

Asian Development Bank

Review of ADB's Long-Term Strategic Framework

A Note to Support Stakeholder Consultations

August 2007

This note was prepared to support ADB's external consultations with stakeholders on the review of ADB's long-term strategic framework.

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I. INTRODUCTION

1. The Asia and Pacific region has changed dramatically since the Asian Development Bank (ADB) adopted its current long-term strategy in March 2001.¹ Recognizing the changing regional and global context, the ADB is undertaking a review of its long-term strategic framework (LTSF), as was announced at the ADB's 40th Annual Meeting in Kyoto, Japan on 5 May 2007. Changes in terms of: the unprecedented high rates of growth in the region, global capital flows into the region, the co-existence of high rates of savings in the region along with the need for high rates of investment, and significant adverse environmental implications associated with the high rates of growth, when taken together, require ADB to review and adapt its LTSF.

2. As a first input into this process, the ADB President convened an eminent persons group (EPG) in June 2006, to obtain insights on the region's future and the future role of ADB. The EPG completed its report in March 2007.² At the same time, ADB has also been undertaking in house reviews on various issues (for example, inclusive growth, private sector development, regional cooperation and integration), in order to make an informed choice on the options and long term strategic framework for ADB. In this regard, a notable body of work is concerned with the relevance of inclusive growth in the region, and the approach and options for ADB for ending poverty and inequality through the inclusive growth approach.

3. The Review of the LTSF will define ADB's future direction and vision to 2020, and a plan for its initial implementation, relevant to the rapidly changing context of the region. As a part of the LTSF review process, extensive internal and external stakeholder consultations have been planned. External consultations will draw views from a wide range of stakeholders, including government, project agencies, development organizations, civil society, private sector, and academia. The views and perspectives obtained through stakeholder consultations will be a central input to the preparation of the new long-term strategic framework (LTSF 2020), which is expected to be finalized by early 2008. The timeframe and major milestones for the Review are provided at Appendix 1.

4. The objective of this paper is to serve as a reference and guidance note to facilitate stakeholder consultations. The paper presents key features of (i) ADB's existing LTSF, and corporate wide strategic planning since adoption of the LTSF in March 2001, (ii) key development challenges facing the region, (iii) some issues for consideration in planning ADB's future strategic framework, based on key inputs available to ADB in terms of EPG report, ADB's operational experience and examination of issues in selective sectors or thematic areas, and finally (iv) some questions to facilitate various stakeholder discussions and reach an understanding on the agreed priorities.

II. ADB'S EXISTING LONG TERM STRATEGIC FRAMEWORK

5. In 1999, the ADB made poverty reduction its single overarching objective, and a region free of poverty is the vision that underpins the 2001–2015 LTSF. The LTSF identifies three core

¹ ADB. 2001. *Moving the Poverty Reduction Agenda Forward: The Long-Term Strategic Framework of the Asian Development Bank (2001–2015)*. Manila.

² ADB. 2007. *Towards a New Asian Development Bank in a New Asia. Report of the Eminent Persons Group to the President of the Asian Development Bank*.

strategic thrusts for ADB's interventions: (i) sustainable economic growth, (ii) inclusive social development, and (iii) good governance for effective polices and institutions. The three crosscutting themes under the LTSF are (i) the role of the private sector in development, (ii) regional cooperation and integration for development, and (iii) environmental sustainability. ADB's two mid term strategic frameworks, MTS I and MTS II, covering periods from 2001-05, and 2006-08 respectively, provided further refinement of the strategic priorities and operational strategies within the overall LTSF. A summary of the existing LTSF, MTS (I and II) are provided in Appendixes 2 and 3 respectively.

6. Guided by the LTSF, and the two mid-term strategic frameworks (MTS I and MTS II), ADB made considerable progress in charting and implementing its operational strategies and policies in country specific and sub regional contexts. This is particularly true of the operational themes emphasized in the LTSF, such as regional cooperation and integration, governance, and private sector development. ADB's developmental role included financing of loans and grants, and policy advice and capacity development provided through its technical assistance modality, and its policy based lending modality.

