ADF 13 Strategic Directions and Resource Allocation Framework

Towards a Sustainable Future for the Most Vulnerable in Asia and the Pacific

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ABBREVIATIONS

ADB – Asian Development Bank
ADF – Asian Development Fund
CA – Concessional assistance
COL – concessional ordinary capital resources lending
DRF – Disaster Response Facility
DRR – disaster risk reduction
DMCs – developing member countries
DSA – debt sustainability assessment
FCAS – fragile and conflict-affected situations
GNI – gross national income
IDA – International Development Association
OCR – ordinary capital resources
PBA – performance-based allocation
RCI – regional cooperation and integration
RHS – regional health security
RPGs – regional public goods
SDG – Sustainable Development Goal
SIDS – small island developing states

NOTE

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

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EXECUTIVE SUMMARY

The combination of the Asian Development Fund (ADF) lending operations and ordinary capital resources (OCR), which took effect on 1 January 2017, has significantly reduced the amount of contributions from donors to the ADF. However, ADF, which has become a grant-only facility, continues to require donors’ contributions to support the poorest and most vulnerable countries in the region.

This paper lays out the strategic directions that the Asian Development Bank (ADB) will pursue in its poorest and most vulnerable developing member countries (DMCs) and presents the resource allocation framework to be used during the ADF 13 (2021–2024) period.

The 25 concessional assistance DMCs—the group A (eligible for ADF grant, concessional OCR lending [COL], or their blending) and B countries (eligible for a blend of concessional and regular OCR loans)—are the poorest and most vulnerable developing member countries among ADB’s DMCs. The concessional assistance countries, and especially the group A DMCs, still face development challenges such as persistent poverty, fragility and vulnerability, gender gaps, climate change, disaster risks, limited private sector development, and low institutional capacity. There is still a need for grants in Asia and the Pacific to support DMCs facing high or moderate risks of debt distress. There is also a potentially catalytic role for grants to play as incentives in targeted areas such as gender equality, climate change adaptation, and disaster risk reduction.

ADF 13 is well placed to help DMCs address these challenges. The ADF is the largest of ADB’s special funds and has an established framework with a sound resource allocation system and governance. Over years, it provides stable and predictable resources at the country level. The assessment by the Multilateral Organisation Performance Assessment Network consistently finds that the development effectiveness of ADB’s support, including concessional assistance, have been positive and improving over time. The assessment of ADB’s Independent Evaluation Department of ADF XI and ADF 12 emphasizes that ADF project performance and results are stronger than the previous ADF periods. These positive evaluations did not change even after the ADF became a grant-only operation.

ADF 13 will be the first ADF to implement the ADB’s Strategy 2030 during its full cycle. ADF 13 will mainstream Strategy 2030’s seven operational priorities in the poorest and most vulnerable DMCs. ADF 13 grants will continue to be provided to group A countries, and on a very selective basis to group B countries, to address specific challenges.

ADF 13 will give special attention to six areas to respond to the main challenges in the poorest and most vulnerable DMCs, in alignment with Strategy 2030:

(i) **Supporting Fragile and Conflict-Affected Situations and Small Island Developing States:** ADF 13 grants will continue to play a critical role in fragile and conflict-affected situations, particularly for institutional development and governance reforms, and essential infrastructure. ADF 13 will support small island developing states (SIDS) to address structural and physical vulnerabilities and higher costs of service delivery.

(ii) **Achieving the Sustainable Development Goal 5’s transformative gender agenda:** ADF 13 grants will be used to go beyond standard gender mainstreaming activities and support projects or components of projects to achieve the Sustainable Development Goal 5’s transformative gender agenda. This could have significant benefits, especially in FCAS where gender inequalities are high. ADF 13 projects will have essential catalytic
roles in demonstrating that innovative gender approaches can change social norms and discriminatory practices. This will encourage countries to pursue more transformative gender actions more generally, including through using their own funds.

(iii) **Supporting climate change adaptation and disaster resilience, and enhancing disaster responses:** ADF 13 grants will be used to incentivize further investment in climate change adaptation and disaster risk reduction, where investments would likely yield streams of benefits over the medium and long term. ADF 13 proposes to expand the coverage of the Disaster Response Facility to include severe disasters triggered by natural hazards as well as those related to humanitarian emergencies caused by conflict, and public health emergencies such as epidemics and pandemics.

(iv) **Fostering regional cooperation and integration, including the provision of regional public goods:** ADF 13 grants will continue to support regional cooperation and integration in group A countries. It will increase the provision of regional public goods in group A countries and selectively in group B countries. ADF 13 will give increasing attention to supporting ocean health and coastal and marine resource management. ADF 13 will support regional health by supporting cross-border communicable disease prevention and control, and promoting effective cross-sector initiatives on regional health.

(v) **Supporting private sector operations in frontier markets, on a pilot basis:** ADF 13 will support expanding private sector operations by piloting a private sector window in group A countries. This will provide an opportunity to expand private sector operations in frontier markets. Activities will also be developed in new sectors with a higher development impact, including agribusiness and social sectors, among others.

(vi) **Enhancing debt sustainability:** While ADF 13 will continue to support countries with risk of debt distress, it will address moral hazard associated with excessive borrowing. The proposed ADF 13 framework provides incentives for all group A countries to improve debt management through preferential access to the thematic pool for countries with prudent or improved performance in fiscal, debt and budget management. In addition, under ADF 13, ADB will provide policy advice and capacity development through technical assistance to countries at high and moderate risk of debt distress. ADB will consider using mechanisms to deter grant-eligible countries from acquiring or expanding non-concessional debt in line with the policies of the International Monetary Fund and the World Bank.

The proposed ADF 13 resource allocation framework will continue to adopt a hybrid system as the ADF 12 framework, consisting of country- and theme-based components. At the same time, to enhance the implementation efficiency of the scarce concessional resources, it is proposed that the ADF 13 framework revise several elements of the existing ADF grant and COL resources allocation mechanism.

The proposed ADF 13 framework will **retain** the following key features of the ADF 12 resource allocation mechanism:

(i) Country classification system and debt sustainability assessment to determine country eligibility for grant;
(ii) Performance-based allocation (PBA) formula, which comprises country performance assessments (17 criteria in five clusters which are macroeconomic management, structural policies, social inclusion and equity, governance, and portfolio performance), per capita gross national income, and population;

(iii) Special post-conflict support for Afghanistan;

(iv) Disaster Response Facility with expanded scope and country coverage; and

(v) Debt distress reserve.

The proposed ADF 13 framework proposes the following revisions to improve the implementation efficiency and effectiveness of resource allocation:

(i) discontinuing the base allocation for all concessional assistance countries and introducing a more efficient economic vulnerability premium for SIDS eligible for ADF grants;

(ii) expanding the thematic use of ADF grants to gender equality and climate change adaptation;

(iii) introducing a single thematic pool applicable for group A countries and very selectively for group B countries, addressing thematic priorities in gender equality, climate change adaptation and disaster risk reduction, and regional cooperation and integration including regional public goods;

(iv) discontinuing the volume discount for group A countries at high and moderate risk of debt distress that receive ADF grants and, instead, giving preferential access to the thematic pool to countries with prudent or improved fiscal, debt, and budget management;

(v) piloting a Private Sector Window for group A countries to help expand private sector operations in frontier markets and new sectors;

(vi) separating the allocation mechanism for ADF and COL to enhance the efficiency of the allocation of concessional assistance resources. COL will be allocated based on needs for concessional assistance by countries (including historical utilization and pipeline), the elements of PBA, and availability of concessional loan resources. For group A countries with moderate risk of debt distress, the grant amount will be half of the country allocation of ADF grants; and

(vii) converting the biennial allocation to four-year allocation with annual updates to improve the predictability of resources and facilitate preparation of multi-year programs.

Three funding scenarios for ADF 13 are proposed for overall ADF 13 grant size of $2.95 billion, $3.19 billion, and $3.39 billion, respectively. The design of scenario 1 rests on DMCs’ becoming ineligible for grants which frees up $233 million. Scenario 2 incorporates adjustment for inflation. Scenario 3 further includes additional $170 million in the thematic pool. The donor contributions for these scenarios are $2.43 billion, $2.69 billion, and $2.91 billion, respectively, compared to donor contributions of $2.59 billion in ADF 12. The details of the financing framework are
discussed in a separate paper, “Financing Framework for Asian Development Fund 13 and Technical Assistance Special Fund 7.”

Donors’ feedback and endorsement are sought for the:

(i) proposed ADF 13 strategic directions;

(ii) proposed ADF 13 resource allocation framework; and

(iii) three indicative funding scenarios for overall ADF 13 grant size of $2.95 billion, $3.19 billion, and $3.39 billion.
I. INTRODUCTION

1. The combination of the Asian Development Fund (ADF) lending operations and ordinary capital resources (OCR), which took effect on 1 January 2017, has significantly reduced the amount of contributions from donors to the ADF. However, ADF, which has become a grant-only facility, continues to require donors’ contributions to support the poorest and most vulnerable countries in the region.¹

2. This paper lays out the strategic directions that the Asian Development Bank (ADB) will pursue in its poorest and most vulnerable developing member countries (DMCs) and presents the resource allocation framework to be used during the ADF 13 (2021–2024) period.

3. Section II presents the development context and the remaining challenges in concessional assistance (CA) countries. Section III highlights that ADF is an effective channel to support the challenges identified. Section IV presents the ADF 13 strategic directions. Section V summarizes key features of proposed ADF 13 framework. Section VI presents three indicative funding scenarios for ADF 13. Section VII summarizes issues for donors’ guidance.

