



October 2016

BETTER PERFORMING INSTITUTIONS IN ADB DEVELOPING MEMBER COUNTRIES

POSITIONING ADB'S APPROACH TO PUBLIC SECTOR MANAGEMENT
AND INSTITUTIONAL PERFORMANCE

This document is being disclosed to the public in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

Director General	M. Locsin, Sustainable Development and Climate Change Department
Deputy Director General	A. Leung, Thematic Advisory Service Cluster (SDTC)
Team Leader	W. Turner, Senior Public Management Specialist, SDTC
Team Members	J. Aquino, Associate Operations Analyst, SDTC G. Bhatta, Technical Adviser (Governance), SDTC K. Bird, Director, Southeast Asia Department C. Buentjen, Principal Public Management Specialist, SDTC B. Carrasco, Director, South Asia Department C. Francisco, Public Management Officer, SDTC R. Hartel, Director, Central and West Asia Department Y. Miyaki, Public Management Specialist (Taxation), SDTC Y. Qian, Director, East Asia Department E. Veve, Director, Pacific Department

NOTES

In this report, “\$” refers to US dollars

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

Abbreviations	ii
Executive Summary	iii
I. Introduction	1
II. Rationale	1
A. Public Sector and Institutional Performance, and why they Matter	1
B. ADB's Practice, Experience, and Performance	5
C. International Trends and Approaches	9
III. Directions	12
A. Integrated Approach to PSM and Institutional Performance	12
B. Enhanced Results-orientation in Operations	13
C. Priority Areas for Operations	14
D. What ADB can Offer: Products and Services	17
IV. Implementing the Approach	21
A. Mainstreaming, Selectivity, and Quality in Operations	21
B. Enhancing Business Processes and Systems	23
C. Generating Operationally-relevant Knowledge and Learning	24
D. Strengthening ADB's Capacity	25
E. Measuring Implementation Progress	27
Appendixes	
1. Institutional Performance in Priority Sectors and Themes	30

ABBREVIATIONS

ADB	–	Asian Development Bank
CPS	–	country partnership strategy
COBP	–	country operations business plan
DMC	–	developing member country
FCAS	–	fragile and conflict-affected situation
GACAP II	–	Second Governance and Anticorruption Action Plan
GCD	–	governance and capacity development
GCF	–	Governance Cooperation Fund
GovTG	–	Governance Thematic Group
ICT	–	information and communications technology
IED	–	Independent Evaluation Development
PPP	–	public-private partnership
PSM	–	public sector management
SDG	–	Sustainable Development Goal
SOE	–	state-owned enterprise
TA	–	technical assistance

EXECUTIVE SUMMARY

This paper positions the Asian Development Bank (ADB) to refocus its approach to supporting public sector management (PSM) and institutional performance in developing member countries (DMCs). The paper aims to inform the preparation of ADB's new long-term strategy for engaging with DMCs until 2030 as well as any future sector or thematic operational plans. The paper also serves as a guide to ADB operations and the work of the Governance Thematic Group (GovTG).

With PSM investments totaling \$16.8 billion over the last decade, ADB is a major financier and partner for countries in Asia and the Pacific to advance PSM reforms and broader institutional development. As DMCs undergo deep changes to respond to complex development challenges and the emergence of new global development agendas, so too does ADB need to make changes in its approaches to supporting DMCs. PSM and institutional reform are challenging areas for ADB to work. They require experience working in the countries and an understanding of the drivers of reform and change. ADB's operational performance has improved, but gaps remain. Recent reviews and evaluations point to the need for ADB to strengthen operational processes so there is sufficient attention to the quality and results of ADB's engagements.

The planned scaling up of ADB's lending capacity offers enormous opportunities for PSM operations and institutional development work. As ADB aims to become "stronger, better and faster", a refocused approach not only strengthens the rationale for scaling up PSM support, including policy-based operations, but by engaging on institutional issues also helps to deliver operational results in other sectors without compromising on quality.

Integrating ADB's Approaches to PSM and Institutional Performance

Rather than the three strands of ADB's work—PSM, governance, and capacity development—being treated as operationally distinct, ADB should integrate them, recognizing each as a means to achieve the common goal of better performing institutions in DMCs. An integrated approach needs to build on ADB's existing action plans for mainstreaming governance and capacity development in sector operations, but aim to eventually replace them so that ADB has a single operational strategy.

Giving more attention to PSM and institutional performance is consistent with the 2030 Sustainable Development Goals (SDGs). It will help DMCs achieve key governance targets under Goals 16 and 17. Effective, accountable, and transparent institutions foster more cost-effective delivery of infrastructure and services, stimulate inclusive economic growth, and enhance development effectiveness. With governance also an important enabler of sustainable development, the way governments perform will determine the achievement of all SDGs.

An integrated approach requires aligning support for upstream public sector policies and reforms with downstream institutional development in priority sectors. PSM reforms are truly cross-cutting and influence sector outcomes, including in the areas where ADB is most active—climate change, education, energy, finance, health, transport, urban, and water. ADB's long experience and deep knowledge of countries in Asia and the Pacific, its strong track record in sector operations and sector-level reforms, and its provision of both public and private sector lending and support under one roof make ADB uniquely placed to make a major contribution to strengthening public sector and institutional performance in DMCs. Coordinating public and

private sector lending and support in a sequenced manner could be one of ADB's most effective integrated solutions.

The variation in institutional performance across the region, and within countries, requires ADB differentiate its support to client needs. While operational decisions are made at the country-level and aligned to country partnership strategies, there are four core PSM reform areas where ADB should look to continue to invest or selectively grow operations: (i) domestic resource mobilization; (ii) public expenditure and financial management; (iii) reform of state-owned enterprises, and (iv) decentralization and subnational governance. Alongside these core areas, private sector development, public-private partnerships, information and communication technology, and anticorruption are cross-cutting areas and functions of governments that are essential to delivering better infrastructure and services and should also be given more attention in ADB operations.

Delivering Holistic Solutions to Developing Member Countries

ADB has the existing products and services to be successful. ADB has and continues to introduce lending and grant instruments that offer more agility to combine, sequence, and adapt to changing circumstances. Time-tested approaches like technical assistance and policy-based operations continue to be important vehicles for PSM and institutional support. There is an opportunity to grow policy-based operations supporting well-defined policy changes that improve development outcomes. Meanwhile, results-based lending is potentially a powerful new approach for ADB to help DMCs improve institutional performance in priority sectors.

ADB is also able to offer DMCs a range of institutional support and services, including knowledge sharing, technical advisory support, innovative solutions, collaborative partnerships and networks, and institutional assessments. They need to be delivered through carefully tailored approaches to the country situation and readiness for change of DMC stakeholders, and aim to add specific value to clients and catalyze change and learning. It requires long-term, strategically guided efforts in low capacity and fragile environments, often focusing on core state functions. In some settings, ADB should support broader policy, regulatory, and institutional reforms, where such reforms are often complex, contested, and hard to achieve. Where better governance and capacities exist, ADB may offer to broker regional networks and cooperation between countries, and make cutting-edge knowledge and innovations available.

ADB cannot do this alone, however. To tap external specialist expertise and access knowledge, ADB must embrace partnerships—both knowledge and financing—with other international development agencies, multilateral and bilateral institutions, the private sector, research and academic institutions, and civil society organizations. Working with partners with global reach can bring knowhow, experience, and valuable lessons from outside Asia and the Pacific.

Enhancing Mainstreaming, Selectivity, and Quality in Operations

Successful implementation of an integrated approach rests on the extent to which institutional support is effectively mainstreamed in operations. Within this mainstreaming approach, ADB needs to be selective in its support, recognizing that the nature of and context of reform and change can in some situations limit what external actors can do. This means ADB making clear choices about the objectives and scope of institutional support so that operations can be more systematic about choosing when to aim for comprehensive institutional strengthening, and when to opt for less.

A stronger results focus in operations requires a framework for ADB to systematically capture and monitor the results of its PSM and institutional support. Developing such a framework needs to be framed by ADB's broad operational objectives. In practice, when ADB operations support PSM and institutional development, they aim to contribute to results at one or more of three broad levels of attention: (i) at project-level to enhance project readiness and implementation; (ii) at sector-level to support sector-wide policy and institutional reforms; and (iii) at cross-sector level to respond to complex and emerging cross-sector—and cross-border—development challenges.

Achieving a sufficient level of operational quality requires making diagnosis, dialogue, design, and delivery—the “4Ds” of quality institutional support—explicit on the subject of institutional performance. The aim is to make operational choices about levels and intensity of ADB's support explicit and consequential, with demands on rigor under the quality dimensions tailored to the level of ambition of the support. Operations with comprehensive institutional support should have to meet higher quality standards. For less comprehensive objectives, the requirements should be less demanding.

Enhancements to ADB's internal business processes and systems are required at various stages of the project cycle to implement an integrated approach. Determining the success of operations delivering intended institutional performance results requires the project classification system be updated according to the scope of the objectives of the support. Operational diagnostics need to be strengthened to appropriately consider institutional performance issues as well as governance risks. Design, implementation and reporting processes must capture the necessary institutional performance information and results, and reflect quality standards.

Strengthening ADB's Capacity

Implementing an integrated approach requires a coordinated “One ADB” effort. Operational departments have primary responsibility for the effective mainstreaming of institutional support in operations. Resident missions take on a crucial role. If ADB is to be the preferred advisor to DMCs, a physical presence in the country is optimal so that ADB is sensitive to the drivers of reform and change, and responsive to DMC needs. GovTG—an internal network for knowledge sharing and cross-departmental coordination on PSM and governance issues—is providing strategic and knowledge support to operational departments. Other support departments and offices should share responsibility for implementation, where relevant.

ADB will need to raise its capacity to provide specialized support to DMCs. It must learn from and scale up the emerging good practices in DMCs, and globally. Practical guides, operational case briefs, and a structured program of training and learning can help to strengthen ADB's tacit knowledge about what works, and why. While enhancements to operational processes and systems should not significantly impact operational transaction costs for ADB overall, resources will be required to catalyze change in how ADB works with institutional performance issues. Moreover, with DMCs continuing to demand support, there are limits to how much PSM and institutional work can be scaled up without additional ADB staff with specialized expertise.

I. INTRODUCTION

1. Public sector management (PSM) is a major sector for Asian Development Bank (ADB) operations, totaling \$16.8 billion over the last decade. On top of this, more than two-thirds of all ADB operations are currently classified as contributing to governance and institutional capacity development in developing member countries (DMCs). ADB is therefore a major financier and partner for countries in Asia and the Pacific to advance PSM reforms and broader institutional development.

2. The Midterm Review of ADB's long-term strategic framework—Strategy 2020—observed that weak governance and institutional capacities continue to constrain development in DMCs.¹ ADB's response to the review included prioritizing financial resources for PSM and institutional issues and establishing the Governance Thematic Group (GovTG) to provide strategic and knowledge support to operations.² The international community has also elevated attention to improving the performance of country institutions in the 2030 Sustainable Development Goals (SDGs). The way governments perform will affect the achievement of all SDGs, with Goals 16 and 17 holding particular relevance to this paper.

3. The purpose of this paper is to position ADB to refocus its approach to supporting PSM and institutional performance in DMCs. The paper aims to inform ADB's new long-term strategy for engaging with DMCs until 2030 as well as any future sector or thematic operational plans in PSM and institutional development. The paper also serves as a guide for ADB operations and GovTG as dynamics change in the region and new global development agendas emerge.

4. The paper is structured as follows. First, the rationale for ADB continuing to invest in PSM and institutions is explained. Second, the paper provides directions for a more integrated approach to PSM, governance, and capacity development to meet the diversity of DMC needs. Third, the paper sets out a medium-term plan with key actions for ADB to pursue to implement an integrated approach.

II. RATIONALE

A. Public Sector and Institutional Performance, and why they Matter

5. **PSM reform is concerned with improving public sector performance by changing the way governments work.**³ People mostly experience the performance of public institutions through the government services they receive—or are denied—with increasing scrutiny over the efficiency, accountability, and transparency of government. The size of the public sector makes it economically significant and a major contributor to investment and growth in countries. It comprises upstream and downstream executive bodies, and non-executive bodies such as legislatures, judiciaries, and audit authorities that maintain a certain level of independence from the executive arm of government.

¹ ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

² ADB. 2014. *Midterm Review of Strategy 2020 Action Plan*. Manila.

³ Adapted from the World Bank's approach to PSM: World Bank. 2012. *The World Bank's Approach to Public Sector Management 2011–2020: Better Results from Public Sector Institutions*. Washington D.C.

6. Upstream central ministries or agencies operate at the center of government and are responsible for functions that cut across government agencies and sectors such as managing aggregate public revenues, expenditures and debt, and regulating and coordinating the wider public sector. Downstream bodies are typically concerned with delivering infrastructure and services such as education, electricity, health, and transport, and include line ministries or agencies as well as more autonomous bodies such as sector regulators and state-owned enterprises (SOEs). The upstream–downstream distinction approximates the division of labor in ADB between “public management specialists” who usually work on upstream and cross-cutting reforms and “sector specialists” who concentrate on downstream and sector-specific reforms.