7. Recognizing the need for selectivity and focus, MTS II (2006-2008) suggested a reorientation in ADB's operational focus into specific areas. It prioritized sectors into core operational areas, sectors where ADB should operate but only in partnership with others, and sectors from where ADB should plan to move out of operations. It also defined reorientation of ADB's roles keeping in view the need for ADB to be responsive, effective, and result oriented.

III. CHANGING CONTEXT AND KEY CHALLENGES FACING THE REGION

8. In recent years, changes in Asia's economic and social landscape have been rapid, and extraordinary.

Changing Regional Context. ADB envisages a vision of an Asia Pacific region in 2020 that would:

- Account for more than 25% of global GDP in nominal dollar terms and as much as 45% of global GDP in PPP terms
- Be close to Latin America in GDP per capita, in stark contrast to 1980 when its per capita income was less than a fourth of Latin America's.
- Have an overwhelming majority of people living in middle-income countries, with perhaps only about 10% of Asians still in absolute poverty (\$1 a day).
- Be much more urban, with the majority of people living in mega or medium size cities, raising new social and environmental issues.
- Remain a "capital-surplus" region, with some countries having surplus savings while others require external (including regional) capital to achieve higher investment rates to fuel economic growth. Asia can be expected to continue to have large accumulated reserves.
- Continue to increase intraregional trade and investment, even as integration advances with the global markets for goods, services, and capital. By 2020 the Asia and Pacific region could account for about one-third of world trade, compared with the U.S. share of about one-seventh.
- Become an even larger user of natural resources including energy, other minerals,

and forest products. Human activities and economic policies in Asia will become more important for the global commons, including the environment.

9. However, the changing context, and achievement of the 2020 vision for Asia and the Pacific region has its associated risks and challenges. ADB must equip itself to meet these new challenges and risks to support Asia's transition to 2020.

10. **Key Challenges and Risks:** The key challenges and risks in Asia's ascendance in the global economy to 2020 are seen as:

- **Rising disparities.** Developing Asia's unprecedented growth rates have been accompanied by rapidly rising income and non-income inequalities. Though the region's poverty incidence measured by \$1 per day declined to 18.0 per cent in 2005, the poverty incidence measured by \$2 per day still remains high at 51.9% in 2005. More than half of developing Asia's population still lives in poor conditions, with limited access to social services such as health and education. Disparities between individuals and regions have widened raising concerns about threat to social harmony, and sustainability of economic reforms that stimulated the growth.
- **Unfinished poverty agenda.** Despite region's strong economic performance, pockets of poverty and social exclusion remain, requiring renewed efforts to eliminate them. The efforts and approaches required for completing this unfinished agenda need to be more varied than those to overcoming extensive poverty. Achieving more inclusive growth by following economic strategies more consistent with individual countries' comparative advantages may be required to help meet this challenge.
- **Environmental degradation.** The region's higher than expected growth has placed serious strains on its environment and natural resources. Given the resource intensity of Asian economic growth, its potential impact on environment, energy use, and resource prices has become a matter of global concern. The countries in the region face an enormous challenge in satisfying their citizen's legitimate desire for a rapid rise in their living standards while sharing in the global efforts to protect the interests of future generations.
- **Infrastructure bottlenecks.** Most Asian economies suffer from bottlenecks in infrastructure, particularly in transport, power, water, and sanitation. It is estimated that the Asia and Pacific region will need approximately \$248.8 billion in investment per annum (equivalent to 6.0% of region's gross domestic product).³ A common challenge for all countries will be to overcome these bottlenecks and to continually upgrade and expand infrastructure to meet the fast expanding needs of more competitive economies in the global markets, to sustain high growth rates.
- **Underdeveloped financial sector.** Asia's financial markets lag well behind its competitiveness in manufacturing and international trade. Developing more robust financial systems, both national and regional will be essential for continuing economic growth and competitiveness. There is also the challenge of intermediating

³ Sources: Fay, Marianne, and Tito Yepes, 2003, *Investing in Infrastructure – What is needed from 2000 to 2010?* Policy Research Working Paper No. 3102. Washington DC: World Bank, World Development Indicators Online (<http://devdata.worldbank.org/dataonline>)

financial resources within the region from countries with excess savings to countries that are capital deficit, while financial markets are still evolving.

