Clients–Contributors–Collaborators: A New Partnership with Upper Middle-Income Countries

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Asian Development Bank
ABBREVIATIONS

ADB – Asian Development Bank
ASEAN – Association of Southeast Asian Nations
CPS – country partnership strategy
DMC – developing member country
ICT – information and communication technology
GDP – gross domestic product
GNI – gross national income
HIE – high-income economy
LIC – low-income country
LMIC – lower middle-income country
MDB – multilateral development bank
MIC – middle-income country
OCR – ordinary capital resources
PFM – public financial management
PPP – public–private partnership
PRC – People’s Republic of China
RCI – regional cooperation and integration
SME – small and medium-sized enterprise
TAS – transaction advisory services
UMIC – upper middle-income country

NOTE

(i) In this report, "$" refers to US dollars.

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APPENDIX

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EXECUTIVE SUMMARY

The Midterm Review of Strategy 2020 concluded that the Asia and Pacific region is changing fast, and the challenge of the Asian Development Bank (ADB) is to enhance its relevance in this rapidly transforming region. The transformation is most evident in middle-income countries with rapid growth rates, dramatic poverty reduction, and a rising middle class that is increasingly benchmarking itself against the living standards of advanced countries.

Their rising prosperity notwithstanding, middle-income countries continue to be beset with significant economic, social, and environmental challenges. Upper middle-income countries (UMICs) share some challenges with lower middle-income countries (LMICs), but they differ in the intensity and complexity of other development problems, including higher inequality, climate change, and the need to upgrade productivity and competitiveness to match those of developed economies. UMICs are also more vulnerable to cyclical economic downturns because they are more integrated with global markets and international trade. The 2007–2008 global economic and financial crisis underscored this when many UMICs were disproportionately affected.

Three important characteristics of UMICs stand out: (i) while distinctive individually, UMICs have made similar progress on many fronts, including on reduction in poverty, human development achievements, international competitiveness, and credit standing; (ii) their progress as a group puts them ahead of LMICs and low-income countries (LICs); and (iii) they still lag behind high-income economies on a range of development indicators. These characteristics provide the basis for treating UMICs as a distinct group that has achieved a level of progress but needs to advance further to join the ranks of developed nations.

With its nearly 50 years of development experience, ADB is well-positioned to support the transition of UMICs to become fully mature economies. Consultations with UMICs have shown that they want to continue to maintain a strong partnership with ADB. UMICs recognize the additionality provided by ADB’s support. They value the knowledge and best practice, innovation, capacity building support, and the high standards of integrity and transparency that come embedded in the development finance that ADB provides. They acknowledge ADB’s ability to leverage and catalyze additional finance, including private finance. They also appreciate ADB’s role and convening power on regional cooperation and integration (RCI).

This paper provides an approach for ADB’s engagement with UMICs. It recognizes UMICs as clients, active contributors to regional development, and important collaborators and partners of ADB in its vision of a region free of poverty. This approach will continue to be refined and will be integrated with ADB’s strategy for the post-2020 period.

The paper proposes engaging with UMICs in six areas: (i) mitigating rising inequalities and promoting inclusive growth, (ii) managing climate change and the environment, (iii) addressing the challenge of demographic change, (iv) boosting productivity and competitiveness, (v) strengthening RCI, and (vi) promoting south–south knowledge collaboration. The first four relate to key UMIC challenges in which they seek ADB’s support. The last two lay out how ADB will foster partnerships with UMICs for stronger development cooperation in the region.

ADB will engage with UMICs to mitigate inequalities by investing in lagging areas and the development of inclusive cities, including through the use of greater subsovereign financing. In addition, ADB will emphasize skills development, education and financial inclusion, and support governance improvements, including innovations in public delivery systems and reform of state-owned enterprises. Support for green infrastructure development through clean energy, energy
efficiency, sustainable transport, and urban renewal interventions will be a key component of
ADB’s partnership with UMICs on climate change and the environment. Social protection
support will help address the demographic challenge in UMICs, arising from aging populations.

ADB’s private sector operations in UMICs will progressively grow as a share of total operations
and, together with public–private partnerships (PPP), will boost productivity and competitiveness
and leverage finance. The emphasis will be on growth-promoting projects that have significant
and sustainable development impact. Strengthening of capital markets will help bring in greater
private finance for infrastructure, including through the growth of pension funds and insurance,
which are also important for strengthening social protection systems.

UMICs are key drivers of the regional economy and also influence prospects of other DMCs
through spillover effects. UMICs will increasingly play a lead role in second generation RCI
interventions and regional public goods, and fostering knowledge cooperation in the region.

UMICs are also important shareholders of ADB and contributors to the Asian Development
Fund. ADB will need to strengthen engagement with UMICs in these roles and better leverage
their resources and expertise to strengthen its development impact in the region.

However, to remain a partner of choice for UMICs, ADB also has to raise the standards of its
own capacity, performance, and effectiveness. Four institutional reform actions are especially
important to ensure ADB’s relevance for UMICs.

First, ADB will need to strengthen and upgrade a core set of anchor staff capacities and skills
that can be accessed across the bank for servicing the more complex needs of UMIC clients
under a “One ADB” approach. Examples of creating anchor capacities include the recent
reconstitution of sector and thematic groups, and the consolidation of staff expertise in the PPP
area by establishing an Office of Public–Private Partnerships.

Second, ADB will need to reform the country partnership strategy (CPS) process to ensure its
relevance for UMICs. The CPS process will be simplified and shortened, and the CPS will be
made more responsive to client needs and expectations from ADB support.

Third, ADB will need to consider a more systematic approach to the use of country systems to
reduce transaction costs, based on country preparedness and demand.

And, fourth, ADB will need to innovate on financing and advisory instruments and services by
progressively mainstreaming the use of results-based lending, reviewing the pricing structure for
lending to those UMICs whose per-capita incomes exceed the graduation threshold, adopting
cost-sharing practices on the preparation of knowledge products, expanding risk participation in
private sector operations, strengthening transaction advisory services, and incentivizing more
subsovereign and RCI operations.

ADB will continue to assist the economic and social development of UMICs and prepare them
for eventual graduation from its assistance. Concurrently, ADB will continue to further assess its
graduation policy. Important factors in this assessment will be the nature of ongoing
development challenges of UMICs, including those related to climate change and the
environment; their vulnerability to economic downturns; and their need for development
assistance. ADB will continue to be guided by the views of its shareholders on graduation and
will also take into consideration the graduation policies and practices of other multilateral
development banks.
I. INTRODUCTION

1. The Midterm Review of Strategy 2020 includes the engagement of the Asian Development Bank (ADB) with middle-income countries (MICs) as a key strategic priority going forward.¹ In doing so, the midterm review recognizes that all but two of ADB’s developing member countries (DMCs) will likely have become MICs by 2020.² Therefore, it is imperative for ADB to respond to development progress in the region and become more relevant and effective for MICs, which will be its main clients in the future.

2. The midterm review makes a distinction between lower middle-income countries (LMICs) and upper middle-income countries (UMICs), noting that the two groups of MICs are in different stages of development and thus have distinct opportunities and expectations from engagement with international development partners. Consequently, it becomes incumbent upon ADB to understand and appropriately react to the diversity of development trajectories of the two groups of MICs. This can be achieved by adopting and implementing specific approaches for each group that underscore the relevance and responsiveness of ADB’s engagement.

3. As noted in the midterm review, LMICs, despite their relatively higher per-capita income, share many development challenges with low-income countries (LICs), including poverty, vulnerability, infrastructure deficits, and governance bottlenecks. The midterm review details ADB’s strategic priorities to support such countries. UMICs share some challenges with LMICs, but differ in the intensity and complexity of other development problems, including higher inequality, climate change, and the need to upgrade productivity and competitiveness to match those of developed economies. UMICs also have generally higher levels of internal institutional capacities to deal with these problems. Their disparate characteristics call for ADB to develop a focused and targeted approach to partnering with UMICs. Such an approach would need to be built on the midterm review priorities, but would recognize that the differing circumstances of UMICs require ADB to calibrate its approach and define relevant terms of engagement with them.

4. The purpose of this paper is to provide a more relevant, responsive, and effective approach for ADB’s partnership with UMICs. This approach will continue to be refined and will ultimately be integrated with ADB’s corporate strategy and priorities for the post-2020 period.

5. In addition to consultations within ADB, a series of external consultations with the governments of selected UMICs—the People’s Republic of China (PRC), Kazakhstan, and Thailand—have guided the directions and recommendations outlined in this paper. The paper has also benefited from in-depth consultations with three multilateral development banks (MDBs)—the European Bank for Reconstruction and Development, the Inter-American Development Bank, and the World Bank Group. Policy and research think tanks and civil society institutions have also provided useful input.

II. THE UPPER MIDDLE-INCOME COUNTRIES

6. There are currently 14 UMICs among ADB’s DMCs (just over one-third of its 40 nongraduate DMCs) on the World Bank’s current definition of countries with gross national incomes (GNI) per capita between $4,126 and $12,745.³ Of these, three are in East and

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² Afghanistan and Nepal are expected to remain low-income countries.
³ Besides the 14 UMICs, ADB’s DMCs include 20 LMICs (with per-capita incomes between $1,046 and $4,125) and six LICs (with per-capita incomes equal to or less than $1,045).
Southeast Asia (PRC, Malaysia, and Thailand); three are in Central and West Asia (Azerbaijan, Kazakhstan, and Turkmenistan); seven island states are in the Pacific (Cook Islands, Fiji, Marshall Islands, Nauru, Palau, Tonga, and Tuvalu); and one island state is in South Asia (Maldives). This paper focuses on the six UMICs in East and Southeast Asia and Central and West Asia.4

7. There are some LMICs that have a GNI per capita relatively close to those of UMICs at the lower end of the upper middle-income spectrum and can potentially reach UMIC status before 2020. These include Mongolia, Indonesia, and Philippines in East and Southeast Asia; Armenia and Georgia in Central and West Asia; and Sri Lanka in South Asia. Many of the development challenges outlined and the directions proposed in this paper would also apply to these countries.