7. **An enabling environment for inclusive economic activities and services hinges on well performing institutions.** There is no single definition of institutions, but all refer to the formal and informal rules that govern social, political, and economic interactions.⁴ Institutional performance—how well and inclusively services are delivered or regulation is implemented for example—is shaped by an array of contextual factors, including the effectiveness of governance arrangements and the strengths of various capacities such as physical assets and human capital. Infrastructure development, which is ADB’s core business, is more likely to be sustainable and contributing to inclusive growth if underpinned by institutions that enable equitable access to services as well as financial, technical, social, and environmental sustainability of investments.

8. In the Asia and Pacific region, the landscape of institutions and the interplay between public and non-public actors are changing. While core state functions such as economic and fiscal management, law and order, and security are necessary for effective government and remain in the hands of the state, there is increasing focus on the role of sub-national governments, the private sector, and citizens in how services are produced and delivered. Opportunities for private sector participation are growing, including through public-private partnerships (PPP). Meanwhile, citizens are becoming more informed and empowered through new information and communications technologies (ICT).

9. Cross-sector and complex challenges such as income inequality, gender disparities, climate change adaptation, green growth, urban development, and financial sector regulation demand new capabilities of public institutions, and the individuals working in them. Deeper vertical specialization must be supplemented with horizontal integration across sector and disciplinary boundaries. Effective regional responses are also needed. With governments required to increasingly meet performance and efficiency standards that mimic what the private sector can offer, the traditional image of omnipotent bureaucrats towering behind paper-stacked desks is rapidly fading, whereas consultative, entrepreneurial, and innovative practices are gaining ground.

10. **By and large, better governance and institutional performance correlates with development and growth in Asia and the Pacific.** There is evidence to suggest that countries with sound policies and regulations, an effective public service, and able to control corruption have grown more quickly than others.⁵ Under ADB’s Country Performance Assessment exercise, PSM and institutional performance has been shown to be gradually improving in the region overall, but significant governance challenges remain (Figure 1).⁶ Countries tend to perform better in the quality of budgetary and financial management and efficiency of revenue

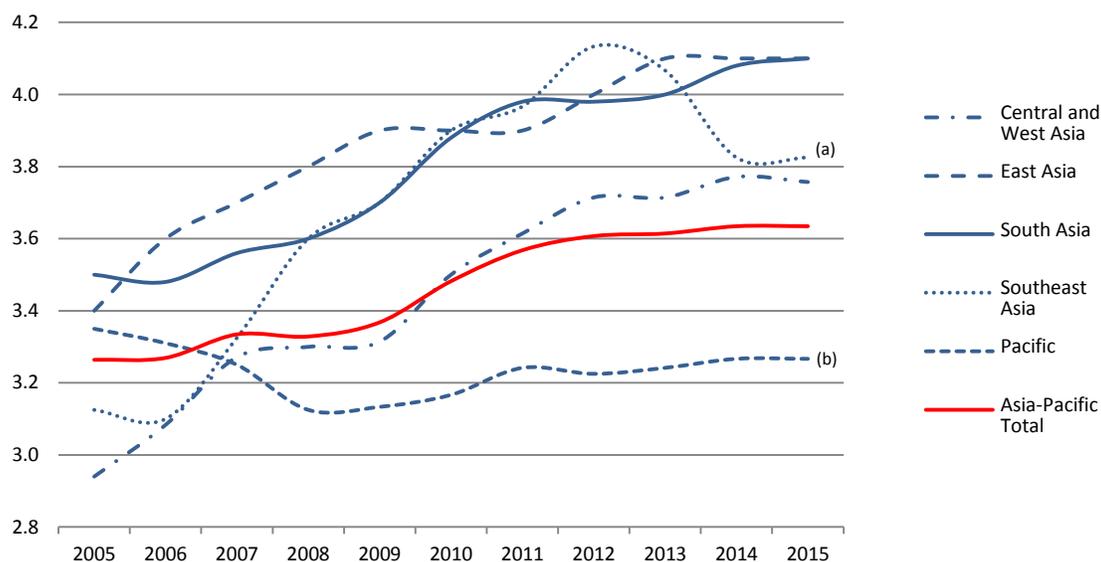
⁴ For example: see: D. North. 1990. *Institutions, Institutional Change and Economic Performance*. Cambridge University Press, United Kingdom.

⁵ ADB. 2013. *Asian Development Outlook 2013 Update: Governance and Public Service Delivery*. Manila.

⁶ The PSM and institutions (governance) rating average for 29 DMCs increased from 3.3 in 2005 to 3.6 in 2015.

mobilization, whereas property rights and rule-based governance, quality of public administration, and transparency, accountability and corruption in the public sector are generally weaker areas. For ADB's stakeholders, both within and outside of government, corruption is perceived as one of the greatest threats to development.⁷

Figure 1: PSM and Institutions Ratings, 2005–2015

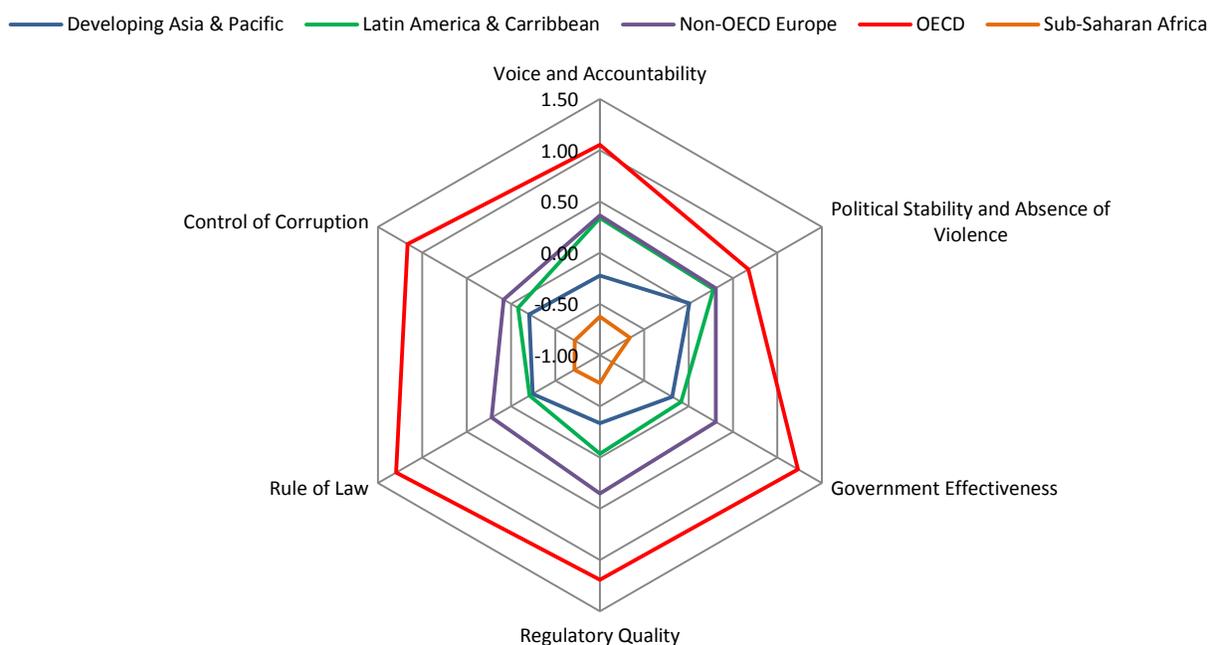


Notes: Indicators range from 1 to 6 with higher values denoting better institutional performance; subregional ratings are the simple average of the relative country ratings; a) Myanmar was included in 2014, which lowered Southeast Asia average rating; b) Cook Islands was excluded after 2007, which lowered the Pacific average rating.
Source: ADB's Country Performance Assessment.

11. While the Asia-Pacific region is showing signs of better governance, it continues to lag most other regions in the world. Using the Worldwide Governance Indicators—a dataset of perception-based relative governance performance—developing Asia and the Pacific is shown to have weaker governance and institutional performance than other regions, except sub-Saharan Africa (Figure 2). This underperforming situation is in each of the six dimensions assessed: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. However, there is a significant heterogeneity when it comes to ADB's five subregions (footnote 5). East Asia and Southeast Asia were the strongest overall, each scoring highest on government effectiveness, regulatory quality, and rule of law. South Asia and Central and West Asia generally scored lower. South Asia's biggest challenges were political stability and regulatory quality. Central and West Asia's scores on controlling corruption, rule of law, and voice were lower. The Pacific was less uniform across the dimensions—strongest in political stability and voice, and weakest in regulatory quality and government effectiveness, though the data used to construct the scores tend to be less reliable for small Pacific economies. Governance performance is also shown to be diverse at the country-level.

⁷ ADB. 2013. *ADB Perceptions Survey: Multinational Survey of Stakeholders 2012*. Manila.

Figure 2: Worldwide Governance Indicators, 2014



OECD = Organisation for Economic Co-operation and Development

Notes: Indicators range from -2.5 to 2.5 with higher values denoting better governance quality. Regional score is the simple average of the country scores.

Source: ADB estimates using World Bank, Worldwide Development Indicators online database (accessed May 2016).

12. **The variability in performance within and across countries demands differentiated policy and investment choices.** In fragile and conflict-affected situations (FCAS), institutional performance is generally poor, state legitimacy and basic services are severely underdeveloped, and the obstacles to successful development are often more complex than in other developing countries.⁸ This requires approaches tailored to particular problems and circumstances, and which—following the New Deal for Engagement in Fragile States—focus on strengthening state capacity and country systems to enable basic service delivery and put in place institutions that bolster peace and stability.⁹ ADB has developed a framework for long-term institution strengthening suited to FCAS DMCs that recognizes the interaction between fragility situations, weak institutions, and development activities.¹⁰

13. Meanwhile, both low- and middle-income countries need to further improve their capacities to adopt and implement appropriate policies and regulations as well as strengthen governance and service delivery functions. The variability in the effectiveness of policies and regulations, public investment in infrastructure and services, and the difference in the speed of change have become important parameters for countries as they strive to develop and reduce poverty. As a large majority of DMCs are projected to attain middle-income country status by 2020, demands for better public services and social welfare programs will grow. This includes

⁸ ADB. 2013. *Operational Plan for Enhancing ADB's Effectiveness in Fragile and Conflict-Affected Situations*. Manila.

⁹ The New Deal, agreed at the Fourth High Level Forum on Aid Effectiveness in Busan in 2011, is a milestone agreement between fragile and conflict-affected states, development partners, and civil society to improve the current development policy and practice in fragile and conflict-affected states.

¹⁰ ADB. 2014. *Engagement in Fragile and Conflict-Affected Situations: Institutional Strengthening Framework: A Guidance Note*. Manila.

demands on subnational governments as decentralization processes transfer more resources and responsibilities to lower levels of government.

14. While there is no “one size fits all” approach to improving PSM and institutional performance in countries, figure 3 shows an indicative pattern of country settings and needs, focus areas for institutional development, and a judgment on the likelihood of results being achieved. FCAS countries, which may be either low- or middle-income, are shown separately to illustrate the particular challenges facing these countries.¹¹ In reality, a country’s development situation may demonstrate characteristics from across this FCAS–low-income-middle-income depiction.

Figure 3: Institutional Development in Different Country Settings



ADB = Asian Development Bank, DMC = developing member country, FCAS = fragile and conflict affected situations, LICs = low-income countries, MICs = middle-income countries
 Source: ADB Governance Thematic Group.

B. ADB’s Practice, Experience, and Performance

15. **ADB has different but mutually reinforcing operational approaches to PSM, governance, and capacity development.** PSM is categorized as a “sector”, with subsectors including support for economic affairs management, public financial management, public administration, decentralization, reform of SOEs, and law and the judiciary. While ADB does not have a bank-wide operational plan for the PSM sector, it is able to prioritize PSM support to DMCs at the country-level through country partnership strategies (CPS) and country operations business plans (COBP).

16. Under Strategy 2020, governance and capacity development (GCD) are treated as a theme or “driver of change” and mainstreamed in operations, including PSM operations, as well as other sectors such as education, energy, finance, health, transport, and water. ADB has two

¹¹ ADB currently categorizes nine DMCs as FCAS: Afghanistan, Federated States of Micronesia, Kiribati, Marshall Islands, Nauru, Nepal, Solomon Islands, Timor-Leste, and Tuvalu.

longstanding action plans for mainstreaming GCD. The 2006 Second Governance and Anticorruption Action Plan (GACAP II) links governance issues to development outcomes and mandates governance risk assessment and risk management in country programming and operations.¹² Through GACAP II, ADB gives priority to public financial management, procurement, and anticorruption in DMCs, which are key institutions and systems needed for effective government performance, and highly relevant to implementing ADB projects.