II. DEVELOPMENT CONTEXT AND CHALLENGES

4. The 25 concessional assistance countries are the least developed among ADB’s members. The CA countries refer to group A (eligible for ADF grant, concessional OCR lending [COL], or their blending) and B DMCs (eligible for a blend of concessional and regular OCR loans). Eligibility for ADF grants is mainly for group A countries. Access to ADF grants and concessional OCR lending (COL) for group A countries is determined by the risk of debt distress.² During the ADF 12 period, ADF grants have also been provided to address several challenges requiring some concessionality such as disaster risk reduction (DRR) in all group A countries and regional health security (RHS) in group A and B countries. Bangladesh, a group B country, has been provided special grant support to address the immediate and urgent needs of the displaced persons from Myanmar. Group B countries usually have access to both COL and regular OCR lending. (Table 1 and Appendix 1).

¹ The amounts of donors’ contributions decreased from $ 4.8 billion during ADF XI to $ 2.5 billion during ADF 12.
² Group A countries at high risk of debt distress (grants-only countries) are eligible for 100% ADF grants, those at moderate risk of debt distress (ADF blend countries) are eligible for 50% ADF grants and 50% COL, and those at low risk of debt distress (concessional OCR-only countries) are eligible for COL only.
Table 1: Concessional Assistance Developing Member Countries

<table>
<thead>
<tr>
<th>At high risk of debt distress</th>
<th>At moderate risk of debt distress</th>
<th>At low risk of debt distress or IDA gap</th>
<th>Group B</th>
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</thead>
<tbody>
<tr>
<td>Afghanistan f</td>
<td>Kyrgyz Republic</td>
<td>Bhutan</td>
<td>Bangladesh</td>
</tr>
<tr>
<td>Micronesia, Federated States of fσ</td>
<td>Solomon Islands fσ</td>
<td>Cambodia</td>
<td>Mongolia</td>
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<tr>
<td>Kiribati fσ</td>
<td>Vanuatu σ</td>
<td>Lao PDR</td>
<td>Pakistan</td>
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<tr>
<td>Maldives σ</td>
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<td>Myanmar f</td>
<td>Palau σ</td>
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<tr>
<td>Marshall Islands fσ</td>
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<td>Nepal</td>
<td>Papua New</td>
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<td>Nauru fσ</td>
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<td>Samoa σ</td>
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<td>Timor-Leste fσ</td>
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<td>Tonga σ</td>
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<td>Uzbekistan</td>
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<td>Tuvalu fσ</td>
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= fragile and conflict-affected situation, σ = small island developing states, IDA = International Development Association, Lao PDR = Lao People’s Democratic Republic.

Notes:
1. India is a group B country and does not have access to concessional assistance.
2. ADB country allocation in 2019 for Maldives is 50% ADF grants and 50% COL because the country is in breach of ADB’s Concessional Assistance Policy regarding non-concessional borrowing by grant recipients.
3. The IDA gap countries are Bhutan, the Lao PDR, and Myanmar. They have gross national income per capita above the operational cutoff for IDA eligibility for more than 2 consecutive years and are assessed as such by IDA. The operational cutoff is $1,175 (2018 prices).
4. Based on the 2019 Debt Distress Classification for Concessional Assistance-only Countries.

5. The concessional assistance countries face significant challenges and are not a homogeneous group. The CA countries, especially the group A countries, still face important development challenges such as persistent poverty, fragility and vulnerability, gender gaps, climate change, disaster risks, limited private sector development, and low institutional capacity.

6. There is still a need for grants in Asia and the Pacific. Grants are needed to support DMCs facing high or moderate risks of debt distress. There is also a potentially catalytic role for grants to play as incentives in targeted areas such as gender equality, climate change adaptation, and disaster risk reduction.

7. Robust economic growth and decline in poverty in the region. Asia and the Pacific has been the fastest growing region in the world in recent decades. It is expected to account for more than half of global production by 2050. Growth in developing Asia is moderating but remains robust as growth forecasts for developing Asia at 5.4% for 2019 and 5.5% for 2020. Sustained economic growth has led to a significant decline in poverty in the region. Extreme poverty, as measured by the $1.90 per day threshold at 2011 purchasing power parity, has significantly declined in developing Asia from 58% in 1990 to about 7% of the total population in 2015.

8. Persistence of pockets of poverty and slow improvement in social and human development in concessional assistance countries. Large pockets of extreme poverty still persist in CA countries. Extreme poverty (measured against a threshold of $1.90 per day) in CA countries is higher than in the developing Asia, at about 10% of the population. This number is

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significantly underestimated, though, since some group A countries without official data have high estimated poverty rates, including two relatively large DMCs: Afghanistan, with an estimated poverty at 55%, and Cambodia, with an estimated poverty at 14%. Many people in CA countries face not only income poverty but also nonmaterial deprivations, such as food insecurity, weak social protection, poor health, and lack of education. Ninety-four million people living in CA countries are undernourished. In 2015, social protection covered only 55% of intended beneficiaries, leaving nearly half the intended beneficiaries without support. While child mortality declined from 36 per 1,000 live births in 2014 to 31 per 1,000 in 2017 in ADB DMCs, child mortality remained substantially higher in the CA countries, at 49 per 1,000 live births. In the Pacific, lower secondary graduation rates fell from 45.3% to 43.8% for females and from 45.5% to 43.6% for males. The most vulnerable groups include those in the low-income bracket, women, indigenous peoples, ethnic minorities, persons with disabilities, hard-to-reach and remote populations, migrants, and displaced and conflict-affected people.

9. **Fragile and Conflict-Affected Situations.** Countries facing fragile and conflict-affected situations (FCAS) present political, social, economic, and environmental challenges that differ from those in other developing countries. In 2019, all 10 ADB FCAS are also CA countries. The vulnerability of countries is a multidimensional concept based on susceptibility to shocks or hazards, the origins of which can be environmental, economic, social, or political. Conflict, political instability, weak governance, economic and social insecurity, and vulnerability to the effects of climate change make it particularly difficult for FCAS countries to achieve their development objectives. Limited institutional capacity further affects a state’s weak ability to carry out the basic functions of governing. Among CA countries classified as FCAS, two (Afghanistan and Myanmar) are considered to be conflict-affected. Afghanistan’s potential for growth and development is vast and continued ADF grant assistance will be essential to helping the country build resilience, and achieve self-reliance and sustainable inclusive growth. Other countries are labelled fragile mainly because of their limited institutional capacity. Fragility and vulnerability remain as some of the biggest obstacles to peacebuilding and poverty reduction.

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6 The Afghanistan Living Conditions Survey 2016–17 estimates the poverty line at 2,064 afghans per person per month, equivalent to US$26, or less than $1 per day at current rates. The Cambodia Socio-Economic Survey 2014 used a national poverty line equivalent to US$46 per month.

7 The Food and Agriculture Organization of the United Nations, International Fund for Agricultural Development, United Nations Children’s Fund, World Food Programme, and World Health Organization. 2018. *The State of Food Security and Nutrition in the World 2018: Building Climate Resilience for Food Security and Nutrition.* Rome. Undernourishment is defined as the condition in which an individual’s habitual food consumption is insufficient to provide the amount of dietary energy required to maintain a normal, active, and healthy life. The estimate for Asia is based on country classifications by the Food and Agriculture Organization of the United Nations.


10 Fragility is a multifaceted concept and can materialize differently in DMCs. Conflicts also refer to diverse situations on the ground from low-intensity conflicts to high intensity violent conflicts.

11 The 10 FCAS are Afghanistan, the Federated States of Micronesia, Kiribati, the Marshall Islands, Myanmar, Nauru, Papua New Guinea, Solomon Islands, Timor-Leste, and Tuvalu. Vanuatu is on the watch list as its average rating is marginally above the cutoff rating. ADB uses the multilateral development banks’ harmonized ratings for determining FCAS. A country is considered FCAS if it has an average rating of 3.2 or less based on the ADB country performance assessment and the World Bank Group country policy and institutional assessment. A country is also considered FCAS if a United Nations and/or regional peacekeeping or peacebuilding mission has been present during the past 3 years. ADB is working jointly with other multilateral development banks to improve the methodology to track fragile situations.


reduction, as well as a threat to growth, development and stability. Fragility, vulnerability, and conflict risks can take place at the subnational level and beyond national borders, as recently illustrated by the crisis of displaced persons in the Cox’s Bazar District in Bangladesh.

10. **Small island developing states.** Small island developing states (SIDS) are characterized by their small size, remoteness from global markets, and heightened vulnerability to shocks. SIDS are particularly vulnerable to climate change, natural hazards, and economic shocks. A single disaster triggered by natural hazards, for example, can significantly set back development progress in SIDS by a decade or more. Their rich biodiversity and coastal zones are susceptible to environmental degradation. Many SIDS confront severe institutional capacity constraints and other factors, which make them FCAS. Thirteen SIDS are eligible for concessional assistance. The financing needs alone for basic infrastructure in the 13 SIDS that are eligible for concessional assistance are estimated to exceed $2.6 billion per year—equivalent to 27% of annual government expenditures in these countries. This amount reflects the high-cost environment of SIDS and the difficulty in achieving economies of scale in small countries.

11. **Persistent gender gaps.** Gender gaps remain persistent in the labor market, wage levels, access to essential services, and decision-making. Among the 13 CA countries with Social Institutions and Gender Index (SIGI) from the Organisation for Economic and Co-operation Development (OECD), 6 countries (3 group A DMCs and 3 group B DMCs) are in the high or very high category, which means highly restrictive institutions for women’s and girls’ rights. According to the World Economic Forum’s Global Gender Gap Report 2018, which ranks 149 countries worldwide, 6 among the 12 CA countries with available data are ranked in the bottom tier. These countries perform particularly poorly in terms of economic participation, educational attainment, and health. Women’s economic participation is often challenged by their domestic care responsibilities. Women and girls in the region spend as much as 11 times more of their day on unpaid care and domestic work than men and boys. Except for one DMC, political empowerment is consistently low across all listed CA countries, indicating the significant need to increase women’s voice in decision-making. Finally, in several CA countries, the level of gender-based violence remains very high. The share of women having an experience of intimate (both married and unmarried) partner violence (physical and sexual) in their lifetime is over 60% in some CA Pacific countries.

