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Enhancing Flexibility of Policy-Based Lending Operations

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ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AfDB	–	African Development Bank
COL	–	concessional OCR lending
CSF	–	countercyclical support facility
DMC	–	developing member country
DPL	–	development policy lending
DTF	–	distance to frontier
IADB	–	Inter-American Development Bank
IDA	–	International Development Association
MDB	–	multilateral development bank
MOL	–	market-based OCR lending
OCR	–	ordinary capital resources
PBL	–	policy-based lending

NOTE

In this report, “$” refers to US dollars, unless otherwise stated.

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EXECUTIVE SUMMARY

This paper proposes to enhance the flexibility of policy-based lending (PBL) of the Asian Development Bank (ADB) financed by the concessional resources. It calls for replacement of the current hard ceiling of the concessional PBL share, set at 22.5% of the entire concessional public sector lending on a 3-year average basis, with the new requirement for Management to report the prospective PBL share to the Board for information. Such reporting would be conducted in the event that the 3-year average of the concessional PBL share is projected to exceed 30% based on annual preliminary staff estimates. Management will make best efforts to ensure that the concessional PBL share remains within this benchmark, as part of ADB's ongoing operational monitoring and planning process.

The role and design of PBL at ADB and other international financial institutions have been evolving to reflect the changing context and understanding of international development. ADB adopted its first program lending policy in 1978 to address foreign exchange shortages faced by its developing member countries (DMCs). In the 1980s, the scope of multilateral development banks' (MDBs) program lending was broadened to address a wide range of policy reforms of developing and transitioning economies. In 1983, ADB reformulated its program lending as an instrument to support policy reforms. Since then, ADB's conventional PBL has been playing the important role of supporting structural reforms in its DMCs. Through a series of subsequent policy reviews approved by the Board, the general ADB-wide ceiling applicable to concessional and non-concessional PBLs combined has been raised from 5.0% (in 1978) to 7.5% (in 1983), 15.0% (in 1987), and 20.0% (in 1999). ADB's present sub-ceiling on concessional PBL was set at the time of the Asian Development Fund (ADF) VI negotiations in 1991, and has not been changed since then. In the meantime, other MDBs have adopted more flexible approaches in their PBL mobilization, leaving room for greater harmonization across development partners.

The proposal to relax the sub-ceiling for concessional PBL has a strong rationale. Available data show that the concessional assistance countries continue to lag in terms of policy and institutional reforms. Flexible use of PBL should help DMCs undertake extensive policy reforms to enhance their development prospects. The structural reforms envisaged under PBL operations would not only improve the efficiency of DMCs' economies but also enhance the effectiveness of broader development financing, including ADB's project loans. Without the rigid ceiling, the quick disbursing feature of PBL should allow more effective countercyclical financing support in times of macroeconomic difficulties, such as financial crises. Greater flexibility would also address the practical difficulty of forecasting and managing the volume of concessional assistance within the tight restriction. It would also better align ADB with other MDBs that have a more flexible approach. Evaluation findings also support the proposal. According to preliminary ratings, the success rate for PBL operations in concessional assistance-only countries has been improving and was higher than those for project lending operations on average, over 2006–2015.

I. PROPOSAL

1. This paper proposes to enhance the flexibility of Asian Development Bank's (ADB) policy-based lending (PBL) operations financed by concessional resources, including Asian Development Fund (ADF) grants and concessional ordinary capital resources (OCR). It calls for replacement of the current hard ceiling on the concessional PBL share, set at 22.5% of the entire concessional public sector lending on a 3-year average basis, with a new requirement for Management to report the prospective PBL share for information to the Board. Such reporting would be conducted in the event that the 3-year average of the concessional PBL share is projected to exceed 30%, based on preliminary annual staff estimates. Management will make best efforts to ensure that the concessional PBL share remains within this benchmark, as part of ADB's ongoing operational monitoring and planning process. The proposed approach would allow more flexibility in PBL operations in support of policy reforms in concessional assistance countries.

