

OPERATIONS MANUAL BANK POLICIES (BP)

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

GOVERNANCE

A. Introduction

1. The Asian Development Bank (ADB) was the first multilateral development bank to have a Board-approved policy on governance. Good governance has subsequently been established as one of the three pillars of ADB's poverty reduction strategy. The governance policy is the foundation for a cluster of other ADB policies on procurement, participation of civil society (nongovernment organizations, community-based organizations, the private sector, research institutions, and academia), anticorruption reform, and public communications.

2. ADB's policy is guided by the provisions of the *Agreement Establishing the Asian Development Bank* (the Charter) as they relate to governance. The capacity of the institutional environment in ADB's developing member countries, in which citizens interact among themselves and with government agencies and officials, helps to determine the impact of economic policies adopted by the government and, therefore, affects the development process. Governance is concerned directly with management of the development process. The capacity of the institutional environment and the quality of governance it reflects are a vital concern for all governments and ADB.

3. ADB's approach to governance issues is guided by the provisions of its Charter. Article 36 of the Charter explicitly excludes political activities and considerations and therefore, ADB cannot act as an agency for political reform. Article 36 requires that only "economic considerations" will be relevant to decisions made by ADB. However, if on purely economic grounds ADB considers an action or measure worth supporting, it may do so even if the action or measure may have political implications. ADB's work on governance, therefore, will follow this pragmatic approach. Differences in political history have resulted in a diversity of political systems and institutional cultures in the Asia and Pacific region. None of these can claim to have any comparative advantage from the point of view of governance.

B. Definition

4. The policy defines "governance" as "the manner in which power is exercised in the management of a country's economic and social resources for development."¹

C. The Policy

5. ADB regards good governance as synonymous with sound development management. It involves both the public and private sectors. It includes the effectiveness

¹ ADB. 1995. *Governance: Sound Development Management*. Manila. para. 4.

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with which development assistance is used, and has a direct effect on the impact of development programs and projects (including those financed by ADB). Sound development management, among other things, takes into account the absorptive capacity of borrowers. Irrespective of the economic policies adopted by a government, good governance is essential to ensure that these policies have their desired effect.

6. The policy identifies four basic elements of good governance, which are all closely linked and mutually reinforcing.

1. Accountability

7. Accountability means making public officials answerable for government behavior and responsive to the entity from which they derive their authority. ADB views accountability more broadly than just the internal governance of the public sector. It also means establishing criteria to measure the performance of public officials, as well as oversight mechanisms to ensure that the standards are met, including through the rule of law and the judiciary. Over time, lack of accountability tends to reduce the state's credibility as an economic partner. It undermines the capacity of governments to sustain the long-term business confidence essential for growth-enhancing private sector investment. Without accountability practices as part of good corporate governance, state enterprises and the private sector will not flourish.

8. Economic accountability relates to the effectiveness of policy formulation and implementation and the efficiency of resource use. Financial accountability covers accounting systems for expenditure control, and internal and external audits.

2. Participation

9. The principle of participation derives from an acceptance that people are at the heart of development. They are its ultimate beneficiaries, and the agents of development, acting through groups or associations, and as individuals. Participation implies that government structures are flexible enough to offer beneficiaries and others affected the opportunity to improve the design and implementation of public policies, programs, and projects.

10. Participation in economic life by agents other than the state includes the role of the private sector in working with governments and the activities of civil society, including nongovernment organizations (NGOs). NGOs offer an additional and complementary means of channeling the energies of private citizens. NGOs can be helpful in identifying people's interests, mobilizing public opinion in support of these interests, and organizing action accordingly. They can provide governments with a useful ally in enhancing participation at the community level and fostering a "bottom-up" approach to economic and social development.

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3. Predictability

11. Predictability refers to (i) the existence of laws, regulations, and policies to regulate society; and (ii) their fair and consistent application. The rule of law encompasses well-defined rights and duties, as well as mechanisms for enforcing them and settling disputes in an impartial manner. These legal frameworks are essential for economic actors in government and the private sector to make rational investment decisions, and also to ensure that all individuals have equal access to opportunities, and are equally protected in participating in economic activities. A predictable regulatory framework helps firms to plan their activities effectively and to forecast the return on their investments with greater confidence.

4. Transparency

12. Transparency refers to the availability of information to the general public and clarity about government rules, regulations, and decisions and how these affect both public and private sector functioning. Thus, transparency complements and reinforces predictability.

13. Access to accurate and timely information about the public and private economy can be vital for economic decision making by the private sector. Transparency in government decision making and public policy implementation reduces uncertainty and helps inhibit corruption among public officials. To this end, rules and procedures that are simple, straightforward, and easy to apply are preferable to those that provide discretionary powers to government officials or are susceptible to different interpretations.

Basis: This OM section is based on:

ADB. 1998. Doc. R89-98. *Anticorruption Policy*. 11 June. Manila.

ADB. 1995. Doc. R151-95. *Governance: Sound Development Management*. 17 August. Manila.

ADB. 1995. Doc. Sec.M46-95. *Compatibility of the Board Paper on Governance with the Bank's Charter*. 17 August. Manila.