17. ADB's framework and action plan for capacity development, adopted in 2007, aims to increase mainstreaming of good capacity development principles and practices, with a particular focus on quality-at-entry in CPSs and operations.¹³ Capacity development is broadly defined as the process whereby a country raises its capacity to manage its affairs successfully. The quality dimensions of capacity development prioritized by ADB include DMC ownership, baseline assessment, attention to country context, results frameworks that indicate improved capacity, and a focus on different levels of capacity—individual, organizational, networks of organizations, and the institutional enabling environment.

18. Actions to strengthen governance and develop capable institutions are means to achieve specific institutional performance and partly overlapping processes serving the same end. ADB's concept of good governance is defined by its 1995 Governance Policy—the first multilateral development bank to adopt a governance policy—and relates to the institutions and mechanisms for effective management and oversight, namely accountability, participation, predictability, and transparency.¹⁴ Capacity development focuses on the processes that enable DMCs to pursue the governance and organizational capacities required to deliver on development objectives. A good governance environment and a certain level of performance capabilities are, in turn, more likely to capitalize on external assistance and increase the pace at which a country's capacities are raised. These links between governance and capacity development reinforce ADB's view of them as one driver of change even as they are treated as operationally separate in some aspects.

19. Some of ADB's corporate mechanisms are also influenced by institutional performance in DMCs. ADB's performance-based allocation policy for concessional financing is based on the principle that aid is most effective in accelerating economic growth and poverty reduction in countries where policy and institutional performance is strong.¹⁵ In determining the composite country performance rating used to derive Asian Development Fund allocations, the PSM and institutions (governance) rating is given the most weight in the allocation formula (footnote 6). As well as being an important indicator of PSM and institutional performance, the Country Performance Assessment exercise provides opportunities for strengthening the policy dialogue with DMCs on these issues. Under ADB's graduation policy, in determining a country's readiness for graduation from regular Bank assistance, the degree to which economic and social institutions have taken hold and their capacity to foster sound development management is taken into account.¹⁶

20. **DMCs continue to demand PSM and institutional support.** Recent operational trends show an increased focus on PSM and GCD (Figure 4). The proportion of ADB sovereign operations for PSM—comprised of loans and grants—averaged 11% in 2010–2015. Within the

¹² ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

¹³ ADB. 2007. *Integrating Capacity Development into Country Programs and Operations: Medium Term Framework and Action Plan*. Manila.

¹⁴ ADB. 1995. *Governance: Sound Development Management*. Manila.

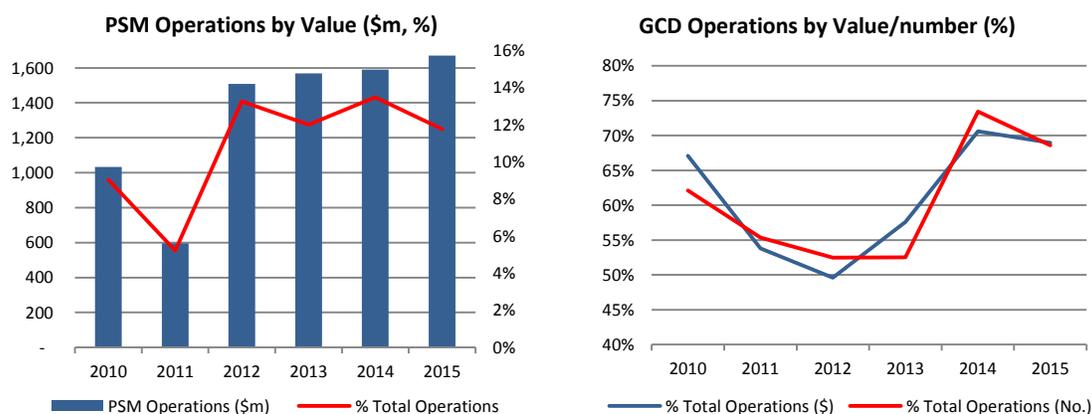
¹⁵ ADB. 2001. *Policy on Performance-Based Allocation for Asian Development Fund Resources*. Manila.

¹⁶ ADB. 1998. *A Graduation Policy for the Bank's DMCs*. Manila.

PSM portfolio, the bulk of operations, at about 70%, were for support for economic affairs management and public financial management. PSM operations also include crisis-response lending to economic and fiscal downturns and natural disasters, which surged in the wake of the 2007–2009 global financial crisis, but has since reduced in scale. PSM operations totaled \$16.8 billion over the last 10 years (2006–2015) making it a major sector portfolio for ADB reaching \$1.5 to \$1.6 billion in new approvals annually since 2012.¹⁷

21. While establishing the financial value of GCD support is difficult, sovereign operations (including PSM operations) classified as mainstreaming or addressing GCD issues averaged about 62% in both financial value and number in 2010–2015, rising significantly since 2012.¹⁸ Mainstreaming GCD in nonsovereign operations was lower at 16% over the same period. Technical assistance (TA) operations, which average more than \$300 million each year, continue to be a primary channel for PSM and institutional support. In 2010–2015, PSM was the largest sector at 18% of total TA. About 80% of total TA was classified as addressing GCD issues. ADB is recognized quintessentially as an infrastructure bank, but these operational trends show that ADB should also be seen as an institutions bank.

Figure 4: PSM and GCD Sovereign Operations, 2010–2015



GCD = governance and capacity development, PSM = public sector management
 Source: ADB Governance Thematic Group

22. DMC demand, when present, will often see PSM and institutional support as a component of an ADB program or project, and not a stand-alone activity. ADB’s support for GCD typically falls under three categories according to the objectives of the support. First, operations focus on the effective implementation of ADB-financed operations, responding to needs of project partners and stakeholders. Support to executing and implementing agencies often targets country systems that most impact ADB operations and where governance risks can be high, such as financial management and procurement. Second, operations aim for broad institutional reform at the sector-level, delivered with a long-term strategic perspective applying a mix of investment and policy-based operations and TA, and in some cases including knowledge sharing, careful coalition building, and roll-out of policy and regulatory reforms and institutional change. Third, operations increasingly aim at addressing institutional challenges that cut across sectors, borders and professional disciplines, drawing on ADB’s regional presence and multi-disciplinary capabilities.

¹⁷ ADB. 2015. *Work Program and Budget Framework, 2016–2018*. Manila.

¹⁸ ADB’s project classification system provides for operations to be classified as GCD by applying a general marker, but without assigning a monetary value to the specific GCD activities.

23. **Sector operational plans reflect trends towards more integrated PSM.** In transport, the focus is shifting from stand-alone infrastructure projects—for example in roads—and the maintenance of such infrastructure to creating sustainable transport systems that are accessible, safe, affordable, and environment-friendly.¹⁹ This shift requires institutions that can collaborate and regulate between a broad range of stakeholders such as economic policy makers, transport and environmental authorities, and private constructors and operators. Similarly, ADB's urban sector strategy emphasizes a systems-oriented and integrated approach to address the challenges of rapidly urbanizing Asia, recognizing the demands on governments to address complex problems that have political, institutional, planning and regulatory dimensions.²⁰ In education, the focus is on quality learning outcomes and the interconnectedness between the various levels and types of education, as well as the links to an increasingly sophisticated labor market.²¹ Institutional arrangements and performance are changing and becoming more complex and demanding, from school level to system level, including the interplay between education systems, the labor market, and social assistance and insurance schemes.²²

24. **PSM and GCD operational performance is improving, but gaps remain.** The success rate of completed PSM operations (loans and grants) was 77% in 2013–2015, on par with other non-infrastructure sectors, and a significant improvement from the 50% rate of success in 2010–2012.²³ The success rate of completed TA operations—important for PSM and institutional support—rose from 80% to 87% between 2010–2012 and 2013–2015. The proportion of ongoing PSM operations achieving satisfactory performance at implementation improved from 56% in 2012 to 84% in 2015.²⁴

25. A thematic evaluation study by ADB's Independent Evaluation Department (IED) in 2014 found the performance of PSM operations to be relatively weaker than most other sector portfolios over the longer term since the 1990s.²⁵ However, where PSM interventions had succeeded, results were often transformative with system-wide impacts. In this sense, PSM interventions have high-risk—high-return characteristics, often facing high risks of failure but offering potential for high development results. PSM operations also tend to perform poorly where operations in other sectors also perform poorly, which points to the importance of understanding country context. The study identified several lessons for improving operational performance (Box 1). Across all sectors, weak local institutional arrangements, capacity and performance, as well as insufficient government ownership and commitment to reforms, are consistency cited as major reasons for less successful ADB sovereign operations (footnote 24).

26. Mainstreaming GCD in country programming and operations has been partially successful. A review of ADB's capacity development approach in 2016 observed good practices across countries and sectors such as DMC ownership, quality diagnosis, attention to country context in design, and good results frameworks.²⁶ The review showed that ADB is successfully engaged in long-term sector-wide approaches aimed at comprehensive reforms, and continues to test modalities such as facility-type TA, multi-tranche financing facilities, and results-based

¹⁹ ADB. 2010. *Sustainable Transport Initiative Operational Plan*. Manila.

²⁰ ADB. 2012. *Urban Operational Plan*. Manila.

²¹ ADB. 2010. *Education by 2020: A Sector Operations Plan*. Manila.

²² ADB. 2013. *Social Protection Operational Plan 2014-2020*. Manila.

²³ IED. 2016. *2016 Annual Evaluation Review*. Manila: ADB.

²⁴ ADB. 2016. *Development Effectiveness Review 2015 Report*. Manila.

²⁵ IED. 2014. *Thematic Evaluation Study: ADB Support for Enhancing Governance in its Public Sector Operations*. Manila: ADB.

²⁶ ADB. 2016. *Capacity Development in ADB Operations: Review of the Medium-Term Framework and Action Plan for Capacity Development*. Manila.

lending. However, ADB's conceptual framework for capacity development, while embodying recognized principles of effective capacity development, has not been fully implemented. There are also weaknesses in how effectively and comprehensively capacity development is being addressed in operations. Meanwhile, a review of GACAP II implementation in 2013 found that integration of governance risk assessment and risk management in country-, sector-, and project-level processes was not consistently applied across ADB, and the underlying analysis of governance risks was of mixed quality.²⁷ IED's 2014 evaluation on governance reached similar conclusions regarding GACAP II implementation, particularly at the project-level.

Box 1: Lessons from Asian Development Bank Support for Governance and Public Sector Management

The 2014 thematic evaluation study of governance and public sector management identified several lessons in the Asian Development Bank's support. These included:

- Develop approaches that strike the right risk/return balance between high risks of failure and potential for high development impacts.
- Prepare rigorous diagnostics at project design and appraisal to assess (i) institutional capacity and resources in counterpart agencies, (ii) motivation for change and overall ownership and commitment to projects, and (iii) political or socioeconomic factors that may pose risks to projects and the time needed for reforms.
- Give adequate allowance for closer monitoring and supervision of high-risk interventions owing to the complexity of public sector management projects and the unpredictability of political and economic contexts.
- Focus on long-term programmatic approaches to build cumulative progress on good governance, following good capacity development practices, and focusing strongly on sustainability.

Source: Independent Evaluation Department. 2014. *Thematic Evaluation Study: ADB Support for Enhancing Governance in its Public Sector Operations*. Manila: ADB.

27. A major achievement of ADB's existing GCD action plans—and Strategy 2020—was to elevate GCD as a corporate priority in ADB. However, the evidence points to number of problems in operations. Operational processes and internal support systems do not always ensure sufficient attention to the quality of ADB's engagement. Rather, attention to institutional issues was found to be uneven and diagnostic depth and quality varied. ADB's ability to determine the results of its institutional support is limited by results frameworks that do not always reflect outcomes at levels that would indicate enhanced performance. The GCD classification of operations, while providing a general marker for sector operations addressing GCD issues, is not linked to quality criteria and practices or to the subsequent monitoring of results. There is also little corporate guidance on how to address institutional issues, and formal learning and knowledge sharing activities have been ad hoc.

C. International Trends and Approaches

28. The international development community continues to share a commitment to strengthen governance and institutions. Institutional development is a relatively significant part of official development assistance provided by development agencies worldwide. Global aid flows aiming broadly at institutional development totaled more than \$22 billion in 2014, an

²⁷ ADB. 2013. *Implementation Review: Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

increase of about \$2 billion from the financing levels in 2009.²⁸ Institutional development accounted for about 11% of total aid flows, a level that has been consistent since 2009. The trend in financing of institutional development to ADB's DMCs is similar to this global aid flows picture.