8. Differences. There are important differences among the UMICs in which ADB operates. These include significant distinctions in their political and economic systems and in their social and cultural norms. From an economic standpoint, UMICs vary significantly in terms of the size of their populations (ranging from 5 million to almost 1.4 billion), gross domestic product (GDP) (ranging from almost $42 billion to over $9 trillion), recent rates of GDP growth (ranging from an average of 3% to over 10%), and the structure of their economies (with the share of manufacturing in GDP ranging from as low as 4.8% to as high as 34.4%). See Table 1.

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<tr>
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<tbody>
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<td>73,560</td>
<td>4.5</td>
<td>4.8</td>
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<td>5.24</td>
<td>41,851</td>
<td>10.3</td>
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… = data not available, GDP = gross domestic product, UMIC = upper middle-income countries.
Note: The table excludes small island UMIC economies.

9. The much smaller share of manufacturing in GDP among the Central Asian UMICs highlights their lack of economic diversification. All three—Azerbaijan, Kazakhstan, and Turkmenistan—are heavily reliant on petroleum resources. In Azerbaijan and Turkmenistan, petroleum products comprise around 90% of total exports, while in Kazakhstan they comprise around 60%. Diversification away from petroleum and towards higher value-added sectors and more complex and sophisticated products is critical for their long-term sustainable growth.5

4 The paper excludes small island economies from its scope since most face unique development challenges arising from small populations, vulnerability, fragility, weak government structures, and low institutional capacities that set them apart from other UMICs. They also require more specific development interventions. ADB’s approach to fragile and conflict-affected states is already summarized in: ADB. 2013. Operational Plan for Enhancing ADB’s Effectiveness in Fragile and Conflict-Affected Situations. Manila.

10. **Transitioning to high-income level.** UMICs also demonstrate considerable variations in the level of their per-capita national incomes even though they belong to the same income group (Table 2). Some UMICs are close to achieving high-income level; while others will take longer to transition. For example, Kazakhstan is likely to achieve high-income level already in 2015, but it could take Thailand 24 years to reach this level, based on their respective projected growth rates.

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<tr>
<td>Kazakhstan</td>
<td>11,380</td>
<td>2006</td>
<td>2</td>
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<td>Malaysia</td>
<td>10,400</td>
<td>1992</td>
<td>5</td>
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<tr>
<td>Azerbaijan</td>
<td>7,350</td>
<td>2009</td>
<td>13</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>6,880</td>
<td>2011</td>
<td>7</td>
</tr>
<tr>
<td>China, People’s Rep. of</td>
<td>6,560</td>
<td>2010</td>
<td>11</td>
</tr>
<tr>
<td>Thailand</td>
<td>5,370</td>
<td>2010</td>
<td>24</td>
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</table>

GNI = gross national income; UMIC = upper middle-income countries.

Note: The estimated number of years required to reach high-income level are based on the International Monetary Fund’s projections for gross domestic product per capita (current dollar prices) for the six UMICs for 2014–2019 taken from the World Economic Outlook (WEO) database (http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/index.aspx) accessed on 1 December 2014. These projected growth rates are applied to gross national incomes per capita and extrapolated to future years using the projected average growth rates for 2014–2019 for the six UMICs. The current income threshold for high-income countries ($12,745) is adjusted for future years by the projected inflation rate of G7 countries from the WEO database and extrapolated to future years using the projected average inflation rate for 2014–2019.


11. Because of variability in their growth rates, some UMICs have persisted in their current income category longer than others. Malaysia, for example, has been a UMIC for 23 years, while Kazakhstan has been a UMIC for 9 years. The rest have been UMICs for 4–6 years.

12. The length of time that a country has been placed in the UMIC category is considered a determinant of the pace of its transition to a high-income country. Based on experience, it is estimated that 15 years is the average transition time for a UMIC to reach high-income level. UMICs that take more than 15 years are considered to be in slow transition. This makes Malaysia a slow transitioning UMIC. In practice, UMICs have followed distinct trajectories and time frames to achieve high-income level. For example, newly industrialized economies such as the Republic of Korea; Hong Kong, China; Taipei, China; and Singapore achieved UMIC status in 7 to 10 years. However, it took Greece 28 years, Portugal 18 years, and Spain 17 years to complete their transitions to high-income status.

13. **Similarities.** While different in several ways, there are a number of similarities among UMICs in terms of their achievements in reducing poverty, battling continuing inequality,
attaining relatively high human development levels, and raising the level of their international competitiveness. As paras. 14-22 show, these and other related similarities allow UMICs to be treated as a separate group that has achieved a level of development which is measurably higher than that of LMICs and LICs, but which is still far below the development levels of high-income economies (HIEs). Consequently, this paper, while recognizing the distinctions among UMICs, builds on their commonalities to propose a broad approach for ADB’s engagement with them.

III. DIFFERENCES BETWEEN UPPER MIDDLE-INCOME COUNTRIES AND OTHER COUNTRY INCOME GROUPS

14. Poverty levels. As expected with their relatively higher incomes, the levels of absolute poverty are generally much lower in UMICs compared to LMICs and LICs. With the dramatic decline in poverty across most parts of Asia, the average percentage of the population living below the $1.25-a-day poverty threshold in four UMICs for which data are available—Azerbaijan, PRC, Kazakhstan, and Thailand—is only 3.2% (this average is based on the latest available survey year for each country), which is far below the 15.5% in LMICs and 23.3% in LICs (Figure 1). For the $2.00-a-day threshold, and including Malaysia with these four UMICs, an average 7.5% of the population is classified as living below this threshold, compared to 39.7% for LMICs and 52.8% for LICs. However, despite their lower national poverty levels, underdeveloped areas of many UMICs, including rural areas and urban slum settlements, can experience a much higher incidence of poverty that can resemble the high poverty levels of LMICs and LICs.

15. Among UMICs, the PRC has a much higher national poverty ratio of 11.8% on the $1.25-a-day and 27.2% on the $2.00-a-day threshold. Recent research from ADB indicates that a new poverty line of $1.51 (in 2005 purchasing power parity terms) may be a more appropriate threshold for Asia and the Pacific. On this measure, 16.5% of the PRC population, or about 221 million, were estimated to still be in absolute poverty in 2010 (the latest year for which data are available). Consequently, the challenge of eradicating poverty with its complex and multifaceted dimensions still remains profound in the PRC.

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7 HIEs in this paper refers to Hong Kong, China; Republic of Korea; Singapore; and Taipei, China. They have graduated from ADB’s assistance. Their GNI per-capita levels, which exceed $12,745, make them high-income on the World Bank’s classification of countries by income categories.

16. **The rise of the middle class.** The sharp decline in poverty has resulted in a rise of the middle class in all UMICs. On average, the middle class constitutes 73% of the population of UMICs, compared to 38% for LMICs and 30% for LICs (these averages are based on the latest available survey data for each country). The rise of the middle class is a harbinger of change and innovation as the economy adjusts to develop sophisticated consumer durables, electronics, and other products to meet the market demand emanating from this increasingly prosperous section of society. Side-by-side, the vocal demands of the tax-paying middle class put pressure on public sector systems to strengthen the delivery of basic services and promote greater transparency and accountability.9

17. **Income inequality trends.** Although a smaller share of their population is poor, UMICs, on average, are more unequal compared to LMICs and LICs. The Gini coefficient, a common measure of income inequality, indicates an average Gini of 38.1 for UMICs, compared to 36.0 for LMICs, and 31.9 for LICs (based on the latest available data; a higher Gini coefficient indicates a higher level of inequality). Separately, an analysis of income shares suggests that UMICs are also more unequal than LMICs and LICs in terms of the relative share of incomes accruing to the highest and lowest 10% and 20% of the populations. Large rural–urban gaps, globalization, market reforms, technological innovations, inequality in wages and salaries, and less redistributive tax and benefit systems appear to have exacerbated inequalities in UMICs as well as in some other countries in Asia and the Pacific.

18. The evidence on the trend in inequality in individual UMICs is more nuanced. The PRC has experienced a significant increase in inequality from the mid-1990s to the late 2000s. In

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Malaysia inequality increased rapidly from 2004 and, with a Gini coefficient of 46.2 (in 2009), it had the highest level of income inequality among all ADB DMCs. However, there is evidence of a small decline in inequality in Azerbaijan, Kazakhstan, and Thailand.

19. **Human development achievements.** Human development achievements of UMICs correlate with income levels and are higher than those of LMICs or LICs but lower than HIEs. As Figure 2 shows, on the Human Development Index (HDI), which is a composite measure comprising life expectancy, education, and income indices, UMICs are ranked as *medium* to *high* achievers, with a median HDI value of 0.73,\(^\text{10}\) higher than the 0.63 median value for LMICs (ranked as *low to high* achievers), and 0.55 for LICs (ranked as *low to medium* achievers). UMICs, however, still rank significantly lower than HIEs (ranked as *very high* achievers). About 74% of the population of UMICs aged 25 and above have benefited from at least some secondary education compared to 59% for LMICs and only 41% for LICs. Almost all births in UMICs are attended by skilled health staff compared to just over three-fourths in LMICs and a little more than half of the total births in LICs.

![Figure 2: Human Development Index Median Value, 2013](image)

<table>
<thead>
<tr>
<th>HIEs</th>
<th>UMICs</th>
<th>LMICs</th>
<th>LICs</th>
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<tr>
<td>0.89</td>
<td>0.73</td>
<td>0.63</td>
<td>0.55</td>
</tr>
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</table>

HIE = high-income economies, LIC = low-income countries, LMIC = lower middle-income countries, UMIC = upper middle-income countries.


