

ASIAN DEVELOPMENT BANK

POVERTY REDUCTION COOPERATION FUND

June 2002

CURRENCY EQUIVALENTS

(As of 18 June 2002)

Currency Unit –		pound sterling (£)
£1.00	=	\$1.4798
\$1.00	=	£0.6758

ABBREVIATIONS

ADB	-	Asian Development Bank
CSP	-	country strategy and program
DFID	-	Department for International Development of the Government of the United Kingdom of Great Britain and Northern Ireland
DMC	-	developing member country
LTSF	-	Long-Term Strategic Framework
MOU	-	Memorandum of Understanding
MTS	-	Medium-Term Strategy
NGO	-	nongovernment organization
NPRS	-	Cooperation Fund in Support of the Formulation and Implementation of National Poverty Reduction Strategies
PPA	-	poverty partnership agreement
PRC	-	People's Republic of China
PRCM	-	Resident Mission of ADB in the PRC
PRF	-	Poverty Reduction Cooperation Fund
PRF-PRC	-	People's Republic of China component of the Poverty Reduction Fund
RM	-	resident mission
RSDD	-	Regional and Sustainable Development Department
TA	-	technical assistance
UK	-	United Kingdom of Great Britain and Northern Ireland

NOTES

- (i) The fiscal year of the Government of the United Kingdom ends on 31 March. The fiscal year used for this PRF cooperation ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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I. BACKGROUND AND RATIONALE

1. **Poverty in Asia.** Close to 900 million of the world's poor (i.e., those living on less than \$1 a day) are in the Asia and Pacific region. Nearly one in three Asians is poor. Although the proportion of people below the poverty line has been declining, the absolute number of poor people is still increasing due to population growth. South Asia, one of the poorest subregions in the world, now has more than half a billion poor, of whom 450 million are in India alone. The People's Republic of China (PRC) has 225 million poor. About 55 million poor are in Southeast Asia, where in the wake of the Asian financial crisis, over 10 million have joined the ranks of the poor. In the Greater Mekong Subregion, with the onset of peace in the 1990s, many people are experiencing rapid improvements in living standards, but poverty is still particularly high among indigenous and socially excluded groups. Many in the Central Asian republics have also slipped into poverty with disruptions in the transition to market economies. The small island countries of the Pacific, despite their relatively higher per capita income, remain vulnerable because they are remote, prone to natural disasters, and have limited capability to deal with external economic shocks. To counteract all this, the bilateral and multilateral development organizations have committed themselves to making a significant contribution to the Millennium Development Goals and reducing poverty throughout the Asia and Pacific region.

2. **ADB Fighting Poverty in Asia and the Pacific.** Recently, an international consensus has emerged, refocusing development assistance toward strategies aimed at poverty reduction. The Asian Development Bank (ADB) is a major development partner of the poorer countries in Asia. In November 1999, ADB's Board of Directors approved the Poverty Reduction Strategy, focusing on pro-poor sustainable economic growth, inclusive social development, and good governance.¹ With the adoption of this strategy, poverty reduction has become ADB's overarching objective, and all activities of ADB are being geared to achieving this. ADB's new comprehensive Long-term Strategic Framework (LTSF)² and Medium-Term Strategy 2001-2005 (MTS)³ support the poverty reduction strategy for the Asia and Pacific region. In 2002, ADB underwent a major reorganization and revision of its business processes with the objective of further strengthening its country-focused operations.

3. **Progress in Implementing the Poverty Reduction Strategy.** Since the adoption of its Poverty Reduction Strategy, ADB has implemented major changes to have greater impact on poverty in the region:

- (i) Poverty analysis processes have been initiated in all developing member countries (DMCs), and poverty partnership agreements (PPAs) have been signed in seven countries, with a further 14 PPAs in preparation.
- (ii) Country strategies and programs (CSPs) have been reformulated to better reflect the poverty reduction agenda.
- (iii) At least 40% of each year's public sector lending volume is targeted for poverty interventions.
- (iv) The share of core poverty interventions has continuously increased.

¹ ADB. 1999. *Fighting Poverty in Asia and the Pacific: The Poverty Reduction Strategy*. Manila.

