

ADB's Crisis Response

In response to this crisis, ADB created the CSF and enhanced the size of its TFP, besides using its regular loan and technical assistance products for crisis-response purposes. ADB established the \$3 billion CSF in June 2009 as a time-bound budget support instrument to provide more effective countercyclical aid to its borrowers. The CSF was intended for DMCs that are eligible for OCR borrowing, including blend countries, which are also eligible for ADF-financing. The facility had a 5-year tenor with a 3-year grace period; it carried an interest rate of 200 basis points above the London interbank offered rate and a commitment fee of 0.75%. Access to the CSF was based on three criteria: (i) the adverse impact of the global economic crisis, (ii) planned countercyclical development expenditures for poverty reduction, and (iii) sound macroeconomic management. In 2009, ADB approved \$2.5 billion in CSF assistance to five countries (Bangladesh, Indonesia, Kazakhstan, the Philippines, and Viet Nam) and disbursed \$2 billion. The remainder was disbursed in early 2010. ADB approved an additional \$400 million ADF commitment authority to help the most fiscally stretched countries that have access only to concessional ADF resources. To support ADF-eligible borrowers' stimulus and social protection packages, ADB allowed front-

loading of up to 100% of their biennial (2009–2010) ADF allocation. In March 2009, ADB expanded the TFP by raising the exposure limit from \$150 million to \$1 billion to improve access to trade finance for DMCs. ADB quickly carried out due diligence assessment of financial strength, and fiduciary and governance standards in commercial banks in DMCs and selected 85 of them as issuing banks under the TFP. Figure 2 shows the timeline of the global economic crisis and ADB's response.

Overall ADB assistance to sovereign and nonsovereign borrowers (excluding the TFP) grew by 28%, from \$11.6 billion in 2008 to \$14.8 billion in 2009. In addition, ADB's trade finance assistance reached \$633 million in 2009 and \$1.2 billion in 2010. Assistance to sovereign borrowers jumped by 46%, from \$9.5 billion in 2008 to \$13.9 billion in 2009, as several governments launched countercyclical fiscal expansion. In 2009, ADB was able also to mobilize about three times more cofinancing to reach \$3.1 billion. Total disbursements reached \$10.64 billion in 2009 compared with \$8.95 billion in 2008, and the overall disbursement ratio for sovereign and nonsovereign operations increased to 30.7% in 2009 against its historical average of about 25%. A significantly higher level of disbursement during the crisis was made

possible by ADB's decision to deliver a far higher proportion (44.7%) of assistance through its quick disbursing program loan modality in 2009 than its average of about 30%. Nearly 70% of program assistance approved in 2009 was disbursed in the same year. Net resource transfer to DMCs increased by 42% in 2009 to reach \$6.5 billion.

In general, the "least affected" (with less than 20% decline in GDP growth rate) DMCs received a greater share of ADB's overall assistance than the "severely affected" (with more than 50% decline in GDP growth rate). Compared with the average assistance received in 2007 and 2008, the severely affected countries received 40% more assistance in 2009 and 11% more in 2010, whereas the least affected countries received 75% more assistance in 2009 and 36% more in 2010. Similar imbalance occurred in disbursements and net resource transfers.