20. **Level of international competitiveness.** The international competitiveness levels of UMICs are also broadly correlated to income levels. With individual scores in the narrow range of 4.41–5.03 in 2013 (except for Turkmenistan, which is not assessed), UMICs rank higher than LMICs and LICs on the Global Competitiveness Index (GCI), which grades countries on the quality of their institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication, and innovation (Figure 3).\(^\text{11}\) At the same time, UMICs lag behind HIEs on each of the GCI components. The catch-up needed by UMICs to close the competitiveness gap with HIEs is most pronounced in the areas of innovation, technological readiness, higher education and training, infrastructure, and quality of institutions.

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\(^\text{10}\) The Human Development Index ranges from 0 to 1, with 1 denoting the highest level of human development.

\(^\text{11}\) The Global Competitiveness Index ranges from 1 to 7, with 7 denoting the highest level of international competitiveness.
21. **International credit standing.** UMICs are deemed more creditworthy compared to LMICs and LICs. Their average institutional investor credit rating of 58.7 is second only to HIEs’ 83.4 average rating (Figure 4). At the individual country level, with the exception of Turkmenistan, all UMICs have a higher credit rating than the average for LMICs and LICs. Once again, the correlation is clear: the credit standing of UMICs is, in general, positively associated with their income status.

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12 The institutional investor credit ratings are based on information provided by senior economists and sovereign-risk analysts at leading global banks and money management and securities firms. Respondents grade each country on a scale of zero to 100, with 100 representing the least likelihood of default. http://www.institutionalinvestor.com/Research/4437/Methodology.html (accessed 21 July 2014).
22. **Vulnerability to economic shocks.** Because of their generally higher level of integration with global capital markets and international trade, UMICs are typically more vulnerable than LICs to cyclical economic downturns. This vulnerability was demonstrated during the 2007–2008 economic and financial crisis and resulted in the UMICs experiencing slower GDP growth (all 6 UMICs), lower demand for their exports (all 6 UMICs), capital flight (PRC, Malaysia, and Thailand), a decline in fixed investment (Malaysia), stock market declines (PRC, Malaysia, and Thailand), rising non-performing loans (Kazakhstan) and, in the cases of Kazakhstan and Malaysia, currency depreciation. The challenge of sustaining growth and staging an early recovery following such periods of crises is common to all UMICs.

23. **Findings and implications.** Three main findings emerge from this discussion. The first is that UMICs, despite being heterogeneous in several ways, share a level of development progress that is similar across many fronts, including on reduction in poverty, human development achievements, international competitiveness, and credit standing. Second, their progress in these areas is correlated to their income status and, as a group, puts them ahead of LMICs and LICs. In this way, per-capita income levels of UMICs appear to be a reasonable proxy indicator for their overall development achievement. For the purposes of this paper, this obviates the need to establish any alternate categorization of countries based on a broader set of development indicators. Third, UMICs still lag significantly behind HIEs on development progress and remain vulnerable to cyclical economic downturns. These findings provide the basis for treating UMICs as a distinct group that has achieved a level of progress but needs to advance further to join the ranks of developed nations.

### IV. RATIONALE FOR ENGAGEMENT WITH UPPER MIDDLE-INCOME COUNTRIES

24. The rationale for ADB’s continued engagement with UMICs rests on four factors: (i) the additionality of ADB’s support, (ii) the need to overcome UMICs’ remaining development
challenges, (iii) UMICs’ importance to the development prospects of Asia and the Pacific, and (iv) their importance to ADB as a multilateral development institution.

A. The Additionality of ADB’s Support

25. Upper middle-income countries’ share in ADB financing. About 20% of ADB’s total public and private sector lending went to UMICs during 2009–2013. This ratio, although significant, is much lower than the percentage of assistance from other MDBs dedicated to UMICs. As shown in Table 3, as much as 78% of the Inter-American Development Bank’s lending and 39% of the World Bank’s lending during 2009–2013 went to UMICs, even though allowance needs to be made for the significantly larger ratio of UMICs in the Inter-American Development Bank’s client countries. In this setting, ADB has to ascertain the nature of UMICs’ future needs for multilateral assistance and, in particular, determine why they would still seek to engage with ADB.

Table 3: Multilateral Bank Lending Shares According to Country Classification (%), 2009–2013

<table>
<thead>
<tr>
<th></th>
<th>ADB</th>
<th>World Bank</th>
<th>IDB</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-income countries</td>
<td>0.0</td>
<td>5.0</td>
<td>6.6</td>
</tr>
<tr>
<td>Upper middle-income countries</td>
<td>19.6</td>
<td>38.7</td>
<td>78.1</td>
</tr>
<tr>
<td>Lower middle-income countries</td>
<td>62.6</td>
<td>37.7</td>
<td>12.1</td>
</tr>
<tr>
<td>Low income-countries</td>
<td>14.7</td>
<td>12.9</td>
<td>1.1</td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank, IDB = Inter-American Development Bank.
Note: The shares do not add up to 100% because the residual pertains to regional and other projects.

26. The value of ADB’s assistance. In purely financial terms, the share of ADB’s lending in total national gross fixed capital formation in UMICs has always been so small (Figure 5), ranging from 0.1% on average for the PRC to 1.8% for Azerbaijan during 2004–2013, that accessing finance solely for obtaining finance has never been the basis of UMICs’ partnership with ADB. In fact, ADB provided an average of only $1.9 annually in lending assistance per capita for UMICs during 2009–2013, compared to $4.6 for LMICs and $7.3 for LICs.

27. Consultations with UMICs confirm that they seek broader value from engagement with ADB that is not contingent on financing alone. The financing arrangement remains important to them to the extent that they value the knowledge and best practice, innovation, and capacity-building support embedded in it, and the possibility to replicate and scale-up successful experiences from ADB engagement with their own resources. UMICs also continue to value the high fiduciary standards, transparency, and international credibility associated with ADB assistance. They acknowledge ADB’s ability to leverage and catalyze additional finance, including private finance. They also appreciate ADB’s role in strengthening regional integration and its convening power to act as a dependable honest broker to promote economic cooperation throughout the region. Therefore, ADB has to consider the multifaceted nature of its engagement with UMICs and the benefits UMICs perceive from such engagement as a paramount consideration in defining its future partnership with them.
28. **ADB’s graduation policy.** Notwithstanding the value UMICs continue to see in maintaining engagement, ADB has a policy of ultimately graduating DMCs from regular assistance that is premised on the (i) DMCs reaching a threshold of GNI per capita (the current threshold is $7,185 in 2013 US dollars, updated periodically), (ii) availability of commercial capital flows on reasonable terms, and (iii) attainment of a certain level of development by key economic and social institutions. The policy recognizes that DMCs reaching the prescribed GNI per-capita income thresholds may differ in the extent of their progress towards developing key institutions for economic and social development, and enables ADB to take a flexible approach to graduation that involves close consultation with client countries.

29. ADB will continue to assist economic and social development of UMICs and prepare them for eventual graduation from ADB assistance. Concurrently, ADB will further assess its graduation policy. Important factors in this assessment will be the nature of ongoing development challenges of UMICs, including those related to climate change and the environment; their vulnerability to economic downturns; and their need for development assistance. ADB will continue to be guided by the views of its shareholders on graduation. In addition, the graduation policies and practices of other MDBs will be taken into account, including (i) the World Bank’s policy, which provides for even more flexibility in its application; (ii) the European Bank for Reconstruction and Development’s policy, which is based on the progress made by countries on a broader set of indicators to measure their transition to market economies and one in which the per-capita income level is not the main consideration; and (iii) the Inter-American Development Bank, which does not have a graduation policy.

30. Box 1 shows contemporary perspectives from these MDBs on the graduation issue in the aftermath of the 2007–2008 global economic and financial crisis. In particular, the crisis has made them more cautious about prematurely graduating countries from their regular assistance.
Box 1: Perspectives of Multilateral Development Banks on Supporting Middle-Income Countries in the Aftermath of the Global Financial Crisis

Consultations on this paper with three multilateral development banks (MDBs)—the World Bank, the Inter-American Development Bank (IADB), and the European Bank for Reconstruction and Development (EBRD)—echoed the conclusion that development is decidedly a non-linear process, of which the harsh consequences of the 2007–2008 global economic and financial crisis are a vivid reminder. A cautious approach to graduation is, therefore, needed amidst the volatility and recessionary impact created by the crisis in middle-income and high-income countries.

In fact, a phenomenon of “reverse-graduation” seems to have taken place in the aftermath of the economic and financial crisis. Several countries that otherwise did not have borrowing status returned to MDBs with requests for various forms of support. With the World Bank, such support took the form of a “reimbursable advisory service” to provide research and analysis, technical assistance, and project-related advice to high-income countries in Southern Europe as well as other countries. In the case of the IADB, Chile, which had stopped sovereign borrowings for several years, has requested to resume such assistance under a new country strategy for 2014–2018. In the case of EBRD, Cyprus, which was not a borrowing country, has obtained operational status in order to qualify for support.

Among member countries of the Asian Development Bank, the Republic of Korea is an example of a country that discontinued borrowing after 1988 but requested and received financial assistance to support its economy following the 1997 Asian financial crisis. The highs and lows of Nauru’s economy present a similar case. In the years after its independence in 1968, Nauru had one of the highest gross domestic products (GDP) per capita in the world based on its phosphate deposits. Revenues from phosphates were deposited into trust funds to secure the country’s economic future. However, subsequent heavy spending from the trust funds brought Nauru to the brink of bankruptcy. With suspension in mining and a fall in public expenditure, GDP fell over a third over 2005–2007. A subsequent recovery of the economy based on the resumption of phosphate mining was then severely interrupted by the onslaught of the economic and financial crisis. GDP plummeted by 19% in 2009 and did not start growing again until 2011.