II. OVERVIEW OF ADB'S POLICY-BASED LENDING

A. Evolution of Policy-Based Lending

2. The role and design of PBL at ADB and other international financial institutions have been evolving to reflect the changing context and understanding of international development. PBL has its origins in balance-of-payment support. ADB adopted its first program lending policy in 1978 to address foreign exchange shortages faced by its developing member countries (DMCs) in the aftermath of the global oil crisis in the 1970s.[1] In contrast to project lending, which supported capital investments, program loans provided financing for the importation of production inputs to increase productive capacity in certain high-priority sectors. Such an instrument was to be used only in special circumstances. PBL was initially limited to 5% of ADB's anticipated overall annual lending, and up to a maximum of 10% of anticipated annual lending at the country level.

3. ADB reviewed and modified its program lending policy in 1983 to enhance its impact.[2] Policy reform objectives were added to include modernization and/or rationalization of production facilities, in addition to capacity utilization objectives. The 1983 policy revision also envisaged enhanced policy dialogue with country authorities on medium-term sector development plans and policies, and the increased use of technical assistance resources to analyze sector issues and strengthen institutions. The ADB-wide ceiling was raised from 5.0% to 7.5% and the country ceiling from 10.0% to 20.0%.

4. A revised PBL instrument was introduced in 1987.[3] The objective of program loans was redefined to address underlying sector needs and constraints—including policy reforms, investment plans, and institutional strengthening. The ceiling on program lending was raised to 15% of total ADB lending, and the 20% ceiling for individual countries was abolished. The scope of lending was broadened to include the financial, industry, energy, transport and telecommunications, and social sectors. The new policy cautioned that program loan conditionalities should not be expected to work in the same way as for project loans; instead, they should be assessed in the broad context of policy reform. To capture this, the process

[1] ADB. 1978. *Program Lending*. Manila.
[2] ADB. 1983. *A Review of Program Lending Policies.* Manila.
[3] ADB. 1987. *A Review of Program Lending Policies*. Manila.

should be reflected in a development policy letter from the government requesting the program loan. Reforms should be paced and transitional costs reduced through the provision of retraining and other adjustment assistance, especially for the poor. The policy also called for the compatibility of program loans with policy reform measures of the International Monetary Fund and the World Bank.

5. ADB introduced further amendments to its PBL instrument in 1996.[4] By then, it was recognized that meeting loan conditions did not guarantee the realization of the expected impact of a program. Even the reformulated program loans tended to be implemented over a relatively short period, providing inadequate time for policies to work fully. Given the significant role of the International Monetary Fund and the World Bank in PBL at the macroeconomic level, it was also felt that ADB program lending should be strengthened at the sector level. Hence, a new sector development program was introduced as a combination of three existing modalities (program loan, project loan, and technical assistance) to address sector needs more comprehensively. Sector analysis also became a precondition for program lending. In addition, poverty, social, environmental, and mitigation measures were emphasized.

6. Program lending experienced a substantial increase during the Asian Financial Crisis in the late 1990s. Several crisis loans were approved in quick succession to help contain the negative impact of the crisis, and the 15% ceiling was exceeded. Even without crisis lending, demand from DMCs for program lending remained strong. In 1999, to separate substantial program lending in a crisis situation from PBL in a non-crisis situation, the special program loan modality was introduced. ADB also introduced the programmatic cluster approach to support DMCs' reform path from the medium-term perspective. In addition, the ceiling on program lending was raised from 15% to 20% of total ADB public sector lending.

7. Further reforms were approved in 2011. They comprised two main elements: mainstreaming medium-term programmatic budget support, and enhancing ADB's short-term crisis response capacity.[5] The refined PBL policy emphasized the importance of country ownership and flexibility in the design and implementation of reforms in a number of the Strategy 2020 priority areas—including finance and private sector development, governance, and institutional development.[6] Under the revised policy, DMC-owned structural reform conditionality was designated a prerequisite for budget support, to ensure its effectiveness.

8. Over the years, PBLs have been increasingly used to support important policy and sector reforms. Their sectoral focus has shifted, in line with development priorities in Asia and the Pacific. Since 2011, a majority of PBLs financed by concessional resources addressed reforms in public sector management. Other areas of focus include energy and finance. A more detailed overview of program lending in concessional assistance countries is in the Appendix, along with examples of how PBL operations have been used to catalyze important policy reforms.