- **Regional and global integration.** Asia's transition to 2020 as outlined above assumes regional cooperation and integration of regional markets for goods, services, and capital, which is likely to improve efficiencies in resource use, and enhance its competitiveness, enabling regional economies to grow at a faster rate than otherwise possible. There is need to facilitate and accelerate further regional integration and expansion of Asia's participation in global markets, which within its political and institutional environment is a challenge that needs to be addressed.
- **Innovation and technological development.** Innovation and technological development will increasingly be the driving force behind the region's economic development. The competitiveness of Asian economies will be determined less by low wages and harder-working labor and more by their ability to master technology and produce higher value goods and services. Accordingly, there is need to provide even greater emphasis to innovation, technology development, and higher education.
- **Transformation of institutions.** There is a real risk that public sector institutions, including those in the financial system, will not adjust quickly enough to meet the demands of dynamic, open, and market-driven economies. Transforming the existing institutional framework will be one of the biggest challenges facing the region.

IV. AN EXAMINATION OF ADB'S FUTURE STRATEGIC DIRECTIONS

11. Most critical among the challenges and risks facing the region seem to be: (i) poverty and low levels of income and human development, (ii) the adverse impact of rapid economic progress on environment and natural resources, and (iii) the need for continued efficiency and regional integration into the global economy. Keeping in view, these challenges, the need for ADB to be selective given its comparative advantage and limited resources, a three pronged approach to promote (i) inclusive growth, (ii) environmentally sustainable growth, and (iii) regional cooperation and integration, taken together could be considered a highly relevant strategy to address these challenges.

A. Inclusive Growth

12. The incidence of absolute poverty declined significantly in many countries and the trend is expected to continue to substantially eliminate the worst forms of deprivation. Yet, poverty in a broader sense will remain a central development issue in Asia. Limited access to economic opportunities due to low human capital endowments will replace the lack of subsistence income as the predominant cause of poverty. Direct poverty alleviation measures are not effective instruments to address the capability poverty in the emerging Asia. Transforming the poor households into economically viable units is the key to achieving enduring poverty alleviation in sustainable manner. A two pronged approach to creating viable and expanding economic opportunities and building human resource capabilities of the poor to access the expanding opportunities may be the best approach to eradicate persistent poverty. Creation of economic opportunities requires a dynamic private sector through market competition and market-based incentive. The role of governments will be to develop and maintain an enabling environment for business investment and private entrepreneurs, necessary for expanding gainful

employment opportunities and a sustained increase in productivity in the economy. It also requires providing access to assets, technology and skill up-gradation to the self employed. It requires the governments to invest in physical infrastructure and human capital, build institutional capacities, maintain macroeconomic stability, adopt market friendly policies, protect property rights, and maintain rules of law. In setting policy and reform priorities, the government should identify the binding constraints to growth and target its efforts and resources at relaxing the binding constraints. In an inclusive growth framework, creation of economic opportunities is only a sufficient condition to eradicate poverty. It will have to be matched by policies to promote inclusive social development to empower people and to ensure all have equal access to development opportunities. This requires: (i) investing in human capacities to improve access to education and health services; (ii) good governance at local level; and (iii) enhancing social safety nets to prevent extreme deprivation. However, within this framework, which sets of operations and activities that ADB should directly support, is a matter of further discussion. A summary of the ADB's inclusive growth paper⁴ is presented at Appendix 5.