12. **Climate change and disaster risks.** Climate change and disasters threaten the long-term sustainability of development in the region. CA countries are particularly impacted. Asia and the Pacific is subject to all major types of natural hazards, including earthquakes, tsunamis, and extreme weather events, including tropical cyclones, floods, and droughts.

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16 The OECD’s SIGI, brings together quantitative and qualitative measures of institutions in terms of their discrimination in the forms of formal and informal laws, attitudes and practices that restrict women’s and girls’ access to rights, justice and empowerment opportunities.
18 World Economic Forum. 2018. *Global Gender Gap Report 2018*. Geneva. The 2018 report benchmarks 149 countries on their progress towards gender parity on a scale from 0 (disparity) to 1 (parity) across four thematic dimensions (economic participation, educational attainment, health and survival, and political empowerment) and provides country rankings.
19 Afghanistan, Uzbekistan and all group A and B Pacific countries are not ranked in the report.
Geophysical hazards (including earthquakes and tsunamis) have also caused significant loss of lives. Between 1999 and 2018, 723,913 lives were lost in ADB’s DMCs as a consequence of natural hazards.\textsuperscript{20} A further 3.4 billion people were affected while reported damage totaled $640 billion.\textsuperscript{21} CA countries alone accounted for 54\% of total fatalities, 39\% of people affected, and 23\% of total reported physical losses. Of the 15 countries worldwide with the highest estimated disaster risk, eight are CA countries (5 group A countries and 3 group B countries).\textsuperscript{22} Climate change and disasters are especially affecting the lives and livelihoods of poor and vulnerable people. The poor rely on fewer and more vulnerable assets, often located in more hazard-prone areas; have limited access to finance; and lack opportunities to engage in sustainable livelihoods. The 2015 Nepal earthquake was expected to push an additional 2.5–3.5\% of the population, equivalent to up to 1 million people, below the poverty line.\textsuperscript{23} SIDS are particularly vulnerable to both climate change and natural hazards, reflecting their narrow economies, remoteness, geographical positions in areas particularly prone to both extreme weather and geophysical events, and diseconomies of scale in addressing risk.

13. **Quality infrastructure gap in concessional assistance countries.** Access to energy increased significantly but about 20\% of people in CA countries still had no access to electricity in 2017. The proportion of population in CA countries using safely managed drinking water remains largely unchanged, with wide rural (84\%)—urban (93\%) disparities. Only 73\% of urban residents and 54\% of rural residents were using safely managed sanitation services, including handwashing facilities with soap and water in 2015. Road access per 10,000 people did not really progress during 2013–2016 in CA countries (footnote 9).

14. **Regional cooperation and integration including the provision of regional public goods.** CA countries increasingly face additional development challenges that are regional in nature. These include poor connectivity between economies, limited regional trade and investment opportunities, and also underinvested regional public goods such as environmental preservation, including ocean health, regional climate change mitigation and adaptation, regional access to education services, and the mitigation of cross border health risks, among others.\textsuperscript{24} Asia and the Pacific has been identified as a hotspot for emerging infectious disease outbreaks, with some of the most expensive and deadliest disease outbreaks originating in the region. While national-level investments are essential to improving health security, there are benefits that can be gained from adopting a regional approach to strengthening health security. As diseases spread without consideration of national borders, effective prevention and control strategies can require cooperation at the supranational level with several national governments acting in concert.

15. **Limited private sector development in frontier markets.** Lower income economies have underdeveloped financial markets, which limit the possibility of any significant increase in


\textsuperscript{21} Including multiple counting of people affected multiple times.


\textsuperscript{24} Regional public goods are public goods whose benefits extend beyond the territory of a single nation to a well-defined region.

resources from the private sector. CA countries particularly group A DMCs, FCAS and SIDS, generally lack stability and market capacity in terms of business environment. In the World Bank Group’s 2019 report on the ease of doing business in 190 countries, more than 50% of group A countries were among the bottom third of countries. Given that jobs are created primarily by the private sector, improving the business environment for entrepreneurs and companies would generate numerous job opportunities for the poorest. This includes small and medium-sized enterprises and inclusive businesses, and supporting the expansion of private sector operations in new sectors such as agribusiness and social sectors.

16. **Debt sustainability.** The number of group A countries at high risk of debt distress has doubled from 2011 to 2019 as a result of weak debt management and a country’s high vulnerability to economic shocks and disasters triggered by natural hazards. Increasing public debt levels and risks in the poorest and most vulnerable DMCs adversely impact investments to achieve Sustainable Development Goals (SDGs) and address climate change. This situation could further worsen in the event of a global economic slowdown.

III. ADF IS AN EFFECTIVE PLATFORM

17. The ADF is the largest of ADB’s special funds and has a long-standing and established framework for resource allocation and governance. Since its inception, the ADF has been part of ADB’s core operations. ADF grants provide stable and predictable resources for recipient countries for annual country programming of ADB operations. This feature is very important for FCAS countries and SIDS, as one of ADB’s key principles for working in these countries is making a long-term commitment to support their development priorities. Being specifically targeted at the poorest and most vulnerable countries, the ADF is a key component to delivering ADB’s mandate and has enabled ADB to better fulfill its role as a key development partner.

18. Accommodating various interests of ADF donors, the ADF embodies a collective effort of donors in supporting the region. Donors continue to have a strong voice, play an active role, and share a common understanding of the strategic direction of the ADF in addressing poverty, vulnerability, challenges in the promotion of regional cooperation, disaster resilience, and disaster response, among others. Major ADB policies have resulted from ADB’s regular consultations with ADF donors. The ADF provides a platform for maximizing common interests among donors, leveraging financial contributions, and responding to diverse country needs. From this perspective, the ADF remains highly relevant to supporting eligible countries with diverse needs and supporting unfinished agendas in the region.

19. **Effectiveness of ADB’s assistance is strong.** ADF as an integral part of ADB benefits from all recent institutional improvements that ADB has implemented. ADB has a successful track record of delivering assistance and obtaining results in these countries through the previous ADF replenishment rounds. A midterm assessment of the ADF 12 found that these funds had been allocated in line with the priorities set by ADB and the ADF donors. The focus on gender mainstreaming has increased, with more than 3 million women and girls set to benefit from new and improved infrastructure provided by ongoing projects. Food security is being strengthened with additional rural roads, value-chain development, and food safety advances.

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27 In 2011, group A high-risk countries were Afghanistan, Nauru, Tajikistan, Tonga and Tuvalu. In 2019, group A high-risk countries are Afghanistan, the Federated States of Micronesia, Kiribati, Lao PDR, the Marshall Islands, Nauru, Samoa, Tajikistan, Tonga and Tuvalu.
as well as irrigation upgrades on almost 40,000 hectares of land. Improving governance and capacity building have been supported by 85% of ADF 12 grants committed so far. More than 3 million people are expected to benefit from strengthened climate and disaster resilience supported through the Disaster Risk Reduction financing mechanism.  

20. **External assessments of the development effectiveness of ADB’s support have also been consistently positive and improving over time.** More recently, the 2019 report of the Multilateral Organisation Performance Assessment Network\(^2^9\) assessed ADB for the fourth time (previous assessments were conducted in 2006, 2010 and 2013). The assessment does not focus on ADF per se but looks at ADB’s organizational effectiveness including concessional assistance operations as a whole (strategic, operational, relationship and performance aspects) and the results it achieves against its objectives. Overall, the assessment finds that ADB has maintained a positive performance trajectory. The assessment appreciates the relevance of ADB’s strategic framework and ADB’s well-recognized comparative advantage based on its ability to provide a combination of financing and knowledge. The assessment also highlights that ADB is closer to its clients and has a well-developed results-based management system. Finally, the *Aid Transparency Index* 2018, which does not specifically focus on ADF, ranks ADB first among 45 donor organizations.\(^3^0\) This is a strong signal of ADB’s commitment to performance and transparency.

21. **Independent Evaluation Department’s assessment of ADF XI and ADF 12 concludes that ADB project performance and results are stronger than during previous ADF periods.** Independent Evaluation Department’s main conclusion is that development results made possible by ADF XI and ADF 12 grants are stronger than for previous ADF periods and there is a strong rationale for continuing ADF support.\(^3^1\) These positive evaluations did not change even after the ADF became a grant-only operation. The evaluation further highlights that ADF transitioning to a grants-only facility has increased the ADF’s relevance. It concludes that it is critical for ADB to continue to scale up ADF grant support for sustainable development in the most vulnerable areas of Asia and the Pacific in order to consolidate development gains and enhance the chances of achieving the SDG goals by 2030.

22. **ADB continues to improve its institutional effectiveness to be stronger, better, and faster.** Following the finalization of Strategy 2030, ADB is carrying out comprehensive reforms to continue to strengthen its operational efficiency and effectiveness, improve internal capacity, respond to the remaining and emerging challenges in the region, and develop differentiated approaches to groups of countries through the modernization of business processes and expansion of its products and instruments. Building on these changes, ADF 13 will be utilized to maximize its impact in the countries eligible for ADF grants and achieve a prosperous, inclusive, resilient, and sustainable Asia and the Pacific in line with major global commitments.