[4] ADB. 1996. *Review of the Bank's Program-Lending Policies*. Manila.

[5] The 2011 PBL policy involved mainstreaming the countercyclical support facility (CSF) to provide budget support to DMCs' fiscal stimulus packages, and providing special policy-based loans for balance of payments support. More flexibility was also provided in setting the terms of the CSF and special policy-based loans. ADB. 2011. *Review of ADB's Policy-Based Lending.* Manila.

[6] ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila.

B. Additional Constraints on Concessional Policy-Based Lending Operations

9. Provision of ADB's concessional PBL has been subject to an additional sub-ceiling set at the time of ADF VI negotiations in 1991.[7] In addition to the ADB-wide ceiling (set at 15% of total public sector lending at the time), ADF donors agreed that a separate sub-ceiling should be set on concessional PBLs, given the high share of PBL utilization observed for concessional loans at the time. This was set at 22.5% of total concessional lending, midway between the ADB-wide ceiling of 15.0% and the International Development Association (IDA) cap then set at 30.0%. The PBL sub-ceiling for concessional assistance has not been adjusted since then. While the PBL policy provides some flexibility in the interpretation of the ADB-wide ceiling, which is to apply under normal circumstances, the sub-ceiling on concessional PBL operations does not include such qualification.

10. In most of the recent years, the concessional PBL share has been carefully managed within 22.5% of total ADF commitments, but compliance with the sub-ceiling has imposed constraints on flexible resource mobilization. Over 2013–2015, the share of ADF-funded PBL reached 22.3%, which is within but very close to the ADF ceiling. Previously, in 2009–2010, the global financial crisis gave rise to demand for countercyclical budget support to ADF-eligible countries (Table 1). Then, at the time of the crisis, Management had to seek a spot waiver from the Board to exceed the sub-ceiling.[8] A similar situation may arise in the future, in times of global or regional economic distress. Budget support under PBL is primarily aimed at financing medium-term development expenditures (as opposed to short-term fiscal stimulus). Hence, depending on the public expenditure planning, demand for concessional PBL could increase even in non-crisis situations.

Table 1: Share of Policy-Based Lending in ADB Operations

Item	2009	2010	2011	2012	2013	2014	2015
Overall							
PBL ($ million)	3,598.90	1,580.90	690.60	1,887.00	1,183.00	2,326.00	2,810.20
Total ($ million)	11,332.90	11,376.70	12,202.20	10,944.30	12,610.70	11,610.10	13,412.30
PBL share (single year, %)	31.8	13.9	5.7	17.2	9.4	20.0	21.0
PBL share (3-year rolling, %)	28.3	24.1	16.8	12.0	10.5	15.3	16.8
Concessional							
PBL ($ million)	994.85	568.30	190.62	435.99	783.00	720.00	688.20
Total ($ million)	3,121.62	3,179.76	2,551.61	3,005.38	3,850.05	3,090.91	2,871.90
PBL share (single year, %)	31.9	17.9	7.5	14.5	20.3	23.3	24.0
PBL share (3-year rolling, %)	25.8	25.2	19.8	13.7	15.0	19.5	22.3

ADB = Asian Development Bank, PBL = policy-based lending.
Note: Data for 2015 are provisional.
Source: Asian Development Bank.

[7] ADB. 1992. *Arrangements for Lending from ADF and TASF Operations Funded by ADF Contributions*. Manila.
[8] ADB. 2009. *Proposed Waiver of the Asian Development Fund Program Lending Limit for 2007–2009*. Manila; ADB. 2010. *Proposed Waiver of the Asian Development Fund Program Lending Limit for 2008–2010.* Manila.

III. CASE FOR MORE FLEXIBLE APPROACH

A. Merits of Greater Use of Policy-Based Lending in Concessional Assistance Countries

11. **The greater scope for policy and institutional reforms.** Most of ADB's concessional PBL operations address private sector development and governance.[9] Available data show that there is scope for concessional assistance countries to advance reforms in both areas. With regard to private sector development, the World Economic Forum's Global Competitiveness Index and the World Bank's Doing Business rating reveal that the performances of DMCs eligible for concessional assistance (group A and group B) are much weaker on average than those of clients of only non-concessional lending (group C). The difference in the performances stands out even more strongly when compared with developing members that have graduated from regular ADB assistance (Brunei Darussalam; Hong Kong, China; Republic of Korea; and Taipei,China) (Table 2).