29. The international commitment to good governance was reaffirmed in the 2030 SDGs, which include efforts to build effective, accountable and inclusive institutions at all levels, strengthen domestic resource mobilization, enhance government transparency, and reduce corruption. The dedicated Goal 16 on governance (and aspects of Goal 17) reinforces good governance as an outcome of sustainable development, in addition to governance viewed as an enabler for achieving the SDGs. The international commitment is also contained in a variety of other international forums and initiatives that ADB supports: the Addis Tax Initiative; Development Partners Network on Decentralization and Local Governance; Effective Institutions Platform; Global Partnership for Effective Development Co-operation; and Open Government Partnership.²⁹

30. Improving institutional performance in Asia and the Pacific is challenging for DMCs and their partners, and approaches continue to evolve. Evidence on what policies and reforms will drive improvements in institutional performance is not always available. Policy and institutional issues are often contested and the political economy factors that determine reform success—or failure—may not be well understood. The balance of driving forces behind success in reform and institutional strengthening has shifted, especially as more countries achieve or near middle-income country status. More countries rightly demand they be in the driving seat, not only in nominal terms, but in practical terms, including in the design of reform and institutional strengthening objectives and trajectories, and in the political, managerial, and technical leadership of reforms. Meanwhile, development agencies have increasingly taken the back seat and play a supporting role.

31. Important trends have emerged in institutional development efforts over the last decade or more, some of which ADB has been quick to adopt.

32. **Increasing focus on higher-level results.** The broad concepts of governance and capacity development are being replaced by a sharper focus on institutional performance results, with such thinking framed by the managing for development results agenda.³⁰ At the outcome level, the aim is to facilitate performing, responsive and resilient institutions that deliver better development results to citizens. Intermediate outputs include better governance and accountability mechanisms, systems and business processes, new and enhanced skills and management practices, as well as greater attention to and support of multi-stakeholder coalitions that can drive reform and change. Lower levels of activity accomplishment—such as number of workshops held and trainees trained, or draft laws and regulations—are increasingly rejected as valid capacity results.³¹ In and by themselves they do not ensure that better

²⁸ Data is sourced from the Organisation for Economic Co-operation and Development (OECD), which became available in 2009. Institutional development is estimated by adding the subcategories of sector policy and management, and sector education and training.

²⁹ Addis Tax Initiative. www.addistaxinitiative.net/; Development Partners Network on Decentralization and Local Governance. <http://delog.org/web/>; Effective Institutions Platform, www.effectiveinstitutions.org; Global Partnership for Effective Development Co-operation. <http://effectivecooperation.org/>; Open Government Partnership. www.opengovpartnership.org/.

³⁰ OECD. 2008. *Managing for Development Results: Information Sheet*. Paris.

³¹ Baser, H. 2011. *Managing for Capacity Results: A Paper for the Cairo Workshop on Capacity Development*: March 28–29, 2011.

institutional performance will follow, even if they may be valid activities or milestones on the road to better performance.

33. **Greater attention to local context and drivers of change.** There is greater attention to the specific context in which institutions operate and where improvements or reforms are sought. Such approaches have their origins in “open systems” thinking and give greater recognition to complexity, context, and politics, where flexibility, experimentation, learning, and adaptation are prioritized.³² So-called “politically smart” support needs to factor in political economy and reform readiness issues in a concrete and practical manner, rather than relying exclusively on technocratic blueprints of best practice.³³ Similarly, problem-driven, iterative and incremental approaches to overcome capability gaps are gaining ground, especially in settings where the institutional and governance starting points are weaker.³⁴ Each of these approaches recognize the importance of supporting the demand side of governance and accountability efforts—commonly understood as citizen participation in the conduct of government or a focus on the users of government services—in addition to supply side reforms that are the traditional domain of development agencies.³⁵ Exposure to cutting edge practices, knowledge, and innovations are also increasingly in demand from countries which are further in their development trajectory.

34. **Looking beyond traditional technical support.** There is a shift away from a narrow focus on training and technical advisory support—inputs that have often been considered synonymous with institutional development no matter their intended and actual effects. Increasingly, knowledge sharing and brokering and the use of social innovation and collaborative practices involving nongovernment actors are applied as drivers of learning, change, and enhanced institutional performance. South-South cooperation, while not a new approach, is on the rise where there are successful experiences to share. Twinning arrangements between peer institutions is another option. Development agencies are also exploring less hands-on approaches, working through or in partnerships with research institutions, the private sector, and civil society organizations. Using their convening power, development agencies have been able to catalyze multi-stakeholder processes and drive specific regional or global networks that address particular aspects of institutional performance.³⁶

35. **Increasing use of country systems.** There is continued international focus on strengthening country systems and moving towards using country systems for delivering external assistance. Development partners need to be cognizant of the potential harm to weak endogenous institutions when they set up parallel systems and structures. The use of country systems such as public financial management, procurement, and environmental and social safeguard systems can in the right circumstances reduce delays in project implementation,

³² Lucas, B. 2013. *Current Thinking on Capacity Development*. Helpdesk Research Report prepared for the Governance, Social Development, Humanitarian and Conflict Applied Knowledge Services, University of Birmingham.

³³ Booth, D., and S. Unsworth. 2014. *Politically Smart, Locally Led Development*. Overseas Development Institute Discussion Paper. London: Overseas Development Institute.

³⁴ M. Andrews, L. Pritchett and M. Woolcock. 2012. *Escaping Capability Traps Through Problem Driven Iterative Adaptation (PDIA)*. Center for International Development Working Paper No. 240. Boston; the World Bank’s PSM strategy also embodies such an approach (footnote 3).

³⁵ World Bank. 2008. *Public Sector Reform: What Works and Why? An IEG Evaluation of World Bank Support*. Washington D.C.

³⁶ For example: the Inter-American Development Bank’s Special Program for Institutional Strengthening, <http://www.iadb.org/en/topics/government/government-institutions.1553.html>; or the World Bank’s “collaborative governance” approach, <http://wbi.worldbank.org/wbi/topic/governance>.

rationalize transactions costs, improve country ownership, and strengthen institutions and systems that improve service delivery outcomes.³⁷ However, the actual use of country systems will depend on institutional capacities and fiduciary concerns, as well as DMC government preferences for using development agency systems and procedures or their own.

III. DIRECTIONS

A. Integrated Approach to PSM and Institutional Performance

36. The Asia and Pacific region is changing fast, and so must ADB. A step change is required—and feasible—in ADB’s operational approach to PSM and institutional performance, capitalizing on and broadening good practices within ADB, and internationally. To successfully scale up PSM and institutional work, ADB needs to be more results-oriented according to operational priorities, and responsive to the development challenges facing the region and new global development agendas.

37. ADB giving more attention to PSM and institutional performance in operations is consistent with the SDGs. It will help DMCs achieve key governance targets under Goals 16 and 17 (Figure 5). Effective, accountable, and transparent institutions foster more cost-effective delivery of infrastructure and services, stimulate inclusive economic growth, and enhance development effectiveness. With governance also an important enabler of sustainable development, the way governments perform will determine the achievement of all SDGs.

Figure 5: Sustainable Development Goals 16 and 17



ADB = Asian Development Bank, PSM = public sector management

Sources: ADB Governance Thematic Group; United Nations. <https://sustainabledevelopment.un.org/>.

³⁷ ADB. 2015. *Clients–Contributors–Collaborators: A New Partnership with Upper Middle-Income Countries*. Manila.

38. **Integrating the existing three strands of ADB’s work: PSM, governance, and capacity development.** Rather than PSM, governance, and capacity development being treated as operationally distinct, ADB should integrate them under an approach that recognizes each as a means to achieving the common goal of better performing institutions in DMCs in and across the sectors and subsectors where ADB is active. An integrated approach needs to build on ADB’s existing action plans for mainstreaming GCD in sector operations because aspects of these plans continue to be relevant and necessary for operational processes.³⁸ However, an integrated approach should aim to eventually replace existing actions plans so that ADB has a single operational strategy.

39. **Aligning upstream PSM support with downstream sector outcomes.** An integrated approach requires that support for upstream public sector policies and reforms are aligned with downstream institutional development in priority sectors. PSM reforms are truly cross-cutting. Core government functions cut across sectors and underpin sector-wide and cross-sector developments, including in areas where ADB is most active—climate change, education, energy, finance, health, transport, urban, and water. Reforms and innovations in PSM have a bearing on sector performance in DMCs and can vary in scope from government-wide reforms, such as the way public resources are allocated in the national budget, to service delivery enhancements and cutting edge solutions for sector authorities. It therefore pays for ADB to stay engaged at the macro level through policy dialogue and coordination on PSM reforms while also engaging on institutional issues in priority sectors.

B. Enhanced Results-orientation in Operations

40. A stronger results focus in operations requires a framework for ADB to systematically capture and monitor the results of its PSM and institutional support. Developing such a framework needs to be framed by ADB’s broad operational objectives. In practice, when ADB operations support PSM and institutional development they aim to contribute to results at one or more of three broad levels of attention:³⁹

- (i) **Project-level: enhance project readiness and implementation.** At project-level, the objective is the efficiency and effectiveness of ADB operations and addressing project challenges where attention to institutional issues can make a difference. Executing and implementing agencies are supported to strengthen relevant systems and processes such as project management, financial management, procurement, and safeguards. Managing governance risks in operations, including procurement risks, is also emphasized at project-level. In discrete investment projects, ADB is still concerned mostly with due diligence requirements, including for the preparation, construction, operation, and maintenance of infrastructure assets, which is ADB’s core business.⁴⁰ Meanwhile, it is through policy- and results-based programs where opportunities to strengthen country systems mainly materialize.
- (ii) **Sector-level: support sector-wide policy and institutional reforms.** At sector-level, the public, private and civil institutions that affect performance in achieving sector objectives and delivering infrastructure and services are given more attention

³⁸ For example: GACAP II includes the provision for governance risk assessment and risk management in operations, and the conceptual framework for capacity development remains valid for considering issues of capacity development in DMCs,

³⁹ These broad levels should not be understood as delimited “either-or” categories, rather as a heuristic categorization that requires different approaches in ADB’s support.

⁴⁰ Nearly two-thirds of ADB’s medium-term operational pipeline is for infrastructure development (footnote 17).

in operations. Sector objectives might be sustainable transport, comprehensive water and sanitation coverage or access to health services. Support can be needed to align sector policies and regulations and improve underlying public sector systems and mechanisms for accountability and performance. Taking a long-term perspective and working with multi-stakeholder coalitions that can drive reform and change can have a better chance of results materializing, both in terms of sustainable sector outputs and the success of ADB operations (footnote 26).

- (iii) **Cross-sector-level: respond to cross-sector development challenges.** Complex and emerging cross-sector—and cross-border—development challenges demand new and more sophisticated public sector capabilities. Such challenges include rising inequality, environmental sustainability, urbanization, and financial sector regulation. DMCs need to deepen vertical specialization to respond effectively as well as manage networks that allow more horizontal integration across sector and disciplinary boundaries. There is usually less experience and evidence to build on and more new ground to be broken by DMCs—and ADB.

C. Priority Areas for Operations

41. The variation in institutional performance across the region and within countries requires ADB to differentiate its support to client needs. ADB is engaged in PSM and institutional strengthening activities in all sectors and is likely to continue to be requested by DMCs to invest in different areas. In determining priority areas for operations, ADB should give consideration to the needs of its DMCs, where results are feasible and support can be effective, and where ADB has a comparative advantage. ADB's long experience and deep knowledge of countries in Asia and the Pacific, its strong track record in sector operations and sector-level reforms, and its provision of both public and private sector lending and support under one roof make ADB uniquely placed to make a major contribution to strengthening public sector and institutional performance in DMCs.

42. While operational decisions are made at the country-level through CPSs and COBPs, there are four core PSM reform areas where ADB should either look to continue to invest or selectively grow operations when opportunities arise.

43. **Domestic resource mobilization.** Many countries are seeking to boost revenues including tax collection by broadening and protecting the domestic tax base and improving tax compliance as well as stemming tax evasion and avoidance and cross-border illicit financial flows. Strengthening domestic tax systems is not only a revenue-raising agenda to provide financing for development, but is also about designing systems that promote inclusiveness, investments and job creation, and match society's views on reducing inequality. Shares of government revenues to gross domestic product in developing Asia remain below world averages. In the 2000s, this averaged around 17.8% in developing Asia compared with 21.8% in Latin America and 28.6% worldwide.⁴¹ In 2016, ADB announced its support for the Addis Tax Initiative, an international commitment to step-up efforts on domestic resource mobilization.⁴² ADB should actively look to support DMCs to strengthen domestic resource mobilization in line

⁴¹ ADB. 2015. *Making Money Work: Financing Sustainable Infrastructure in Asia and the Pacific*. Manila.

⁴² The Addis Tax Initiative - Declaration (July 2015). www.addistaxinitiative.net/.

with Goal 17.1 of the SDGs. ADB should also work with forums for regional cooperation and information sharing among tax authorities in the Asia and Pacific region.⁴³

44. Public expenditure and financial management. Effective public expenditure and financial management—including procurement practices—is central to DMCs implementing their policy objectives and national development and poverty reduction plans. It goes to the heart of a government's ability to maintain fiscal discipline and strategically allocate and utilize public resources to deliver efficient and sustainable infrastructure and services. The performance of downstream sector institutions, including at subnational levels, depends on upstream public financial management systems working well. For example, the operation and maintenance of infrastructure assets need to be resourced adequately and supported with sound asset management systems. This has a direct bearing on the sustainability of ADB-financed investment projects. GACAP II also gives priority to good public financial management and procurement in strengthening government accountability and tackling corruption. ADB is already a major partner to many DMCs in public financial management reforms, which accounts for over one-third of PSM operations since 2010. With gaps remaining in the quality of budgetary and financial management in many DMCs, ADB is well placed to provide future support.

