup> an

<sup>23</sup> The use of a 3-year rather than a 5-year historical lending average will also ensure that the memory of pre-PBA history in current allocations recedes more quickly.

<sup>24</sup> ADB. 1998. *The Bank's Policy on Gender and Development*. Manila.

ADB-wide GAD Action Plan was finalized in 2001. This Action Plan makes commitments in three broad areas: (i) preparation of gender strategies for CSPs to ensure integration of gender concerns in pipeline projects, (ii) increased loans with GAD as a thematic classification and with effective gender mainstreaming, and (iii) increased TA and sector work on gender. An Interim Progress Report on GAD Policy Implementation, finalized in late 2002, demonstrated that, since approval of the policy, ADB has significantly increased its GAD activities compared with the prepolicy period.<sup>25</sup> ADB has made progress on integrating gender concerns into its country strategy and programming activities, and gender thematic assessments are now prepared in conjunction with CSPs. However, considerable variation exists in the depth of analysis and meaningful integration of gender concerns in CSPs. Aside from loan projects, ADB has initiated TA initiatives in support of DMC governments' efforts to improve women's economic and social status.

67. GAD issues are particularly important because they are embedded in most MDGs and MDG-related indicators. The CSP policy dialogue should include a strategic agenda for GAD issues and foster national and sector GAD policies suitable for each DMC's cultural and economic realities. Gender analysis is an essential part of the initial social assessment and must feed into project designs. Project-related policy dialogue should identify mechanisms for effectively implementing strategic gender requirements. Further, CSP and loan preparation teams should include gender experts.

68. ADB established an External Forum on Gender and Development (EFG) in 2001 to expand the organization's contacts with gender experts from governments, academia, and civil society, and to keep ADB informed about current issues and approaches related to women in the Asia and Pacific region. The EFG has met three times, with a fourth session scheduled for June 2003. Box 4 summarizes key findings of the EFG to date.

**Box 4: External Forum on Gender and Development**

The EFG commended ADB for its commitment to mainstream gender concerns into all aspects of its operations and welcomed ADB's endorsement of the MDGs as a comprehensive rights-based development agenda with a strong gender dimension. The EFG supports ADB's partnerships with international agencies and efforts to obtain observer status at the United Nations.

However, the EFG expressed concerns about the lack of visibility of gender issues in ADB's reorganized structure, and in particular the very limited number of gender specialists assigned to regional departments. Certain aspects of ADB's "institutional culture" may hamper efforts to recruit, retain, and promote professional women. More generally, the EFG observed a lack of positive incentives for operations staff to address gender issues in their work. These factors create challenges for ADB in its efforts to fulfill gender commitments to the ADF Donors. The EFG recommended that these concerns be addressed and is working with Management and senior staff to strengthen implementation of the GAD policy and fulfill ADF commitments.

69. ADB has taken a number of steps to integrate gender concerns in its operational activities. ADB's commitment to poverty reduction lends urgency to the goal of gender mainstreaming, given that two thirds of the poor in the region are women and that achieving MDG-related goals requires systematic integration of GAD issues. Targets are being set to increase the number of loans with gender as a thematic classification, and the gender content of the loan pipeline is being monitored and reported at Management meetings. The GAD Policy provides an institutional mechanism to accelerate and strengthen mainstreaming of gender in ADB operations. It provides for a full review and evaluation of implementation after 5 years.

<sup>25</sup> ADB. 2002. *Policy on Gender and Development: Interim Progress Report*. Manila.

This review, to be carried out in early 2004, will focus on the quality of gender analysis and strategies in CSP/CSPUs, integration of gender issues into poverty analyses, and allocating ADB staff resources to support gender mainstreaming, among other issues. However, much more needs to be accomplished to fully anchor gender in our key operational activities. While progress has been made, increased attention will need to be given to GAD if the MDGs are to be realized.

### **C. Environment**

70. During the last four decades, the environment and natural resources in the Asia and Pacific region have come under intense pressure. Environmental degradation in the region is pervasive, accelerating, and largely unabated. Recognizing this, ADB revised the Environment Policy consistent with and supportive of the PRS.<sup>26</sup> The policy revolves around ADB's commitment to address five major challenges, stated as needs for (i) environmental interventions to reduce poverty, (ii) mainstreaming environmental considerations in economic growth, (iii) maintaining global and regional life support systems, (iv) working in partnerships, and (v) integrating environmental considerations into ADB operations. These challenges represent a consensus resulting from extensive stakeholder consultations.

71. ADB engages in diverse activities to address the five environmental challenges identified in the policy. For example, ADB helps DMC governments combat environmental degradation through advisory, regional, and project interventions. Agriculture and natural resources projects have involved biodiversity conservation, coastal resource management, stabilization of shifting cultivation, irrigation, watershed management, integrated pest management, coastal greenbelt conservation, and marine culture and natural resource management. Widespread adoption of environmental impact assessment techniques in ADB-supported public sector projects has helped make ADF VIII investments more sustainable and has contributed to improved regulatory regimes and practices. Within ADB projects, alternative project technologies are considered to ensure that investments are both financially sustainable and as environmentally benign as possible. Increasingly, stand-alone environment projects address crosscutting concerns that directly affect the poor. Efforts to improve natural resource management now directly involve the poor, women, and socially excluded groups.

72. Implementing ADB's Environment Policy requires careful attention to environmental assessment, dissemination of information, and managing consultative process. Effective environmental assessment requires (i) upstream environmental assessment at the level of country programming, (ii) structured consultations in the conduct of environmental assessments, and (iii) emphasis on monitoring and compliance with environmental requirements during project implementation. Environmental assessment is treated as an ongoing process rather than a one-time event. Information about the results of environmental assessment must be disseminated both within and outside the ADB through meetings and all available media (e.g., electronic mail; facsimile; and an interactive web site with the overview paper, environment policy working paper, questionnaires, consultation schedule and contacts, and synthesis of comments). Country consultation meetings involving government agencies, NGOs, academia, the private sector, civil society, and other development agencies are then held to solicit feedback on the draft environment policy working paper. Taken together, these activities are helping ADB address the five challenges identified in the Environment Policy.