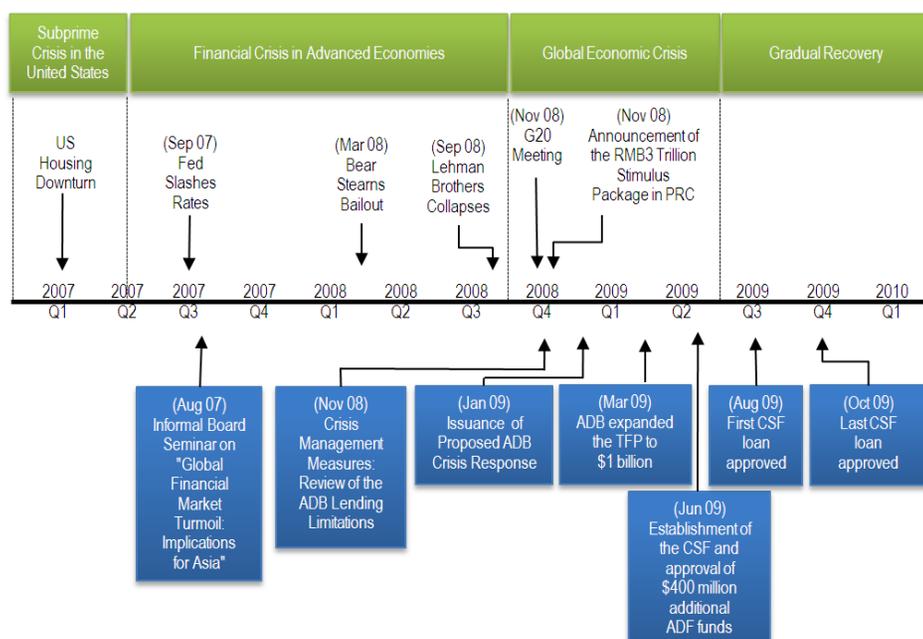
Highlights of Lessons

Institutional readiness and greater flexibility are important in responding to crises.

Timeliness is critical in crisis response; usually, the earlier the response, the more effective it is. ADB, however, had no capacity to mobilize additional funds in late 2008, and was unable to provide much assistance until the second half of 2009, by which time the crisis began to abate and recovery started in some DMCs. Such a delay in providing assistance did diminish the value of its assistance to some extent. Institutional readiness to assist in future crises should place emphasis on (i) the need for capital headroom for contingencies, and (ii) the timeliness of assistance. There will be a trade-off between ADB's crisis-response operations and its normal operations unless ADB augments its risk-bearing capacity to mount a crisis response when a crisis is imminent. To stay prepared, ADB could evaluate the options for possible crisis response size, financing modalities and terms of such response, and their implications for normal lending operations as part of its medium-term planning.

Surveillance of more countries and regions would further enhance ADB's

Figure 2. Timeline of the Global Economic Crisis and ADB's Response



crisis-response ability. ADB was better prepared institutionally to respond to this crisis than to the Asian crisis in 1997, in part to the Office of Regional Economic Integration's assistance to surveillance in East and Southeast Asia. ADB could further strengthen the depth and frequency of macroeconomic analysis of countries, and widen its surveillance capacity development and monitoring activities to regions outside East and Southeast Asia. A deep understanding of the macroeconomic situation in the DMCs, and continuous monitoring of macroeconomic and finance sector developments will enable ADB to assess the vulnerability of individual DMCs to future crises and equip itself to respond more effectively.

A crisis-response facility for ADF-only countries would have been useful.

While ADB successfully mobilized significant additional resources to help DMCs, the benefits of its response were unevenly distributed, to the disadvantage of severely affected countries. As a group, the countries that were most affected by the crisis received ADB assistance at a lower growth rate than moderately and least affected countries. This was, in part, due to the absence of a concessional crisis-response window that would exclusively help smaller and poorer countries. ADB did try to enhance assistance to severely affected countries, but the rigidity of ADF allocation and the difficulties in the use of regular program and project loans for such countries constrained its efforts.

What is most important in a crisis situation is making more resources available. For this, the focus of ADB should be on increasing disbursements. During crisis situations, ADB would also need to assess net resource transfers to DMCs from all official sources of development assistance. The evaluation found that a number of smaller DMCs, although most affected by the crisis, received negative net transfers from ADB in 2009—making ADB operations inadvertently pro-cyclical. This situation would not have arisen if the eligibility criteria used to allocate crisis-response resources to DMCs had taken into consideration the projected net resource transfer position from all sources, particularly for the most vulnerable countries.

Better internal coordination and collaboration at ADB among departments would have made the assistance more efficient. ADB's response to the crisis would have been even more efficient and resulted in a more optimal use of resources if there had been an arrangement with one nodal lead to coordinate crisis-related responses of operations departments and relevant knowledge departments. There was close interdepartmental coordination for preparing Plan B, which was readied in December 2008. However, better coordination between operations departments could have moderated the crisis-induced asymmetry in the operational burden on departments and staff. A coordinated and collaborative approach would have allowed cross-departmental use of experienced and highly skilled staff, which could have further improved the quality of products and, possibly, reduced processing time, which had already been compressed.

The CSF could be designated as a standby facility offering greater flexibility in disbursements. Blend countries would benefit from longer tenor where needed. The evaluation found the CSF to be a useful instrument to respond to a crisis. However, it would be more effective if it offered more flexibility in loan size and tenor to fit the diverse needs of countries. As found in the case of Bangladesh, greater flexibility in withdrawing funds from the loan in the amounts and at the time needed by the government would have made the instrument more effective. Greater flexibility in disbursements, similar to the deferred drawdown facility offered by the World Bank, would have enhanced the CSF's responsiveness. Further, a fixed 5-year tenor for all countries makes the instrument less suitable for some poorer countries that are eligible for a blend of ADB's OCR and ADF assistance. Some of them could find it impractical, if not disruptive, to repay the loan within just 2 years in hefty biannual installments. A longer tenor (up to 8 years based on assessed need) would make the facility more concessional to the blend countries, which are unlikely to get access to the crisis-response window under the ADF.