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IV. ADF 13 STRATEGIC DIRECTIONS

23. **Mainstreaming Strategy 2030 through ADF 13.** ADF 13 will be the first ADF to implement the ADB’s Strategy 2030 during its full cycle.\textsuperscript{32} ADF 13 is a critical instrument to implement ADB’s corporate strategy in line with major global commitments, including the SDGs, that donors, DMCs, and ADB have pledged to support. Strategy 2030 will be guiding the implementation of ADF 13. ADF 13 will mainstream Strategy 2030’s seven operational priorities in the poorest and most vulnerable DMCs, and sustain its effort to eradicate extreme poverty.

24. **Access to ADF 13 grants varying across groups of countries.** ADF 13 grants will implement the seven Strategy 2030 operational priorities in group A countries at high risk of debt distress (grants-only countries) and at moderate risk of debt distress (ADF blend countries). The bulk of ADF 13 grants will continue to be allocated on a country basis to group A countries. As each country is different and faces specific challenges, the operational focus will be decided at the country level when the country partnership strategies and the country operations business plans are prepared. Additional ADF 13 grants will be offered on a project basis to address specific challenges under the thematic priorities.

25. **ADF 13 grants will be provided to group A countries at low risk of debt distress and International Development Association (IDA) gap countries (COL-only countries) to address specific challenges under the thematic priorities. ADF 13 grants will also be provided on a very selective basis to group B countries to address specific challenges.**

26. **Proposed six areas of special attention under ADF 13.** ADF 13 will give special attention to six areas to respond to the main challenges in the poorest and most vulnerable DMCs, in alignment with Strategy 2030. ADF 13 will create synergies across ADF 13 areas for special attention to maximize its operational impact. For instance, climate change can exacerbate fragility in countries facing FCAS. Consequently, this helps create incentives to invest in climate change adaptation in FCAS to build quality rural infrastructure and support a sustainable and productive agricultural sector. By doing so, ADF 13 can promote the mutual benefits of each area of special attention and have an overall greater impact on DMCs. Figure 1 summarizes the linkages between Strategy 2030, the ADF 13 areas for special attention, quality infrastructure as cross-cutting-priority, and how the strategic directions are implemented through the proposed ADF 13 allocation framework (Section V).

1. Supporting Fragile and Conflict-Affected Situations and Small Island Developing States

27. ADF 13 grants will continue to play a critical role in FCAS through the continuation of special support to Afghanistan, which is a grant-only country with large development needs and assessed at high risk of debt distress. Group A SIDS are either at high or moderate risk of debt distress. Grant financing is vital to SIDS to preserve debt sustainability, as borrowing for a single investment project might significantly increase their debt burden because of the small size of their gross domestic product (GDP). ADF 13 grants are also necessary to support investments with positive externalities and with low financial return such as in gender equality, climate change adaptation, disaster risk reduction, post-disaster recovery, connectivity and access, institutional strengthening, and private sector development. ADF 13 grants will contribute to the reduction of SIDS’ vulnerability to shocks through the proposed economic vulnerability premium (paras 45–47).

2. Addressing the Sustainable Development Goal 5’s Transformative Gender Agenda

28. Overall, addressing gender inequalities has intergenerational benefits, as illustrated by the impact of educated mothers on children and has large social and economic impact beyond girls and women’s wellbeing. Estimates show that if the region eliminated gender inequalities, it
would add 12% (or $4.5 trillion) to annual GDP by 2025.\textsuperscript{33} Despite these key facts, actions that could significantly improve the situation of girls and women tend to be disregarded when projects are designed because the common perception is that gender inequalities are the result of deeply rooted tradition and social norms. In addition, governments could be reluctant to borrow for addressing gender inequalities as the benefits are not necessarily immediate and are not easy to quantify. Without a proper awareness, governments would tend to under-invest in projects with high gender benefits.

29. ADB projects can strongly demonstrate the approaches to narrowing persisting gender gaps and entrenched gender discrimination through projects such as the school-to-work transition, labor force participation, leadership and decision-making, and access to services. ADB projects may incorporate a strong component addressing gender inequalities in a standard project (e.g., a menstrual hygiene assistance output included in a water supply project to enhance girls’ school attendance as well as stop harmful cultural practices in segregating menstruating women in rural areas; or a dedicated pilot output on providing more secure husband-wife joint housing titles in an urban low-income settlement upgrading project). At the same time, ADB has already started exploring new approaches to strengthening capacity development in Afghanistan and Pakistan through technical assistance (Box), and gender projects or gender components of projects would further address the persistent gender gaps in CA countries.

30. The SDG 5’s transformative gender agenda provides strategic entry points for challenging the discriminatory social norms that drive gender inequalities.\textsuperscript{34} ADF 13 grants will be used to go beyond standard gender mainstreaming activities and support projects or components of projects to achieve the SDG 5’s transformative gender agenda. This could have significant benefits, especially in FCAS where gender inequalities are high (Appendix 2). ADF 13 projects will have essential catalytic roles in demonstrating that innovative gender approaches to changing social norms and discriminatory practices. This will encourage countries to pursue more transformative gender actions more generally, including through using their own funds. ADB through the utilization of ADF 13 is committed to address the sexual exploitation and abuse and sexual harassment agenda.


\textsuperscript{34} The SDG 5’s transformative gender agenda includes five main areas: (i) eliminating violence against women and girls; (ii) reducing and rebalancing unpaid care and domestic work, (iii) encouraging women’s participation in decision-making and leadership; (iv) emphasizing sexual and reproductive health and rights; and (v) creating access to economic and productive resources, information and communication technology and supporting legal or institutional reforms for protecting women’s rights and changing gendered social norms.
3. Supporting climate change adaptation and disaster resilience

31. Historically, governments are reluctant to borrow for disaster risk reduction projects as the benefits may not be reaped for many years and are realized in the form of reduced disaster losses, rather than yielding assured near-term benefits and positive streams of direct or indirect income. Investments in climate change and disaster resilience are further stymied in some cases by their public good nature. Such investments may be underfunded because investors do not take account of their positive (and reduction and eradication of negative) externalities, such as the benefits to downstream communities and neighboring countries of investments in flood risk management or tsunami early warning system. To reverse this trend, ADF 13 grants are necessary to incentivize further investment in climate change adaptation and disaster risk reduction.

32. ADF 13 will give special attention to supporting climate change adaptation and disaster resilience (Appendix 3). This includes post-disaster response. Progress on climate change adaptation in CA countries has lagged progress on climate change mitigation, in part reflecting the more embedded nature of climate change actions across a wide range of development projects, requiring wide-ranging specialist knowledge on related opportunities. ADF 13 grants will have an important role, as both adaptation and disaster risk reduction require significant context-specific responses and a multifaceted risk management approach that can adequately encompass uncertainty, complexity, and long-term perspective.

33. Enhanced response to disasters under ADF 13. Response to disasters triggered by natural hazards will be enhanced during ADF 13. All group A DMCs will be able to receive

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35 For example, the formation and path of tsunamis can be monitored and tracked yet there was no tsunami early warning system in place for the Indian Ocean prior to the 2004 Indian Ocean tsunami. The tsunami caused death and destruction across 14 countries located around the ocean, killing 230,000 people. A joint early warning system, including a network of sea level gauges and deep-sea sensors, and related procedures for disseminating warnings could have saved many thousands of lives.

36 In 2019, ADB adaptation finance in CA countries reached $1.0 billion while mitigation finance reached $2.7 billion.

ADF grants in case of severe disasters leading to estimated damages and losses exceeding 10% of GDP. Such severe disasters result in large and urgent post-disaster financing needs that could not be met quickly by additional concessional borrowing without undermining the debt sustainability of DMCs. In addition, the special support received by Bangladesh under ADF 12 revealed ADB’s need for a source of financing and eligibility rules to respond more systematically to disasters and emergencies beyond those triggered by natural hazards. It also revealed that, under specific circumstances, the requirement that limits the provision of ADF grants only to group A DMCs in high or moderate risk of debt distress could be made more flexible to support countries hosting internationally displaced people and providing a global public good.

34. ADF 13 proposes to expand the coverage of the Disaster Response Facility (DRF) to include severe disasters related to humanitarian emergencies caused by conflict, and public health emergencies such as epidemics and pandemics on top of those triggered by natural hazards. ADF 13 proposes offering grant assistance to group A and B countries when they accommodate significant cross-border inflows of displaced people following a disaster.

4. Fostering Regional Cooperation and Integration Including the Provision of Regional Public Goods

35. ADF 13 will continue to support regional cooperation and integration (RCI) in group A countries. It will increase the provision of regional public goods (RPGs) in group A countries and selectively in group B countries by aligning the costs and benefits of national projects that address them. A key rationale for grant-funded interventions is to capture the positive externalities that an investing country does not enjoy and mitigate the negative externalities imposed beyond national boundaries. Grants would make investments in projects addressing regional public goods viable from a national perspective. ADF 13 grants will be used to demonstrate the benefits of projects with regional public good properties and incentivize governments to opt for these investments. ADF 13 will give increasing attention to supporting ocean health and coastal and marine resource management.

36. Regional health security. Building on the positive track record of the ADF 12 regional health security (RHS) set-aside, ADF 13 will support regional health by (i) supporting cross-border communicable disease prevention and control; and (ii) promoting effective cross-sector initiatives on regional health, such as regional universal health coverage to ensure that countries are prepared to prevent, detect and respond to human and animal disease outbreaks before they become pandemics which have devastating consequences on human and animal health and a negative impact of trade. Despite high returns on investment, many countries are hesitant to borrow to strengthen health security if they have not recently experienced a major epidemic. Part of ADF 13 grants will be critical to catalyze investments in RHS.