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<sup>26</sup> ADB. 2002. *Environment Policy of the Asian Development Bank*. Manila.

## D. Core Labor Standards

73. ADB's Core Labor Standards (CLS) initiatives are implemented within the context of the Social Protection Strategy (SPS).<sup>27</sup> The SPS commits ADB to develop quality interventions in the areas of labor markets, social insurance, social assistance, schemes to protect communities, and child protection. ADB's Social Protection Network has taken the lead in recruiting and deploying specialists, issuing guidelines, and engaging in dialogues with partners such as NGOs, labor unions, and the International Labour Organisation (ILO).

74. ADB is increasingly engaging in labor issues. Examples include situations in which workers lose their employment as a result of public or private sector restructuring or when ADB projects involve developing labor market policies or investments. In other cases, interventions address labor legislation, forced labor, workplace discrimination, child labor, or constraints to workers' rights. ADB also supports active dialogues, as in the case of a regional technical workshop in 2002 attended by representatives from the governments of Bangladesh, Nepal, Philippines, and Thailand; labor and employer organizations; labor/research institutes; social accountability/standard organizations; NGOs; international aid agencies; ILO; and ADB staff. The workshop recommended that governments, ADB, and ILO (i) highlight labor standards in policy dialogue with governments, (ii) promote improved labor standards by designing projects to address child labor, (iii) improve occupational safety, (iv) reduce discrimination at the workplace and eliminate bonded labor; and (v) strengthen monitoring of working conditions. ADB also supports direct interventions addressing core labor issues, as shown in Box 5.

### Box 5: Fighting Bonded Labor Practices in Pakistan

In the Sindh Rural Development Project in Pakistan (approved in late 2002), ADB is engaging in extensive policy dialogue regarding the abolition of bonded labor practices in the project area. The feudal relationship between landlords and sharecroppers was a major structural barrier to reaching the majority of poor households. Among the key outputs of the project were (i) registration of landless sharecroppers, leading to the recognition of their existence and basic rights; (ii) amendments to land tenancy laws, leading to improved and more balanced landlord-sharecropper relations; (iii) development of a simplified accounting system to reduce the risk of fraud affecting the poor; and (iv) transfer of land and property rights through rural homestead settlement programs.

75. ADB is starting to integrate CLS into CSPs/CSPUs, and all ADB interventions are expected to comply with CLS. Projects are required to incorporate necessary and appropriate steps to ensure that procurement of goods and services, contractors, subcontractors, and consultants comply with the country's labor legislation (e.g., minimum wages, safe working conditions, social security contributions) as well as with CLS. Full implementation of CLS into ADB operations remains an ongoing process.

## E. Private Sector Development

76. ADB has always recognized the importance of private sector operations in the region's development. ADB's Private Sector Development (PSD) Strategy<sup>28</sup> is based on the assumptions that (i) sustained economic growth creates jobs and reduces poverty; (ii) the private sector is the largest source of employment and investment; and (iii) a vibrant private sector increases the tax base for the delivery of social services provided by the state. ADB has undertaken a number of initiatives to implement its PSD Strategy, but given the huge investment needs of DMCs and

<sup>27</sup> ADB. 2001. *Social Protection Strategy*. Manila.

<sup>28</sup> ADB. 2000. *Private Sector Development Strategy Paper*. Manila.

their limited borrowing capacities, more work remains to be done to mobilize private investment. ADB operations have the potential to create enabling conditions for business and pave the way for attracting much-needed private funds. However, a review of ADB's PSD portfolio has revealed that the PSD classification is applied to projects to widely varying degrees, and that clearer guidelines for determining PSD status in ADB operations should to be developed.

77. An example of ADB's public sector operations in support of PSD is shown in Box 6.

**Box 6: Public Sector Operations in Support of PSD**

Recent public sector operations supporting PSD include projects involving (i) trade and investment facilitation, including customs harmonization; (ii) deepening the financial sector through financial sector reforms and capital markets programs; (iii) state-owned enterprise (SOE) reforms; and (iv) small to medium enterprise (SME) support. In a recent TA project for SOE reform in Indonesia, for example, ADB worked with the Government, SOE management, labor unions, and other stakeholders to develop corporate restructuring plans for 21 SOEs, privatization strategies for 8 SOEs, and corporate governance reforms in 30 SOEs. In addition, the TA provided assistance in drafting the new SOE law and developed new labor policies for addressing redundancies in the SOE sector.

78. However, on the public sector side, ADB has a limited number of PSD specialists who are expected to develop strategic tools for strategy implementation and provide strategic as well as operational support to increase the private sector impact of public sector operations (both loans and TA projects) in most of ADB's 41 DMCs and across all sectors. The tasks at hand, including implementing the PSD Strategy ADB-wide, providing strategic inputs to country strategies and programs, mainstreaming PSD in ADB's operations, and coordinating all PSD-related activities in ADB, are clearly unmanageable, given the scarce resources available. In addition, valuable sector specialization cannot be provided by such a limited number of PSD specialists. Given the enormous potential for PSD in DMCs, additional resources in the form of seasoned individuals with expertise in PSD, including long-term experience in related policy dialogue, strategic planning as well as operations—ideally both in the public and in the private sector—are needed to more effectively implement the PSD Strategy.

79. Given the limited amount of resources available for this important theme, ADB is taking a strategic approach to PSD. Since adoption of the PSD Strategy in March 2000 and in accordance with its requirements, a number of private sector assessments (PSAs), which serve as inputs into CSPs, have been drafted. ADB's aim is to identify PSD constraints and opportunities and address them through strategically programmed priority operations. A PSA review showed that the quality and methodology applied to PSAs varied considerably. To respond to the need for improved quality, consistency, and efficacy of PSAs, ADB has developed a good practice approach to mainstreaming PSAs.