B. Overcoming Challenges

31. UMICs still need to significantly catch-up to match the development levels of HIEs. UMICs find that the remaining challenges to achieving high-income level with inclusive and environmentally sustainable economies and societies are harder to overcome than their previous transitions from low-income to middle-income countries. It is also difficult for UMICs to sustain growth when they are unable to compete globally in higher value-added and more sophisticated economic sectors. Furthermore, they remain vulnerable to economic downturns. The challenges described in paras. 32–40 are not necessarily unique to UMICs; however, for several of the challenges, UMICs are disproportionately affected, and for others, they continue to need to make further progress to match HIE standards even though their current achievement levels may be higher than those of LMICs and LICs.

1. Addressing Regional Disparities and Gender Inequality for Inclusive Growth

32. Faced with high and rising inequalities (para. 17), UMICs face a steep challenge to create greater and more equitable access to economic opportunities and jobs for inclusive growth. Regional and provincial disparities in UMICs, along with remaining poverty, are of particular political, social, and economic concern. In several UMICs, growth patterns have resulted in lopsided levels of economic development in their poorer interior regions and rural
areas, with per-capita incomes of such areas sometimes matching those of LICs and LMICs. For example, in 2012, the PRC had four provinces in which per-capita incomes matched those of LMICs (24 provinces had per-capita incomes in the range of UMICs, while another three provinces had such high per-capita incomes that they could be considered as HIEs). In the PRC’s central and western provinces, the average GDP per capita is currently only about 55% of the level of GDP in the eastern coastal provinces. In addition, Kazakhstan’s poorest region has a per-capita income that is only 29% of that of its richest region.

33. UMICs also need to address their large gender gaps in order to reduce disparities and promote inclusive development, as evidenced by their average gender inequality index of 0.3, which is much higher than the 0.1 average index of two HIEs, the Republic of Korea and Singapore. With the additional challenge of demographic change resulting in a decline over-time in the labor force due to aging populations, it is even more crucial that UMICs harness the potential and productivity of women as important and equal segments of their national labor force.

2. Climate Change and Environmental Challenges

34. Most UMICs are energy-intensive economies, including the PRC and the resource-rich UMICs in Central Asia. High energy intensity leads to large carbon dioxide and greenhouse gas emissions. Compared to the Organisation for Economic Co-operation and Development countries, the UMICs emit less carbon dioxide per capita but more greenhouse gas per capita (Figure 6). The intensity of such emissions is a major factor in climate change and a reminder of the potential adverse impacts of growth and industrialization on the environment. In addition, UMICs face other complex environmental challenges such as high levels of air and water pollution, habitat and biodiversity loss, and desertification and erosion. On the 2014 Environmental Performance Index, UMICs are all ranked significantly below HIEs.

13 The gender inequality index is a composite measure reflecting inequality in achievement between women and men in three dimensions: reproductive health, empowerment, and the labor market. It ranges between 0, where women and men fare equally, and 1, where one gender fares as poorly as possible in all three dimensions.

3. Unfinished Policy Agendas and Governance

35. Most UMICs have undertaken significant reforms to create enabling market conditions and strengthen public institutions. Yet, there remains a substantial unfinished policy reform agenda. For the most part, many UMICs have implemented first generation reforms, such as the rationalization of public expenditures, trade liberalization, reduced government intervention in domestic markets, financial deregulation, and liberalization of foreign investment. However, second generation reforms are unfulfilled in most UMICs, such as those related to improving the efficiency of state-owned enterprises and running them on market principles; adopting international transparency standards and corporate governance; protecting intellectual property rights; improving legal and regulatory frameworks, including those for public–private partnerships (PPPs); and developing sound financial systems, including capital markets.

36. The principles of accountability and transparency are critical bedrocks for second-generation reforms. Table 4 shows the UMICs’ performance on some global governance indexes where they score low on indicators for corruption and budget transparency. Separately, in two of the Worldwide Governance Indicators, government effectiveness and regulatory quality, only Malaysia ranks above the 70th percentile. The other five UMICs do not rank above the 61st percentile for either indicator, indicating the need for substantial strengthening and catch-up in these areas.\(^{16}\)

Table 4: Upper Middle-Income Countries Performance on Selected Governance Indexes

<table>
<thead>
<tr>
<th></th>
<th>AZE</th>
<th>PRC</th>
<th>KAZ</th>
<th>MAL</th>
<th>THA</th>
<th>TKM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corruption Perceptions Index 2013</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>--Rank (out of 177)</td>
<td>127</td>
<td>80</td>
<td>140</td>
<td>53</td>
<td>102</td>
<td>168</td>
</tr>
<tr>
<td>--Score (out of 100)</td>
<td>28</td>
<td>40</td>
<td>26</td>
<td>50</td>
<td>35</td>
<td>17</td>
</tr>
<tr>
<td><strong>Control of Corruption 2010</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>--Score (-2.5 to 2.5)</td>
<td>-1.17</td>
<td>-0.60</td>
<td>-0.99</td>
<td>0.12</td>
<td>-0.34</td>
<td>-1.44</td>
</tr>
<tr>
<td>--Percentile</td>
<td>9</td>
<td>33</td>
<td>15</td>
<td>61</td>
<td>47</td>
<td>2</td>
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<tr>
<td><strong>Open Budget Index 2010</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>--Score (out of 100)</td>
<td>43</td>
<td>13</td>
<td>38</td>
<td>39</td>
<td>42</td>
<td>...</td>
</tr>
</tbody>
</table>

... = data not available, AZE = Azerbaijan, PRC = People’s Republic of China, KAZ = Kazakhstan, MAL = Malaysia, THA = Thailand, TKM = Turkmenistan.

Source: Transparency International. www.transparency.org/country

4. Building Greater Resilience to Global and Regional Shocks

37. The significant impact of the 2007–2008 economic and financial crisis clearly revealed that ADB UMICs still need to create firmer institutional capacities and stronger macroeconomic frameworks that are sufficiently robust to mitigate vulnerabilities and adversities associated with such a major crisis. The crisis reinforced the fact that development is not just a linear process in which countries only continue to progress. Severe economic setbacks can occur, throwing tens of millions of people into joblessness and poverty. Even developed economies can be hit hard from such shocks. The crisis brought a number of Organisation for Economic Co-operation and Development countries to the brink of bankruptcy with failing financial institutions, stagnating real economies, and mounting unemployment. Multibillion-dollar packages cosponsored by the International Monetary Fund, the European Central Bank, and other donors were quickly


brought to the rescue of the ailing economies. With the vulnerability of developed countries and their need for external assistance during the crisis, MICs and other developing nations with fewer resources and lower capacities understood that they too were subject to the vagaries of the economic cycle in the connected global environment and needed to have effective countercyclical policies and instruments to withstand its damaging impacts.

5. Aging Populations

38. As with most HIEs, the populations of UMICs are increasingly aging. An examination of population pyramids of UMICs between 1980 and 2010 reveals that their once preponderantly young populations are experiencing a much larger bulge in the middle age and older population brackets (Figure 7 illustrates the case of Thailand, and the same trend is visible for the other UMICs). As this trend continues, UMICs will have to cope with issues related to supporting an elderly population and a declining young population. These issues will include high pension outlays, fewer workers contributing to pay-in retirement schemes, higher and long-term costs for health care, and the need to provide adequate elderly care services.

![Figure 7: Population Pyramids of Thailand, 1980 and 2010](http://populationpyramid.net/)

6. Productivity Gap

39. The average labor productivity of HIEs is 3.5 times greater than UMICs (Figure 8). The gap could be even larger given that the productivity estimates of resource-rich UMICs may be overstated. At the same time, UMICs have typically advanced beyond their previous comparative advantage of low wages, and thus find it difficult to compete with LMICs and LICs on the cost of labor. Therefore, UMICs require sharp and systematic increases in productivity. However, their productivity is held back because agriculture, which has lower productivity levels compared to other economic sectors, remains a large employer in some UMICs such as Azerbaijan, the PRC, and Thailand. UMICs, consequently, need to diversify into higher value-adding and more sophisticated industries and services, including those based on information and communication technologies (ICT). This need is also made clear by the lower ranking of UMICs in relation to HIEs on a complexity ranking that measures the extent of diversification and ubiquity of a country’s exports (footnote 5). To catch-up with HIEs, UMICs need to

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strengthen human capital and innovation, overcome technology deficits, and build a vibrant and competitive private sector.

Figure 8: Labor Productivity per Person Employed, 2013
US dollars

UMICs
HIEs

0 20,000 40,000 60,000 80,000 100,000

UMIC = upper middle-income countries.

7. Infrastructure Gaps

Infrastructure plays a vital role in increasing productivity, helps to reduce transport costs, and improves access to employment and social services. While UMICs typically have much more expansive and modern infrastructure compared to LMICs and LICs, there are often disparities within countries and gaps between the quality of infrastructure in UMICs and HIEs. UMICs collectively rank well behind HIEs and Organisation for Economic Co-operation and Development countries on the infrastructure subindex of the Logistics Performance Index (Figure 9). This subindex measures the quality of trade and transport-related infrastructure (ports, railroads, roads, and ICT). Collectively, UMICs in 2014 averaged an overall Logistics Performance Index ranking of 73.5 compared to 15.0 for HIEs (higher numbers denote lower performance).

Figure 9: Ranking in the Logistics Performance Index and Scoring on the Infrastructure SubIndex
2014

UMICs OECD HIEs

LPI = logistics performance index, OECD = Organisation for Economic Co-operation and Development, UMIC = upper middle-income country.
C. Importance to Asia and the Pacific

41. UMICs make important contributions to Asia and the Pacific. The PRC in particular is a major contributor to the region’s GDP and trade. The UMICs combined accounted for 47% of Asia and the Pacific’s GDP (2013) and 40% of the region’s trade (2012). Hence, UMICs are key drivers of the regional economy, and their economic and financial policies have broad implications for regional and global financial stability.

42. Furthermore, UMICs are key players in regional political and security organizations. The PRC and Kazakhstan are members of the Shanghai Cooperation Organization, and Malaysia and Thailand are members of the Association of Southeast Asian Nations (ASEAN). Both organizations are instrumental in the region’s political and security realms, and they are increasingly extending their influence over economic matters. The establishment of the ASEAN economic community in 2015 will further position UMICs to play an important developmental role in the subregion.