45. Reform of state-owned enterprises. In many countries, SOEs are the main providers of essential services such as electricity, water supply, and public transport. Some of the world's largest firms are SOEs and many are in ADB's DMCs, including in the People's Republic of China, India, Indonesia, Malaysia, and Thailand.⁴⁴ However, SOEs can be a drain on public resources, with governments forced to inject capital or provide guarantees to third-party lenders, including to monopoly SOEs that deliver services, often at high costs, but with low service standards.⁴⁵ Reforming SOEs can lead to increased efficiencies, better returns on capital and reduced costs, in turn, improving infrastructure and services and producing better outcomes for the economy. Cross-sector SOE reform agendas can have multiple objectives, including fiscal stability and better public resource management, road maps to corporatization and privatization, and corporate governance of SOEs. Linking cross-sector reforms with sector operations looking at specific SOE performance is important for strengthening SOEs so they can absorb commercial finance and make more effective use of their balance sheets. There are opportunities to expand ADB's work in SOE reforms, including stronger links between public and private sector operations, and continuing to work with global and regional partners.⁴⁶

46. Decentralization and subnational governance. Worldwide, basic services are mostly provided by local governments and other local actors, enabling local development and community and citizen access to services.⁴⁷ Strengthening sub-national governments at provincial and municipal levels through fiscal decentralization and greater autonomy is complex, and sub-national levels continue to depend on intergovernmental fiscal transfers from the central government. Decentralization requires appropriate legal and institutional frameworks, building consensus and trust across a wide range of national and subnational stakeholders, joining up with wider public sector reform processes, and developing local capacities. ADB has supported DMCs with fiscal decentralization, including local-level planning, accessing local

⁴³ For example: the Study Group on Asian Tax Administration and Research; <https://sgatar.org/>.

⁴⁴ *The Economist*. 2012, Special Report: State Capitalism. 21 January.

⁴⁵ ADB. 2016. *Pacific Private Sector Development Initiative: Progress Report 2014-2015*. Manila.

⁴⁶ For example: the Association of Southeast Asian Nations (ASEAN) Corporate Governance Scorecard produced biennially by ADB in collaboration with the ASEAN Capital Markets Forum draws on the G20/OECD Principles of Corporate Governance.

⁴⁷ Development Partners Network on Decentralization and Local Governance (DeLoG). 2013. *Post-2015 Global Development Agenda: Making the Case for Decentralisation and Local Governance: DeLoG Working Paper*. Bonn.

sources of revenue, and public expenditure management in countries like Cambodia, India, Indonesia, Nepal, Pakistan, and the Philippines. As international efforts to localize the SDGs intensify, growing demand from DMCs is anticipated in areas like municipal financing and institutional development for urban governance and management systems.

47. Alongside these core PSM areas, there are other cross-cutting areas and functions of governments and public administrations that are essential to delivering better infrastructure and services and should be given more attention in ADB operations.

48. **Private sector development.** Governments play a central role in improving the investment and business climate for private sector activity. Strengthening the enabling factors for private sector development through upstream work to improve the transparency and predictability of policy, legal, and regulatory regimes can help reduce the costs of doing business, protect businesses, and increase business innovation and productivity. The effectiveness of PSM support through sovereign operations is enhanced by coordination and alignment with financial sector operations and private sector or nonsovereign operations, including efforts to catalyze private sector partners and resources. As ADB aims to systematically expand private sector development and operations to 50% of its annual operations by 2020, coordinating public and private sector lending and support in a sequenced manner could be one of ADB's most effective integrated solutions.

49. **Public-private partnerships.** Where feasible, ADB encourages the use of PPPs in the delivery of infrastructure and services. Given the large infrastructure deficits in Asia and the Pacific, PPPs are increasingly accepted as a financing modality to attract private financing. While PPPs are not a panacea for all situations, when efficiently and transparently procured, the benefits of involving the private sector in the delivery of infrastructure and services include efficient use of the resources, improved asset and service quality, and improved PSM practices, including management of fiscal risks so that PPPs are fiscally affordable and economically sustainable.⁴⁸ However, in many DMCs, the policy, regulatory and institutional arrangements for government PPP programs need to be developed. Support for public officials focuses on helping the public sector adapt to its role in the PPP arrangement, including the provision of transaction advisory services and knowledge work by ADB's Office of Public-Private Partnership.

50. **Information and communication technology.** The spread of ICT has promoted a more connected and interdependent world, and proven to be a powerful tool for improving both the demand and supply sides of public services.⁴⁹ The strategic use of ICT can facilitate fast and efficient delivery of public services, and improve government accountability and openness. Harnessing new technologies requires a reform-oriented mindset, enabling institutional policies, structures and capacities, and business models that introduce appropriate financial and managerial arrangements. PSM is the single largest sector in ADB's ICT for development portfolio.⁵⁰ Depending on the country context, e-governance solutions are pursued to improve government-to-citizen, government-to-business, government-to-government, or government-to-employee services. Success depends on ICT readiness and literacy, a change management process that builds acceptance of ICT innovations, and sufficient attention to institutionalizing ICT projects including the resources required to operate and sustain them.

⁴⁸ ADB. 2012. *Public-Private Partnership Operational Plan 2012–2020*. Manila.

⁴⁹ ADB. 2013. *Empowerment and Public Service Delivery in Developing Asia and the Pacific: Policy Report*. Manila.

⁵⁰ ADB. 2014. *Promoting Information and Communication Technology in ADB Operations*. Manila.

51. **Anticorruption.** As corruption continues to pervade the region, governments need to be at the forefront of anticorruption campaigns to tackle corruption in both the public and private sectors. Corruption undermines economic performance and hurts the poor disproportionately by diverting funds intended for development and weakening a government's ability to provide basic services.⁵¹ ADB has a zero tolerance policy towards corruption in its projects and the conduct of its staff. Anticorruption is mainstreamed in operations through GACAP II, and ADB continues to support anticorruption efforts in DMCs and look for opportunities to coordinate with development partners and empower non-state actors.⁵²

52. There is also a need to align PSM and institutional support to new global development agendas and where the Asia and Pacific region faces continuing uncertainties and challenges. Many countries need to effectively mitigate and adapt to the effects of climate change, with ADB committing to double its climate financing to \$6 billion by 2020 from the current level of \$3 billion. Many countries must address rapid urbanization, develop stronger institutional frameworks and governance structures for the environment, and close large infrastructure gaps. The institutional performance issues and priorities in ADB's main sectors and themes are summarized in appendix 1.

D. What ADB can Offer: Products and Services

53. **Delivering holistic solutions to DMCs.** Helping DMCs effectively respond to public sector and institutional problems requires ADB to calibrate its support according to the results sought. It requires long-term, strategically guided efforts in low capacity and fragile environments, often focusing on core state functions. In some settings, ADB should support broader policy, regulatory, and institutional reforms, where such reforms are often complex, contested, and hard to achieve. In countries and sectors where better governance and capacities are available, ADB may offer to broker regional networks and cooperation between countries, support innovation processes, and make cutting-edge knowledge available. Limited, just-in-time support can assist DMCs reach the next level of institutional performance, in some cases matching recognized best global practices. PSM and institutional solutions should be delivered through a strategic lens that looks beyond individual activities and enables DMCs to exploit ADB's array of products and services.

54. ADB cannot do this alone, however. To tap external specialist expertise and access to knowledge, ADB must embrace partnerships and alliances with other international development agencies, multilateral and bilateral institutions, the private sector, research and academic institutions, and civil society organizations. ADB has made partnerships—both knowledge and financing—a strategic priority (footnote 1). Development agencies with global reach such as the International Monetary Fund, Organisation for Economic Co-operation and Development, and the World Bank bring knowhow, experience, and lessons in PSM and institutional development from outside Asia and the Pacific. Emerging evidence points to gains to ADB from leveraging knowledge and finance, and creating synergies, while avoiding duplication of effort.⁵³

⁵¹ United Nations Office on Drugs and Crime. 2004. *United Nations Convention against Corruption*. Vienna.

⁵² For example: the ADB/OECD Anticorruption Initiative for Asia and the Pacific, which was established in 1999, supports 31 member countries and jurisdictions to fight corruption; <https://www.oecd.org/site/adboecdanti-corruptioninitiative/>.

⁵³ IED. 2016. *Thematic Evaluation Study: Effectiveness of Asian Development Bank Partnerships*. Manila: ADB.

Operational Instruments and Modalities

55. ADB has—and continues to introduce—lending and grant instruments that offer more agility to combine, sequence, and adapt to changing circumstances. Developing capable institutions is typically a long-term, non-linear, and cumulative effort extending beyond individual operations. ADB’s investments aiming for comprehensive reform should be characterized by a strategic and long-term programmatic approach while being flexible and agile in combining, sequencing, and adapting support. Sector road maps keep the strategic perspective and different operations can provide the flexibility to adapt to changing circumstances and lessons learned. ADB’s current inventory of operational instruments and modalities—if used strategically and selectively—can be effective in responding to DMC needs and achieving PSM and institutional development results.

56. **Technical assistance.** Time-tested approaches like TA continue to be an important vehicle for ADB’s PSM and institutional support, increasingly as part of long-term sector engagements. Smartly and strategically applied, TA is an essential supplement to loan and grant operations, enabling a continuous dialogue with and support to DMCs. Since the early 2000s, ADB has experimented with facility-type TA to provide longer term and more flexible engagement in DMCs, with variations in their strategic, thematic, and operational focus. Some provide flexible, quick-response advisory support across multiple sectors whereas others are strategically focused on tackling multiple issues and developing capacities within a single sector. TA is an indispensable instrument for maintaining a strategic perspective, looking beyond the sometimes narrower objectives of individual operations, and identifying future investment opportunities. ADB’s shift to a new and simplified categorization of TA in 2016 helpfully distinguishes transaction TA, which directly benefits ADB project preparation and execution, from knowledge and support TA that has broader institutional development objectives.

57. **Policy-based operations.** PSM accounts for the majority of policy-based loans, which are in the form of budget support and linked to the implementation of DMC policy and reform actions. Policy-based operations are delivered as stand-alone support or through a programmatic approach that offers the opportunity for continual dialogue with government and other stakeholders over the medium-term. A marked improvement in the performance of policy-based operations since the 1980s and 1990s occurred as better practices were introduced such as improved sector analyses to understand reform contexts and enhanced policy dialogue and country ownership.⁵⁴ Understanding the implications of political economy factors in policy reforms has also been shown to improve operational performance.⁵⁵ With policy-based lending comprising about 15% of total ADB lending (footnote 17), and within the 20% policy ceiling, there is an opportunity to grow policy-based operations supporting well-defined policy changes that improve development outcomes.⁵⁶ Policy-based lending can be attractive to middle-income country governments with improving institutional performance as they undertake structural or organizational reforms. IED’s planned evaluation of policy-based lending in 2017 should provide further evidence on the performance of this modality and opportunities for its expanded use.

⁵⁴ ADB. 2011. *Policy Paper. Review of ADB’s Policy-Based Lending*. Manila; IED. 2007. *Evaluation Study. Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries*. Manila: ADB.

⁵⁵ ADB. 2013. *Managing Reforms for Development: Political Economy of Reforms and Policy-Based Lending Case Studies*. Manila.

⁵⁶ ADB’s 20% policy-based ceiling refers to the combined annual stand-alone policy-based loans, subprogram loans under the programmatic approach, the policy-based component of sector development programs, and policy-based guarantees not exceeding 20% of total public sector lending on a 3-year moving average. There are no individual country ceilings for policy-based lending.

The use of such a modality, and results-based lending described below, also promotes greater use of country systems in ADB operations.

58. **Results-based lending.** ADB introduced the results-based lending instrument in 2013 on a pilot basis covering 2013–2019.⁵⁷ Results-based lending supports government investment programs and ties disbursements to program results, and emphasizes support for developing country institutions and systems. Operations place a premium on recipients to credibly demonstrate progress toward development results, which reinforces broader results-based management practices.⁵⁸ Initially, social sector operations were seen as the best fit for results-based lending, but other sectors, in particular energy, transport, and urban development, are now processing results-based programs.⁵⁹ Results-based lending is potentially a powerful new approach for ADB to help DMCs improve institutional performance in priority sectors.