Table 2: Average Reform Rating of ADB Developing Member Countries: Private Sector Development

Item	Global Competitiveness Index 2015–2016 Score	Ease of Doing Business 2016 DTF Score
Group A	3.82	56.04
Group B	4.01	57.81
Group C	4.67	66.84
Graduates	5.35	79.67

ADB = Asian Development Bank, DTF = distance to frontier.
Note: The Global Competitiveness Index score ranges from 1 to 7. The DTF score ranges from 0 to 100.
Sources: World Economic Forum. 2015. *The Global Competitiveness Report, 2015–2016.* Geneva; World Bank Group. 2016. *Doing Business 2016*. Washington, DC.

12. The World Bank's worldwide governance indicators show a similar trend. The majority of ADB's PBL addresses government effectiveness (aimed at improvement in public sector management). Data suggest that concessional assistance countries still have to catch up significantly to enhance their development prospects by further advancing reforms (Table 3). Policy dialogue conducted as part of PBL operations allows DMC governments to tap into ADB's technical advice for further improvement of policy and institutions.

Table 3: Average Performance Rating of ADB Developing Member Countries: Governance, 2014

Item	Government Effectiveness	Regulatory Quality	Rule of Law
Group A	(0.6)	(0.8)	(0.5)
Group B	(0.4)	(0.5)	(0.4)
Group C	0.0	(0.3)	(0.4)
Graduates	1.5	1.5	1.3

( ) = negative, ADB = Asian Development Bank.
Note: Group averages of governance scores on a scale from –2.5 to +2.5. Data for the Cook Islands are not available, hence not covered.
Source: World Bank. Worldwide Governance Indicators. http://info.worldbank.org/governance/wgi/index.aspx#reports

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[9] In March 2014, ADB refined its project classification system in further alignment with Strategy 2020. Under the new system, projects are thematically classified into five drivers of changes (private sector development, governance and capacity development, gender equity and mainstreaming, knowledge solution, and partnership). Some 78% of PBL approved thereafter adopted private sector development, and all had governance as one of the themes.

13. **Macroeconomic distress.** Concessional assistance countries have more limited options to respond to macroeconomic challenges, yet they often have more limited fiscal space to respond to such challenges. During economic crises, DMCs with access to non-concessional lending have the option to mobilize ADB's countercyclical support facility (CSF) or special PBL. This type of support is not included in the ADB-wide PBL ceiling (20% under normal circumstances).[10] Concessional assistance-only countries do not have access to this crisis instrument, so they often have to resort to the flexible use of conventional PBL as the only option to receive fast-disbursing budget support in the face of macroeconomic difficulty. The current hard ceiling on concessional PBL would further limit the scope for ADB's poorest DMCs to resort to such an option, when they are faced with economic distress, and place them in a vulnerable position.

14. **Positive spillover to investment lending operations.** A sound policy environment is key for successful development financing, and experience shows that reforms improve the productivity of multilateral development banks' (MDBs) investment lending operations in the public and private sectors. Empirical evidence has verified such positive linkage.[11] Accordingly, reforms catalyzed by PBL can be expected to improve the effectiveness of ADB's project loans, and active use of PBL should ensure the effectiveness of overall ADB assistance to its DMCs.

B. Practical Problems with the Rigid Ceiling

15. **Practical difficulty to predict and manage the lending pipeline.** The share of PBL is calculated against the approvals of entire public sector lending. Lending pipelines are constantly adjusted throughout the year, and as a result it is not easy to predict and manage the actual PBL share correctly (as a de-facto moving target). Unexpected pipeline developments in the corporate-level aggregate may require a sudden adjustment of lending sources or amount toward the end of each year, at the risk of jeopardizing the development financing planning of affected DMCs. Because of the difficulty of accurate projection, Board waivers have to be sought nearly on an ex-post basis toward the end of the year, when it becomes almost certain that the ceiling would be breached. Up-front reporting to the Board on the projected PBL share would be preferable to the current approach of sudden pipeline adjustment and/or waiver, only after it becomes clear that such efforts could not work out at the end of the year.