80. ADB operates under the principle that DMCs must exercise leadership and ownership of their own development agenda and priorities by demonstrating initiative, commitment, and accountability. Country ownership and leadership in the PSD process require capacity building and continued dialogue and consultation between ADB and key stakeholders in and among DMCs. ADB facilitates such exchanges through policy dialogue, workshops, conferences, and training, like for example the highly successful ADB-PPIAF conference on "Infrastructure Development—Private Solutions for the Poor" held at ADB headquarters in Manila in October 2002. In addition, ADB's RMs have been interacting closely with governments, chambers of commerce, and the private sector to facilitate exchange on PSD.

## **F. Infectious Diseases Including HIV/AIDS<sup>29</sup>**

81. ADB places a high priority on combating HIV/AIDS and other infectious diseases. Although ADB support for control and prevention of communicable diseases focuses primarily on system building and integrated primary health care, some disease-specific projects and programs are also supported. ADB has initiated the Asian Vaccination Initiative, which will strengthen immunization programs against communicable diseases. Similarly, ADB supports the World Health Organization (WHO)/United Nations Children's Fund (UNICEF) Roll Back Malaria Initiative. Where feasible, existing health projects are being retrofitted to address HIV/AIDS. A regional HIV/AIDS project approved in 2001 covers Cambodia, Lao People's Democratic Republic (Lao PDR) and Viet Nam. Project management units have been established, and implementation is well under way. Several TAs and projects focusing on communicable diseases (including malaria, tuberculosis, pneumonia, vaccine-preventable diseases, water and food-borne diseases, and HIV/AIDS) have been approved and implemented during the last 2 years. Many projects and TAs in the pipeline for 2002 and 2003 have health components that support the prevention of communicable diseases.

82. ADB, in cooperation with the other major MDBs, has been engaged in high-level dialogue with the Global Fund for AIDS, TB and Malaria on defining a strategic relationship between the MDBs and the Global Fund. The MDBs are considering, inter alia, a possible joint memorandum of understanding with the Global Fund that would set out administrative arrangements for both strategies and cooperation. ADB will report to donors on further developments at an appropriate time during any future negotiations on ADF replenishment.

## **G. Drug Control**

83. ADB's leading role in subregional economic cooperation in the Greater Mekong Subregion (GMS) led to the development of cooperative arrangements between ADB and the United Nations Drug Control Programme (UNDCP) East Asia Regional Center. Results include ongoing cooperation at the institutional, program, and project levels and drug eradication efforts in Lao PDR, Myanmar, Thailand, and Yunnan province of the People's Republic of China (PRC). Priority is given to subregional cooperation, with an emphasis on improving livelihoods among the rural poor in opium-poppy producing areas and ultimately eradicating drugs in the subregion. ADB intends to coordinate its activities in drug control with the initiatives under combating money laundering and financing of terrorism.

## **H. Regional and Subregional Cooperation**

84. Regional integration and cooperation are playing an ever more important role in the Region's development. Recognizing the importance of regional and subregional cooperation, ADB's Strategy and Policy Department recently reviewed the development and institutional context of ADB's regional cooperation activities. ADB is reviewing the institutional frameworks of these activities to make them more responsive and effective in addressing the increasingly complex demands of subregional cooperation. Among ADB's subregional initiatives are the GMS Program, the Central Asian Regional Economic Cooperation Program (also known as the Greater Silk Road Program), and South Asia Subregional Economic Cooperation Program. The West Asian countries of Afghanistan, Pakistan, and Turkmenistan are working together on various initiatives, with the prospect of future involvement by India. ADB's subregional activities

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<sup>29</sup> Human immunodeficiency virus (HIV)/acquired immune deficiency syndrome (AIDS).

also address specific sectors, as shown in the subregional collaboration to combat malnutrition described in Box 7.

**Box 7: Subregional Program to Improve Nutrition for Poor Mothers and Children**

One of the outputs of the Almaty Forum (2001) was a subregional agreement to boost production, distribution, and consumption of iodized salt and iron-enriched wheat flour. The Forum led to an agreement between ADB and several Central Asian governments (Azerbaijan, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan) to work together to combat iodine deficiency, goiter, and iron deficiency anemia. This included establishing standards for flour fortification, trade regulations to facilitate movement of fortified foods across borders, and the promotion of social marketing and communications strategies through NGOs. ADB cosponsored the initiative collaboratively with UNICEF and the Kazakh Academy of Nutrition, with some grant funding (almost \$7 million) from ADB's Japan Fund for Poverty Reduction.

## I. Internal Governance

85. The Board of Directors in 2000 developed a detailed action plan for internal governance initiatives that included (i) informal, quarterly meetings between staff and Board members to discuss the schedule of Board meetings and the work program; (ii) more frequent meetings of the Budget Review Committee of the Board, with meetings held as needed and in any case at least semiannually; (iii) the creation of DEC; (iv) strengthening of and increased visibility for OED; (v) greater Board involvement and input to the CSP/CSPU process; (vi) strengthening of the Inspection Function with increased Board involvement; and (vii) retreats for Management and the Board on a semiannual basis to build communications and improve strategic planning. All of these recommendations were implemented in 2001, with the exception on the review of the Inspection Function, which began in 2002.

86. Accountability continues to be enhanced through various mechanisms, and the Board is currently reviewing a working paper on the Inspection Function.<sup>30</sup> This process began during last quarter 2001, when an interdepartmental working group and steering committee were set up to review the Inspection Function. Various other activities were undertaken in 2002 and 2003 to strengthen the Inspection Function. There is now a consensus and strong expectation that the new mechanisms must complement and enhance ADB's objectives of poverty reduction, development effectiveness and efficiency, and increased project quality.

87. The recently established DEC is responsible for (i) annual reviews of the work program of OED, (ii) reviews of selected OED evaluation reports and ADB follow-up actions, (iii) reporting to the Board on high priority operations evaluation issues, (iv) monitoring and reporting to the Board on the implementation of its decisions, (v) reviewing annual programs for preparation of project completion reports and TA completion reports, and (vi) reviewing the annual report on ADB's loan and TA portfolio. The DEC's six members are serving an initial term of two-and-a-half years; subsequently, members will serve a two-year term. OED provides secretariat support. DEC disseminates its findings in ongoing dialogues with the Board and development partners and places results prominently on the ADB web site to ensure global transparency.