59. **Multitranches financing facilities.** Since 2005, ADB has used multitranches financing facilities as a programmatic and flexible instrument to finance sector development extending for a period up to 10 years. Multiple investments are structured and staggered under the umbrella of a single commitment, with the provision of financing aligned to project readiness and the long-term needs of clients. Although ADB's use of multitranches financing facilities has reduced in recent years, the instrument offers the advantage of long-term dialogue with DMCs that links physical investments with opportunities for "soft" investments addressing institutional performance issues.⁶⁰

60. Other instruments include **investment projects**, which remain ADB's most used lending modality, and offer opportunities for addressing institutional issues, especially at the project-level and related to managing infrastructure assets. The **countercyclical support facility** was established in the wake of the 2007-2009 global financial crisis to provide balance-of-payments assistance to governments in times of economic and financial crises. With the recent cyclical downturn generating vulnerabilities in many DMCs through external and fiscal pressures and increasing levels of debt, countercyclical support will continue to be an important instrument. ADB also provides **financial intermediation loans** to further policy reforms in the financial and real sectors, support small and medium businesses and borrowers, and strengthen the governance, capacity, and sustainability of the participating financial intermediaries.

Institutional Support and Services

61. The challenge for ADB is to deliver institutional support and services that are carefully tailored to the country situation and readiness for change of DMC stakeholders, aim to add specific value to clients, and catalyze change and learning. With institutional performance as the goal, it counteracts the tendency to focus prematurely on inputs and processes or ad hoc support that is not effectively aligned to operational results. However, institutional strengthening is also as much about knowing how to support change and having appropriate tools available, as it is having a performance goal in sight. ADB is able to draw on a mix of institutional support and services in engaging with DMCs.

62. **Knowledge sharing.** ADB has elevated the importance of knowledge management and knowledge sharing in operations, including introducing the requirement for country knowledge

⁵⁷ ADB. 2013. *Policy Paper: Piloting Results-Based Lending for Programs*. Manila.

⁵⁸ For example: Asia Pacific Community of Practice for Managing for Development Results. 2011. *Framework for Results-Based Public Sector Management and Country Cases*. Manila.

⁵⁹ ADB. 2016. *Scoping Paper: Results-based Lending Midterm Review*. Manila.

⁶⁰ ADB. 2016. *Multitranches Financing Facility Annual Report 2015*. Manila.

plans as part of CPSs. This forms part of the “finance++” ambition of ADB to add value to its clients beyond financing of infrastructure and other investments.⁶¹ Enabling knowledge acquisition by DMCs is a vital component of enhancing institutional performance, especially as opportunities for knowledge transfer grow through regional cooperation. ADB’s knowledge services draw on its own knowledge delivered through knowledge products, technical advisory services, and structured training programs offered by ADB as well as the ADB Institute.⁶² ADB can also connect DMC stakeholders to global knowledge and learning centers and facilitate South-South cooperation and twinning arrangements such as the promotion of utility twinning in the water sector. Developing DMCs’ capacity for generating own knowledge solutions relevant to the development challenges facing DMCs should increasingly form part of ADB’s offerings. New guidelines on applying solutions through strategic knowledge partnerships are currently being developed by ADB to provide new and more flexible modes for collaborating with knowledge partners on a non-commercial basis.

63. Technical advisory support. ADB continues to offer more traditional or core technical advisory services such as policy and regulatory development, strategic planning, business process reengineering, management development, skills and competency development, and introduction of results-based management practices. Enhancing individual skills and competencies, which continues to be in demand by DMCs, is an essential building block of better organizational performance. Support should aim for synergy between the needs of clients, the technical “know how” to be offered, and the specific results to be achieved. Services are provided through international and national consultants with specialist sector and technical expertise, including through project implementation units financed by ADB operations when such units are needed. While dialogue with DMCs is a role that ADB staff should lead, the use of consultants and other external sources of expertise will continue to be required. Increasingly, ADB needs to expand its sources of expertise to attract high caliber individuals and organizations, including universities, training institutes, and think-tanks. Domestic service providers located in DMCs are also on the rise as local capacity is developed.

64. Innovative solutions. ADB has emerging experiences with leveraging new technologies and e-governance to achieve operational results. ADB is increasingly looking to assist DMCs in scouting for, testing or developing new ideas and innovations that can help meet institutional performance challenges. Applying innovations in public management or in interactions between public and non-public actors—such as how more open data is used to shape policies and organizational practices—is vital to public service delivery and regulatory endeavors. ADB should continue to support competitive crowd sourcing of innovative ideas and “innovation market places” to advance the application of innovative solutions. ADB should also target the underlying management and ICT capabilities that organizations need to perform more innovatively, such as improving flows of information, data, and knowledge; tackling rules, processes and procedures that hinder innovation; and empowering workforces.

65. Collaborative partnerships and networks. ADB no longer works primarily with DMC governments alone. ADB also plays a catalyzing and brokering role to forge collaborative partnerships between governments, the private sector, civil society organizations, and other development actors to bring together the supply and demand sides of reform and institutional

⁶¹ ADB. 2013. *Knowledge Management Directions and Action Plan (2013–2015): Supporting “Finance++” at the Asian Development Bank*. Manila; ADB’s “finance ++” approach refers to the combination of ADB’s own finance *plus* leveraging resources through partnership *plus* providing knowledge to DMCs to maximize and accelerate development effectiveness.

⁶² Training programs by the ADB Institute target mid- and senior-level officials from DMCs and delivered in the form of policy dialogues, course-based training, and e-learning; <http://www.adb.org/adbi/capacity-building-training>.

change. ADB's multi-disciplinary capabilities and experience across sectors, its presence across Asia and the Pacific, and its convening power can assist DMCs to mobilize institutions for collective action, such as PPPs for the provision of infrastructure and services. Successfully overcoming entrenched development problems, including political economy challenges, requires outreach capabilities, collaboration based on common interests, and active participation in multi-stakeholder networks that can bring about reform and change. For example, ADB's engagement with the Open Government Partnership—an international platform for countries committed to making their governments more open, accountable, and responsive to their citizens—provides a means for ADB to support constructive engagement between governments and civil society organizations in DMCs.⁶³

66. **Institutional assessments.** Diagnostics explore how to address specific institutional problems and should be prepared with the close involvement of DMC stakeholders. ADB uses a variety of diagnostic tools in operations to assess institutional performance:

- (i) *Sector assessments* are prepared for operations and provide the strategic reference for institutional performance issues in a particular sector as well as inform individual, sequences or packages of support.
- (ii) *Program impact assessments*, which are prepared for policy-based operations, estimate the benefits and costs of policies and reforms and provide a stronger evidence-base for government programs and actions.
- (iii) *Governance risk assessments* determine the risks to development effectiveness and results at country, sector, and project levels, and focus on the performance of public financial management, procurement, and anticorruption systems.
- (iv) *Procurement risk assessments* look specifically at the performance of country procurement systems within ADB's overall governance risk management framework.

67. Institutional capacity diagnostics at the project- or agency-level, while not a standard feature of ADB operations, may be helpful to shape specific organizational development processes. A variety of other diagnostic tools are available such as political economy analysis.⁶⁴ ADB needs to draw on and adapt good international practice as it continues to refine and improve the quality and relevance of its assessment tools, and make these tools available to DMC officials to use in their own processes.

IV. IMPLEMENTING THE APPROACH

A. Mainstreaming, Selectivity, and Quality in Operations

68. **Successful implementation of an integrated approach rests on the extent to which institutional support is effectively mainstreamed in operations.** Experience shows that addressing DMCs' institutional performance—from policy and regulatory frameworks to capabilities for managing investment projects—are less effective if dealt with ad hoc rather than mainstreamed in CPSs and operations. This is true no matter if institutional performance issues are at the core of ADB's engagement or of less salience. Within this mainstreaming approach,

⁶³ ADB became a multilateral partner to the Open Government Partnership in 2014 and supports DMCs that are existing members of the initiative or aspiring to join.

⁶⁴ ADB. 2013. *Guidance Note: Use of Political Economy Analysis for ADB Operations*. Manila.

ADB needs to be selective in its support, recognizing that the nature of and context of reform and change can in some situations limit what external actors can do. This means ADB making clear choices about the objectives and scope of institutional support so that operations can be more systematic about choosing when to aim for comprehensive institutional strengthening, and when to opt for less.

69. The nature of institutional work means ADB operations incurring transaction processing costs. This needs to be weighed against ADB's stated aim of becoming "stronger, better and faster" as it scales up operations—stronger lending capacity, better provision of knowledge and expertise, and faster at delivering projects without compromising on quality.⁶⁵ While more attention to institutional performance issues contributes to making ADB better and faster—especially in the long-term as institutional constraints to project design and delivery are corrected—not all operations need the same level of attention. The focus on operational selectivity is therefore important so that none of the attributes of "better" or "faster" suffer.

70. **Quality dimensions for ADB's institutional support—the "4Ds".** To achieve a sufficient level of operational quality requires making diagnosis, dialogue, design, and delivery—the 4Ds of quality institutional support—explicit on the subject of institutional performance. The aim is to make operational choices about levels and intensity of support to institutional performance explicit and consequential, with demands on rigor under the 4Ds tailored to the level of ambition of the support. ADB operations with comprehensive institutional support should have to meet higher quality standards. For less comprehensive objectives, the requirements should be less demanding. Not all operations need to have explicit institutional performance objectives, either because they are not needed, or because other development partners are already responding to DMCs' needs.

71. Four quality dimensions should guide ADB's institutional support.

- (i) **Diagnosis.** Addressing institutional problems starts with good diagnostics. It is at the sector-level—above the level of individual operations—where institutional performance issues, including the risks to development effectiveness and results, need to be given sufficient attention. Sector assessments and road maps pointing to more comprehensive investment in institutional strengthening provide the strategic reference for subsequent operations. They also point to the need for further diagnostics at the project- or agency-level to help shape specific organizational development processes in addition to mandatory due diligence requirement such as economic analysis, financial management assessment, and procurement risk assessment.
- (ii) **Dialogue.** Continuous dialogue with DMC stakeholders is critical to successful operations, especially interventions in complex settings. It confirms the political, managerial and technical ownership and readiness to reforms and change. Opportunities for dialogue on institutional performance occur during regular country portfolio and operation fact-finding and review missions. Dialogue is not only with the government, but needs to be multi-stakeholder, including with the private sector, civil society organizations, and other development partners, as relevant.
- (iii) **Design.** Attention to country context, DMC development priorities and plans, and performance issues need to be reflected in the design of institutional strengthening

⁶⁵ ADB President's opening address to the 48th Annual Meeting of the ADB Board of Governors, 4 May 2015.

activities, including in the specification of institutional performance results. Good designs explain how addressing institutional problems links to broader development and sector results and have performance indicators that measure enhanced institutional performance. They tailor support and services to DMC needs and appropriately consider the governance risks to development effectiveness and results, be they risks to infrastructure investments or policies and reforms.

- (iv) **Delivery.** Some flexibility to adapt to changing circumstances and lessons learned is needed to successfully deliver institutional support while keeping the operational focus at the level of institutional performance. Close monitoring and supervision of operations is needed to gauge implementation progress as well as identify risks and opportunities. The achievement of institutional performance results needs to be explicit in operational completion reporting, and lessons learned documented.

B. Enhancing Business Processes and Systems

72. Enhancements to ADB's internal business processes and systems are required at various stages of the project cycle to implement an integrated approach (Figure 6). The focus is on a limited yet strategic number of actions to adjust processes and systems, and complement broader corporate reforms underway as part of the Strategy 2020 Midterm Review.⁶⁶ The primary aim is to ensure a sufficient level of operational quality in attention to institutional performance issues.