37. ADB has been expanded its technical capacity in health and health security in particular through strategic partnerships with WHO, Japan International Cooperation Agency (JICA), the

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38 Many countries are under the false impression that investments in human capital and health security are not productive. Through the ADF 12 Regional Health Security (RHS) Set-Aside, ADB incentivized countries to borrow for investments in health security by providing countries with additional grants. By co-financing loans with grants, ADB was able to leverage significant investments in countries that were originally resistant to borrowing for the health sector including strengthening primary health care system which is an integral part of health security. The $53 million in RHS grants available under ADF 12 were leveraged into four projects worth a total of around $200 million.
United Nations Children’s Fund (UNICEF), the US Centers for Disease Control and Prevention, Australia’s Department of Foreign Affairs and Trade (DFAT), United States Agency for International Development (USAID) and various academic institutions and non-government organizations. These partnerships have greatly expanded ADB’s capacity to engage with countries and assist with the preparation and supervision of regional health security projects. In addition, ADB as multisectoral institution that has convening power and influence in several sectors beyond health, is able to lead health security initiatives which require close collaboration across multiple sectors. By leveraging these connections, ADB can contribute to strengthening regional health security through engagements with strategic sectors, including health, finance, agriculture, tourism, environment, and urban to complement actions from other humanitarian and development partners.

5. Supporting private sector operations in frontier markets on a pilot basis

38. Through blended finance, grants can support ADB’s private sector operations, to de-risk investments, mobilize private finance, and bring projects to markets that might not proceed in the absence of these concessional resources. ADF 13 will support expanding private sector operations by piloting a private sector window in group A countries that will support greater opportunity for ADB’s private sector operations in frontier markets. Activities will also be developed in new sectors with a higher development impact. These include deepening ADB’s interventions in agribusiness, social sectors, new technology, and infrastructure beyond energy. These activities will further support promoting gender equality and climate change mitigation and adaptation by 2030 by strengthening gender and climate-sensitive project designs in private sector operations.

6. Enhancing Debt Sustainability

39. ADF 13 will address the debt distress risks faced by ADF eligible countries by providing grants and technical assistance. Many SIDS are indebted due to the impacts of disasters and the high costs of recovery, further exacerbated by constrained fiscal space, limited revenue generation potential, and high costs of public services. ADF 13 will align with the World Bank–International Monetary Fund (IMF) multi-pronged approach to addressing debt vulnerabilities through the provision of technical assistance in four areas: debt analysis and early warning systems, debt transparency, debt management capacity, and review of debt policies.

40. While ADF 13 will continue to support countries with risk of debt distress, it will address moral hazard associated with excessive borrowing. The proposed ADF 13 framework provides incentives for all group A countries to improve debt management through preferential access to the thematic pool for countries with prudent or improved performance in fiscal, debt and budget management. In addition, under ADF 13, ADB will provide policy advice and capacity development through technical assistance to countries at high and moderate risk of debt distress. ADB will consider using mechanisms to deter grant-eligible countries from acquiring or expanding non-concessional debt (paras 56–60) in line with the policies of the IMF and the World Bank.

V. THE PROPOSED ADF 13 RESOURCE ALLOCATION FRAMEWORK

41. The proposed ADF 13 resource allocation framework will continue to adopt a hybrid system as the ADF 12 framework (Appendix 4), consisting of country- and theme-based components. At the same time, to enhance the implementation efficiency of the scarce concessional resources, it is proposed that the ADF 13 framework revises several elements of
the existing ADF grant and COL resources allocation mechanism. This section summarizes the key features of the proposed ADF 13 framework and discusses in detail the proposed revisions. Figure 2 illustrates the proposed ADF 13 framework.

Figure 2. Proposed ADF 13 Grant Framework

ADF = Asian Development Fund, RCI = regional and cooperation integration, RPGs = regional public goods, SDG = Sustainable Development Goals.


42. The proposed ADF 13 framework will retain the following key features of the ADF 12 resource allocation mechanism:

(i) Country classification system and debt sustainability assessment to determine country eligibility for grant;

(ii) Performance-based allocation (PBA) formula, which comprises country performance assessments (17 criteria in five clusters, which are macroeconomic management, structural policies, social inclusion and equity, governance, and portfolio performance), per capita gross national income, and population;

(iii) Special post-conflict support for Afghanistan;

(iv) Disaster Response Facility with expanded scope and country coverage, at 8% of total ADF grant resources. Details of the proposed expansion of DRF under ADF 13 are discussed in a separate discussion paper Expanded Disaster Response Facility under ADF 13 (footnote 37); and

(v) Debt distress reserve at 7% of total ADF grant resources comparable to the remaining amount for the debt distress reserve under ADF 12.

39 The Disaster Response Facility under ADF 12 is set at 10% of total ADF resources; this translates to 8% of total ADF resources under ADF 13.
43. The proposed ADF 13 framework proposes the following revisions, which are summarized in Appendix 5, to improve the implementation efficiency and effectiveness of resource allocation:

(i) discontinuing the base allocation for all CA countries and introducing a more efficient economic vulnerability premium for SIDS eligible for ADF grants;

(ii) expanding the thematic use of ADF grants to gender equality and climate change adaptation;

(iii) introducing a single thematic pool applicable for group A countries and very selectively for group B countries, addressing thematic priorities in gender equality, climate change adaptation and disaster risk reduction, and regional cooperation and integration including regional public goods;

(iv) discontinuing the volume discount for group A countries at high and moderate risk of debt distress that receive ADF grants and, instead, giving preferential access to the thematic pool to countries with prudent or improved fiscal, debt, and budget management;

(v) piloting a Private Sector Window (PSW) for group A countries to help expand private sector operations in frontier markets and new sectors;

(vi) separating the allocation mechanism for ADF and COL. COL will be allocated based on needs for concessional assistance by countries (including historical utilization and pipeline), the elements of PBA, and availability of concessional loan resources. For group A countries with moderate risk of debt distress, the grant amount will be half of the country allocation of ADF grants; and

(vii) converting the biennial allocation to four-year allocation with annual updates to improve the efficiency of the allocation process.

44. The following sections discuss in detail these proposed revisions of the existing ADF grant allocation framework.

A. Proposed Economic Vulnerability Premium for ADF Eligible Small Island Developing States to Replace Base Allocation

45. The PBAs for SIDS are generally very small due to their small population size, and not sufficient to meet the country needs for key development programs. ADF 12 allocates an annual $6 million base allocation (increased by $7 million per year for 2019–2020) which is applied to all CA countries, including those with larger PBA.

46. ADF 13 framework introduces an economic vulnerability premium for SIDS eligible for ADF grants, to complement their PBAs. The allocation of the economic vulnerability premium is proposed to be limited to the ADF-grant eligible SIDS because other ADF-grant eligible countries benefit from much larger PBAs. The amount of the economic vulnerability premium for SIDS will depend on the degree of the vulnerability of countries, measured by the Economic
Vulnerability Index (EVI) scores. The proposed economic vulnerability premium will replace the base allocation under ADF 12.

47. The overall proposed envelope for the economic vulnerability premium under ADF 13 will be guided by the overall base allocation amount for ADF-grant eligible countries under ADF 12. SIDS will be divided into groups based on their EVI scores and assigned a premium in a range of $40 million–$55 million per cycle ($10 million–$14 million per year). The most economically vulnerable countries will receive the highest premium. Group A countries with moderate risk of debt distress will receive half of the economic vulnerability premium. As of 1 January 2019, 10 SIDS will be eligible for the economic vulnerability premium. It is estimated that all 10 ADF grant-eligible SIDS are expected to receive at least the same amount for the economic vulnerability premium as they received for the base allocation during ADF 12. Additional information on the methodology for calculating the economic vulnerability premium for SIDS and an alternative approach to calculating an economic vulnerability premium are presented in Appendix 6.

B. The Proposed Thematic Pool under ADF 13

48. ADF 13 proposes to pool the existing set-asides under ADF 12 together to a single thematic pool, and expand the thematic use of ADF grants to address SDG 5’s transformative gender agenda and climate change adaptation.

49. The proposed thematic pool will cover three thematic priorities in:

(i) achieving the SDG 5’s transformative gender agenda;

(ii) supporting climate change adaptation and disaster risk reduction; and

(iii) fostering RCI including provision of RPGs, RHS (preventive actions), and ocean health actions, among others.

50. Project selection process. The resources will be allocated to projects through an annual project submission and selection process using a two-step approach (Appendix 7). First, the projects will have to meet the project eligibility criteria. Second, projects will be prioritized using a scorecard. The scorecard will assign a higher weight to the criterion of prudent or improved fiscal, debt and budget management. A higher score will be considered if the projects:

(i) are in countries with prudent or improved fiscal, debt and budget management;

(ii) have high development impact in the relevant thematic area(s) and strong positive regional spillover effects;

(iii) are in countries where portfolio performance is high;

(iv) involve two or more countries and cutting across multiple thematic areas;

(v) leverage external funding or have enhanced buy in of the government; and

(vi) are innovative.

The EVI was set up by the United Nation’s Committee for Development Policy, and captures several characteristics such as population size, remoteness, size of economic base, and vulnerability to climate change, among others.
51. An internal committee will review project proposals during an annual project submission and selection process. To assess (i) and (iii) above, the committee will use existing performance indicators from the country performance assessment.

52. **Country eligibility.** The thematic pool will be available to all group A countries based on the selection process (paras 50–51). The thematic pool funds can finance up to two-thirds of the project costs for group A countries.

53. The thematic pool can be accessed by group B countries on a very selective basis, with priority to FCAS and SIDS. The project eligibility criteria will be more stringent for group B countries. For the thematic priority of addressing SDG 5’s transformative gender agenda, access of group B countries is restricted to projects piloting innovative solutions or taking place in countries performing poorly in terms of gender equality.\(^{41}\) For the thematic priority in supporting climate change adaptation and disaster risk reduction, projects of group B countries should target the poorest and most vulnerable populations and pilot innovative solutions, including use of innovative design and high technology, or leverage additional finance, including finance from the private sector. For the thematic area of fostering RCI, including provision of RPGs, access of group B countries to funds is restricted to RPGs. A cap of 10% will be introduced for overall allocations for group B countries from the thematic pool. A higher leveraging ratio will be applied to group B countries with a maximum of one-fourth of the project costs to be funded by the thematic pool.