<sup>30</sup> ADB. 2003. *Review of the Inspection Function: Establishment of a New Accountability Mechanism*. Manila, Working Paper 1-03, 17 February.

## VII. MAKING ADB A MORE EFFECTIVE ORGANIZATION AND PARTNER IN DEVELOPMENT

### A. ADB and Its Development Partnerships

88. ADB recognizes that, given the magnitude and far-reaching impact of poverty in the region, it cannot accomplish its objective without strong and committed cooperation among donor partners. This takes the form of close collaboration at the strategic, sector, and project levels, and requires mutual trust and good communications. Such close partnerships lower transaction costs for client countries as well as the donors themselves. The following are some examples of how ADB is working with its development partners and enhancing its own processes and procedures in the fight against poverty.

### B. Enhanced Business Processes to Fight Poverty

89. To improve its own effectiveness and become a better partner, and recognizing that the PRS represents a major shift in strategic thinking, ADB has substantially realigned its organization and resources.<sup>31</sup> ADB's comprehensive review of its operational business processes led to the introduction of a new set of business processes in January 2002 (see footnote 14) guided by the following principles: (i) alignment with the LTSF and MTS, (ii) quality at entry, (iii) more flexibility and greater accountability, (iv) greater client participation and ownership, (v) a team approach, (vi) simplified documentation, (vii) elimination of processing stages that do not add value, and (viii) more effective use of information technology. The functions of former program and project departments now reside within five unified RDs in support of enhanced country focus and clear accountability. Operational support for strategic issues such as poverty, governance, social dimensions, and environment has been mainstreamed into sector divisions located in the RDs. RSDD provides a consolidated focus for technical expertise, quality advice, and compliance monitoring. RSDD and the five RDs collaborate on regional and subregional cooperation.

### C. Expanded Resident Mission Role

90. Donors recommended that ADB implement the RM policy during the ADF VIII period.<sup>32</sup> Overall, the action plan has been successfully implemented, although the range and level of activities implemented depends on country circumstances and organizational resources. RMs have always had close contacts with DMC governments, and government agencies appreciate their expanded role. Newer RMs are building strong relationships, as in the People's Republic of China Resident Mission, Lao Resident Mission, and Mongolia Resident Mission. RMs communicate important information on country issues through both formal and informal channels, and play an active role in aid coordination, particularly in countries where ADB is the largest aid provider. This entails coordinating meetings and coordinating work to reduce overlap and increase efficiency.

91. Decentralization to RMs is now effectively ongoing under the reorganized structure, and assisted by the regional management team approach. RMs are becoming major players in country, sector, and thematic level coordination forums. Many are strengthening their sector and thematic capabilities by engaging staff with gender, governance, and social sector expertise.

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<sup>31</sup> An ongoing review on the progress of implementation of the reorganization will be completed by the second quarter of 2003.

<sup>32</sup> ADB. 2000. *Resident Mission Policy*. Manila.

They also fulfill a specific and vital function in country programming. The increased level of RM activity and the success of pilot tests in four countries show that properly staffed RMs can be given a primary role in this function. Many RMs are also active in external relations and information dissemination (e.g., press conferences, interviews, articles for newspapers, and coordinating media visits) and have established or expanded their websites and set up libraries.

#### **D. Strengthened Collaboration with Other Donors**

92. ADB collaborates with bilateral and multilateral donors to support the formulation and implementation of each DMC's NPRS/PRSP. ADB regularly consults with other agencies such as the World Bank, the International Monetary Fund, the United Nations Development Programme, and the European Union. In certain sectors, ADB shares information and otherwise collaborates with specialized agencies of the United Nations, including WHO, the Food and Agriculture Organization of the United Nations, and the International Fund for Agricultural Development. ADB also works closely with the bilateral development agencies of countries such as Australia, Japan, the Netherlands, and the United Kingdom. Areas of collaboration include joint consultations on poverty reduction; cofinancing; cooperative TA; and pooled economic, thematic, and sector work. ADB has taken a lead role in donor coordination in DMCs where it has a comparative advantage and/or when requested by the government. Examples include (i) governance in Indonesia; (ii) selected aspects of poverty reduction in some DMCs together with the World Bank and the United Kingdom's Department for International Development; (iii) water supply and sanitation in Nepal and Sri Lanka; (iv) water resources and forestry/biodiversity in Bangladesh, Cambodia, Sri Lanka, and Viet Nam; and (v) health sector reform in Cambodia, Lao PDR, and Viet Nam.

93. MDBs are key development partners for governments in their efforts to reduce poverty. The key elements of an MDB system of collaboration are now in place, supported by regular interaction of the MDBs' Presidents and their joint statements providing strategic guidance. Memoranda of Understanding between ADB and other development institutions (including the World Bank and the European Bank for Reconstruction and Development) provide operational guidance at the country and regional levels, and a structure for harmonizing policies and developing joint platforms. Coordinated analytical work and advice are growing in importance, as is collaboration to address country-level and regional challenges. In addition, an MDB working group is examining the issue of the link between evaluation and country-based strategic planning or the "scaling-up" of measuring and monitoring development effectiveness. As mentioned in Chapter IV (How ADB Supports Good Governance), ADB is also working closely with other MDBs on harmonizing procedures and practices.

94. Shareholders and the development community are now showing increased interest in MDB activities and collaboration, with several studies and proposals for reforming and strengthening the MDBs as a group put forward in recent years. For example, the procurement group has produced a master standard bidding document for procurement of goods and is in the final stages of disseminating similar standards for civil works and consultants. Similarly, the environmental assessment group has produced a good practice framework for environmental assessments and promoted the common use of a Pollution Abatement Handbook. Box 8 provides a good illustration of ADB's active collaboration in the water sector.