- (i) **Updated project classification.** A change is required to how institutional support in operations is recognized and classified. The current GCD classification is not linked to quality criteria or subsequent monitoring of results. To systematically determine the success of operations delivering intended institutional performance results, the project classification system should be updated according to the scope of the objectives of the institutional support, proposed as: (i) sector-wide or cross-sector institutional performance in DMCs; (ii) institutional sustainability of ADB-funded investment projects; (iii) DMC agency performance in implementing ADB operations; (iv) or no explicit institutional performance objectives. A review of the GCD classification should be conducted and operational guidance issued on the updated project classification, including differentiated quality requirements for operations.
- (ii) **Operational diagnostics.** With sector assessments required for operations, ADB-wide operational guidance should be developed for preparing sector assessments and road maps that appropriately consider institutional performance issues, including undertaking institutional analysis. The Southeast Asia Department has prepared its own guidance, which provides a sound basis for strengthening the diagnostic tools available across ADB.⁶⁷ Following updated staff guidance on assessing governance and procurement risks, there should also be increased

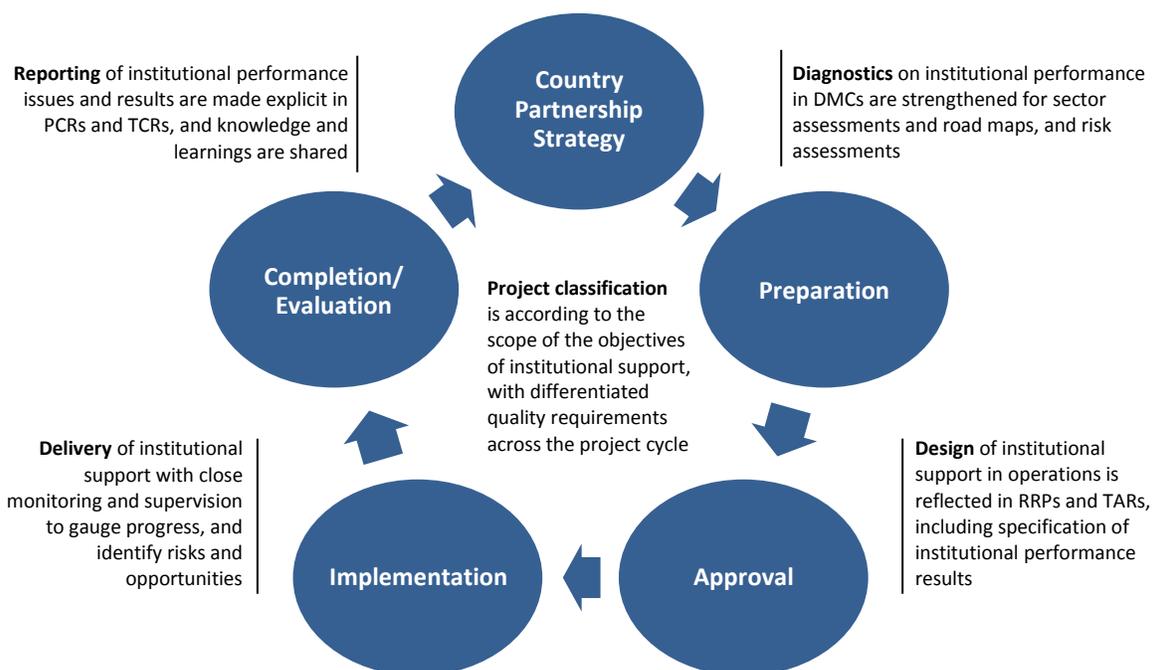
⁶⁶ Complementary actions in the Strategy 2020 Midterm Review Action Plan include (i) improving implementation of GACAP II; (ii) inclusion of knowledge management plans in CPSs; (iii) expanding civil society engagement in operations and policy dialogue; (iv) facilitating strategic knowledge partnerships with external institutions; (v) developing modalities for innovation and new technologies; (vi) establishing full-time secretariats for ADB's communities of practice, including for governance; and (vii) strengthening of resident missions.

⁶⁷ ADB. 2011. *A Framework for Preparing Sector Assessment, Strategy and Roadmaps in Southeast Asia Regional Department*. Manila.

attention on improving the quality and application of governance risk assessment and procurement risk assessment.⁶⁸

- (iii) **Operational reporting of results.** Design, implementation and reporting processes need to reflect the quality standards set for certain categories of institutional support according to the updated project classification. Existing operational documents—Report and Recommendation of the President, TA Report, Project Administration Manual, Project Completion Report and TA Completion Report—can be used to capture the necessary institutional performance information, but with greater attention to meeting specified quality requirements.

Figure 6: Business Process Changes in ADB’s Project Cycle



ADB = Asian Development Bank, PCR = Project Completion Report, RRP = Report and Recommendation of the President, TAR = Technical Assistance Report, TCR = Technical Assistance Completion Report.
 Source: ADB Governance Thematic Group.

C. Generating Operationally-relevant Knowledge and Learning

73. Addressing complex and often contested policy and institutional issues is at the heart of PSM operations and offer important lessons, which—if fed back to future country programming and operations—will support ADB’s reputation as a trusted partner to DMCs. ADB has successful in-house experiences combining good diagnostics and close collaboration with DMC stakeholders and development partners; with adept and integrated use of operational modalities and institutional support and services. ADB must learn from and scale up the emerging good practices, while at the same time learning from and sharing innovative practices in DMCs, and

⁶⁸ ADB. 2014. *Revised Staff Guidance for Implementing the Second Governance and Anticorruption Action Plan (GACAP II): Assessing and Managing Governance Risks in ADB Operations*. Manila; ADB. 2014. *Guide on Assessing Procurement Risks and Determining Project Procurement Classification*. Manila.

globally. The aim is to strengthen ADB's tacit knowledge about what works and why in the area of institutional development to guide operational planning, performance, and results.

74. Knowledge sharing and learning actions should include:

- (i) **Practical and responsive “how to” guidance.** Building on ADB's longstanding Governance Brief series, short, practical guides on specific aspects of PSM and institutional performance can be helpful to ADB staff and DMC stakeholders looking for tailored advice. Aligned to operational priorities, topics can be related to institutional issues in particular sectors and themes or address operational requirements and processes such as institutional analysis, change readiness and change management, results frameworks and indicators, and the benefits and risks of using country systems.
- (ii) **Learning from good practices.** ADB's good practices and experiences sometimes remain hidden in operations. A greater effort is needed to condense and showcase these in manners appropriate to the dominant learning styles of ADB staff and DMC stakeholders. ADB's existing Knowledge Showcases series provides an effective platform for operational case briefs on institutional performance that demonstrate results at project-, sector-, or cross-sector-levels. Operations should be selected according to their institutional complexity, innovation, and learning potential.

D. Strengthening ADB's Capacity

75. In 2015, ADB significantly strengthened its ability to respond to the needs of its DMC by planning to scale up its lending operations by up to 50% over time.⁶⁹ There is also a projected 45% increase in TA resources available to operations over the medium term, from 2015 levels (footnote 17). The planned scale up in resources offers enormous opportunities for PSM operations and institutional development work. Refocusing ADB's approach not only strengthens the rationale for scaling up PSM support, including policy-based operations, but by engaging on institutional issues also helps to deliver operational results in other sectors without compromising on quality.

76. **A coordinated “One ADB” effort.** ADB's main role in PSM and institutional performance in DMCs is an advisory role and must be obtained through trust, responsiveness, and quality. Collaboration across departments and offices is required. Operational departments have primary responsibility for the effective mainstreaming of institutional support in country programming and operations. Resident missions take on a crucial role. If ADB is to be the preferred advisor to DMCs, a physical presence in the country is optimal so that ADB is sensitive to the drivers of reform and change, and responsive to DMC needs.

77. In 2015, GovTG was established as an internal network for knowledge sharing and cross-departmental coordination on PSM and governance issues. Through its interdepartmental Committee and full-time Secretariat located in the Sustainable Development and Climate Change Department, GovTG is able to provide strategic direction and knowledge and learning support to operational departments.⁷⁰ Membership of GovTG has reached some 300 staff from

⁶⁹ ADB. 2015. *Enhancing ADB's Financial Capacity for Reducing Poverty in Asia and the Pacific*. Manila.

⁷⁰ The GovTG Committee is chaired by the Sustainable Development and Climate Change Department, and comprises staff from the six operational departments, Economic Research and Regional Cooperation Department,

various departments, offices and resident missions. Drawing on this network can help raise ADB's in-house expertise, together with staff skills development and greater mobility of staff between departments to meet operational needs. Where feasible, GovTG should look at being a source for networks of DMC authorities to interact on PSM and institutional issues. Since 2016, GovTG has implemented a \$1.5 million regional TA to enhance the mainstreaming of governance and capacity development in operations and augment operational department resources.⁷¹ The TA includes the provision of funding for national governance experts placed in resident missions. GovTG is also well placed to forge partnerships and collaboration with other internal sector and thematic groups as well as external partners.

78. Other support departments and offices should share responsibility for implementation, where relevant. The Operations Services and Financial Management Department provides technical advice and guidance to regional departments on project financial management and performance, and procurement risk assessment at country, sector, and project levels. The Office of Anticorruption and Integrity provides advice and guidance on anticorruption, integrity due diligence, anti-money laundering, and counter terrorism of financing issues, assesses project-level integrity and corruption risks, and monitors the implementation of risk mitigating measures in projects.

79. **Skills development.** ADB will need to raise its capacity to provide specialized support to DMCs. The mainstreaming of public sector and institutional performance requires multidisciplinary teams in operations because of the breadth of factors influencing institutions and institutionalized behavior. The variety of professional disciplines of ADB staff, combined with appropriate training, would constitute a solid resource base for providing qualified support. ADB's cadre of sector specialists—not only public management specialists—are indispensable in advancing multidisciplinary approaches. They should increasingly be seen as, and supported to be institutional development specialists as well as sector specialists. In collaboration with the ADB Institute, a structured program of training and learning on governance and institutions is to be run by GovTG as an annual offer to ADB staff and DMC stakeholders. Such programs, if targeted and implemented well, can be effective in facilitating skills development and cross-sector peer learning and exchange.

80. **Resource requirements.** While enhancements to internal business processes and systems should not significantly impact operational transaction costs for ADB overall, resources will be required to catalyze change in how ADB works with institutional performance issues, especially when ADB operations aim for more comprehensive institutional strengthening and the demands on monitoring and supervision of activities are higher. Moreover, with DMCs continuing to demand PSM and institutional support, there are limits to how much PSM and institutional work can be scaled up without additional ADB staff with specialized expertise.

81. There are opportunities to attract additional financing. Specialized trust funds provide ADB with additional means to address institutional and governance issues in sector operations, including in areas where institutional strengthening is not yet familiar ground to ADB. Specialized funds complement broader ADB operations and some have been established with

Office of Anticorruption and Integrity, Office of the General Counsel, and Operations Services and Financial Management Department.

⁷¹ ADB. 2015. *Technical Assistance Report: Enhancing Governance and Capacity Development as Driver of Change in ADB Operations*. Manila.

an explicit aim of enhancing institutional performance in the relevant sector.⁷² It will be important that ADB maximizes the potential for institutional support through trust funds.

82. The conclusion of the multi-donor Governance Cooperation Fund (GCF) in 2015 opens the prospect of refocusing any replacement fund on institutional performance issues in DMCs.⁷³ The GCF was considered a successful and relevant mechanism.⁷⁴ It contributed to delivering GACAP II and addressing priority governance issues in DMCs. The GCF also allowed for flexibility and adaption to context, and experimentation and innovation to address some of the more challenging aspects of governance. The creation of a similar fund in the future should allow ADB to intensify knowledge sharing and learning with DMCs and development partners, and offer specialized support to DMCs to address complex institutional challenges, as well as apply innovative approaches and means to solving them.

E. Measuring Implementation Progress

83. Table 1 presents an indicative results framework for an integrated approach to PSM and institutional performance extending to 2020. It aims to systematically capture, measure, and monitor relevant results aligned to the four levels of ADB's overall corporate results framework. This indicative framework would need to be updated, as necessary, to align with ADB's next long-term strategy for engaging with DMCs until 2030.

84. At the level of institutional performance progress in Asia and the Pacific, performance improvement is gauged through the PSM and institutions (governance) rating measured by ADB's Country Performance Assessment (footnote 6). The ratings cover 29 DMCs with access to the Asian Development Fund, or 73% of countries with ADB operations, and are countries that exhibit generally weaker institutional performance.⁷⁵

85. At the level of ADB's contribution to institutional performance results, the success of completed PSM operations and TA operations—recognizing the value of the TA instrument to institutional development—are most relevant. The updated project classification, when introduced, will allow ADB to systematically capture and report on completed operations delivering intended institutional performance results. The baseline and target for this new performance indicator will need to be established in accordance with the updated project classification and the associated differentiated quality requirements for ADB operations.

At the level of ADB's operational management of PSM and institutional support, ADB's performance can be measured through the implementation performance of ongoing PSM operations, the proportion of operations mainstreaming institutional development—becoming less significant when the new level two performance indicator is introduced—and operations using country systems. The baseline and target for operations mainstreaming institutional development may need to be updated according to the updated project classification.

The GovTG should report on implementation progress against the performance indicators in the indicative results framework as part of its regular reporting to the Management.

⁷² Examples of trust funds with a strong institutional focus are the Urban Climate Change Resilience Trust Fund and Regional Malaria and Other Communicable Disease Threats Trust Fund.

⁷³ The GCF was established in 2001 as a multi-donor trust fund with \$7.3 million financing from the governments of Canada, Denmark, Ireland, and Norway to support implementation of GACAP II.

⁷⁴ ADB. 2016. *Technical Assistance Consultant's Report: Review of Support for Implementation of the Second Governance and Anticorruption Action Plan (Financed by the Governance Cooperation Fund)*. Manila.

⁷⁵ ADB. 2016. *Annual Report on the 2015 Country Performance Assessment Exercise*. Manila.