16. **Consistency between concessional and non-concessional operations.** The prospective merger of OCR and the ADF from 2017 onward will substantially increase the scale of ADB's overall operations. However, this will also bring about inconsistencies in caps on PBL within the new OCR operations. After the merger, the new OCR operations will comprise concessional OCR lending (COL) and market-based OCR lending (MOL). Whereas MOL PBL

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[10] These two crisis response instruments generate headroom for additional lending by setting short maturity (5–8 years), and are not suitable for concessional assistance-only countries with weak repayment capacity. ADB's Graduation Policy does not allow non-concessional lending to DMCs with low per capita gross national income and creditworthiness, except for projects that earn foreign exchange and are able to service their foreign debt fully from net foreign exchange earnings. ADB's PBL policy limits access to the CSF and PBL to DMCs eligible for MOL. ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank.* Manila; and ADB. 2011. *Review of ADB's Policy-Based Lending.* Manila.

[11] Based on the economic rate of return from 1,163 public sector investment projects financed by the World Bank and 113 private sector projects financed by the International Finance Corporation in 61 development countries, Isham and Kaufmann (1995) found that countries with undistorted policies are likely to end up with highly productive investments, and investments become more productive as policy-making improves. See J. Isham and D. Kaufmann. 1995. The Forgotten Rationale for Policy Reform: The Productivity of Investment Projects. *Policy Research Working Paper.* No. 1549. Washington, DC: World Bank.

would be constrained by the soft ceiling of 20.0% applicable in normal circumstances, those under COL would be restrained by the tight 22.5% ceiling. While concrete harmonization of restrictions on the entire PBL operations across concessional and non-concessional resources is not a direct subject of this paper, it deserves attention for consideration in the future.

C. Harmonization with Other Multilateral Development Banks

17. The current sub-ceiling of 22.5% was established in 1991 on account of the prevailing cap of 30% adopted by IDA**.** Thereafter, as part of development policy lending (DPL) reform in 2004, the World Bank removed its cap on DPL and replaced it with reporting requirements by management to the board on the anticipated DPL share in total lending.[12] For the IDA 15 period (2008–2011), IDA management was expected to seek board guidance if the share of DPL in concessional operations was projected to exceed the benchmark of 30%, but it was no longer deemed to constitute a hard ceiling as was previously the case.[13] Hence, the gap between ADB's hard ceiling of 22.5% and IDA's flexible practice has become more pronounced.

18. The World Bank's removal of the DPL ceiling reflected its recognition that rigid numerical caps do not ensure optimal use of program lending. The World Bank assessed that the tight numerical restriction precluded the scope for contextual judgment on the appropriateness of DPL. In addition, the cap—set at corporate aggregate levels—had little practical relevance, as staff process DPL based on individual countries' needs. Likewise, the board approves individual transactions rather than the entire pipeline. The same argument could be made for ADB.

Table 4: Ceiling by Multilateral Development Banks (%)

Item	ADB	AfDB	IADB	World Bank
Overall	20.0	No ceiling	30.0	No ceiling
Concessional	22.5	25.0	30.0	No ceiling

ADB = Asian Development Bank, AfDB = African Development Bank, IADB = Inter-American Development Bank.

Note: The share presents a limit for conventional budget support operations at the corporate level, excluding crisis response. The IADB's ceilings are 30% for both non-concessional and concessional PBLs.

Source: ADB. 2011. *Review of ADB's Policy-Based Lending*. Manila; AfDB Group. 2012. *Bank Group Policy on Program-Based Operations.* Abidjan; World Bank. 2004. *From Adjustment Lending to Development Policy Lending: Update of World Bank Polic*y. Washington, DC; hearings from the staff of multilateral development banks.

19. ADB's restriction on PBL is tighter than any other MDBs. ADB is the only MDB that sets different numerical shares for non-concessional and overall PBL operations (Table 4).[14] For instance, the Inter-American Development Bank (IADB) has a higher ceiling of 30%, allowing more flexible mobilization of PBL. The same ceiling applies for both ordinary capital (for a 4-year period) and biannually-allocated concessionary resources.