**Box 8: Donor Collaboration as Key Component of ADB's Water Sector Work**

The challenges of ensuring that water is conserved and managed wisely are huge, and no single agency can hope to address them in isolation. Thus, ADB's Water Policy ("Water for All") emphasizes the importance of partnerships with governments, other international and bilateral agencies, the private sector, research institutes, and NGOs. ADB's Cooperation Fund for the Water Sector (December 2001) is a multidonor facility that features a water awareness program, pilot demonstration activities, support for regional networking and events, knowledge management, and capacity building. The Fund helped support several initiatives in connection with preparations for the 3rd World Water Forum in Kyoto, Japan, where ADB is taking a leading role in the themes of water and poverty, water and cities, water and small island countries, shared water resources in central Asia, and poverty and floods. ADB established a Water and Poverty Initiative to ensure a strong focus on poverty reduction, with partners including the African Development Bank, Gender and Water Alliance, Global Water Partnership, International Union for the Conservation of Nature, International Water Management Institute, Inter-American Development Bank, Japan Bank for International Cooperation, Japan International Cooperation Agency, Netherlands Ministry of Foreign Affairs, Royal Danish and Netherlands Embassies in Bangladesh, UNICEF, WaterAid, Water Supply and Sanitation Collaborative Council, and others.

95. ADB works closely with its development partners to provide global public goods effectively. Global public goods have benefits that span borders, generations, and population groups (e.g., treatments for communicable diseases, environmental protection, trade integration). The need for these goods is perhaps most acute in the poorest countries, including ADF countries (in particular, effective tools to fight HIV/AIDS and other infectious diseases). Recognizing this, ADB collaborates closely with its partners to develop cohesive strategies and programs based on each institution, concentrating on its own comparative strengths and harmonizing activities to achieve cost-effective solutions.

## **E. The Way Forward**

### **1. Working with Partners**

96. ADB and its development partners have made significant progress in building a coherent MDB group that collaborates at the forefront of the global development agenda. However, this progress is fragile, and ADB still faces major challenges in making the transition from strategic alignment to integrated operational collaboration. Of central importance is enhanced coordination of country operational work. The collaboration under way is reducing the negative aspects of inter-MDB competition and increasing complementarities. Ongoing efforts will be required, however, to increase transparency and mutual understanding.

97. The financial and analytical strength of the MDBs makes it essential that they work together to improve mutual understanding of the determinants of social and economic development and improve the way in which the international community fights global poverty. ADB will continue to participate and, where appropriate, take the lead in MDB collaborations to increase the effectiveness of development cooperation through analytical work, better coordination and harmonization, and effective resource mobilization.

98. The work of ADB and its development partners revolves around the Monterrey consensus, which provides a shared framework incorporating the principles of (i) poverty reduction as a key mandate; (ii) the use of a long-term, comprehensive approach; (iii) country ownership; (iv) strategic development partnerships; and (v) a consistent focus on results and development effectiveness. ADB endorses the harmonization of operational policies, procedures, and approaches as essential for reducing transaction costs for DMCs and enhancing aid effectiveness, and continues to work closely with bilateral donors and

governments to strengthen and maximize the use of local resources, while maintaining accountability.

## **2. Global Public Goods**

99. Beyond the country level, ADB and its partners continue to articulate joint and specific roles in the provision of global public goods. In particular, ADB will be a responsive and responsible partner with reference to the Global Fund for AIDS, TB and Malaria and other global initiatives that can have a major impact in reducing poverty. ADB looks forward to positive collaboration with the recently formed international task force on global public goods and will do its best to support its work. Regional integration issues and support for client countries in general on trade-related issues are also very important areas of attention.

## **3. Enhancing Development Effectiveness**

100. Carefully coordinating MDB and bilateral programs within the context of the national poverty reduction strategy and the MDGs is now of vital importance in poor countries. Recognizing this reality, ADB will need to strengthen its collaboration with other MDBs and bilateral agencies to harmonize efforts where relevant and to identify areas or sectors in which ADB's existing expertise gives it a comparative advantage. Depending on country-specific parameters, optimal development strategy might involve division of labor in some cases and joint operations in others. ADB must ensure that its CSPs/CSPUs provide a clear and comprehensive picture of development partner activities and an analysis of how those efforts are related to ADB operations. ADB should also work closely with other development partners in reporting the progress on the MDGs. Such collaboration will enhance development effectiveness and create the ability to optimally mobilize available external resources in the global fight against poverty.

# **VIII. MOBILIZATION, ALLOCATION, AND USE OF ADF VIII RESOURCES IN FIGHTING POVERTY**

## **A. Overview**

101. This chapter highlights issues related to mobilization, allocation, and use of ADF VIII resources during 2001-2002 and projections for 2003-2004. This includes discussion of thematic allocations, sector allocations, and financial management and planning.

## **B. Donor Contributions**

102. ADF funds are obtained primarily from new donor contributions and existing resources. New donor contributions to ADF VIII have been based on "fair burden sharing," with donors agreeing to share the cost of replenishment in a manner that balances demand for equity with the legitimate, prioritized concessional needs of ADF-eligible countries. Levels of burden sharing are determined based on negotiated outcomes, with some donors taking on higher than their "fair" shares. At the September 2000 negotiations in Okinawa Japan, 25 donors recommended a level of ADF operations (2001-2004) of \$5,646 million, with 49% coming from burden-shared new donor contributions, 49% from repayment of earlier loans and investment and loan income under the expanded advance commitment authority (EACA) program, and 2% from accelerated encashments. A pledge of an additional \$100 million contribution to ADF VIII

was received from Spain. See Table 1 on the status of ADF VIII contributions as of 31 December 2002.