B. Environmentally Sustainable Growth

13. The continued economic boom in Asia and its spread aroused new and stronger doubts about the environmental cost and sustainability of Asia's development now, than a decade ago. Climate change agenda will increasingly occupy the core of development agenda in Asia and elsewhere in the world in coming years. Poor environment affects the poor and their livelihoods more than the non-poor. ADB endeavors to alleviate poverty through environmentally sustainable development in a number of ways. First, by investing in environment and natural resource management to benefit the poor through improved environmental quality, and enhanced livelihoods through improved long-term productivity of ecosystems. ADB also seeks to reduce the vulnerability of the poor to natural calamities. Second, ADB mainstreams environmental considerations into economic growth by building DMC capacity for developing policy, legislative, and institutional framework to enhance their regulatory and enforcement capacities. Third, ADB assists DMCs to address regional trans-boundary environmental issues by promoting regional cooperation, facilitating the transfer of technology, mobilizing grant resources, and building DMC capacity for policy making. Fourth, ADB will seek to mainstream environmental considerations into all ADB operations, through systematic application of environmental analysis, environmental assessment, environmental monitoring and evaluation, and implementation of procedures for environmentally responsible procurement. Fifth, by promoting partnerships with the civil society, the private sector and the Government, ADB seeks to promote environmental protection through knowledge sharing and transfer.

C. Regional Cooperation and Integration

14. Promoting regional cooperation has been an integral part of ADB's development strategy. Regional integration refers to a process through which economies in a region become more interconnected. Such economic interconnection can result from market-led and private-sector-driven actions and/or government-led policies and collective initiatives in a region. The latter, collective policies and initiatives by governments which, in turn, could be either formally embodied in an intergovernmental treaty or informally agreed upon by the participating countries, is regional cooperation. Regional integration is thus broader in scope than regional cooperation. The two could, however, be mutually reinforcing in the sense that regional cooperation can deepen regional integration and at the same time rising regional integration can

⁴ ADB 2007. *ERD Working paper series No. 97, Inclusive Growth toward a Prosperous Asia: Policy Implications.*

prompt, and even compel, governments to cooperate collectively to internalize externalities created by integration.

15. ADB's new Regional Cooperation and Integration (RCI) strategy rests on four pillars. It seeks to promote (i) regional and sub-regional economic cooperation program, (ii) trade and investment promotion, (iii) monetary and financial cooperation and integration, and (iv) cooperation in regional public goods. The key objective of regional and sub-regional economic cooperation is to build regional infrastructure: roads, electricity, and telecommunications, to improve connectivity to provide better and reliable access to regional markets. Enhanced cross border labor and goods mobility will expand economic opportunities regionally. To complement, the creation of regional infrastructure, RCI strategy actively seeks to facilitate trade and investment through regional trade arrangements and strengthened regulatory coordination. These two complementary policies are particularly important to small nations and landlocked countries to improve their access to markets. The third pillar of RCI strategy is to foster regional monetary and financial cooperation and integration. The main objective of this pillar is to enhance monetary and financial cooperation and integration with a view to mobilizing the large volumes of savings in the region to fulfill the unmet demand for investment in Asia. Although an integrated regional financial market provides considerable benefits, it is constrained by institutional and regulatory impediments. One of the important objectives of the RCI is to harmonize accounting, reporting, and regulatory standards; simplify tax and registration procedures; strengthen regional credit rating agencies; and remove regulatory hurdles that hamper the development of financial instruments. Finally, the RCI seeks to promote cooperation in regional public goods, particularly in preventing the spread of disease and pollution in the region. RCI seeks to promote regional public goods through (i) coordinated actions promote clean air, environmental protection, control of communicable diseases, and management of natural disasters; and (ii) dissemination information on regional public goods through publications, workshops, and shared standards. A detailed note on RCI is at Appendix 6.

V. QUESTIONS TO GUIDE STAKEHOLDER CONSULTATIONS

16. It is helpful to have some questions for organizing stakeholder perceptions and views, which will help bring forth clarity and consensus on choices for the future. Drawing on all the information in the preceding sections of the paper, the remainder of this section sets out important questions for the consultations, on which ADB will appreciate stakeholders' views and suggestions.

A. ADB's Vision:

- What should be ADB's Vision to 2020, should it continue to be: *"An Asia and Pacific Region Free of Poverty"*?

B. ADB's Mission:

- What according to you should be ADB's Mission, should it be centered on: Inclusive growth, environmentally sustainable growth, and regional economic integration?

C. Risk and Challenges of the Region:

- Do you agree with the key development challenges and risks for the Asian and Pacific Region, as set out in Section III? What are other key challenges and risks that ADB should be aware of?
- How important is it that ADB and the region address these challenges and risks?