For other background information and references, see:

ADB. 2006. *Second Governance and Anticorruption Action Plan (GACAP II)*. 31 July. Manila.

ADB. 1998. Doc. R54-98. *Cooperation Between the Asian Development Bank and Nongovernment Organizations*. 27 March. Manila.

ADB. 1998. Doc. IN42-98. *A Review of the Law and Development Activities of the Asian Development Bank*. 18 February. Manila.

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This OM section is to be read with OM Sections C4/OP, C5/BP, and C5/OP.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Director, Public Management, Governance, and Participation Division, Regional and Sustainable Development Department.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

These procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

GOVERNANCE

A. Introduction

1. The Asian Development Bank (ADB) seeks to play a strategic role in promoting good governance in the Asia and Pacific region. In implementing its policy on governance, ADB takes account of the need for flexible and country-specific approaches. ADB-supported programs and projects are, therefore, designed to raise the quality of governance in the developing member country (DMC) concerned, particularly in sectors in which ADB is making loans. ADB recognizes that flexible long-term arrangements are often most effective for addressing institutional and capacity development aspects of efforts to strengthen governance systems.

2. ADB must focus and prioritize its activities in governance where (i) there is greatest demand from DMCs; (ii) DMCs have plans, or are prepared to develop plans for improving the performance of country systems; and (iii) ADB can offer support from sufficient skilled staff and external sources of expertise.

3. ADB's second governance and anticorruption action plan (GACAP II), approved in July 2006, provides strategic guidance to the implementation of the policy. Under GACAP II, three governance themes are prioritized in ADB operations: (i) public financial management, (ii) procurement, and (iii) combating corruption through preventive, enforcement, and investigative measures. In consultation with DMCs, ADB identifies opportunities for promoting good governance in its operations in each country.

4. ADB's Strategy 2020 re-iterates ADB's commitment to supporting governance and anticorruption reform in DMCs, and endorses the GACAP II approach. Strategy 2020 states: "ADB will increase support for good governance and the building of development capacities... ADB will attempt to reduce the profound harm corruption inflicts on development, particularly on the poor... ADB considers improving governance, curtailing official corruption, and helping make public institutions and organizations more capable as highly effective ways to increase private sector investments throughout the region..."¹

¹ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila. paras. 32 and 33.

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B. Application of the Policy

5. Governance is a cross-cutting theme and governance issues must be considered and integrated into all ADB operations including country partnership strategies (CPSs), project preparation and implementation, and monitoring and evaluation.

C. Implementation of the Policy

6. ADB aims to carry out its policy on governance primarily by mainstreaming its governance priorities in all ADB operations. GACAP II specifies the minimum set of actions necessary to fulfill the mandatory requirements of ADB policies. This does not preclude further ADB governance and anticorruption assistance, where such assistance is requested by DMCs, falls within Strategy 2020 priorities, and is reflected in the CPS. In the case of small DMCs in the Pacific, or DMCs where ADB has no or minimal lending programs, the risk will need to be assessed and managed accordingly.

7. Strategy 2020 identifies good governance and capacity development as a key driver of change (footnote 1). ADB will bring the four elements of good governance (accountability, participation, predictability, and transparency) deeper into the mainstream of its operations and activities. It will regard accountability for economic performance, effectiveness of policy formulation and implementation, and the efficient use of public resources as essential to preserving financial resources for development purposes. ADB will work to make sure that the poor participate in meaningful ways in decision-making processes that affect the management of resources on which they depend for subsistence. To help regional integration fulfill its potential to catalyze growth, ADB will support the establishment of transparency and predictability in regulations and decisions on cross-border issues, trade and investment cooperation, regional financial integration, and regional public goods.

8. GACAP II focuses on the following key result areas (i) improving identification and management of governance, institutional, and corruption risks in CPSs, and annual country portfolio reviews; (ii) strengthening governance and anticorruption components in program and project design; (iii) strengthening program and project administration and portfolio management; and (iv) improving organizational structure, human resources, and access to expertise within ADB.

9. A distinguishing feature of GACAP II is the adoption of a risk-based approach to governance assessment. This requires identification of risks of corruption in public financial management and procurement and the classification of major risks at country, sector, and project levels. Major risks are those that are likely to occur, would have serious negative consequences for development effectiveness, and may not be completely mitigated over the life of the CPS.

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10. **Country partnership strategies.** GACAP II requires risk assessments and risk management plans to inform CPS formulation and preparation of projects in DMCs where ADB has a lending program. The directors general of the regional departments will determine the sectors to be covered by the risk assessments and whether national and/or subnational assessments are required. The directors general will determine the appropriate timing for preparing and updating the CPS risk assessments and risk management plans. The directors general will consult with Private Sector Operations Department (PSOD), as sector risk assessments should include corruption risks for private sector operations.