**Table 1: Status of ADF VIII Contributions  
as of 31 December 2002**

<b>Donor</b>	<b>Instruments of Contribution Submitted</b>	<b>Receipt of Promissory Notes for First Installment Payment</b>	<b>Receipt of Promissory Notes for Second Installment Payment</b>
Australia	✓	✓	✓
Austria	✓	✓	✓
Belgium	✓	✓	✓
Canada	✓	✓	✓
Denmark	✓	✓	✓
Finland	✓	✓	✓
France	✓	✓	✓
Germany	✓	✓	✓
Hong Kong, China	✓	✓	✓
Italy <sup>a</sup>	✓	✓	✓
Japan	✓	✓	✓
Korea, Republic of	✓	✓	✓
Netherlands	✓	✓	✓
New Zealand	✓	✓	✓
Norway	✓	✓	✓
Portugal	✓	✓	✓
Singapore	✓	✓	✓
Spain	✓	✓	✓
Spain-additional <sup>b</sup>	✓	✓	✓
Sweden	✓	✓	✓
Switzerland	✓	✓	✓
Taipei, China	✓	✓	✓
Thailand	✓	✓	✓
Turkey	✓	✓	✓
United Kingdom	✓	✓	✓
United States <sup>c</sup>	✓	✓	✓

<sup>a</sup> The Italian authorities informed ADB that they are in the process of obtaining all approvals necessary for the submission of ADF VIII Instrument of Contribution and installment payments.

<sup>b</sup> In 2002, Spain pledged an additional contribution to ADF VIII of \$100 million, and has paid the first of the two equal installments.

<sup>c</sup> Funds (\$97.2 million) have been appropriated. However, ADF VIII has not been authorized. Therefore, the US has not yet submitted its Instrument of Contribution.

### **C. Allocation and Use of ADF VIII Resources**

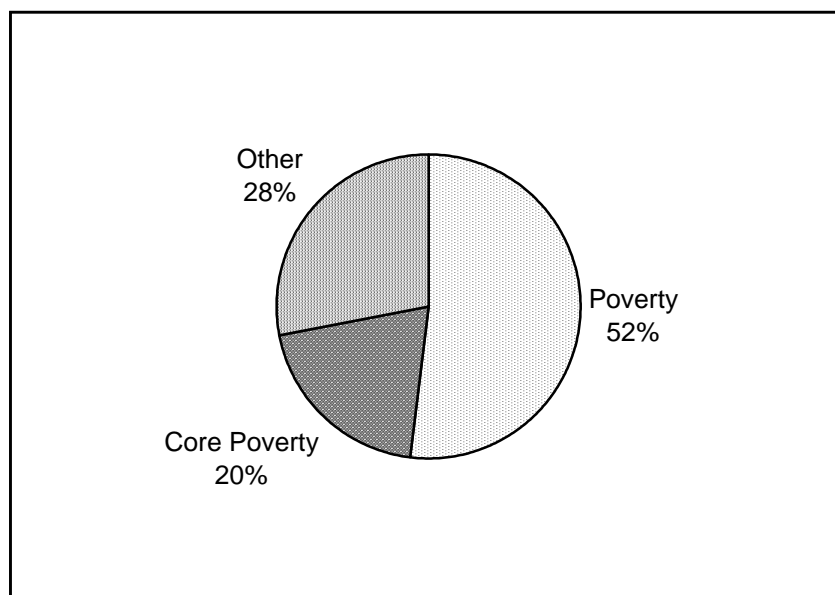
103. ADB's overarching objective of poverty reduction dictates that all ADB projects have a tangible impact on poverty. ADB emphasizes the measurement of poverty impact and the use of a classification system, with the portfolio including (i) poverty interventions (PI), including a

subset of core poverty interventions (CPI), and (ii) other (thematic) interventions.<sup>33</sup> The following are some key breakdowns of the ADF VIII portfolio for the 2001-2004 period:

- (i) **Loan classification.** Seventy-two percent of ADF loan volume will go to PI/CPI interventions.
- (ii) **Thematic classification.** Over one quarter (27%) of loans have a thematic classification of economic growth, and 20% are classified as human development.
- (iii) **Sector classification.** Energy, and transport and communications together account for 23%, while agriculture and natural resources accounts for 26%.
- (iv) **DMC Group classification.**<sup>34</sup> Group A countries (ADF only) comprises 31% of the estimated total ADF VIII lending program, while Group B1 (ADF and limited OCR) accounts for 62% for 2001-2004.

104. Figure 2 shows the poverty classification for ADF VIII lending over the 2001-2004 period; taken together, 72% of ADF loan volume goes to PI/CPI interventions. The “other interventions”<sup>35</sup> are also required to have a measurable poverty impact.

**Figure 2:  
Project Classification for ADF VIII Lending, 2001-2004**



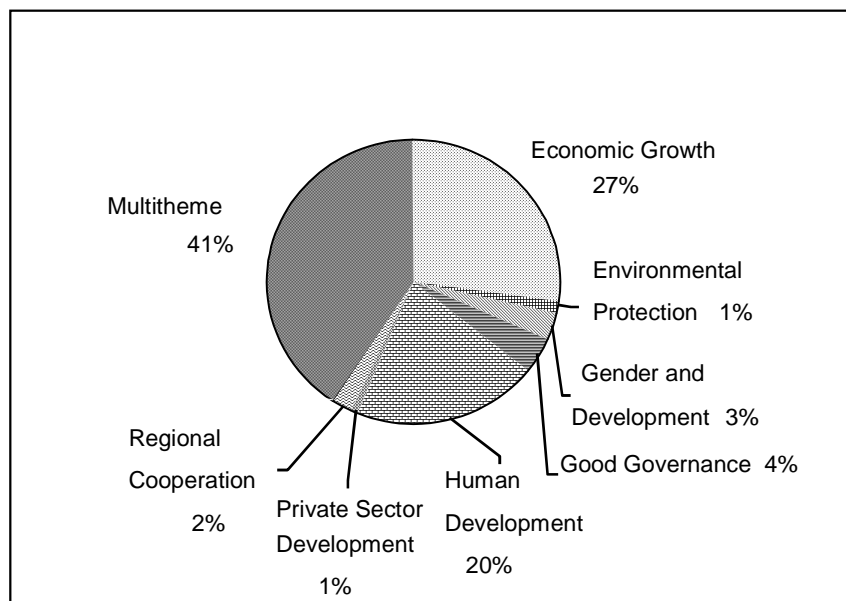
<sup>33</sup> ADB. 2000. *Staff Instructions: Loan Classification System – Confirming to the Poverty Reduction Strategy*. Manila