D. Role of ADB

- Given the changing regional context, should ADB's business model remain centered on project financing? Should ADB take on a larger role in knowledge development? Should ADB be selective and implement its program and operations increasingly in partnership with other donors?
- How should ADB further the advancement of knowledge for development in the Asia and Pacific region? Is policy dialogue and technical knowledge embodied in its lending operations sufficient? If not, what else should ADB do?

E. Long Term Strategic operational focus

- What should be ADB's core operational areas to address the future development challenges and risks of the region?
- What should be ADB's operational focus (specify sectors) within each core operational area?
- To what extent should ADB remain directly active in (i) education, (ii) health, and (iii) agriculture?
- How can ADB be selective in its operations and be responsive to a range of client needs at the same time?
- How could ADB help broaden citizens' access to productive employment and other economic opportunities? In this regard, what should be the nature of innovative financial instruments for social sector funding and the development of human capital?
- What should be ADB's thematic priorities to 2020, should these be, for example, good governance, capacity development, gender, knowledge management?

F. ADB's Competencies and Services

- What, in your views, are ADB's core competencies? Do you agree that to be effective, ADB should focus on a few core competencies?
- What are the competencies that ADB needs to have in order to address the region's key development challenges and risks?
- What innovations in lending and non-lending products and services would you recommend to ADB, so that ADB can effectively address the region's key development challenges and risks?

Appendix 1: Timeframe and major milestones for the Review

Major Milestones	Date
<ul style="list-style-type: none"> ▪ Interdepartmental Working Group established; first meeting on LTSF review schedule of activities/ approach 	April 2007
<ul style="list-style-type: none"> ▪ <u>Governors' Seminar</u> at ADB 40th Annual Meeting in Kyoto kicks off consultation process 	May 2007
<ul style="list-style-type: none"> ▪ Consultation plan presentation at informal Board seminar 	June 2007
<ul style="list-style-type: none"> ▪ Internal/external consultations 	July to September 2007
<ul style="list-style-type: none"> ▪ ADB Board and Management Retreat 	October 2007
<ul style="list-style-type: none"> ▪ Drafting of the Board paper 	November 2007 onward
<ul style="list-style-type: none"> ▪ Formal Board meeting on Board paper discussion 	March 2008

Appendix 2: Highlights of ADB's Long term Strategic Framework (2001-15)

Vision: ADB's vision is an Asia and Pacific region free of poverty, ADB has made poverty reduction in its developing member countries its overarching mission. The Long-Term Strategic Framework (LTSF) provides an agenda for ADB's poverty reduction and growth-financing activities over the 15 years from 2001 to 2015. The LTSF will be implemented through a set of three medium-term strategies each covering a five-year period.

Core Areas of Intervention:

- **Sustainable economic growth**
Broad based growth-promoting activities, including investments in both physical and social infrastructure, and an environment program that promotes environmentally sound development.
- **Inclusive social development**
Investments in social support programs and a policy and reform agenda that will promote equity and empowerment, especially for women and disadvantaged groups.
- **Governance for effective policies and institutions**
Support for public sector management at all levels; legal and judicial reform, and improving public accountability. Governance must also promote process and procedures for more effective participation in decision making to promote equitable and inclusive growth, especially by civil society.

Crosscutting strategic themes complementing the core areas:

- **Promoting the role of the private sector in development**
Builds on private sector development strategy, recognizes the central role of the private sector and of markets in the development process, and responds to the challenges of mobilizing private sector resources to address the region's increasingly complex development agenda.
- **Supporting regional cooperation and integration**
The need to support the development of the developing member countries through cooperation, to provide wider development options through greater access to resources and markets, to address shared problems that stretch across borders, and to take advantage of opportunities for sharing knowledge and information.
- **Addressing environmental sustainability**
Putting environment considerations in the forefront of all development decision making and planning in the developing member countries and in all ADB initiatives, and not only stopping but reversing the enormous and costly degradation and damage to the environment that have already occurred.