Precautionary financing instrument as a facility variant. A precautionary financing instrument (similar to the contingent loan provided to Indonesia) would be a useful instrument to respond to future crises, particularly to help middle-income countries. To be effective, the facility has to be provided rapidly and jointly by all participating agencies, since the intent of such an intervention is to give a positive signal to the markets. The contingent loan to Indonesia is akin to ADB's regular program loan in its tenor and processing approach. ADB would need to assess the implication that longer tenors in crisis-support loans would have on its own capital capacity. If the CSF is designed as a flexible instrument, the precautionary finance instrument could become a variant of the CSF. This would also allow fast-track processing of precautionary finance loans—a great advantage during a crisis.

More rigorous assessment of vulnerability and coping abilities, and paying attention to net resource transfers, would have improved targeting. A further refinement of selection criteria—to include assessment of (i) the vulnerability of a DMC via a composite index based on information that reflects the fundamental strength of the policy regime and structural aspects of the economy, (ii) the ability of the social protection systems to cope with a crisis, and (iii) the net resource transfers from all official sources of development assistance—could ensure the flow of resources to countries that are more affected by a crisis and in greater need. The criteria also need to include triggers for CSF assistance and principles for determining the quantum of assistance from ADB.

The Trade Finance Program is a useful instrument during crises. The TFP is an excellent crisis-response tool, particularly in Asia, where trade intensity is high, and for smaller DMCs that rely on foreign trade and are more vulnerable to global crises. Continuation of the program could help ADB stay engaged with local banks in DMCs and would assist in scaling up the facility in response to a crisis. It could potentially strengthen the banking sector in weaker DMCs, and fill persistent market

gaps by helping smaller DMCs access trade finance. However, the TFP's actual performance in this regard will have to be assessed in greater depth. It would thus be useful to study the relevance and effectiveness of the TFP at the subproject/borrower level from the point of view of development impact, ADB profitability, and ADB additionality.

A medium-term focus on building social protection systems in DMCs collaboratively by development partners would enhance DMCs' resilience to crises. Social protection programs are attractive crisis-mitigating instruments for two reasons: (i) they have a built-in countercyclical bias; and (ii) they protect the poor, who are the first to be affected by a crisis. If a country has an established social protection program—such as the conditional cash transfer program of Brazil, or the employment guarantee program of India—it can be scaled up or down as required. In the presence of such programs, ADB's crisis support would be more effective and DMCs would become resilient to crises. However, social protection programs are often characterized by poor targeting, leakages, and waste. For this reason, deeper knowledge about the operation and performance of such schemes is necessary if ADB is to rely on them in future. In the medium term, ADB, jointly with other aid agencies, could develop comprehensive, well-targeted social protection systems in DMCs, keeping in mind country vulnerabilities, affordability, and administrative and political economy considerations.

Moving Forward

Ideally, ADB needs to be prepared, both institutionally and financially, to respond to a crisis. Its ability to respond financially will depend on two important factors: (i) its risk-bearing capacity, defined by capital scope; and (ii) the credit quality of its portfolio, which a crisis could affect in unexpected ways. As ADB's exposure to nonsovereign operations increases, so too does the vulnerability of its portfolio. Its ability to respond to a crisis would also be influenced by the reflow of resources from its past lending. There are three broad ways in which ADB could remain prepared for a crisis:

- Create a layer of buffer capital as a reserve that is adequate to support the increased lending necessary during a crisis—although this could adversely affect ADB's development effectiveness.
- Carry on with a sustainable level of operations and, when a crisis arises, reduce the level of future operations adequately in order to accommodate the necessary increase in crisis lending. These two options entail a trade-off between crisis response and regular operations.
- A third option would be for ADB to augment its risk-bearing capacity to mount a crisis response with shareholders' assistance when a crisis is imminent. To stay prepared, ADB could evaluate its options regarding the feasible extent of a crisis response, financing modalities, and terms of such a response, and

the implications for normal lending activity, as part of its medium-term planning.

References and Related Links

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