43. UMICs have the potential to play a greater role in the provision of regional public goods and regional cooperation and integration (RCI), as they have both positive and negative spillovers in the region. An example of positive spillovers is when a UMIC strengthens its financial system, which in turn helps to promote greater regional financial stability, or has an open trade policy that promotes trade opportunities for less-developed countries. In health, regional public goods can arise from a UMIC strengthening its epidemiological policies and programs that improve the health of its population while generating a positive externality of reduced transmission of pathogens and diseases across borders. An example of a negative spillover is the impact on the environment and climate resulting from a carbon intensive UMIC economy.

44. To benefit from and contribute to RCI, UMICs are members of one or more regional cooperation arrangements, such as the Greater Mekong Subregion and the Central Asia Regional Economic Cooperation Program. They play a significant role in enhancing connectivity in the subregions and transferring knowledge. It is clear that UMICs have the stature and influence to play a far larger role in promoting RCI prospects, including by becoming bigger co-financiers of regional arrangements and regional forums. This would break away from the typical donor–recipient dichotomy and make the UMICs even more valued development partners with the responsibility to define, implement, and finance regional initiatives. UMICs are also useful sources of knowledge, and harnessing them for knowledge partnerships would greatly benefit the less-developed countries in the region.

D. Importance to ADB as a Multilateral Development Institution

45. UMICs are important for the support and contribution they provide to ADB in its assistance for the development of other DMCs. Crucially, four out of the six UMICs (PRC, Kazakhstan, Malaysia, and Thailand) are contributors to ADB’s Asian Development Fund, which supports the economic and social development of less-developed countries.

46. UMICs are important clients of ADB’s public and private sector operations. Their credit standing helps ADB maintain its AAA credit rating, which allows ADB to obtain cheaper funds

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18 For example, the PRC finances the ADB-administered PRC Poverty Reduction and Regional Cooperation Fund, and ADB UMICs in ASEAN participate in the ASEAN Infrastructure Fund.
from the market and pass them on to DMCs on concessional terms. UMICs are also effective project implementers and several of them have the capacity to undertake complex and innovative projects. A UMIC such as the PRC demonstrates high quality in its operational portfolio supported by ADB, with an average project success rate of 97% during 2009–2013. ADB learns useful lessons from such successful implementation experiences and applies them to improve development results in other DMCs.

V. ADB’S STRATEGIC PARTNERSHIP WITH UPPER MIDDLE-INCOME COUNTRIES

47. The persistence of development challenges faced by UMICs and their potential to support development prospects of Asia and the Pacific point to several areas in which ADB can maintain and deepen its engagement with UMICs in a strategic and selective manner. Paras. 49–72 describe these areas.

48. Cutting across the various engagement areas, private sector operations and PPPs based on commercial principles and full cost recovery will become increasingly important modalities of ADB’s partnership with UMICs. Moreover, knowledge partnerships with UMICs will be expanded and technical advisory functions will be strengthened. An overarching emphasis will be placed on innovation and value–addition in all lending operations, and advisory and knowledge support.

49. ADB proposes six specific areas of engagement with UMICs: (i) mitigating inequalities and promoting inclusive growth, (ii) managing climate change and the environment, (iii) addressing the challenge of demographic change, (iv) boosting productivity and competitiveness by developing the private sector, (v) strengthening RCI, and (vi) promoting south–south knowledge collaboration. The first four relate to key challenges that must be met in UMICs and the final two lay out how ADB will foster partnerships with UMICs for stronger development cooperation in the region. While ADB’s engagement with UMICs in these areas is not exclusive to this group of countries and may extend to other DMCs as well, the proposed areas are particularly relevant to UMICs and represent strategic pivots of ADB’s engagement with them. Guided by these pivots, ADB’s specific engagement with each UMIC will continue to be defined in the country partnership strategy (CPS) document that will be further streamlined and simplified (para. 78).

A. Cooperation to Help Overcome Development Challenges

1. Mitigating Inequalities and Promoting Inclusive Growth

50. ADB will promote inclusive growth as the principal means of helping to reduce inequality and promote balanced development in UMICs. In addition to social protection (para. 60), support for inclusive growth will be manifested in the areas described in the following paras (51–56).

51. Investments in lagging areas and regions. Urban–rural income gaps are a major contributor to inequality. Therefore, ADB’s strategic infrastructure development projects and social sector investments in UMICs will increasingly focus on lagging rural and other areas and regions to address geographical disparities in economic opportunities and access to services. Greater complementarities will be created between infrastructure and social sector projects to promote inclusiveness of investments to address inequality. Inclusive project designs and more effective implementation will ensure that the inclusiveness objectives of infrastructure projects are achieved.
52. **Inclusive cities development.** ADB will simultaneously support the development of inclusive cities in UMICs, given that on average over half of their populations already live in urban areas. This will require upgrading urban infrastructure and delivery systems that create economic opportunities both for urban residents and for rural migrants who come to cities in search of better livelihoods. In addition to being inclusive, cities will need to be competitive in terms of their infrastructure and quality of human resources to attract private and public investments. They will also need to be “green” to protect the environment and promote improved living standards. Urban sustainability assessments for selected UMIC cities will be commissioned to provide an analytical framework for undertaking integrated urban development, while considering equity, competitiveness, and the environment. Subsovereign assistance to directly support investments in cities and municipalities will be incentivized and expanded (para. 93).

53. **Skills development and education.** As a crucial part of the strategy to mitigate inequalities, ADB will promote partnerships for secondary and higher education, and support technical education and vocational training for developing the skills base of the labor force and generating equitable access to economic opportunities. These are important investments to promote greater absorption of the labor force released from the agriculture sector into modern industrial and services sectors as UMICs continue to develop and diversify their economic base. To raise the employability prospects of the skilled labor force, the following will be emphasized: competency-based education, direct links to industry and infrastructure sectors, and enterprise-based training to respond to specific needs for trained personnel in both country and regional contexts.

54. To address the productivity gap of UMICs, human resource investments will aim to strengthen the technological base of UMICs and create capabilities for greater domestic innovation and higher competitiveness. The quality of education will be a key focus in all ADB investments in the sector, aided by ICT applications and stronger functional links with the private sector. The use of results-based lending (para. 85) is particularly suited to support ADB’s contributions in UMICs, including in education and social protection.

55. **Financial inclusion.** Financial inclusion is a key area of ADB’s support through both private and public sector operations for creating access to economic opportunities, generating employment, and reducing disparities. Access to finance for small and medium-sized enterprises (SMEs) will continue to be an important pillar of support, including trade finance to support a more vibrant role for SMEs in the development of national and regional value chains. ADB’s experience with SME finance in Kazakhstan has shown the possibilities of innovation in such support in UMIC contexts by using local currency finance (Box 2). Partnerships will also be explored to better connect customers and clients in distant and lagging areas in UMICs to financial services through mobile technology and payment systems.
Box 2: Financial Inclusion in Kazakhstan

An innovative $500 million multitranche financing facility (MFF) for the Kazakhstan Small and Medium Enterprise Investment Program\(^a\) approved in September 2010 seeks to increase access by small and medium-sized enterprises (SMEs) to medium-term credit in local currency. The expected impact of the MFF is sustained job creation and economic growth. The facility was designed to provide local currency fixed-interest rate financial intermediation loans to participating financial institutions (PFIs) that would then on-lend to eligible SMEs. The MFF is structured around 3 to 4 tranches.

Tranche 1 was released in September 2011 and financed by a $150 million equivalent financial intermediation loan to the Damu Entrepreneurship Development Fund, guaranteed by the Republic of Kazakhstan. The loan was re-lent through subloans to qualified PFIs to fund their working capital and investment loans, leases, and other financing products to SMEs.

Under tranche 1 (completed in September 2013), the fund and the PFIs disbursed the entire $150 million equivalent to SME borrowers. By the end of 2013, on a cumulative basis, the portfolio of PFI loans to SMEs comprised 28% for new funded investments, 58% for financing working capital, and 14% for refinancing existing loans. A total of 2,500 loans benefitted 781 SME borrowers. The average amount lent to each SME borrower was about $300,000. Women-owned or managed enterprises constituted 31% of total borrowers. Over 1,670 new jobs were created. As the funds are being revolved until the repayments have to be made, the final cumulative impact of the program is expected to be much larger.

Tranche 2 for $122 million equivalent to continue financing support to SMEs was disbursed at the end of November 2014. A third tranche is being processed for disbursement in 2015.

\(^a\) ADB. 2010. Report and Recommendations of the President to the Board of Directors: Kazakhstan: Multitranche Financing Facility for the Small and Medium Enterprise Investment Program. Manila.

Source: ADB’s Central and West Asia Department.

56. Governance and institutions. Given the unfinished policy and institutional agendas in UMICs (paras. 35 and 36), a vital crosscutting component of support for mitigating inequalities will be improving governance (namely greater transparency, accountability, efficiency, and anti-corruption); strengthening policies and regulations for inclusive innovation to improve the quality, delivery, and access to basic services, especially for the excluded poor populations; and enhancing the quality of public investments. ADB will closely align its support to the priorities of UMICs for policy and institutional reforms, and will continue to assist with strengthening necessary capacities for the implementation of their reform agendas. Particular emphasis will be placed on second-generation reforms (para. 35) to improve the efficiency, accountability, and corporate governance of state-owned enterprises; and enhance regulatory and supervisory frameworks. Strengthening institutional capacities and instruments for effective countercyclical macroeconomic management to override periods of economic and financial crisis will continue to be a key priority.