Table 1: Indicative Results Framework

Indicators	Baseline (Year/Period)	Target (Year/Period)
Level 1: Institutional Performance Progress in Asia and the Pacific		
PSM and institutions (governance) rating (index) ^a	3.6 (2015)	Above baseline (2020)
Level 2: ADB Contribution to Institutional Performance Results		
Completed PSM sovereign operations rated <i>successful</i> (%)	77% (2013–2015)	80% (2020)
Completed TA operations rated <i>successful</i> (%)	87% (2013–2015)	85% (2020)
Completed sovereign operations delivering intended institutional performance results (%)	Not available ^b	Not available ^b (2020)
Level 3: ADB Operational Management of PSM and Institutional Support		
Performance of PSM sovereign operations at implementation (ongoing) rated <i>satisfactory</i> (%)	84% (2015)	85% (2020)
Operations supporting institutional development (governance/capacity development) (%)	65% (2013–2015)	Above baseline (2020)
Sovereign operations using country systems (%) ^c	60% (2015)	Above baseline (2020)
Level 4: ADB Organizational Management of PSM and Institutional Support		
Business Processes and Practices		
<ul style="list-style-type: none"> Review of the project classification system for governance and capacity development is conducted and an updated classification system is developed according to the scope of the objectives of institutional support, including operational guidance detailing differentiated quality requirements across the project cycle (2017/2018). Operational guidance for preparing sector assessments and road maps that appropriately analyze institutional performance issues will be developed (2017/2018). Application of staff guidance on assessing governance and procurement risks is supported to improve the quality of governance and procurement risk assessments (2016–2020). 		
Knowledge, Learning, and Skills Development		
<ul style="list-style-type: none"> “How-to” guidance notes are prepared on specific aspects of strengthening institutional performance (2016–2020). Operational case briefs on institutional performance enhancements are prepared to demonstrate results at the project, sector, and cross-sector levels (2016–2020). A structured program of training and learning on leadership, governance, and institutions is developed and delivered annually (2016–2020). 		
Resources		
<ul style="list-style-type: none"> GovTG Secretariat is fully resourced and provides effective support to ADB operations in implementing the approach to PSM and institutional performance (2016–2020). \$1.5 million regional TA to enhance mainstreaming of governance and capacity development in operations is implemented by the GovTG (2016–2018). 		

Indicators	Baseline (Year/Period)	Target (Year/Period)
<ul style="list-style-type: none"> Governance Cooperation Fund is reviewed and recommendations for a new dedicated institutional development trust fund is presented to the Management (2016/2017). 		

ADB = Asian Development Bank, GovTG = Governance Thematic Group, PSM = public sector management, TA = Technical Assistance

Notes:

^a Aggregate regional rating under ADB's Country Performance Assessment based on unweighted average of individual country scores from 1 (low) to 6 (high).

^b Baseline and target for this indicator will need to be established in accordance with the revised project classification for governance and capacity development.

^c Country systems monitored are public financial management and procurement systems.

Sources: Independent Evaluation Department. 2016. *2016 Annual Evaluation Review*. Manila: ADB; ADB. 2016. *Development Effectiveness Review 2015 Report*. Manila.

Appendix 1: Institutional Performance in Priority Sectors and Themes

Sector/Theme	Issues and Priorities
Agriculture and Food Security	<p>The Asian Development Bank’s (ADB) operational plan for sustainable food security emphasizes the multi-sector nature of food security and agricultural development, including in infrastructure (e.g., transport, energy, and irrigation), finance sector development (e.g., small and medium-sized enterprise development and microcredit), and regional cooperation and integration such as trade facilitation. Institutional capacity issues in developing member countries (DMCs) and insufficient attention to institutional diagnostics and support has hampered ADB’s efforts in the sector. Support is needed to foster resilience, connectivity, and increased productivity. There is also a focus on building collaborative partnerships and boosting research and knowledge work.</p> <p><i>Source: ADB. 2009. Operational Plan for Sustainable Food Security in Asia and the Pacific. Manila.</i></p>
Disaster Risk Management	<p>ADB’s integrated disaster risk management (DRM) approach is cross-sectoral with a strong focus on institutional capacity and performance. It seeks to integrate disaster risk reduction in development, address the intersection between DRM and climate change adaptation, and ensure adequate financing arrangements to manage and reduce risks. Integrated DRM addresses these areas through common, crosscutting actions to institutionalize DRM, strengthen capacity and knowledge, invest in disaster resilience, and promote stakeholder engagement and coordination through a wide range of DRM partnerships including private sector involvement. To mainstream DRM in DMC development plans and ADB operations, support is targeted at regulatory and legislative frameworks and budgetary processes, developing DRM-related public goods and services, and efforts to mobilize additional public and private resources for DRM.</p> <p><i>Source: ADB. 2014. Operational Plan for Integrated Disaster Risk Management 2014–2020. Manila.</i></p>
Education	<p>In education, ADB is stepping up its engagement with a focus on quality, inclusiveness, and relevant skills at all educational levels in DMCs. ADB continues to emphasize policy reforms and institutional development as key vehicles to foster integration, inclusiveness, and innovation in the education sector. ADB is helping DMCs move beyond a focus on enrollment to quality learning outcomes and the interconnectedness between the various levels and types of education, as well as the links to an increasingly sophisticated labor market. ADB promotes new and innovative models of service delivery and financing, among others through public-private partnerships and partnerships at community level. Regional cooperation and cross-border cooperation plays a significant role both to increase labor mobility and to foster knowledge sharing in the region. ADB itself aims to strengthen its partnerships with public and private institutions in the region.</p> <p><i>Source: ADB. 2010. Education by 2020. A Sector Operations Plan. Manila.</i></p>

Sector/Theme	Issues and Priorities
Energy	<p>ADB's energy operations build on about 50 years' efforts in energy expansion—electricity in particular—and sector reforms. Institutional development, governance, and efficiency improvements aim to help DMCs restructure and reform their energy sectors through establishment of effective price regulation, unbundling integrated utilities, and introducing competition where feasible. Reforms can take a long time and ADB's continued association helps to ensure that all stakeholders—especially consumers—benefit. Sector reforms, including private sector participation and corporatization, are designed and sequenced carefully on a country-by-country basis in a transparent manner. ADB also promotes knowledge production and sharing in energy through regional knowledge hubs that can generate innovative concepts and promote science, technology, and management development related to clean energy.</p> <p><i>Source: ADB. 2009. Energy Policy. Manila.</i></p>
Environment	<p>With environmentally sustainability growth a strategic agenda under Strategy 2020, environmental issues are increasingly integrated across ADB operations. To promote the transition to green growth and address the causes and consequences of climate change, ADB stresses the need to strengthen environmental governance and management capacity. Many DMCs have established policy, legal, and institutional frameworks to promote sustainable development. However, where policy frameworks are sound, actual implementation does not always materialize due to limited institutional capacity, lack of technical expertise, insufficient funding, and fragmented institutional arrangements. Knowledge and capacity development is focused on the rules and regulations and organizational arrangements for compliance and enforcement, and strengthening of country systems and capacities for environmental safeguards.</p> <p><i>Source: ADB. 2013. Environment Operational Directions 2013–2020: Promoting Transitions to Green Growth in Asia and the Pacific. Manila.</i></p>
Finance	<p>In the finance sector, ADB focuses on strengthening the basic monetary and financial infrastructure in DMCs, promoting inclusive finance for inclusive growth, deepening capital markets for infrastructure promotion, and strengthening the stability and integrity of the sector. Operations and policy advice are combined to support interrelated financial sector development issues and reforms. As an analytical underpinning, ADB carries out periodic, comprehensive reviews of the financial sector, primarily as part of country partnership strategies. ADB seeks to strengthen knowledge work and partnerships with international organizations and financial standard-setters to promote best practices, while facilitating knowledge transfer among DMCs. There is also a need to be responsive to DMCs' calls for urgent advice owing to rapid developments and risky situations such as capital flows, asset bubbles, inflationary pressures, and exchange rate volatility.</p> <p><i>Source: ADB. 2011. Financial Sector Operational Plan. Manila.</i></p>
Gender	<p>ADB has invested heavily and successfully to mainstream gender in operations, thereby contributing to narrowing the gender gap in education, empowering women economically, increasing their voice and ensuring attention to investments of particular salience to women like water and sanitation. Previous experiences,</p>

Sector/Theme	Issues and Priorities
	<p>tested approaches, and lessons from gender mainstreaming are consolidated, replicated and expanded across sector operations. The gender capacity of DMC partners responsible for project implementation is also a focus, making important contributions to DMC ministries' knowledge of and capacity for gender mainstreaming. While gender mainstreaming remains the primary approach, on its own it may not be sufficient to narrow persistent gender gaps and inequalities. Targeted public policies and investments in women and girls are required to accelerate better gender equality outcomes, including policy and legal reforms to tackle issues of gender-based violence, anti-trafficking, and giving women voice in decision making in formal and informal institutions. Special attention is given to enhancing the quality and relevance of gender research and knowledge products, and expanding global and regional partnerships for knowledge exchange.</p> <p><i>Source: ADB. 2013. Gender Equality and Women's Empowerment Operational Plan, 2013–2020: Moving the Agenda Forward in Asia and the Pacific. Manila.</i></p>
Health	<p>Achieving better health outcomes requires investments in infrastructure, technology, medical goods, human resources, capacity development, and health systems reforms. As countries prosper, expectations of better health service infrastructure and healthier living conditions rise. Regionwide, countries have made efforts toward achieving universal health coverage, but the resources available remain low, particularly in Asia and the Pacific. ADB is increasing its investments in health services in DMCs, including in health infrastructure, to increase the supply of services, and health financing to create demand for services. Achieving universal health coverage also means efficient management of health systems aimed at maximizing better-quality outcomes from limited resources. Health governance is a particular focus, including strengthening planning, financial management, health information, and health regulatory systems, backed by information and communications technology (ICT) solutions to ensure quality, efficiency, effectiveness, transparency, and accountability.</p> <p><i>Source: ADB. 2015. Health in Asia and the Pacific: A Focused Approach to Address the Health Needs of ADB Development Member Countries: Operational Plan for Health, 2015–2020. Manila.</i></p>
Social Protection	<p>Social protection systems in DMCs remain underdeveloped. They are often fragmented and poorly coordinated among several government agencies that lack capacity to implement social protection programs. ADB is helping governments develop social protection strategies and integrate them into national development plans, and develop capacity to improve and expand social protection programs, collect data, and report on the use of social assistance and insurance schemes. ADB promotes awareness of social protection in DMCs by engaging in policy dialogue, analyzing social protection systems, and supporting knowledge products, sharing and South-South exchanges. As well as continued development of ADB-financed social protection projects, ADB is actively identifying opportunities to integrate social protection into projects, particularly in the education, finance, health, and public management sectors.</p> <p><i>Source: ADB. 2013. Social Protection Operational Plan 2014–2020. Manila</i></p>

Sector/Theme	Issues and Priorities
Transport	<p>The overarching theme of ADB's transport operations is to assist DMCs to develop transport that is more sustainable—economically, socially, and environmentally. Sustainable systems need to be accessible, safe, affordable, and environment-friendly. They require institutions that can collaborate and regulate between a broad range of stakeholders such as economic policy makers, transport and environmental authorities, and private constructors and operators. ADB's support is increasingly differentiated to country contexts. Small, low-income countries continue to depend on ADB to finance much of their transport investment requirements. However, for the region as a whole, financing from ADB will only cover a small portion of total investment needs. For this reason, ADB is adding value to its investments through enhanced knowledge support to DMCs on strategic issues and in specialized fields of transport. Institutional development is particularly important for urban public transport, strengthening the performance of railways, road sector management and financing, and road safety.</p> <p><i>Source: ADB. 2010. Sustainable Transport Initiative Operational Plan. Manila.</i></p>
Urban	<p>ADB's urban sector operations emphasize a systems-oriented and integrated approach to address the challenges of rapidly urbanizing Asia, recognizing the demands on governments to address complex problems that have political, institutional, planning and regulatory dimensions. There is an emphasis on integrated planning, approaching urban as a system rather than provision of individual specific interventions on an ad hoc basis. The complexity of urban governance structures requires capacity development initiatives look holistically at the public sector management cycle, focus on the interdependency of the components needed to be strengthened, and the challenges of integration between national and sector agencies and national and subnational governments. Improved urban management is supported through operations and complemented by knowledge and innovation solutions, and peer-to-peer learning and sharing good practices among cities.</p> <p><i>Source: ADB. 2012. Urban Operational Plan. Manila.</i></p>
Water	<p>The entire business of water management requires a collaborative approach between the public and private sectors, within the different levels of government from central to local levels, and integration across sectors. Knowledge, technology, and innovation play a central role in driving efficiencies and in keeping costs low. Increasingly, DMCs seek significant improvements to governance arrangements to deliver more robust water security. ADB is helping DMCs identify policy reforms that support the design and implementation of enhanced water agendas. The reforms need to be owned by broad coalitions of water constituents in the countries. ADB supports the building of such coalitions, including community representatives, research institutions, private sector, civil society, government agencies, and the media. Develop capabilities in water resources management is also focused on financial management, including revenue, trading, expenditure, and asset management.</p> <p><i>Source: ADB. 2011. Water Operational Plan 2011–2020. Manila.</i></p>

ADB = Asian Development Bank, DMC = developing member country, DRM = disaster risk management.