[12] World Bank. 2004. *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy*. Washington, DC. The World Bank's operational manual sections on development policy financing (OP/BP 8.60) no longer present the bank-wide ceiling on DPL.

[13] The hard ceiling of 30% is no longer stated in subsequent IDA replenishment reports.

[14] Since the European Bank for Reconstruction and Development does not undertake PBL operations, it is not covered by this paper.

D. Findings from Independent Evaluation

20. Evaluation findings support the proposal for enhanced flexibility. According to preliminary ratings by project validation reports and project performance evaluation reports, the success rate for PBL operations in concessional assistance-only countries has been improving and was higher (69%) than those for project lending operations (63%) in these countries over 2006–2015.[15] An earlier special evaluation study conducted in 2007 recommended the relaxation of the ceiling on program lending's share of total lending.[16] The study highlighted the need to review the current ceiling to bring it more in line with DMCs' needs for PBL. Another special evaluation study conducted in 2011 pointed out the absence of ADB's crisis response capacity for concessional assistance-only countries and recommended to set up a new facility for this purpose.[17] However, given the debt sustainability implications, it would be difficult to introduce a new facility with harder lending terms (as in the case of the CSF and special PBL) for concessional assistance-only countries with weak repayment capacity. In the absence of such special lending instruments for concessional assistance-only countries, relaxation of the current PBL sub-ceiling to allow for more flexible use of existing concessional resources in crisis situation may be the best alternative.

IV. ISSUES FOR DONORS' ENDORSEMENT

21. Donors' endorsement is sought to replace the hard ceiling of 22.5% by prior reporting on the anticipated concessional PBL share to the Board, when it is projected to exceed 30% in preliminary annual staff estimates. Management will make best efforts to ensure that the concessional PBL share remains within this benchmark, as part of ADB's ongoing operational monitoring and planning process.

22. The proposed approach would allow more flexibility in PBL operations in support of policy reforms in concessional assistance countries. The current hard sub-ceiling was not set on the basis of DMCs' development needs, and its rigidity imposes unnecessary constraints on support to concessional assistance countries. Other MDBs have adopted a more flexible approach in the use of PBL, and there is no reason that ADB should not follow suit. In particular, the World Bank's approach adopted for IDA 15 deserves consideration. Its higher benchmark of 30% allows for more flexible use of PBL, while up-front reporting on the projected PBL share enhances board oversight. ADB should adopt a similar approach for its PBL operations financed by concessional resources. The 30% threshold would also bring ADB's practice closer to that of the IADB, serving harmonization among MDBs.

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[15] The rating is also higher than that for ADB's entire PBL operations for the same period.

[16] ADB. 2007. *Special Evaluation Study: Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries*. Manila.

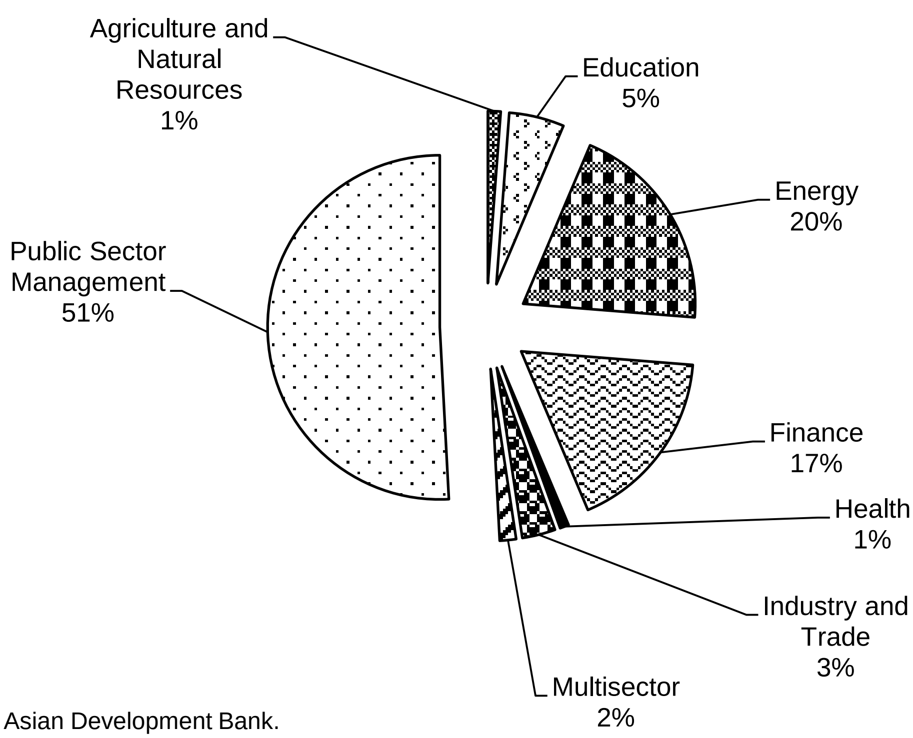
[17] ADB. 2011. *Special Evaluation Study: Real-time Evaluation of Asian Development Bank's Response to the Global Economic Crisis of 2008–2009.* Manila.