2. Managing Climate Change and the Environment

57. Stronger attention to climate change and the environment is required in UMICs in view of the challenges faced (para. 34). ADB’s partnership with UMICs in this context will be premised on promoting environmentally sustainable infrastructure that supports low carbon development. Initiatives will focus on energy (clean energy, renewable energy, and improved energy efficiency); low carbon and environmentally sound modes of transport; more effective and sustainable water management; and sustainable and integrated urban development. In addition to mitigation, ADB will promote climate change adaptation and resilience in UMICs by mainstreaming these priorities in development planning as well as in project designs and implementation. Furthermore, ADB will support climate-proofing of infrastructure and integrated disaster risk management.
58. ADB will also promote the preservation and improved management of natural capital, including water resources and biodiversity, to sustain environmental assets. Improving environmental governance and management capacity will be a continuing focus. Finally, ADB will contribute to strengthen country environmental safeguard systems in UMICs and other DMCs (para. 83).

3. Addressing the Challenge of Demographic Change

59. UMIC populations are aging, with critical implications for the economy and society of these countries (para. 38). Economically, the challenge is to sustain economic growth with a labor force that is declining, which, in turn, requires compensating increases in labor productivity. There are also clear implications for labor market policies, including those related to the retirement age, pension and insurance systems, and openness to attracting and retaining migrant labor from overseas. Socially, the rising dependency ratios in UMICs and their implications on the standards of living, delivery of health services, social protection arrangements, and systems for elderly care have to be addressed. With respect to caring for the elderly, traditional family support systems and filial ties may be weakening because of socioeconomic changes, including migration of working age adults to urban centers in search of employment.

60. Social protection systems. To help address the challenges of demographic changes and mitigate inequalities, ADB will support the strengthening of social protection systems in UMICs, including through helping replicate successful experiences with conditional cash transfers from Latin America and other parts of Asia. It will assist with the reform of pension systems to increase their sustainability and affordability to provide old-age economic security. It will support social health insurance programs to ensure access to health services for the elderly. ADB will also extend policy and advisory support for strengthening elderly care systems. It has already started to support this with the Yichang Municipal Government in the PRC (Box 3).

<table>
<thead>
<tr>
<th>Box 3: Strategic Elderly Care Services Development in the People’s Republic of China (Yichang)</th>
</tr>
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<tbody>
<tr>
<td>Aging is a main demographic challenge in the People’s Republic of China (PRC), with the proportion of its population above the age of 60 expected to grow from 12% in 2010 to 34% by 2050.</td>
</tr>
<tr>
<td>The Asian Development Bank is providing policy and advisory technical assistance (TA) to the Yichang Municipal Government in the Hubei province of the PRC to strengthen elderly care planning and services. Hubei province has selected Yichang to be a model city for the provision of elderly care in the PRC.</td>
</tr>
<tr>
<td>The TA is preparing a report on national and international experience in elderly care. It is reviewing the role of the public, private, and nongovernment sectors in elderly care and will assess the financial capacity of local governments to provide home-based, community and institutional elderly care services. The TA will support capacity development of concerned officials in elderly care services planning. Finally, the TA will help the local authorities prepare a strategic elderly care services development plan based on a thorough analysis of needs, financing and human resources capacity.</td>
</tr>
<tr>
<td>The TA findings will potentially be replicable in Hubei and nationally, and will contribute to the body of knowledge on planning elderly care services in the PRC as well as in other developing member countries.</td>
</tr>
<tr>
<td>Source: ADB. 2014. Technical Assistance to the People’s Republic of China on Strategic Elderly Care Services Development in Yichang, Manila.</td>
</tr>
</tbody>
</table>

4. Boosting Productivity and Competitiveness by Developing the Private Sector

61. Private sector development is critical for addressing productivity gaps in UMICs, strengthening their competitiveness, and generating jobs. The private sector is also important in helping to address the infrastructure deficit and in supporting social sector development. Consequently, the share of ADB’s private sector operations in total operations in UMICs will grow progressively. The emphasis of ADB’s support for the private sector will be on growth-promoting projects that have significant and sustainable development impact.

62. Private sector operations. Among UMICs, ADB already has a strong portfolio of private sector operations in the PRC and Thailand, with a growing presence in Kazakhstan. Current priority areas for private sector operations in UMICs include energy efficiency projects and renewable energy generation, cleaner transport, water and waste water treatment, and agribusiness development. Box 4 provides an example of an innovative ADB private sector operation in the area of solar energy in Thailand.

63. Another key area for private sector operations is the financial sector to broaden long-term sources of financing. In this context, the potential for deepening of capital markets in UMICs remains significant. Therefore, ADB will support the strengthening of bond markets to support private investment in infrastructure, including the development of institutional investors. Developing contractual savings, including pension funds and insurance, will help provide additional long-term finance for infrastructure while supporting social protection systems (para. 60). ADB will also assist with the development of subnational debt markets as it strengthens its subsovereign assistance (para. 93) for municipal infrastructure financing.

Box 4: Bringing Advanced Solar Technology in Thailand

The Lopburi Solar Project in Thailand is one of the largest solar power projects in Asia and is the first project under the Solar Initiative Program of the Asian Development Bank (ADB). The project utilizes thin-film photovoltaic technology, which uses amorphous silicon thin-film solar cells. Compared to other types of photovoltaic cells, the thin-film panels have relatively lower costs and are suitable for the climatic environment of Thailand because they do not require near-perfect solar conditions.

In April 2010, ADB approved a $70 million loan for the project with a tenor of 18-years through a complex back-to-back swap structure. It is the longest ADB financing accorded to a renewable energy project in the private sector.

The project was developed by the Natural Energy Development Company, a company jointly owned by Hong Kong’s CLP Holdings, Japan’s Mitsubishi Corporation, and the Electricity Generating Public Company, Thailand’s first independent power producer. The Electricity Generating Authority of Thailand, the country’s largest electricity generator and sole distributor, has been purchasing electricity from the plant since it became operational.

Recognizing its innovative financing structure, the project was awarded the Euromoney Asia Pacific Renewable Energy Project of the Year and the Alpha Southeast Asia Project Finance Deal of the Year in 2010. The success of the project has prompted the replication of its model, not just in Thailand, but in Malaysia and the Philippines.

Source: ADB’s Private Sector Operations Department.
64. Project development and public–private partnerships. To leverage greater development financing from the private sector and other sources, ADB will become a more active project developer for UMICs and other DMCs. It will help client countries develop and design projects and assist them in attracting external financing, including private investors. To achieve this objective, ADB will also strengthen its support for private sector development, including PPPs.

65. One key constraint to PPPs is the lack of bankable projects eligible for private sector finance. Therefore, ADB is developing a new Asia Pacific Project Preparation Financing Partnership Facility to help DMCs prepare a pipeline of ready-to-finance infrastructure projects that can attract and secure financing from private sector sources. This idea should have particular appeal for UMICs who seek credible investment opportunities in bankable infrastructure and other projects, as well as access to private financing to address their own large infrastructure needs. Projects selected for support will mainly be PPPs where the private sector constitutes a majority of the project’s financing. The Asia Pacific Project Preparation Financing Partnership Facility will support the following: upstream enabling reforms; project preparation and due diligence; placement work, including managing roadshows; preparation of bid documents and contracts, and assistance with negotiations; and the attraction of high quality sponsors by capitalizing on ADB’s strong knowledge of infrastructure markets in Asia.

66. In addition to transaction advice (para. 92) through the newly established Office of Public–Private Partnerships (para. 76), financing support for addressing viability gaps of PPP projects will also be selectively provided. Such assistance will ensure that ADB does not create market distortions for private sector financial entities engaged with financing PPPs. ADB will also seek to support a second generation of PPPs in the social sectors and for agribusiness development.

B. Cooperation to Support Regional Cooperation and Integration

67. ADB’s strategic partnership with UMICs has to be premised on the value ADB can continue to add to the development agendas of these countries as well as their capacities to contribute to the development prospects of Asia and the Pacific. This is critical because the growing interconnectivity of today’s economies implies that development is not an isolated challenge that is treatable with stand-alone and country-specific solutions, but one that increasingly requires collaborative and coordinated approaches regionally and globally.

1. Regional Cooperation

68. Second generation regional cooperation and integration. ADB will continue to support regional and cross-border connectivity, logistics, and customs harmonization, along with knowledge and analytical work, to strengthen regional trade and support further development of value chains that mutually benefit UMICs and other DMCs. It will encourage a lead role for UMICs on a second generation of RCI initiatives that support productivity and competitiveness of regional economies. To this end, ADB will strengthen partnerships between UMICs and other DMCs with the objectives of improving the regional investment climate, promoting skills development to enable workers to take advantage of regional employment opportunities, and supporting access to finance for SMEs seeking to become part of regional value chains.

69. Regional public goods. Climate change and the environment are public goods and require global and regional efforts to protect and promote sustainable development. Globally, UMICs and some LMICs are playing a significant role in shaping the course of international
negotiations and protocols on climate control and containing greenhouse gas emissions. Regionally, UMICs continue to maintain greenhouse gas emissions per capita at levels that are significantly higher than those for LMICs and LICs (para. 34). To mitigate cross-border dimensions of environmental spillovers, ADB will encourage UMIC investments for both climate change adaptation and mitigation through cofinanced arrangements and better leveraging of its own assistance (para. 57). It will support the adoption of new and innovative resource-saving and conservation technologies. ADB will also strengthen the utilization of donor trust funds to promote greater access of UMICs and other DMCs to climate finance.

70. Concurrently, ADB will support strengthening the participation of UMICs in collaborative regional approaches and solutions for food security and the control of communicable diseases. In addition, it will work to strengthen regional financial stability, including the provision of countercyclical assistance as necessary, and promote financial and monetary cooperation, including measures to prevent the spread of financial contagion.

2. South–South Knowledge Collaboration

71. ADB will seek to specifically promote greater south–south knowledge sharing based on closer collaboration among UMICs and with LMICs and LICs to address the region’s challenges. South–south cooperation in terms of trade, investment, and capital flows among developing countries has already magnified (para. 41). Bilateral trade and development cooperation programs are on the rise. The New Development Bank and the Asian Infrastructure Investment Bank are important new initiatives to “multilateralize” south–south cooperation and to give it an interregional dimension.