54. Utilization of the thematic pool will be reported during the annual donor consultation meetings and reviewed at the midterm of ADF 13.

55. **Indicative shares** for the thematic pool priorities and range of amounts for the proposed ADF 13 funding scenarios are proposed in Table 2. The proposed shares and amounts for the thematic priorities in supporting climate change adaptation and disaster risk reduction and fostering RCI, including provision of RPGs, are largely based on demand for RCI and DRR under ADF 12. A relatively small size is proposed for the priority addressing the SDG 5’s transformative gender agenda. Project proposals will be considered for strong demonstration purpose. An annual resource allocation will be conducted on a project basis in line with the project eligibility criteria and the project prioritization principles (paras 50–51 and Appendix 7). In order to allow sufficient time for country programming, project preparation, and commitment of resources, resource allocations may be frontloaded subject to resources availability. For example, 40% of each of the notional envelopes are expected to be allocated in the first year, 35% in the second year, and 25% in the third year.

\(^{41}\) Data sources will include OECD Social Institution, Gender Index and World Economic Forum Global Gender Gap Report and other country gender assessments.
Table 2: Proposed Indicative Shares and Amounts for Thematic Pool Priorities for ADF 13

<table>
<thead>
<tr>
<th>Proposed Thematic Pool Priorities</th>
<th>Proposed Indicative Share (% of thematic pool)</th>
<th>Indicative Range for Financing Scenarios 1–3 ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Achieving the SDG 5’s transformative gender agenda</td>
<td>20</td>
<td>142–186</td>
</tr>
<tr>
<td>Supporting climate change adaptation and disaster risk reduction</td>
<td>40</td>
<td>283–373</td>
</tr>
<tr>
<td>Fostering regional cooperation and integration including provision of regional public goods</td>
<td>40</td>
<td>283–373</td>
</tr>
</tbody>
</table>


C. Addressing Moral Hazard under ADF 13

56. **Discontinuing the grant volume discount.** The 20% grant volume discount applied under ADF 12 is intended to disincentivize countries from borrowing excessively. The impact of the volume discount to address moral hazard, however, is limited in penalizing countries at high and moderate risks of debt distress irrespective of the underlying causes of their increasing indebtedness. The volume discount is particularly ineffective in addressing moral hazard for SIDS, for which debt sustainability is mainly affected by vulnerabilities to economic trends and disasters triggered by natural hazards, rather than fiscal imprudence. The countries that face increasing risks of debt distress are not offered opportunities to improve their debt management. In addition, the volume discount does not directly reward countries at low risk of debt distress for prudent debt management.

57. Under ADF 13, it is proposed to discontinue the grant volume discount. This would help maximize the grant access for the ADF eligible countries through PBAs. The PBA formula through the country performance rating already contains criteria on public debt policy and management, which at the country level is related to the risk of debt distress. Countries with high or increasing scores on public debt policy and management and low or decreasing risk of debt distress will receive additional PBA allocations compared to countries with elevated debt risks.

58. **Preferential access to the thematic pool for countries with prudent and improved debt management.** The proposed ADF 13 framework provides incentives for all group A countries to improve debt management, through preferential access to the thematic pool (paras 48–55). Projects in countries with prudent or improved performance in fiscal, debt and budget management will be given a higher weight in the allocation of the thematic pool. Preferential access to grants through the thematic pool will provide an incentive for a larger set of group A countries, including group A countries at low risk of debt distress and IDA gap countries to continue improving debt management.

59. **Policy advice and capacity building to support debt sustainability through technical assistance.** Under ADF 13, support for ADF countries at high and moderate risk of debt distress will include significant policy advice and capacity building in debt management through the provision of technical assistance in coordination with the World Bank–IMF multi-pronged approach and other multilateral development banks. A Technical Assistance Special Fund (TASF) set-aside will be established under the proposed TASF 7 to support debt
transparency, debt management capacity, and review of debt policies for ADF countries at moderate or high risk of debt distress.\footnote{ADB.2019. *Seventh Replenishment of Technical Assistance Special Fund*. Paper prepared for the ADF 13 Replenishment Meeting. 5–7 November}

60. **Continuing the Non-Concessional Borrowing Policy.** IDA introduced mechanisms to deter grant-eligible countries from acquiring or expanding their non-concessional debt.\footnote{IDA. 2010. IDA’s Non-Concessional Borrowing Policy: Progress Update. Washington, DC; IDA. 2008; IDA’s Non-Concessional Borrowing Policy: Review and Update. Washington, DC; and IDA. 2006. IDA Countries and Non-Concessional Debt: Dealing with the ‘Free-Rider’ Problem in IDA14 Grant-Recipient and Post-MDRI Countries. Washington, DC.} Under the Non-Concessional Borrowing Policy, currently being reviewed and considered to be replaced by the Sustainable Development Finance Policy under IDA19,\footnote{The proposed Sustainable Development Finance Policy of IDA transforms the grant volume discount for IDA-only countries at moderate and high level of debt distress into a performance-based set-aside to incentivize measures to move towards sustainable borrowing policies by strengthening linkages with the IDA allocation framework.} IDA allocations are reduced or terms are hardened. ADB is considering to continue using mechanisms to deter grant-eligible countries from acquiring or expanding their non-concessional debt. Under these mechanisms, ADF grant country allocations may be reduced or access to the thematic pool could be discontinued if a country over-borrows debt on commercial terms.

D. **Piloting a Private Sector Window for Group A Countries**

61. ADF 13 proposes a Private Sector Window (PSW) for group A countries. The PSW is proposed to be 2% of total ADF grant resources. An unused portion will be reallocated to the thematic pool subject to donors’ endorsement. The implementation of the PSW including the respective resource utilizations will be reported during the annual donor consultation meetings and reviewed at the midterm of ADF 13. Details of the proposed pilot PSW are discussed in a separate discussion paper *ADB Private Sector Window to Promote Private Sector Operations in Group A Countries* (footnote 25).

E. **Separating the Allocation of ADF and COL**

62. Following the combination of ADF lending operations with the OCR balance sheet, ADF has become a grant-only fund while COL is funded from ADB’s OCR balance sheet. With ADF grants and COL originating from two different funding sources, but with a linked allocation system, the current allocation system has diminished the efficiency of CA allocation (Appendix 8). Despite availability of COL resources, its allocation is restricted by limited ADF resources that are predetermined by donor contributions. Furthermore, COL allocations entirely based on the PBA formula do not take into account changing country needs and greater capacity of some group B countries for utilizing the resources. De-linking ADF grant and COL allocations is expected to enhance the efficiency of the concessional assistance allocation framework.

63. The allocation of COL is proposed to be based on country needs for concessional assistance (including historical utilization and pipeline), the elements of PBA, and availability of concessional loan resources. For group A countries with moderate risk of debt distress, the grant amount will be half of the country allocation of ADF grants. The country needs for concessional assistance will take into account country demand and the work program and...
budget framework process. It will be calculated on a 5-year average of 2 years’ historical commitments and 3 years’ pipeline. This would minimize fluctuations across annual commitments for countries and ensure countries’ absorptive capacity can be better factored in.

64. COL allocation for group B countries will be prioritized in areas such as DRR, adaptation to climate change, regional projects (RCI and RPGs such as RHS), gender equality, social sectors, food security, and public sector management. As a consequence, the current COL regional set-aside will be discontinued. The need for COL reserve will be observed through an annual update of COL allocations.

F. Converting Existing Biennial Allocations to 4-Year Allocations with Annual Updates

65. ADF 13 proposes to allocate ADF grants and COL resources for the 4 years of the entire period of the ADF 13 cycle, with an annual update. This will increase the predictability of resources and facilitate the preparation of multi-year country programs of loan and grant projects. The country allocations will be updated at the beginning of each year in order to maximize the resources utilization. Country allocations and utilization will be reported during the ADF 13 midterm review.

VI. PROJECTED FUNDING FOR ADF 13 GRANT OPERATIONS

66. Three indicative funding scenarios for ADF 13 are proposed, based on the proposed revisions of the resource allocation framework for ADF 13 provided in Section V. The indicative allocations under the three scenarios are presented in Table 3.

(i) Scenario 1 rests on DMCs’ becoming ineligible for ADF grants which frees up $233 million. The overall ADF 13 grant size would be $2.95 billion compared to $3.18 billion under ADF 12.

(ii) Scenario 2 is based on scenario 1 and adjusted for inflation (2% annually). The overall ADF 13 grant size would be $3.19 billion, comparable to $3.18 billion under ADF 12.

(iii) Scenario 3 is based on scenario 2 plus a $170 million increase in the thematic pool. The overall ADF 13 grant size would slightly increase to $3.39 billion, compared to $3.18 billion under ADF 12.

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45 The work program and budget framework defines the parameters and main thrusts of ADB’s operations, and provides the framework for preparation of the budget for the upcoming year.