TRENDS IN POLICY-BASED LENDING IN CONCESSIONAL ASSISTANCE COUNTRIES

A. Sectoral Distribution

1. Although project lending continues to be the primary lending mode of the Asian Development Bank (ADB), policy-based lending (PBL) has been increasingly used to support important policy and sector reforms in ADB concessional assistance countries. Over time, the sectoral focus of PBL has shifted, in line with the development priorities of Asia and the Pacific. Shortly after its inception in 1978, program lending was directed primarily to finance imports of essential inputs in the agriculture and natural resources sector. In the wake of the Asian financial crisis in 1997/1998, financial sector reforms emerged as a major area of interventions. As the important role of governance and capable institutions for development had been recognized in the 2000s, an increasing share of PBL was mobilized in public sector management. Since 2011, more than half of PBL financed by concessional resources has been approved on the basis of the recent and prospective reforms of developing member countries (DMCs) in public sector management. Other areas of sectoral focus include energy and finance, followed by education, industry and trade, multisector, agriculture and natural resources, and health (see Figure).

Figure: Sectoral Distribution of Policy-Based Lending Financed by Concessional Resources, 2011–2015



Source: Asian Development Bank.

B. Examples of Selected Operations

2. ADB's PBL operations have been playing a key role in catalyzing policy reforms in its DMCs. Examples of successful interventions are discussed below.

3. **Cambodia Financial Sector Program Clusters (2001).**[1] ADB's technical assistance and policy support in 1999–2001 led to the formulation of the government's financial sector blueprint for 2001–2010. ADB supported the government's plan through the first Financial Sector Program (FSP) cluster from 2001 to 2007, which enabled the government to lay the legal and regulatory groundwork for a sound, market-oriented financial sector. The government took strong action to consolidate the banking system and introduced stricter rules for capital adequacy, governance, and risk management. Moreover, it sought continuing support from ADB to make sure the reforms were durable and that ordinary citizens had broad access to financial services. The original blueprint was updated, and the government adopted it in February 2007 as the country's Financial Sector Development Strategy, 2006–2015. The Second Financial Sector Program (FSP II) was also designed and approved in 2007. The Financial Sector Development Strategy was last updated for 2011–2020, and ADB's third cluster and technical assistance supported implementation of its early phase. During the implementation period of the three clusters, public confidence greatly improved, leading to increased financial intermediation and enabling the financial sector to contribute to economic growth and poverty reduction. Cambodia's financial deepening has accelerated, with increased supply of financial services. The ratio of broad money supply (M2) to gross domestic product (GDP) increased from 13.0% in 2001 to 53.4% in 2013.[2]

4. **Samoa Economic Recovery Support Program—Subprograms 1 and 2 (2010).**[3] ADB used PBL to support the government's establishment of a medium-term expenditure framework for transparent, accountable, and efficient use of public funds in Samoa. The ADB program filled rehabilitation and reconstruction budget needs after the 2008–2009 global economic crisis and a tsunami disaster in 2009. It helped make the legal and regulatory environment more conducive to private sector investment, improve the management of state-owned enterprises, deregulate the telecommunications industry, and liberalize air transport. The program also opened up official records of government contracts and performance to public scrutiny. The country's GDP growth rate recovered from –5.6% in 2009 to 2.7% in 2012.[4]

5. **Lao People's Democratic Republic Basic Education Sector Development Program (2006).**[5] The program helped the government of the Lao People's Democratic Republic to expand lower secondary schooling by 1 year and carry out other national educational reforms

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[1] ADB. 2011. *Review of ADB's Policy-Based Lending.* Manila; ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan for Subprogram 3 of the Third Financial Sector Program in the Kingdom of Cambodia*. Manila.