Strategic Operating Principles:

- Ensuring country leadership and ownership of the development agenda
- Taking a long-term approach to development assistance
- Enhancing strategic alliance and partnerships
- Measuring development impact

Appendix 3: Highlights of ADB's Mid-term Strategic Framework I and II (2001-05; 2006-08)

A. Highlights of MTS I

- The developing member countries can be broadly classified in 3 categories (i) very low-income, (ii) low-income, (iii) middle income. Implement the MTS I will be guided by the different needs and priorities of each of these groups.
- Operate in sub-regional context that share the same "neighborhood" facing the same cross-boarder development constraints.
- Centerpiece national poverty reduction strategy (NPRS) for developing country programs.
- Promote partnerships for assistance based on NPRS.
- Develop indicators to monitor and evaluate results.

Aligning the organization with the strategy

- Align the organizational structure and business process and become more client focused.
- Develop a learning organization drawing on its internal expertise, past experience and practices.
- Make assistance modalities more.
- Improve integrated resource management on the basis of better assessment of the cost of delivery and ensure adequate resource for country programs.

B. Highlights of ADB's Mid-term Strategic Framework II (2006-2008)

Strategic Priorities

- Catalyzing Investment
- Strengthening inclusiveness
- Promoting regional cooperation and integration
- Managing environment
- Improving governance and preventing corruption

Operational Model

- Sectors categorized into 3 groups. Group I – core operational sectors where ADB will build up a critical mass of expertise. Group II – non-priority for ADB but are important for meeting client needs. Group III – sectors where ADB intends to wind up its operations.
- Reform technical assistance activities, giving more focus and priority to sectors/themes, and reducing the number of technical assistance projects.
- Enhance intermediation function through fee-based administration of grants and loans, credit enhancement instruments, loan and guarantee syndications, and other risk sharing arrangements.
- Introduce new lending products to reduce response time and transaction costs.
- Implement projects and monitor portfolio performance under the results-based framework.

Appendix 4: Highlights of Eminent Persons Group Report (March 2007)

A. Transformation of Asia and the Pacific

- By 2020, incidence of widespread absolute poverty in most countries would have been conquered.
- Average per capita in PPP terms comparable to Latin America
- Global GDP would approach 45 percent, world trade 35 percent; Asia's intra-regional trade would match the European Union
- "Capital surplus" region as a magnet for private capital flows
- There will be a number of low-income or fragile economies with large development challenges
- Basic challenges would change: *from fighting extensive poverty to tackling issues arising from the countries' economic success*

B. New ADB: Focusing on 3 complementary strategic directions

- From Poverty Reduction to Inclusive Growth
- From Growth to Environmentally Sustainable Growth
- From Primarily National Focus to Supporting Regional Integration

C. New Operational priorities

- Infrastructure Development
- Financial Sector Development and Intermediation
- Energy and Environment
- Technological Development and Innovation
- Regional Integration
- Knowledge Management

D. Strategy for transition

- Three-pronged approach for transition
 - ⇒ Continue to follow the current broad poverty alleviation focused strategy in low-income, small and island economies that remain eligible for concessional financing.
 - ⇒ Focus ADB efforts on helping countries achieve "middle-income" status.
 - ⇒ Build and strengthen ADB capabilities in areas that will become the core business by 2020.
- Strengthening ADB's operational relevance
 - ⇒ Reduction of transaction costs associated with ADB assistance
 - ⇒ Strengthening institutional capacity and culture
 - ⇒ Greater flexibility in budgetary and human resources policies for quicker reallocation and redeployment of resources
 - ⇒ Character of the institution and role of regional members must evolve with the changes in the economic environment for ADB to retain credibility with the major stakeholders

Appendix 5: Highlights of ADB paper on Inclusive Growth⁵

Highlights

- Overcoming economic and social inequalities through an inclusive growth process
- It is not based on a redistributive approach to poverty
- Inclusive growth encompasses poverty reduction and advances development agenda

Key policy ingredients of inclusive growth: two anchors

- Creation of productive and decent employment opportunities through high and sustainable growth
- Promoting social inclusion to ensure equal access to opportunities by all

Rationale for a central strategic focus on inclusive growth

- Need to respond to new challenges in Asia, incidence of \$2-a day poverty still remains at 50%.
- Rising inequalities in Asia, if not addressed, poverty will remain a major issue even by 2020
- Current PRS inadequate in responding to all the new challenges and risks in the changing regional context