11. A CPS should include a country risk assessment and risk management plan that covers ADB's three thematic governance priorities (public financial management, procurement, and combating corruption). The risk assessments should include institutional analysis, including the existence and proper enforcement of legal and regulatory frameworks. Country risk assessments will inform the preparation of sector risk assessments and risk management plans for ADB's priority sectors in the DMC. The country and sector risk management plans will define the minimum actions ADB intends to take to support governance in the DMC. Sector risk assessments should inform the preparation of sector analysis and road maps. A consolidated summary of country and sector risk management plans should be included as a linked document to the CPS to be stored electronically in the knowledge repository managed by the concerned regional department.

12. The introduction of the risk assessment exercise should be positive and forward-looking, and should be presented as a means to strengthen constructive dialogue and engagement between ADB and the DMC. DMC stakeholders should be involved with the risk assessment process from the beginning, and their active participation should be encouraged through to the finalization of the risk management plans.

13. **Project design and administration.** The risk assessments and risk management plans must be prepared for projects in ADB priority sectors in the DMC. The risk assessments must focus on ADB's three thematic governance priorities and should be informed by country and sector risk assessments and risk management plans. Identified risks and mitigation measures will inform project design. Project concept papers may provide a preliminary assessment of financial management, procurement, and corruption risks, which will be further developed with the preparation of project risk assessments and risk management plans. The preliminary assessment is expected to draw heavily on the relevant country and sector risk assessments and risk management plans, and country portfolio review mission updates. The project risk assessments and risk management plans can be prepared by ADB staff or consultants, with the required expertise. Terms of reference must be prepared and budget resources allocated, either from the ADB budget or from a project preparatory technical assistance budget. Risk management plans will be monitored through project review missions.

14. **ADB organizational management.** ADB's performance on preventing and controlling corruption in ADB-financed programs and projects will be regularly reviewed.

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ADB Management will ensure that regional departments and resident missions have appropriate staff resources to implement GACAP II.

15. **Consultation processes.** Governance projects and governance aspects of sector projects will be identified through a consultative process, including forums convened to seek opinions or to discuss the findings of governance risk assessments from a variety of stakeholders, including government and civil society organizations.

16. **Civil society involvement.** GACAP II emphasizes the need to involve civil society organizations to provide oversight and promote links between DMC governments and citizens. This will strengthen participation and improve accountability. Civil society should be consulted when preparing risk assessments and risk management plans. Where feasible and based on an assessment of civil society capacity (conducted jointly with the government of the DMC), efforts should be made to enable grassroots civil society organizations to monitor governance project results during implementation.

17. **Communication and dissemination.** ADB's Public Communications Policy commits ADB to "a presumption in favor of disclosure of information".² The policy also states that, with respect to assessment studies conducted to inform preparation of a CPS document, including governance assessments, "ADB shall make strategy and program assessments publicly available upon completion." However, the sensitivity of some of the information in the risk assessments could result in the application of one or more of the exceptions to presumed disclosure, as described in the Public Communications Policy. In such cases, the full risk assessment reports will not be made publicly available, but will be stored in the electronic knowledge repository. However, the major findings of the risk assessments should be summarized and included as a CPS linked document to be made publicly available.

D. Implementation Arrangements

18. The regional departments, resident missions, and PSOD are primarily responsible for implementing ADB's governance policy. The Regional and Sustainable Development Department (RSDD) provides advice, guidance, and assistance with implementation of the governance policy, and has overall responsibility for coordinating and monitoring ADB's governance-related activities. RSDD, in collaboration with the Budget, Personnel, and Management Systems Department is responsible for designing and conducting learning and development programs for ADB staff on implementation of GACAP II. The Central Operations Services Office will provide technical advice to regional departments on procurement risk assessments and design of procurement risk mitigation measures.

19. The Office of Anticorruption and Integrity is the point of contact for allegations of fraud and corruption in ADB-financed activities or among its staff. The Office of the General Counsel may be consulted on matters relating to legal and judicial reform, including access to justice issues, as well as on anti-money laundering issues and

² ADB. 2005. *Public Communications Policy*. Manila.

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initiatives. The Office of Cofinancing Operations may provide guidance and advice on cofinancing for governance-related activities.

20. Implementation of GACAP II by regional departments, resident missions, and PSOD will need to be managed at many levels to ensure that accountability and responsibility is not compromised, and to bring about organizational change. Although all divisions in regional departments and PSOD have direct responsibility for implementation, the regional departments and PSOD must appoint a focal person to facilitate change, coordinate implementation, share good practices and learning experiences, and report on implementation.

E. Monitoring and Evaluation Arrangements

21. RSDD compiles information on ADB's governance-related activities and prepares periodic reports and good practice case studies. RSDD also provides advice and guidance on projects with governance sector and/or thematic classifications, governance risk assessments and risk management plans, and governance aspects of CPSs.

22. The regional departments will assist the Public Management, Governance and Participation Division in RSDD by providing information on achievements and on lessons learned in governance initiatives for purposes of periodic reporting to the ADB Board of Directors, ADB Management, and the public.

Basis: This OM section is based on OM Sections C4/BP and the documents cited therein.

Compliance: This OM Section is subject to compliance review.

For inquiries: Questions may be directed to the Director, Public Management, Governance and Participation Division, Regional and Sustainable Development Department