[2] In the same period, credit to the private sector has risen from 6.0% of GDP to 40.4%, and total deposits from 10.4% to 49.1%. Reflecting improved public confidence in the banking system and financial deepening, total bank assets reached 83% of estimated GDP in 2013, from the record of 22% in 2005. A. Batten et al. 2015. The Financial Systems of Financially Less Developed Asian Economies: Key Features and Reform Priorities. *ADB Economics Working Paper Series.* No. 450. Manila.

[3] ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster and Loan for Subprogram 1 Economic Recovery Support Program. In Independent State of Samoa.* Manila; ADB. 2014. *Development Effectiveness Review*. Manila.

[4] Data are sourced from ADB. 2014. *Asian Development Outlook 2014: Fiscal Policy for Inclusive Growth.* Manila.

[5] ADB. 2014. *Completion Report: Basic Education Sector Development Program in the Lao People's Democratic Republic.* Manila; ADB. 2014. *Development Effectiveness Review*. Manila.

that greatly expanded the impact of ADB's modest financial intervention (about $22 million). The country now has the international norm of 12 years of primary and secondary education, and the lower secondary curriculum has been overhauled to give students a better chance in the country's job market after they graduate. Higher enrollment and better math and science exam scores indicate that wide long-term development benefits lie ahead as students come up through the reformed education system. The country's gross enrolment ratio for secondary education increased from 43.9% of the school-age population in 2001–2009[6] to 50.0% in 2008–2014.[7]

6. **Afghanistan Postconflict Multisector Program (2002).**[8] In August 2002, officials of the Government of Afghanistan requested that ADB provide a concessional $150 million Postconflict Multisector Program Loan. The program objective was to promote economic growth and poverty reduction through the introduction of fundamental policy and institutional reforms for improved efficiency in three key economic sectors—governance and finance, transport, and energy. The program loan objectives and achievements must be viewed in the context of Afghanistan's long years of conflict and the devastation of the country's physical and human capital. Notwithstanding these challenges, the government carefully guided the reform process and ongoing capacity building. Afghanistan's Human Development Index rating, which reflects multiple elements of development and people's living standards, increased from 0.334 in 2000 to 0.448 in 2010 (footnote 7).

7. **Nepal Rural Reconstruction and Rehabilitation Sector Development Program (2007).**[9] ADB approved the Rural Reconstruction and Rehabilitation Sector Development Program in November 2007. The program aimed to support the Government of Nepal's key agenda of achieving inclusive growth for sustainable poverty reduction. It consisted of a policy component (the program) for $50 million and an investment component (the project) for $50 million. The choice of rural infrastructure with a focus on rural roads for project investment was pertinent, as it served the twin objectives of (i) providing much-needed sustainable road access in rural areas, the lack of which was considered a critical constraint on rural economic growth, poverty reduction, and inclusiveness; and (ii) generating quick income opportunities for poor rural households, which suffered most during the conflict. The headcount rural poverty rate declined from 34.6% to 27.4% from 2004 to 2010.

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[6] United Nations Development Programme (UNDP). 2010. *Human Development Report 2010: The Real Wealth of Nations—Pathways to Human Development*. New York.

[7] UNDP. 2015. *Human Development Report 2015: Work for Human Development.* New York.

[8] ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Afghanistan for the Postconflict Multisector Program Loan*. Manila; ADB. 2009. *Completion Report: Postconflict Multisector Program in Afghanistan*. Manila.

[9] ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grants to Nepal for the Rural Reconstruction and Rehabilitation Sector Development Program.* Manila; ADB. 2014. *Completion Report: Rural Reconstruction and Rehabilitation Sector Development Program in Nepal.* Manila.