46 For details on projections for eligible countries for the ADF 13, please refer to Appendix 1.
Table 3: Projected ADF Funding and Indicative Allocations during ADF 13
($ million)

<table>
<thead>
<tr>
<th>Item</th>
<th>ADF 12 Allocation</th>
<th>Proposed ADF 13 Scenario 1</th>
<th>Proposed ADF 13 Scenario 2</th>
<th>Proposed ADF 13 Scenario 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Amount</td>
<td>Amount</td>
<td>Amount</td>
</tr>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Country allocation, of which</td>
<td>1,783</td>
<td>1,741</td>
<td>1,884</td>
<td>1,884</td>
</tr>
<tr>
<td>Performance-Based Allocation</td>
<td>887</td>
<td>804</td>
<td>970</td>
<td>970</td>
</tr>
<tr>
<td>Special Support to Afghanistan</td>
<td>521</td>
<td>547</td>
<td>524</td>
<td>524</td>
</tr>
<tr>
<td>Base Allocation</td>
<td>376</td>
<td>376</td>
<td>376</td>
<td>376</td>
</tr>
<tr>
<td>Economic Vulnerability Premium</td>
<td></td>
<td>390</td>
<td>390</td>
<td>390</td>
</tr>
<tr>
<td>Set-asides/Thematic pool</td>
<td>775</td>
<td>708</td>
<td>766</td>
<td>932</td>
</tr>
<tr>
<td>Pilot Private Sector Window</td>
<td></td>
<td>59</td>
<td>64</td>
<td>68</td>
</tr>
<tr>
<td>Disaster Response Facility</td>
<td>225</td>
<td>236</td>
<td>255</td>
<td>271</td>
</tr>
<tr>
<td>Reserve for changes in debt distress</td>
<td>221</td>
<td>207</td>
<td>224</td>
<td>238</td>
</tr>
<tr>
<td><strong>Total ADF Grants</strong></td>
<td><strong>3,005</strong></td>
<td><strong>2,950</strong></td>
<td><strong>3,193</strong></td>
<td><strong>3,393</strong></td>
</tr>
<tr>
<td><strong>Memorandum Items</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bhutan and Lao PDR</td>
<td>178</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total ADF 12 Grants</strong></td>
<td><strong>3,183</strong></td>
<td><strong>2,950</strong></td>
<td><strong>3,193</strong></td>
<td><strong>3,393</strong></td>
</tr>
</tbody>
</table>

ADF = Asian Development Fund, Lao PDR = Lao People’s Democratic Republic.

Note: Under the International Development Association grant framework, Bhutan and Lao PDR are classified as gap countries. Per the Concessional Assistance Policy of the Asian Development Bank, these countries became ineligible for ADF grants beginning in 2019. Numbers may not sum precisely because of rounding.


67. The donor contributions for the three scenarios are $2.43 billion, $2.69 billion, and $2.91 billion, respectively, compared to donor contributions of $2.59 billion in ADF 12. The details of the financing framework are discussed in a separate paper, “Financing Framework for Asian Development Fund 13 and Technical Assistance Special Fund 7”.

68. **Indicative concessional ordinary capital resources lending amount.** In addition to ADF grant resources, an overall indicative amount of $13.7 billion COL from ADB’s OCR balance sheet is expected to be made available during ADF 13.

VII. ISSUES FOR DONORS CONSIDERATION

69. Donors’ feedback and endorsement is sought for:

(i) proposed ADF 13 strategic directions;

(ii) proposed ADF 13 resource allocation framework; and

(iii) three indicative funding scenarios for overall ADF 13 grant size of $2.95 billion, $3.19 billion, and $3.39 billion.

CURRENT CLASSIFICATION OF CONCESSIONAL ASSISTANCE COUNTRIES

1. Country classification is determined by two criteria: gross national income per capita and creditworthiness. The Graduation Policy of the Asian Development Bank (ADB)\(^1\) uses the same operational cutoff as the International Development Association (IDA) to determine eligibility for concessional resources.\(^2\) The gross national income per capita operational cutoff is $1,175 at 2018 prices. The creditworthiness assessment is a multidimensional rigorous evaluation procedure combining quantitative and qualitative indicators, which takes into account country economic growth and development prospects including social development, poverty, vulnerability, fiscal policy and public debt burden, current and capital account vulnerability, economic structure, monetary and exchange rate policy, financial sector development, among others.

2. Group A countries are lacking creditworthiness and are eligible for Asian Development Fund (ADF) grants and/or concessional ordinary capital resources lending (COL) depending on their debt distress classification.\(^3\) Group B or ordinary capital resources (OCR) blend countries\(^4\) include those with limited creditworthiness and are eligible for COL and regular OCR lending. Group A and B are concessional assistance countries.

3. Developing member countries (DMCs) identified as gap countries by IDA\(^5\) are ineligible for ADF grants.

4. The bulk of the demand for ADF grant depends on the risk of debt distress of group A DMCs. Of the group A DMCs, ten are at high risk of debt distress: nine receive 100% grant allocation and the other one receives 50% ADF grant under the application of the nonconcessional borrowing policy; three are at moderate risk and receive 50% ADF grant, and two are at low risk and receive 0% grant. It is not anticipated that these group A DMCs would dramatically change their debt outlook.

5. The ten group A small island developing states (SIDS) have all been above the income threshold for some time but are still lacking creditworthiness and are assessed at high or moderate risk of debt distress. Reclassification considerations are in abeyance until there is a clearer path to sustainability.

6. Among the non-SIDS group A DMCs, two have already crossed the income threshold for ADF eligibility and may be expected to become gap during ADF 13.

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\(^2\) Concessional resources were formerly referred to as ADF resources before the combination of ADF lending operations with the OCR balance sheet, which became effective on 1 January 2017.

\(^3\) Group A countries at high risk of debt distress are eligible for 100% ADF grants (subject to a 20% volume discount applied to their grant allocation under the performance-based allocation system). Those at moderate risk of debt distress are eligible for 50% ADF grants (subject to a 20% volume discount applied to their grant allocation under the performance-based allocation system) and 50% COL. Those at low risk of debt distress are eligible for COL only. From 2019, countries identified as International Development Association-gap countries are eligible for COL only, regardless of their risks of debt distress.

\(^4\) India is classified a group B country and has no access to concessional assistance.

\(^5\) IDA gap countries have GNI per capita above the operational cutoff for IDA eligibility for more than 2 consecutive years and are assessed as such by IDA. The operational cutoff is $1,175 (2018 prices).
(i) Cambodia is at low risk of debt distress and likely to remain so. The transition is expected to have minimal impact on Cambodia.

(ii) Kyrgyz Republic, however, is at moderate risk of debt distress and may have difficulty adjusting to an abrupt transition. An early engagement to strengthen Kyrgyz Republic’s public financial management is considered, in line with the planned shift to a more proactive approach to debt sustainability.

7. There is no country predicted for reclassification from group A to B for ADF 13.
THE SUSTAINABLE DEVELOPMENT GOAL 5’S TRANSFORMATIVE GENDER AGENDA

The proposed ADF 13 thematic pool will support operations addressing gender equality. These operations should address one of the five key actions of Sustainable Development Goal 5’s transformative gender agenda.

<table>
<thead>
<tr>
<th>Action</th>
<th>Examples of potential projects or output of projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Eliminating violence against women and girls¹</td>
<td>• Building gender-based violence survivors’ shelter and economic empowerment support</td>
</tr>
<tr>
<td></td>
<td>• Building country system in addressing sexual harassment, exploitation and abuse following the principles of the joint Multilateral Development Banks heads’ statement</td>
</tr>
<tr>
<td>2. Reducing and rebalancing unpaid care and domestic work</td>
<td>• Building affordable and sustainable childcare services, both in urban and rural areas</td>
</tr>
<tr>
<td></td>
<td>• Supporting community- and home-based elderly care services</td>
</tr>
<tr>
<td></td>
<td>• Piloting effective public campaigns for men’s roles in care and domestic work.</td>
</tr>
<tr>
<td>3. Encouraging women’s participation in decision-making and leadership</td>
<td>• Supporting training in women’s leadership</td>
</tr>
<tr>
<td></td>
<td>• Implementing feedback mechanisms and open data for effective integration of women citizens’ voices</td>
</tr>
<tr>
<td>4. Emphasizing sexual and reproductive health and rights</td>
<td>• Reducing early pregnancy, child marriage, and sex-selective abortions through effective public campaigns</td>
</tr>
<tr>
<td></td>
<td>• Supporting menstrual hygiene education and facilities at school and home</td>
</tr>
<tr>
<td>5. Creating access to economic and productive resources, information and communication technology and supporting legal or institutional reforms for protecting women’s rights and changing gendered social norms.</td>
<td>• Promoting agriculture and housing land and other asset</td>
</tr>
<tr>
<td></td>
<td>• Supporting mobile clinics for reproductive health services</td>
</tr>
<tr>
<td></td>
<td>• Supporting legal, institutional, and governance reforms to remove gender-discriminatory provisions and gender stereotypes</td>
</tr>
<tr>
<td></td>
<td>• Supporting women and girls in the nontraditional technical and vocational education and training</td>
</tr>
<tr>
<td></td>
<td>• Promoting behavioral changes through education and skills training and public campaigns</td>
</tr>
</tbody>
</table>

Source: Asian Development Bank

¹ ADB through the utilization of ADF 13 is committed to address the sexual exploitation and abuse and sexual harassment agenda through the implementation of its normal policies and procedures, including but not limited to its procurement, financial management, disbursement, safeguard and results management policies, and its commitments to prevent sexual exploitation and abuse and sexual harassment, both within its own institutions and in its operations.
DIMENSIONS OF CLIMATE AND DISASTER RESILIENCE

The proposed ADF 13 thematic pool will support operations addressing climate change adaptation and disaster risk reduction, in alignment with the Strategy 2030 Operational Plan for Priority—Tackling Climate Change, Building Climate and Disaster Resilience, and Enhancing Environmental Sustainability, 2019–2024—that outlines the comprehensive and integrated approach of Asian Development Bank (ADB) to strengthen climate and disaster resilience. This approach addresses four key aspects of resilience: physical, financial, social and institutional, and eco-based resilience.