² ADB. 2001. *Moving the Poverty Reduction Agenda Forward in Asia and the Pacific: The Long-Term Strategic Framework of the Asian Development Bank (2001-2015)*. Manila.

³ ADB. 2001. *Medium-Term Strategy (2001-2005)*. Manila.

- (v) Loan projects are being redesigned to better address poverty reduction and to assess the impact of loans on the poor. In this context ADB has focused on those sectors in which it has a comparative advantage for sustainable poverty reduction, such as enhancing the poverty reduction impact of its economic infrastructure, income and employment generation, and education projects.
- (vi) Various technical assistance (TA) and capacity-building activities to support poverty reduction have been initiated.
- (vii) A variety of thematic, economic, and sector work is focusing on poverty reduction. For example, work is being done on social protection, nutrition for the poor, and the impact of roads on poverty.
- (viii) New funding sources have been obtained to pilot poverty reduction and governance activities and to help mainstream the new thinking in ADB.
- (ix) New staff have been hired to work as poverty reduction specialists.
- (x) ADB has also improved its knowledge management and cooperation with other aid agencies. This has been particularly demonstrated in joint conferences and publications such as the Manila Social Forum (November 1999) and the Asia and Pacific Poverty Forum (February 2001).

4. **Challenges for ADB.** However, to implement the Poverty Reduction Strategy successfully, ADB faces some major challenges. First is the decline of resources for TA grants to support capacity building and advisory inputs for poverty reduction, policy formulation and programming, and poverty impact assessments of investment projects.⁴ Second, ADB is strengthening the role of its resident missions (RMs) and its cooperation with other funding agencies at the country level in support of nationally led poverty reduction strategies. Third, ADB needs opportunities to pilot-test new approaches for poverty reduction. Strengthening its role as a regional development bank, ADB needs to promote cross-border activities to cope with regional volatility, which affects the poor adversely. Fourth, ADB needs to further strengthen its capacity to incorporate cross-cutting and multidisciplinary dimensions for poverty reduction, such as governance, social development, gender, and environment. The reorganization of ADB has recognized the need to strengthen the function of ADB as a knowledge management and learning institution, and to enhance multidisciplinary collaboration. The Regional Sustainable Development Department (RSDD) has been created to ensure consistency and compliance with policies, and to promote knowledge dissemination within and outside the bank.

5. **United Kingdom's Support.** The Government of the United Kingdom of Great Britain and Northern Ireland (UK) strongly supports ADB's Poverty Reduction Strategy, and common priorities are reflected in ADB's LTSF and MTS and in the Department for International Development's (DFID) White Paper on International Development⁵ and its Institutional Strategy Paper for ADB.⁶ ADB's and DFID's policies are thus closely aligned for poverty reduction. DFID and ADB recognize that ADB has considerable potential to make a significant contribution to the

⁴ ADB is currently revising its policies on resources allocation for technical assistance, and on cooperation funds with bilateral donors.

⁵ Secretary of State for International Development. 2000. *Eliminating World Poverty: Making Globalization Work for the Poor*. London: DFID.

⁶ DFID. 2000. *Working in Partnership with the Asian Development Bank*. London: DFID.

Millennium Development Goals of poverty reduction throughout Asia. DFID is committed to supporting the mainstreaming of poverty in ADB's programs, and to strengthening ADB's learning and knowledge management functions. It also supports ADB's move to strengthen country focus and aid coordination through enhanced responsibilities in RMs and cross-border activities. The LTSF points out that ADB needs a higher proportion of nonloan funding (which includes activities other than TA). It commits ADB to develop, in partnership with bilateral and other sources, mechanisms such as trust funds to target poverty interventions better. Given the constraints on availability of resources for technical and pilot assistance, trust fund money is needed to (i) help ADB ensure a consistent and comprehensive integration of poverty reduction issues into individual country strategies, (ii) develop more detailed poverty analysis (particularly on distributional benefits) for individual loans, (iii) encourage more participatory processes at all stages of the project cycle, (iv) promote subregional capacity-building work, and (v) undertake pilot projects for future ADB operations. DFID is willing to offer support through a Poverty Reduction Cooperation Fund (PRF), which will help ADB reorient and supplement its portfolio in line with its poverty reduction objectives, and enhance its potential to contribute to the Millennium Development Goals.