<sup>34</sup> Under the ADB’s DMC Group classification, Group A countries (ADF only) are Afghanistan, Bhutan, Cambodia, Kiribati, Kyrgyz Republic, Lao PDR, Maldives, Mongolia, Myanmar, Nepal, Samoa, Solomon Islands, Tajikistan, Tuvalu, and Vanuatu; Group B1 countries (ADF and limited OCR) are Azerbaijan, Bangladesh, Cook Islands, Federated States of Micronesia, Pakistan, Marshall Islands, Sri Lanka, Tonga, and Viet Nam; and Group B2 countries (OCR and limited ADF) are PRC, India, Indonesia, Nauru, and Papua New Guinea.

<sup>35</sup> These refer to projects with nonspecific poverty interventions.

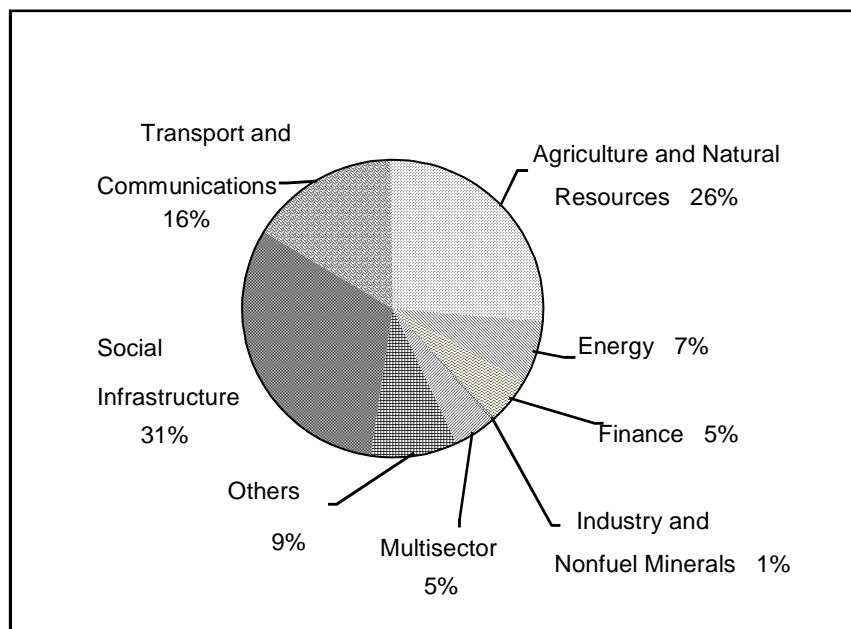
105. Figure 3 shows the thematic classification of ADF lending program (\$ volume) for 2001-2004. More than one quarter (27%) of loans have a thematic classification of economic growth, followed by 20% with human development. The other specific thematic classifications occur in fewer than 10% of loans. A large proportion (41%) of loans are classified in the “multitheme” classification, which refers to projects covering two or more themes including, for example, gender and development, governance, and private sector. The large proportion classified as multitheme projects reflects the multidimensional nature of the poverty interventions and socially oriented projects that ADF loans support.

**Figure 3:  
ADF VIII Lending by Thematic Classification, 2001-2004**



106. Figure 4 shows the sector classification of ADF lending program (\$ volume) for 2001-2004. The energy, and transport (including rural and feeder roads) and communications sectors together account for 23% of ADF VIII lending. The combined agriculture and natural resources and social infrastructure sectors, where most projects with PI/CPI interventions are concentrated, account for 57%.

**Figure 4:  
ADF VIII Lending by Sector Classification, 2001-2004**



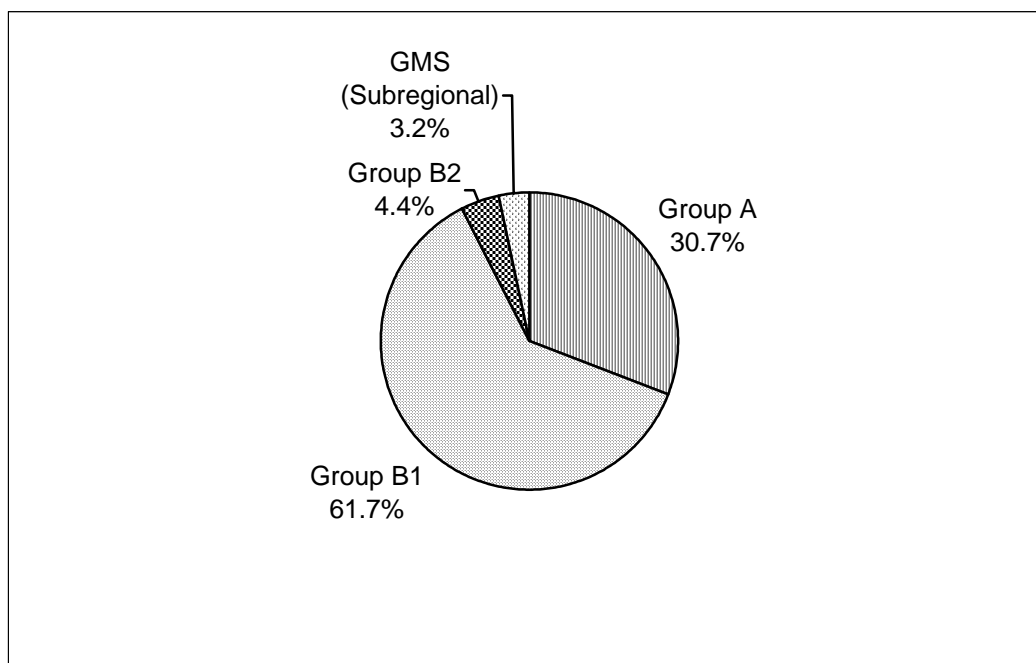
Note: Multisector refers to projects with two or more sectors and/or subsectors.