Ending Poverty and Inequality through Inclusive Growth by 2020-Implications for ADB

- **Vision:** Asia and the Pacific - A Region Free of Poverty (with Opportunity for All?)
- **ADB Mission:** To foster inclusive, sustainable and harmonious growth and development across developing Asia
- **ADB's Roles:** To mobilize and intermediate financial resources, knowledge and partnerships
- **ADB Strategic framework: Three pillars** are suggested

(a) **Investing in creating opportunities** to support high and sustainable growth, through following operational priorities

- Infrastructure
- Energy and Environment
- Financial sector development
- Regional Cooperation

(b) **Investing in broadening access to opportunities** to support social inclusion, through following operational priorities

- Social development (education, health, microfinance, and water and sanitation)

(c) **ADB Thematic priorities:** (i) Private sector development, (ii) Good governance, (iii) Knowledge management

⁵ ADB 2007. *ERD Working paper series No. 97, Inclusive Growth toward a Prosperous Asia: Policy Implications.*

Appendix 6: Regional Cooperation and Integration

Introduction

Regional cooperation and integration (RCI), if appropriately designed and managed, can help improve cross-border connectivity, increase regional trade and investment, promote efficient regional financial intermediation and reduce macroeconomic vulnerability to shocks, and provide regional public goods. All of these will help reduce poverty and improve living standards of DMCs. RCI is thus an additional platform that can complement national-level policies and programs aimed at socio-economic development and poverty reduction.

ADB's Priorities in Supporting Regional Cooperation and Integration

From ADB's perspective, RCI is not an end in itself, but only a means to achieve its overarching objective of poverty reduction in Asia. ADB adopted the Regional Cooperation and Integration (RCI) Strategy in July 2006 to guide its work in supporting RCI in Asia and the Pacific.⁶ The RCI strategy is built on four priority areas (pillars), which are mutually reinforcing so they can contribute to ADB's overarching goal of poverty reduction (See Figure A).

Regional and subregional programs on cross-border infrastructure and related software (Pillar 1 of ADB's RCI Strategy) could help improve cross-border physical connectivity to provide greater opportunities for the poor to participate in market activities. Cross-border infrastructure projects—e.g., transport, energy, and telecommunications—are essential for the movement of goods, services, people, and information across countries. They enlarge market access, reduce economic distance, and facilitate trade, investment, and labor flows. The resulting intensification of cross-border economic activities can create employment, particularly in the labor-intensive sectors of DMCs, thus contributing to poverty reduction.

Benefits from improved physical connectivity to DMCs may be constrained if regional trade and investment flows are restricted. Therefore trade and investment cooperation and integration (pillar 2) is important to maximize the benefits of cross border and physical connectivity. Trade openness and greater FDI flows can connect DMCs with global markets where there is demand for developing country products. Trade facilitation measures to improve transparency, efficiency, and procedural uniformity of cross-border transportation of goods would also benefit DMCs, where the inefficiencies are sometimes more costly to industries than are tariff barriers. Support for DMCs will also be carried out through the Aid-for-Trade (Aft) program in collaboration with the WTO. The Aft and the Doha Round are two tracks of a process to achieve a meaningful trade development round.