6. **Coordination in Partnership.** The PRF will complement the Cooperation Fund in Support of the Formulation and Implementation of National Poverty Reduction Strategies (NPRS), which was established in November 2001 as a trust fund from the Government of the Netherlands.⁷ While the NPRS supports poverty strategy formulation and regional capacity-building activities on poverty reduction in selected DMCs of ADB, the PRF will broaden this framework by including all eligible DMCs,⁸ and additional activities as specified in paras. 8 and 9. The PRF will also supplement the Japan Fund for Poverty Reduction, which pilots innovative poverty reduction projects in Asia.⁹ Furthermore, the PRF will closely coordinate with the UK's country-specific poverty reduction fund for India.¹⁰ The PRF is open for other donors to contribute.

II. THE POVERTY REDUCTION COOPERATION FUND

A. Objectives and Scope

7. **Purpose and Objectives.** The goal of the PRF is to assist ADB in reducing poverty in its DMCs. The PRF will thus augment ADB's efforts for poverty reduction and, as a result, will (i) assist in policy dialogue and strategy formulation on poverty reduction; (ii) develop new programs and projects with increased focus on poverty reduction; (iii) monitor and assess the poverty reduction impact at the project, meso-, and macro-levels; (iv) launch pilot poverty reduction activities to influence future loan design;¹¹ (v) involve broader stakeholder

⁷ The NPRS has an initial grant financing of \$6 million from the Government of the Netherlands.

⁸ See paras. 9 and 10 for further clarifications.

⁹ The JFPR pilots innovative investments for direct poverty reduction projects in the size of \$1 million to \$5 million, which are conceptually linked to ADB loans. The JFPR contribution by the Government of Japan is currently \$295 million, including \$90 million for Afghanistan and neighboring countries.

¹⁰ In June 2001, ADB approved the Technical Assistance Cooperation Fund for India with a grant contribution from the Government of UK of £20 million (approximately \$28.5 million) for 2001-2004. The fund supports (i) participatory poverty assessments and other poverty-focused surveys; (ii) appraisal studies for social sector lending; (iii) studies examining the issues of enabling environment for poverty reduction; (iv) poverty focused monitoring, evaluation, and impact assessment work; (v) conferences, workshops, and mutual learning events, focusing on poverty reduction; and (vi) recruitment of consultants to support ADB's role and capacity to address poverty issues.

¹¹ Pilot projects will follow the standard ADB environmental safeguard procedures. For TA type of activities, where

consultations at all stages of design and implementation; (vi) strengthen ADB's role as the regional development bank for Asia and the Pacific to promote poverty reduction; and (vii) perform other activities as mutually agreed upon between DFID and ADB.¹² Appendix 1 summarizes the PRF Framework.

8. **Activities and Scope.** More specifically, the PRF will support (i) TA for capacity and institution building; (ii) provision of advisory inputs; (iii) thematic and sector work; (iv) monitoring, evaluation, and impact assessment; (v) public conferences, workshops, and other events; (vi) innovative activities such as micro and pilot projects, with clear demonstration effects; (vii) national experts based in RMs working on poverty analysis, and poverty-related gender, stakeholder participation, and governance issues; (viii) outreach and communication; and (ix) administrative costs of fund management. The PRF will not be used for permanent staffing costs (including salaries and training). It will also not support work that is not country-based (albeit cross-border activities can be supported as long they will have a measurable impact on the poverty situation in a country). Projects supported by the PRF will generally be in the range of \$0.1 to \$1.0 million.

9. **Eligibility.** PRF project proposals must meet the following eligibility criteria: All activities financed by the Fund should (i) have a strong poverty reduction focus; (ii) support the relevant ADB CSP¹³ and the policies of the government; (iii) be designed to support shared poverty objectives in the existing and pipeline activities of other funding agencies, to enhance effectiveness, avoid duplication, and accelerate learning; (iv) not substitute for activities that would otherwise be financed by ADB (conceptual additionality); (v) make maximum use of local expertise and civil society participation; and (vi) support projects solely based on their merit for systemic poverty reduction, with no specific country allocation or country window within the PRF (unless otherwise specified for the PRC¹⁴). The implementation arrangements for the PRF and for the PRF-PRC will further refine these criteria to ensure that PRF funds are used only in support of a strong poverty reduction focus, while not being so prescriptive that they unnecessarily restrict ADB's programming options.