72. A south–south partnership. ADB will promote a systematic approach to south–south cooperation with a lead role for UMICs. This will be premised on their capabilities and expertise to share knowledge and best practices with other DMCs and learn from their experiences at the same time. Such a partnership between ADB and UMICs to work with other DMCs would represent triangular cooperation in which development initiatives would be jointly planned, financed, and implemented. The program will be supported by regional technical assistance and contributions from member countries, and enable cross-country learning and sharing of experiences, knowledge, technologies, and resources. National and regional centers of excellence will be commissioned to facilitate dialogue, train human resources, and transfer knowledge and expertise. ADB will examine lessons learned from engaging with HIEs, such as the Republic of Korea and Singapore, on south–south cooperation and how these experiences might be relevant for UMICs. In addition, the experience gained from ADB’s ongoing effort of promoting south–south cooperation between Asia and Latin America will be studied (Box 5).
Box 5: Enhancing South–South Cooperation between Asia and Latin America

Middle and upper middle-income countries in Asia and Latin America have many development experiences to share with one another. Countries in both regions face common challenges such as high inequality, climate change, aging populations, and rapid urbanization.

Supported by a technical assistance (TA) project approved in 2011, the Asian Development Bank (ADB), Inter-American Development Bank and the Corporación Andina de Fomento (the Development Bank of Latin America) are working together to promote knowledge sharing between countries of Asia and Latin America, including by providing forums for policy makers and technical experts to learn from experiences in developing different solutions to common challenges. Activities supported under the TA include interregional forums, learning exchange visits, development of staff exchange programs between institutions, and joint studies and policy papers.

Under the TA, ADB and the Inter-American Development Bank have collaborated on facilitating south–south policy dialogue and knowledge transfer in the areas of countercyclical economic policies, regional cooperation and trade and transport facilitation, social safety nets and conditional cash transfer programs, managing for development results, universal broadband access for inclusive growth, urbanization, and inclusive business.

ADB and the Corporación Andina de Fomento cooperation has focused on developing south–south perspectives on improving corporate governance, engaging youth in development, climate change, development of competitive cities, and scaling-up sustainable urban transport.

The TA has helped to improve capacity, strengthen relationships, and share relevant knowledge to better inform policy makers on innovative approaches to address development challenges faced by middle-income countries in Asia and Latin America. It has also supported a new trade agreement between Mexico and the Republic of Korea. The TA will be completed in 2015.


VI. ADB’S EFFECTIVENESS IN UPPER MIDDLE-INCOME COUNTRIES

73. To remain a partner of choice for UMICs and to respond to the complexity of their challenges, ADB has to raise the bar on its own capacity, performance, and effectiveness. The Midterm Review of Strategy 2020 recognized the broader challenge of strengthening ADB’s capacity and recommended important actions, some of which are particularly relevant for improving ADB’s responsiveness to MICs. These include measures to improve staff skills, motivate improved staff performance, strengthen resident missions, and create a “One ADB” approach to better leverage bank-wide expertise to support client countries. Measures to streamline business processes such as for procurement and disbursement to reduce transaction costs for client countries are also included.

74. Four key areas for institutional strengthening and reform are especially important from the point of view of enhancing ADB’s relevance for UMICs: (i) strengthening ADB’s anchor capacities and skills that can be accessed across the bank under the “One ADB” approach to provide the best possible service to clients, (ii) improving the country partnership strategy process, (iii) using country systems, and (iv) innovating on financing and advisory instruments and services.
A. Strengthening ADB’s Anchor Capacities

75. ADB will ensure that the quality and capabilities of staff are commensurate to meeting the expectations of UMIC clients in the areas of engagement identified in this paper. With responsibility for UMICs dispersed across ADB’s regional departments, and given the constraint on resources, it would be unrealistic to plan for expanding staff resources and skills in each of these areas in every department. Instead, ADB will strengthen a core set of anchor capacities that will be available to all operational departments under the “One ADB” approach for servicing the needs of UMIC clients. Specific operational areas in which anchor capacities will be strengthened include skills development and vocational education; social protection and health systems management; pensions, insurance, and capital markets development; regional and global value chain development; and private sector development and operations.

76. The role of ADB’s reconstituted sector and thematic groups (formerly communities of practice) as centers of expertise and their renewed mandate to provide greater support to operational departments will help strengthen and accumulate capacity in critical sectors and thematic areas. The recent consolidation of staff expertise in the PPP area by establishing an Office of Public–Private Partnerships to support upstream PPP work and operations in all client countries provides another example of creating such anchor capacity. In some operational areas, anchor capacities in specialized knowledge departments may be further strengthened. While in other areas, it may be expedient to build such capacities in one regional department that can support all other departments. Mechanisms and incentives that are currently being put in place to encourage staff to work and contribute across departmental boundaries will support sharing and the availability of skills in the various areas.

B. Improving Country Partnership Strategies

77. ADB’s country programming and strategy development work will be reassessed and revised to improve its relevance for UMICs and promote greater efficiencies. The CPS document, prepared once every 3–5 years for each UMIC becomes outdated quickly because of the dynamic nature of ADB’s engagement with these countries. In many UMICs, sovereign lending is unpredictable and does not follow regular cycles; yet the current CPS document presupposes a standard sector-based engagement structure and assumes the preparation of regular pipelines of standard investment projects. Because of these differences, it is questionable whether CPSs should continue to follow the same structure and template in all DMCs, including UMICs.

78. Consequently, the current standard CPS format and template will be reviewed to make it more flexible and responsive to the needs of UMICs and other client countries. One option that will be explored is to transform the current CPS into a shortened country engagement framework that identifies only the broad strategic directions and areas of partnership that ADB will pursue in a given UMIC. The need for all the linked documents that are currently attached to the CPS will also be reassessed. Sovereign lending and knowledge solutions pipelines, where applicable, may be attached to the engagement framework. The necessary background work and analyses to inform country strategy and operations could follow their own independent cycles and be conducted separately from the process of preparing the engagement framework.

C. Using Country Systems

79. The use of country procurement, public financial management (PFM), and safeguard (environmental and social) systems is expected to reduce delays in project implementation,
rationalize transactions costs, improve country ownership, and strengthen institutions and systems to improve service delivery. Currently, however, no UMIC qualifies for full and unreserved use of country systems in ADB projects because of their lack of equivalence on one or more dimensions of country systems with ADB’s policy and procedural standards and requirements. At the same time, the strength of country systems of individual UMICs varies significantly (Box 6). Since a uniform approach to country systems is not feasible given existing differences, country-specific approaches consistent with capacities and strengths of individual UMICs are needed.

**Box 6: Differences among Upper Middle-Income Countries on Country Systems**

**Procurement.** The People’s Republic of China (PRC), Kazakhstan, Malaysia, and Thailand have procurement systems that are associated with ‘medium risk’ from the perspective of the Asian Development Bank (ADB) on the use of such systems in its operations. Azerbaijan and Turkmenistan have procurement systems that are associated with ‘high risk’.

**Public financial management.** The PRC, Kazakhstan, Malaysia, and Thailand have public financial management systems that are associated with ‘moderate risk’. Azerbaijan’s public financial management system is associated with ‘high-substantial risk’, while Turkmenistan’s is associated with ‘high-substantial risk’.

**Environmental policy principles.** The PRC, Kazakhstan, and Thailand show fuller equivalence between their respective country legal and policy frameworks and that required by ADB policy. Azerbaijan, Malaysia, and Turkmenistan also show full or partial equivalence on some principles, but no equivalence on several other important policy principles (including the principle on ‘disclosure of information’ on environmental assessments).

**Involuntary resettlement.** For all six UMICs, equivalence assessments suggest significant gaps between national legal frameworks and systems and ADB’s policy standards on involuntary resettlement.

**Indigenous peoples.** The national laws of the PRC, Malaysia, and Thailand show significant gaps with ADB’s policy on indigenous peoples. Indigenous peoples are not recognized by Azerbaijan, Kazakhstan, and Turkmenistan.


Accordingly, ADB will adopt a phased approach to the use of country systems. In doing so, ADB will learn from the experience of other MDBs such as the World Bank, which implemented a pilot approach to the use of country systems in its operations. Under the first phase (2015–2017), ADB will systematically consider the use of country systems in the PRC and Kazakhstan, and will broaden the sample by including four other DMCs that are considered to have well-functioning internal systems and are expected to have lower fiduciary and safeguard risks for ADB. The actual use of country systems, however, will continue to depend on the preference of a DMC for using ADB’s or its own systems and its institutional capacities at the central and lower government levels. Under the second phase (beginning in 2018), based on lessons learned from the first phase, ADB will refine its approach to the use of country systems from the point of view of ultimately mainstreaming this approach in eligible DMCs. The linked document on the use of country systems elaborates this approach, which will take on

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board the considerations outlined in paras. 81-83 on procurement and public financial management systems and safeguard systems.\textsuperscript{21}

81. **Procurement and public financial management systems.** Under its results-based lending and policy-based lending modalities of support to DMCs, ADB already accepts the use of country systems. For its investment lending operations, ADB has made important changes in its approach to assessing country procurement systems based on a 10–point procurement reform action plan that was adopted in August 2014 that will potentially allow greater use of country procurement systems in ADB operations.\textsuperscript{22} The action plan introduced a risk-based approach to procurement that provides more flexibility in procedures and quicker approval processes for procurement on ADB projects. UMICs with strong country procurement systems are expected to particularly benefit from the new system that allows national competitive bidding to be used more widely. In such countries, post-procurement reviews will increasingly take the place of pre-procurement approvals, where warranted. Furthermore, ADB will review its procurement policy in 2015 to remove the policy constraint of using country systems and facilitate a more systematic use of country procurement systems in ADB’s investment lending operations.