107. Between 1997 and 1999, 29% of ADF allocation was for social infrastructure investments, as compared with 34% for physical infrastructure investments. For 2000-2002, allocation to social infrastructure remained approximately the same (28%), while agriculture and natural resources increased to 31%. For 2003-2005, social infrastructure is estimated to increase to approximately 36% of total ADF resources. The shift towards increased investment in social infrastructure and poverty interventions is being phased in systematically while maintaining a focus on the physical infrastructure and broad economic growth investments necessary to sustain and increase productivity and revenue generation. The transition towards more direct poverty reduction interventions is evident in the 2003-2005 period as individual CSP programs shift and existing pipeline projects work their way through the 3-year rolling plan period. Overall, social infrastructure projects show a steady increase in loan volume from \$1.1 billion in 1997-1999 to \$1.3 billion in 2000-2002, and an estimated \$1.5 billion for 2003-2005. In 2005, the estimated volume of lending to the social infrastructure sector is approximately \$567 million, compared to an average of \$356 million in the pre-PRS period, 1997-1999.

108. Figure 5 shows the distribution of ADF VIII resources by DMC group classification. Group A countries (ADF only) comprise 31% of the estimated total ADF VIII lending program. Sixty two percent of the total ADF lending program for 2001-2004 is for Group B1 countries (ADF and limited OCR), reflecting their high absorptive capacities and relative performance, while Group B2 countries (OCR and limited ADF) account for only 4% and the Greater Mekong Subregion 3%. Countries with the largest shares in the ADF lending program for 2001-2004 are Pakistan (19%), Viet Nam (17%), and Bangladesh (15%).

109. ADB supported postconflict initiatives in Afghanistan in 2002, with such allocations comprising 9% (\$150 million) of total ADF lending for the year. Afghanistan's share in terms of the total ADF lending program for 2001-2004 is equal to 7% (\$430 million).

**Figure 5:  
ADF VIII Lending by DMC Group Classification, 2001-2004**



#### **D. Financial Planning and Management**

110. Resources for concessional financing are increasingly becoming scarce, thus making effective and efficient management of their resources absolutely essential. Recognizing this, ADB developed a long-term strategy for financing its concessional operations during ADF VIII by closely linking financial management of total ADF resources to new resource mobilization from donors. This strategy was designed to gradually make ADF self-financing, with new donor contributions constituting a decreased proportion of total ADF resources over time. To accomplish this, ADB is maximizing commitment authority by using existing resources prudently and efficiently under the EACA scheme.

111. The EACA program involves matching future reflows with disbursements while maintaining liquidity at an acceptable level. This enables ADB to generate additional commitment authority from the following: (i) future reflows of past ADF loans, (ii) revenue from service charges and interest income net of administrative expenses, (iii) investment income, (iv) resources set aside from OCR, (v) loan savings and cancellations, and (vi) any OCR net income transfer that may be approved by the Board of Governors from time to time. At the conclusion of the ADF VIII negotiations, ADB committed \$685 million of EACA annually for the 4-year period 2001-2004. Favorable outcomes in loan repayments and investment income, however, allowed ADB to commit larger-than-anticipated amounts in each year of the ADF VIII period (approximately \$800 million annually). Nevertheless, the additional commitment authority is not adequate to enable ADF to meet the total demand for concessional assistance in ADF VIII.

112. Additional resource mobilization for grant-financed TAs is currently highly constrained, while at the same time ADB is taking prudent steps to generate funds from existing resources. In addition, policies and measures to improve TA efficiency and effectiveness and to finance TA in a sustainable manner are under way.

## **E. The Way Forward**

113. The use of ADF VIII resources has been effectively managed, although ADF continues to face a number of risks and constraints. ADB is exhausting all efforts within limits to maximize commitment authority from internal resources. These efforts have to date enabled ADB to meet the donor-specified lending levels.

114. A number of major unforeseen events have occurred since the ADF VIII Donors' Report in 2000 was approved by the Board of Directors. The tragic events of 11 September 2001 and their aftermath significantly affected the Asia and Pacific region in general, and the way in which ADB manages ADF VIII resources in particular. Large, unplanned commitments of ADF resources to Afghanistan led to reallocations and a revisiting of funding levels for other ADF-eligible countries. To alleviate the "crowding out" of such planned assistance, donors may consider additional contributions to ADF and TA funds, as demonstrated by Spain's \$100 million additional commitment to ADF VIII.

115. ADB continues to seek donors' support for both ADF and the Technical Assistance Special Fund (TASF) for new contributions, and in mobilizing resources to ADF VIII in a timely manner, which involves (i) Instruments of Contribution, (ii) promissory notes, and (iii) encashment of promissory notes.

## **IX. CONCLUSION**

116. It is an inescapable reality that fighting poverty in the Asia and Pacific region will require a continuing long-term commitment by development partners working together, including close donor collaboration. ADB believes that it has made and continues to make significant strides towards this goal. While much remains to be done, ADB is moving along a productive path. ADB will continue to effectively use ADF to leverage positive change in its client countries, and in the ADB itself.

117. Considering the current and projected demand and supply of ADF VIII resources, ADB is carefully considering the following approaches:

- (i) Aligning planned levels of ADF lending with resource availability during the remainder of ADF VIII;
- (ii) Freeing currently committed ADF resources by canceling loans that are not moving, or are performing poorly;
- (iii) Opportunities for generating additional commitment authority through the EACA scheme;
- (iv) Allocation of a portion of OCR net income to ADF; and
- (v) Request for supplementary contribution from ADF donors under ADF VIII.

118. ADB will update donors on its progress during the remaining ADF VIII years (2003-2004). An action plan/status report will be submitted at an appropriate point during future ADF negotiations.