10. **Geographical Scope.** The PRF will be open to all poor DMCs classified by ADB as A, B1, or B2 countries, excluding India.¹⁵ However, it is expected that particular emphasis will be given to countries with a high incidence of poverty, a large number of poor people, and special dimensions of poverty otherwise not being addressed. India will not have access to the PRF because a separate fund has been set up through DFID-ADB cooperation to finance poverty reduction issues in India.

appropriate, special emphasis will be given to the environment-poverty nexus.

¹² This document is based on the agreement reached between DFID and ADB as summarized in the Aide Memoire dated 8 March 2002, as well as follow up discussions with both parties in Beijing, Manila, and London.

¹³ The PRF can also support technical assistance and other projects that are included in CSP under seeking grant funding. While all PRF funded activities will be justified under the strategic orientation of the CSP, not all PRF funded projects need to be included in the project list of the CSP document.

¹⁴ See para. 11.

¹⁵ Under the graduation policy, ADB classifies its developing member countries as following: As of 6 March 2002, Group A countries comprise Afghanistan, Bhutan, Cambodia, Kiribati, Kyrgyz Republic, Lao People's Democratic Republic, Maldives, Mongolia, Myanmar, Nepal, Samoa, Solomon Islands, Tajikistan, Tuvalu, and Vanuatu. Group B1 countries comprise Azerbaijan, Bangladesh, Cook Islands, Marshall Islands, Federal States of Micronesia, Pakistan, Sri Lanka, Tonga, and Viet Nam. Group B2 countries include PRC, India, Indonesia, Nauru, Papua New Guinea, and Turkmenistan. Group C countries comprise Fiji Islands, Kazakhstan, Malaysia, Philippines, Thailand, and Uzbekistan. In addition, ADB has nonborrowing DMCs, and OECD member countries. The country classification determines the access to ADB's concessional finance window and has implications for cost-sharing in project and TA financing.

11. **PRC Component.** The PRF will also comprise a component for financing PRF activities in the PRC. A separate PRC component is needed because DFID is financing such projects from its country allocations for the PRC, whereas funds are provided through a regional cooperation window for all other eligible countries. Because of the direct link to DFID's PRC portfolio, it is also expected that such PRF projects for the PRC will be closely linked to and integrated into ADB's CSP, promote civil society participation in poverty reduction, and make maximum use of local expertise and nongovernment organization (NGO) involvement.¹⁶

B. Implementation Arrangements

12. **Approval Process for the PRF.** The following approval process will guide the selection of projects for PRF countries excluding the PRC:

- (i) Projects can be proposed at any time by the regional departments and the RMs through a three-page concept paper to RSDD.
- (ii) RSDD will initially screen the proposals and submit them to DFID.
- (iii) After obtaining approval of the concept paper by DFID on a project approval basis for pilot projects¹⁷ and RM support staff, and on a non-objection basis for other activities, the regional departments (including the RMs) will finalize the project proposal, following ADB's general procedures under its revised business processes.
- (iv) In line with the mandate delegated to RSDD under the new business processes, RSDD will also function as ADB's internal clearinghouse for policy compliance and quality assurance before the PRF proposal will go to Management or the Board of Directors for approval on a non-objection basis.

The general approval process is summarized in Appendix 2. The special arrangements for the PRC are summarized in Appendix 3. The outline of the concept paper for DFID approval is in Appendix 4.

13. **Work Program.** Projects will be processed on a regular basis. DFID and ADB will coordinate closely to keep a balance on the country, sector, and thematic allocations. To monitor the implementation, ADB and DFID will have a yearly partnership meeting and additional semiannual stock-taking meetings. A status report on PRF implementation and a work program for PRF financing will be prepared for these meetings. This work program will be arranged according to the PRF input-output matrix as suggested in Appendix 5.