82. Comprehensive governance risk assessments and management plans will be ADB’s primary instruments for assessing benefits and risks of using country PFM and procurement systems. Staff guidelines for the implementation of ADB’s Second Governance and Anti-Corruption Action Plan have been recently revised to reflect ADB’s policy focus on greater alignment with and use of country PFM and procurement systems. These revised guidelines will supplement ADB’s new procurement guidelines.\textsuperscript{23} Ultimately, the implementation of these guidelines and resulting assessments of DMCs will determine the feasibility of using country systems consistent with the capacities and strengths of PFM and procurement systems in individual countries.

83. **Safeguard systems.** ADB’s Safeguard Policy Statement (2009) commits the institution to strengthen the country safeguard systems of DMCs in the areas of environmental assessment, involuntary settlement, and indigenous people.\textsuperscript{24} The policy allows for the use of country safeguard systems, subject to equivalence and capacity assessments. Initial equivalence assessments of the six UMICs show, however, that a universal approach for the use of all three aspects of country safeguard systems is currently not possible (Box 6). Still, recognizing the progress made on strengthening environmental policies and legal frameworks, ADB will initiate a dialogue in selected UMICs and other DMCs and identify a roadmap with time frames, capacity strengthening requirements, and country preferences for the ultimate use of the country environmental safeguard systems.\textsuperscript{25}

D. **Innovating on Financing and Advisory Instruments and Services**

84. ADB’s partnership with UMICs will be supported through an innovative mix of financing, knowledge, and advisory instruments and services. In addition to attracting greater external financing, where possible, emphasis will be placed on combining ADB support with UMICs’ own

\textsuperscript{25} Indonesia is the only DMC so far that has formally requested ADB to align with and use country safeguard systems.
resources for greater leveraging of capital. The key modalities and structures to be emphasized are outlined in paras. 85–93.

85. **Results-based lending.** The use of results-based lending as a key instrument to provide programmatic assistance in support of government sector plans and objectives has significant potential in UMICs. Results-based lending disburses funds against outputs and results achieved, and relies on the use of country systems for purposes of procurement, disbursement, and safeguards (para. 81). Consequently, the use of results-based lending will help align ADB and government systems, and result in reduced transaction costs for clients. Demand is growing for the use of this modality. ADB’s first results-based lending program in the PRC, which is in the education sector, is currently being processed. If this and other such initiatives are successful, ADB will explore exempting UMICs from the current bank-wide cap on the use of results-based financing of 5% of total ADB lending. After the current pilot phase is completed in 2019, ADB will consider mainstreaming this modality.

86. **Ordinary capital resources set-aside for regional cooperation and integration.** In order to strengthen RCI support, a pool of resources will be set-aside from ADB’s ordinary capital resources (OCR) in each financial planning cycle, on the lines of the already available RCI set-aside from the Asian Development Fund. The OCR set-aside will encourage greater focus on RCI initiatives in UMICs and other OCR-eligible clients and will support a degree of reprioritization of ADB’s resources from country-specific projects to regional initiatives.

87. **Fee and pricing structure.** ADB will review the fee and pricing structure (including the loan tenor) for UMICs whose per-capita incomes exceed ADB’s graduation threshold (para. 28), and who continue to borrow until such time that they graduate from ADB assistance. The review will assess pricing structures for such UMICs.

88. **Cost sharing on knowledge management.** UMICs seeking support from ADB in knowledge management should be willing to contribute to the costs of such work. A Knowledge and Experience Exchange Program signed by ADB and the Government of Kazakhstan in 2013 provides an example of a knowledge partnership where Kazakhstan has agreed to pay for 50% of the total operational cost of the program (Box 7). Besides cost sharing, ADB will also explore a fee-for-service mechanism for UMICs to provide knowledge services on demand.

89. Using a cost-sharing approach, and under the framework of a country knowledge plan to be prepared for each country, ADB will strengthen its knowledge support to UMICs to assist with policy, institutional, and sector reforms and dialogue. Such support will be entrenched in ADB’s unique operational experience and expertise, and, for this purpose, it will be vital to maintain a strong link between lending operations and non-lending knowledge support. However, because it is a relatively small institution, ADB cannot accumulate and retain all needed knowledge expertise inside the institution. Therefore, it will work closely with external centers of excellence and development partners to convene the best available regional and international expertise to support UMIC needs for specific knowledge and analytical inputs and to strengthen south–south exchanges.

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26 Exploring the use of sovereign wealth funds is one of several ways of mobilizing domestic resources in UMICs. In this connection, a recent example of an innovative approach is the partnership framework arrangement signed in 2013 by the Government of Kazakhstan with ADB and other international development partners under which the government would mobilize the equivalent of $5.6 billion from its national oil fund to cofinance investment projects with development partners.

cooperation (para. 72). For this purpose, ADB will explore changes needed to its current approach to be able to convene such expertise in a timely, flexible, and efficient manner.

### Box 7: Knowledge and Experience Exchange Program with Kazakhstan

In 2013, the Government of Kazakhstan and the Asian Development Bank (ADB) entered into a strategic partnership program to facilitate exchange of knowledge, best practices, and capacity enhancements to promote innovation and efficiency. The ultimate objective of the Knowledge and Experience Exchange Program (KEEP) is to assist Kazakhstan in achieving a more diversified, competitive, and inclusive economy.

The financing of activities under KEEP is shared equally between ADB and the government during 2013–2015. The government and ADB are both contributing $1.25 million each to support the program cost of $2.50 million over this period.

KEEP is promoting knowledge partnerships around four key themes: (i) inclusive growth and economic diversification, (ii) institutional and policy development, (iii) regional cooperation and integration, and (iv) competitiveness and efficiency enhancement.

Knowledge work under KEEP is driven by Kazakhstan’s strategic priorities and will address emerging development issues and opportunities. Its main outputs will be in the form of socioeconomic research and recommendation reports, policy advisory notes, and an eminent persons seminar series.

As of January 2015, KEEP was supporting five sub-projects in the areas of market concentration and competition, economic diversification with a focus on the services sector, development of the government’s new economic policy, economic costs of traffic accidents in Kazakhstan, and procurement of performance-based road maintenance services.

A KEEP coordinating committee comprising of representatives of relevant government agencies and ADB staff is responsible for the program’s execution and administration. ADB’s Kazakhstan Resident Mission is the secretariat to the KEEP coordinating committee and facilitates its activities.


90. **Risk participation and guarantees for private sector operations.** ADB’s private sector operations will grow in UMICs (para. 61). In addition to traditional private sector lending and equity support, there is robust demand in some UMICs for ADB’s syndicated B-loan product, a funded risk participation arrangement with other lenders, with ADB remaining the lender of record and other lenders benefiting from ADB’s preferred creditor status. The bulk of ADB’s B-loan deployment in recent years has been in the PRC in sectors such as waste-to-energy, water distribution, and gas infrastructure. Such B-loan activities are planned to be extended to other UMICs such as Azerbaijan and, possibly, Kazakhstan, especially in large projects in the oil and gas sector.

91. In addition to B-loans, there is demand in UMICs for ADB’s partial credit guarantees to cover political and commercial risks to fill specific market gaps such as lack of interest of commercial banks to extend long-tenor loans and third party investors’ requirements for credit enhancement of debt instruments. ADB has been successful in mobilizing third party capital using its unfunded risk participation products and considers these powerful tools to support private sector projects in UMICs. Unfunded risk participation allows ADB to transfer a part of the risk to cofinanciers and supports the entry of international banks into infrastructure sectors. This arrangement also allows cofinanciers to participate in long-term local currency transactions.
Unfunded risk participations have already been executed in the PRC and Thailand, and there is scope for expansion.

92. **Transaction advisory services.** ADB will strengthen PPPs in UMICs and other DMCs (para. 64). Transaction advisory services (TAS) will support PPP clients, including governments and subsovereign and state-owned entities. TAS will help with developing projects, screening and identifying bankable PPP projects, advising on commercial and financial structures for such projects, and facilitating the financial close of these projects. TAS may be financed by the client’s own funds and/or through ADB financing consisting of loans, grants, technical assistance, and other means. ADB will charge a fee for providing TAS to recover its costs and expenses.

93. **Subsovereign support.** ADB will streamline its approach to extend direct subsovereign financing support to provincial governments and municipalities, as well as to state-owned enterprises, as appropriate. A set-aside pool of funds will be created to encourage and incentivize subsovereign financing. Where sovereign support is needed to build the bankability of subsovereign projects, central governments could provide guarantees and carry contingent liabilities for such financing. State-owned enterprises that are extended subsovereign finance without guarantees will be those that run on commercial principles and are not subject to specific vested interests and undue government interference in management and operations. For such bankable state-owned enterprises, resources will be provided to develop a pipeline of projects while related support from ADB’s public sector window will be discouraged.

**VII. CONCLUSION**

94. UMICs face increasingly complex development challenges and a host of unfinished agendas that require international partnerships. Even high-income countries today resort to external assistance to address policy and institutional reforms, and tackle downturns of economic cycles. Furthermore, the interconnected nature of world economies requires collaborative solutions and regional and international partnerships to deal with intricate problems. UMICs are increasingly prominent actors and contributors in the international development community. They are also important shareholders of ADB, and their support and engagement directly facilitates ADB’s poverty reduction and development mandate in other DMCs.

95. UMICs continue to find value in partnering with ADB to find collective solutions to their development problems. They seek the additionality that comes with ADB’s support in the form of knowledge and best practice, innovation, and capacity building together with international credibility and assurance of the highest level of integrity. They aim to replicate lessons learned from successful development practice on ADB-assisted projects. UMICs acknowledge ADB’s ability to leverage and catalyze additional finance, including private finance. They also appreciate ADB’s role and convening power on regional integration. ADB will continue to collaborate with UMICs in all these roles until such time that they graduate from ADB support and assistance.
LINKED DOCUMENT
(http://www.adb.org/Documents/LinkedDocs/?id=2015-Policy and Strategy)

Promoting the Use of Country Systems in ADB’s Operations: A Systematic Approach