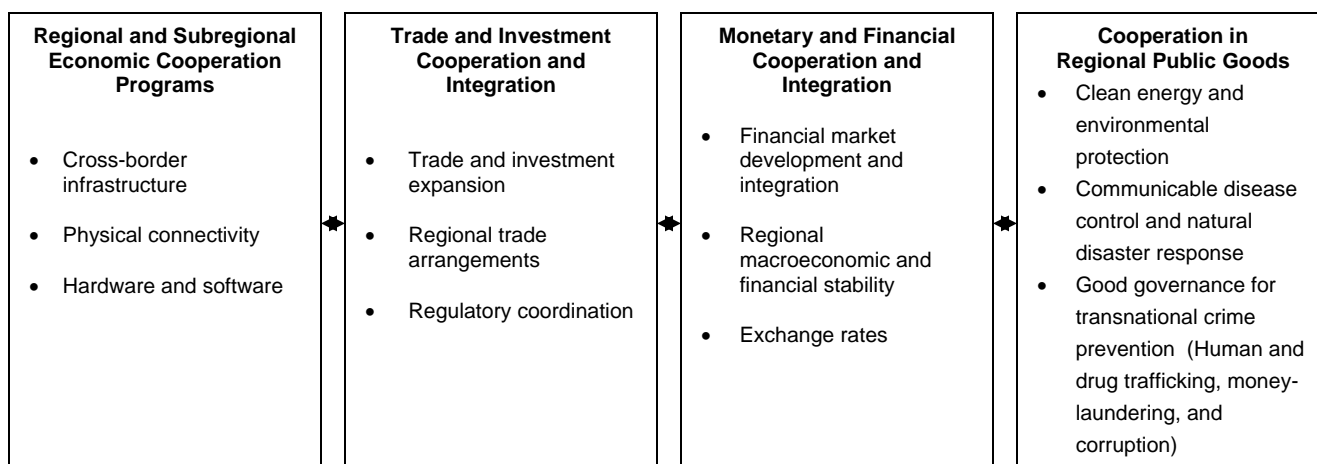
Monetary and financial cooperation and integration (Pillar 3) could contribute to regional macroeconomic and financial stability which is crucial to sustain robust growth and reduce poverty. The 1997–1998 Asian financial brought about large macroeconomic contractions. Economic growth plunged in many crisis-affected countries and the impressive achievements in poverty reduction over the previous three decades encountered a major setback. The crisis thus underscores the critical importance of maintaining macroeconomic and financial stability for sustaining robust growth, continued poverty reduction, and social improvements. It also highlights the importance for DMCs to develop well-functioning, local-currency bond markets in Asia through the Asian Bond Markets Initiative (ABMI) to reduce incentives to rely too heavily on domestic bank financing and external short-term borrowing.

Provision of regional public goods (RPGs, pillar 4) is critical to support poverty reduction efforts. Improved cross-border physical connectivity and expansion of regional trade and investment bring major benefits to DMCs, but they may also have adverse cross-border impacts on the environment and people. Environmental degradation, threats of communicable diseases (e.g., avian influenza, HIV/AIDS, and SARS) and natural disasters can affect the poor disproportionately and undermine the economic gains that have been achieved. Prevention of these threats can protect the poor and help accelerate poverty

⁶ ADB. *Regional Cooperation and Integration Strategy*. Manila. 2006.

reduction efforts. Consequently, the provision of RPGs (pillar 4) has become a key element of ADB's approach to RCI.

Figure A: Four Pillars of Regional Cooperation and Integration



Role of ADB in Supporting Regional Cooperation and Integration

As the region's leading development finance institution, ADB is well placed to facilitate RCI in Asia and the Pacific. ADB plays four distinct roles in supporting and promoting RCI: providing financial resources for RCI projects, programs, and related technical assistance and/or helping DMCs mobilize funding and technical assistance (i.e., acting as a money bank); creating, consolidating, and disseminating knowledge and information on RCI to the DMCs (i.e., acting as a knowledge bank); helping DMCs and regional and/or subregional bodies build institutional capacity to manage RCI (i.e., acting as a capacity builder); and serving as catalyst and coordinator of RCI for the DMCs (i.e., acting as an honest broker). These four functions are mutually supportive and reinforcing, enabling ADB to serve as a facilitator in supporting and promoting RCI.

The RCI strategy requires ADB to commit adequate human and financial resources to its RCI activities. In February 2007, the ADB Board of Directors approved the establishment of the Regional Cooperation and Integration Financing Partnership Facility (RCIFPF). The RCIFPF coordinates existing and new resources, and facilitates the provision of financial assistance for RCI activities, on a joint or parallel basis with development partners, alongside ADB's own assistance. However, additional financial resources are still required to finance both the lending and the non-lending components of the RCI Strategy. ADB's support for Pillar 1 of the RCI Strategy will cover significant lending as well as non-lending operations. ADB's support for Pillars 2, 3, and 4 is primarily of non-lending in nature – and may involve lending activities as needed and appropriate.