14. **ADB Responsibilities.** ADB will be responsible for (i) services provided by headquarters and RM staff for designing, preparing, overseeing, coordinating, and managing the projects and activities under the PRF; and (ii) office, secretarial, and equipment support. Within ADB, RSDD will be responsible for managing the PRF and will function as the communication link to DFID on technical matters; it will be responsible for reporting on

¹⁶ ADB does not, in principle, support earmarking of funds for DMCs. Considering that (i) the PRC component is a smaller portion of a bigger cooperation fund that is open to all DMCs; (ii) the PRF will address poverty directly; and (iii) the arrangement for a PRC component under the PRF is preferable to setting up an alternative, separate, country-specific fund for the PRC only, ADB proposes to support the component arrangement.

¹⁷ The allocation for pilot projects should not exceed 30% of the total yearly allocation.

implementation progress to DFID on the activities financed under the PRF; RSDD will also support the operational departments in project processing. The regional (operational) departments will be responsible for developing, processing, and implementing the individual projects. The Office of Cofinancing Operations will act as the official channel of communications between DFID (and other possible participating donors¹⁸) and ADB; it will monitor and report on the financial performance of the PRF. The PRF cooperation will particularly strengthen the role of ADB's RMs. The PRF will particularly encourage staff from RMs to initiate and implement projects that particularly support innovative action research, and country- or theme-focused poverty analysis, stakeholder coordination, NGO involvement, pilot activities, and monitoring of poverty reduction. It will further strengthen selective RMs by providing additional consultant expertise to ADB's staff.

15. **Central Screening and Coordinating.** To have maximum poverty reduction mainstreaming and additionality impact in ADB operations, RSDD will nominate a PRF coordinator who will be responsible for (i) supporting—through a teamwork approach—operational departments and RMs in project processing; (ii) mainstreaming appropriate cross-cutting concerns for poverty reduction; and (iii) overall fund management.

16. **Role of DFID.** DFID will need to know in advance and agree to the procedures for processing individual proposals. The involvement of DFID will be geared to promote mutual understanding and facilitating partnership, and care will be taken to avoid additional administrative burdens on ADB or DFID staff. A new DFID staff person posted in the British Embassy in Manila will undertake the DFID administration work for PRF. She/he will communicate directly with the PRF coordinator in RSDD. The main vehicle for DFID's periodic involvement will be an annual review meeting, which will assess the activities under the PRF during the previous year and agree on an indicative allocation of resources for the following year.

17. **Procurement.** TAs financed under the PRF will be processed and administered under standard ADB procedures. ADB's *Guidelines on the Use of Consultants*, will be applied in the selection and engagement of the consultants to be financed under the PRF, and the procurement of goods and other services for TA operations will be in accordance with ADB's *Guidelines for Procurement* or any other arrangements as agreed upon between ADB and DFID. Projects will make maximum use of local expertise and civil society involvement.

18. **Reporting and Auditing.** ADB will maintain all records and accounts, in accordance with its standard procedures, to record contributions, interest, and investment income, as well as expenditures financed by the PRF. ADB will furnish to DFID annual reports on the implementation of the PRF. The annual report will also be made available to the ADB Board of Directors. Upon request, ADB will also make available to DFID all relevant documents and records concerning the PRF and the individual projects. Furthermore, ADB will furnish audit reports from the external auditors as required by DFID. Six months before closing of the PRF, ADB and DFID will jointly initiate an independent external evaluation of its performance and impact. ADB will, in accordance with its usual procedures, inform DFID promptly of any condition that interferes or threatens to interfere with the performance of ADB in the implementation of the PRF. DFID and ADB will consult each other directly on any event determining changes in the implementation of the PRF.

¹⁸ See para 21.

19. **Timing.** The PRF will commence in July 2002. The final date for approval by ADB of activities financed under the PRF will be 31 March 2006.

C. Financing

20. **Contribution from DFID.** The Government of the UK has proposed to make an initial contribution to the Fund in the amount of £39 million, comprising (i) £30 million (approximately \$42.8 million) from its regional cooperation window for PRF countries, and (ii) £9 million (approximately \$12.7 million) from its window for activities in the PRC. At its discretion, the Government of the UK or any other member country of ADB may provide additional resources to the PRF. Within 2 weeks after signing the Memorandum of Understanding (MOU) on the Establishment of the PRF with ADB,¹⁹ DFID will deposit an initial £3.25 million (for all countries covered under the PRF) into a US dollar interest-bearing account to be specified by ADB (the ADB account). Subsequent installments will be made semiannually on receipt of a request from ADB together with a financial statement detailing the use of the previous installment. ADB will manage the financial contribution to the PRF. The Table below provides a summary of the indicative DFID contributions. The amount of each tranche may, however, be varied at the discretion of DFID in light of the actual uptake of the funds made available in previous tranches, provided always that DFID undertakes to ensure that ADB has available to it funds sufficient to meet planned disbursements over the 6 months following the planned date of payment of any tranche.

Indicative Contributions to the PRF

(£ million)

Item	PRF from the Regional Fund Window	PRF from the PRC Financing Window
UK Financial Year 2002/2003 July 2002 January 2003 Subtotal	£2.5 million £2.5 million £5.0 million	£0.75 million £0.75 million £1.5 million
UK Financial Year 2003/2004 July 2003 January 2003 Subtotal	£2.5 million £2.5 million £5.0 million	£1.25 million £1.25 million £2.5 million
UK Financial Year 2004/2005 July 2004 January 2004 Subtotal	£5.0 million £5.0 million £10.0 million	£1.50 million £1.50 million £3.0 million
UK Financial Year 2005/2006 July 2005 January 2006 Subtotal	£5.0 million £5.0 million £10.0 million	£1.0 million £1.0 million £2.0 million
Total	£30.0 million	£9.0 million

21. **Other Donors.** The PRF will be open for other donors' contributions also. Contributions from other donors will be effected through the signing of similar MOUs and respective amendments through appendixes to this Board information paper. These MOUs will be subject to approval by ADB Management and will be sent to the ADB's Board for information. Contributions from other donors under the PRF will be deposited into separate US dollar interest-bearing accounts to be specified by ADB. Such contributions will finance activities under

¹⁹ Or, if later, when ADB and DFID have agreed on a provisional list of projects to be supported by the PRF.

the PRF in accordance with the agreement reached during the annual review and work program meeting.

22. **Service Charge.** For administering the PRF, ADB will be paid a service charge in accordance with ADB's policy on service charges for administration of grant cofinancing from bilateral sources.²⁰ ADB may use part of the Fund (and any interest income and investment and reinvestment income thereon) to cover the administrative costs of up to 5% of the expenditures incurred under the PRF and the costs of external audit.

23. **The ADB Account.** Interest earned on the ADB account will be used for PRF activities only. The PRF will be deposited into a US dollar interest-bearing account to be specified by ADB. Interest earned on such amount will be used for PRF activities only. The resources of PRF may be freely exchanged by ADB into other currencies as required. Any fees, including the service charge for administering the Fund, and for auditing purposes in accordance with para. 22, and charges related to the purchase of such other currencies, will be paid out of the Fund. If other currencies are required to pay for any eligible expenditures, ADB may purchase the required currencies with the proceeds of the PRF. The PRF will be held by ADB on behalf of the participating donors and will be administered separately from ADB's own resources.

24. **Disbursement.** ADB will make withdrawals from the PRF account as necessary to meet expenditures eligible under the PRF for various projects and other expenditures. ADB will administer such project funds on behalf of DFID. ADB may invest and reinvest pending disbursement of the DFID contribution. Any income earned from the investment as well as from the ADB account, will be credited back to the ADB account and used for the purposes of the PRF.

III. RECOMMENDATION

25. It is recommended that the Board approve (i) the establishment of the proposed cooperation fund and its administration in accordance with the provisions set forth in this paper; and (ii) ADB entering into a Memorandum of Understanding on the Establishment of the Poverty Reduction Cooperation Fund with the Government of the United Kingdom in relation to its contribution to the PRF substantially in the form of the draft attached hereto.

²⁰ ADB. 2000. *Review of Service Charges for the Administration of Grant Cofinancing from Bilateral Sources*: Manila: ADB.