<table>
<thead>
<tr>
<th>Resilience goals</th>
<th>Examples of potential support through the ADF 13 Thematic Pool</th>
</tr>
</thead>
</table>
| 1. Physical resilience – enhanced resilience of physical infrastructure and assets | • Incremental costs of strengthening the climate change and disaster resilience of new infrastructure (e.g., ports, bridges, roads, power supply, and water supply and sanitation systems)  
• Retrofitting programs (e.g., school seismic retrofitting)  
• Physical disaster risk reduction measures (e.g., sea walls, river dikes, stream and creek training, landslide slope protection, and storm water drainage).  
• Community infrastructure (e.g., health centers, rural roads, cyclone shelters) through community-driven development projects. |
| 2. Financial resilience – enhanced resilience of public financial management systems and financial institutions | • Integration of climate change and disaster resilient considerations in public financial management systems, including in the allocation and tracking of public resources  
• Enhancing capabilities to use post-disaster financing effectively |
| 3. Social and institutional resilience – enhanced resilience of poor and vulnerable communities and improved risk governance | • Climate smart agriculture.  
• Enhanced hazard forecasting, monitoring, and early warning capabilities.  
• Adaptive social protection (e.g., social assistance programs) |
| 4. Eco-based resilience – holistic resilience approach incorporating nature-based solutions | • Upper watershed restoration, wetlands restoration, mangrove rehabilitation.  
• Installation of detention basins and retention ponds to reduce flooding and impacts of storm surges, coastal erosion, and sea level rise. |

ADF = Asian Development Fund.
Source: Asian Development Bank
OUTLINE OF ADF 12 FRAMEWORK

1. The allocations of concessional resources to countries eligible to access to Asian Development Fund (ADF) 12 grant resources and concessional ordinary capital resources lending (COL) are described in the Concessional Assistance Policy of the Asian Development Bank (ADB).\(^1\) ADB prepared the policy following the approval to combine ADF lending operations with the ordinary capital resources (OCR) balance sheet (effective on 1 January 2017).

2. The ADF 12 framework is a hybrid system consisting of country- and theme-based components that determine the volume of resources for each eligible country. The country-based component includes the performance-based allocation (PBA), and the base and special allocations. The theme-based component includes the regional cooperation and integration (RCI) set-aside, the disaster risk reduction (DRR) mechanism, and the regional health security (RHS) set-aside. It also introduces the salient features of ADB’s graduation policy and country classification system including the role of debt sustainability analysis, which determines the terms of concessional finance.\(^2\)

3. The graduation policy and the Concessional Assistance Policy guide the eligibility for ADB’s concessional resources. ADB’s country classification is determined by two criteria: gross national income (GNI) per capita and creditworthiness, implying that ADB’s DMCs are gradually moving from grants only to market terms as they become wealthier and more creditworthy. Concessional assistance-only countries (group A) include the DMCs that lack creditworthiness and are therefore eligible for ADF grants and/or COL. OCR blend countries (group B) include those with limited creditworthiness and are eligible for COL and regular OCR lending.\(^3\) Group A and B are concessional assistance countries. Regular OCR-only countries (group C and India) have adequate creditworthiness, are above the operational cutoff of the International Development Association (IDA) of $1,175 in 2018 prices (which can be thought of as a measure of need) and are eligible for regular OCR lending only. The emphasis on creditworthiness and the ability for self-finance explains why some countries with GNI per capita substantially above the cutoff are still borrowing on concessional terms.

4. For group A countries, access to ADF grants and COL (and their share) is determined by the risk of debt distress, which is based on a debt sustainability analysis using the joint International Monetary Fund–World Bank debt sustainability framework for low-income countries. Group A countries at high risk of debt distress (ADF-only countries) are eligible for 100% of ADF grants, those at moderate risk of debt distress (ADF blend countries) are eligible for 50% of ADF grants (subject to a 20% volume discount) and 50% COL, and those at low risk of debt distress (COL-only countries) are eligible for COL only. Beginning in 2019, countries such as Bhutan and the Lao People’s Democratic Republic, identified as “IDA gap” have become eligible for COL only, regardless of their risk of debt distress.\(^4\)

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\(^3\) India is a group B country and has no access to concessional resources.

\(^4\) Gap countries have GNI per capita above the operational cutoff for IDA eligibility for more than 2 consecutive years, and are assessed as such by IDA. The operational cutoff for IDA eligibility on or after July 2019 is a 2018 GNI per capita of US$1,175, using Atlas methodology.
5. For each country eligible for concessional assistance (comprising ADF grants and COL), the volume of allocated resources under ADF 12 is determined by a hybrid system that includes the following elements (Table A4.1):

(i) a base allocation that is not linked to performance,

(ii) special post-conflict support for Afghanistan in grants\(^5\) and special reengagement support for Myanmar in COL,\(^6\)

(iii) a country-based allocation that uses the PBA formula,

(iv) a thematic set-aside for DRR that is allocated on a country basis through the PBA formula,

(v) thematic set-asides that are allocated on a project basis for RCI, and RHS (ADF grants only),

(vi) Disaster Response Facility, and

(vii) debt distress reserves to accommodate changes in a country’s debt distress.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Performance-Linked</th>
<th>Not Performance-Linked</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt distress-linked</td>
<td>Disaster Risk Reduction(^a)</td>
<td>Special post-conflict support (Afghanistan)</td>
</tr>
<tr>
<td>For group A countries only</td>
<td>Disaster Response Facility(^b)</td>
<td>Special reengagement support (Myanmar)</td>
</tr>
<tr>
<td>Debt distress-linked</td>
<td>Performance-based country allocations</td>
<td>Base allocation</td>
</tr>
<tr>
<td>For group A and B countries</td>
<td></td>
<td>Regional set-aside</td>
</tr>
<tr>
<td>Not debt distress-linked</td>
<td></td>
<td>Regional health security (ADF grants only)</td>
</tr>
<tr>
<td>For group A and B countries</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

ADF = Asian Development Fund.

\(^a\) Grants for disaster risk reduction, which is an ex ante facility, are allocated directly to countries in accordance with their performance-based allocation.

\(^b\) The Disaster Response Facility (DRF) is an ex post facility that is accessed after a disaster. In the event of a qualifying disaster, a group A country can get up to 100% of its annual final performance-based allocation from the DRF to respond to the disaster. The risk of debt distress determines the proportion of grants in the country’s DRF allocation.


\(^5\) During ADF 12, PBA and special support for Afghanistan (ADF grant) amounts to $0.9 billion with the post-conflict premium accounting for 56% of the total allocation.

\(^6\) During ADF 12, PBA and special support for Myanmar (COL) amounts to $1.4 billion. The re-engagement premium accounts for nearly 54% of the total allocation.
### PROPOSED CHANGES IN THE ADF 13 FRAMEWORK

<table>
<thead>
<tr>
<th>Item</th>
<th>Proposed Changes</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Retain</td>
<td>Modify</td>
</tr>
<tr>
<td><strong>A. Country allocation</strong></td>
<td></td>
<td></td>
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<tr>
<td>Country classification system</td>
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<td></td>
</tr>
<tr>
<td>Debt sustainability assessment</td>
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<td></td>
</tr>
<tr>
<td>Performance-based allocation</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Special support to Afghanistan</td>
<td>✔</td>
<td></td>
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<tr>
<td>Base allocation</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>Economic Vulnerability Premium</td>
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<td></td>
</tr>
<tr>
<td><strong>B. Theme-based allocation</strong></td>
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<td></td>
</tr>
<tr>
<td>Set-asides/Thematic pool</td>
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<td></td>
</tr>
<tr>
<td>Disaster Response Facility</td>
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</tr>
<tr>
<td>Reserve for changes in debt distress</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Piloting a Private Sector Window</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td><strong>C. Addressing moral hazard</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Addressing moral hazard</td>
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<td></td>
</tr>
<tr>
<td>Grant volume discount</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td><strong>D. Concessional OCR allocation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>COL allocation</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Biennial period for country allocations</td>
<td>✔</td>
<td></td>
</tr>
</tbody>
</table>

ADF = Asian Development Fund, COL = concessional ordinary capital resources lending, DRR = disaster risk reduction, DSA = debt sustainability assessment, PBA = performance-based allocation, RCI = regional cooperation and integration, RHS = regional health security, SIDS = small island developing states

PROPOSED ECONOMIC VULNERABILITY PREMIUM UNDER ADF 13

1. **Background.** The Strategy 2030 of the Asian Development Bank (ADB) recognizes small island developing states (SIDS) as requiring special attention on account of their unique development challenges. Under performance-based allocation system, SIDS receive low allocations due to the small size of their population.

2. **Proposal to introduce economic vulnerability premium.** ADB proposes to replace the base allocation for all concessional assistance countries under Asian Development Fund (ADF) 12 with an economic vulnerability premium for ADF grant-eligible SIDS under ADF 13 to allocate additional financial resources for SIDS on top of their performance-based allocation (PBA). The amount of the economic vulnerability premium for SIDS is proposed to vary according to the degree of vulnerability of countries in contrast to the base allocation under ADF 12 which allocates a uniform amount to all concessional assistance countries.

3. **Economic Vulnerability Index reflects determining factors of structural vulnerability of SIDS.** The Economic Vulnerability Index (EVI) measures the structural vulnerability of countries to economic and environmental shocks. It covers 145 developing countries worldwide, including all the 10 SIDS that are recipients of ADF grants, and is updated every 3 years by the United Nations Committee for Development Policy. The latest update was made in 2018. The EVI is composed of two sub-indices with eight variables, in total, namely, population, remoteness from world market, merchandise export concentration, share of agriculture, forestry and fishing in gross domestic product, share of population in low elevated costal zones, instability of exports of goods and services, victims of disasters triggered by natural hazards, and instability of agricultural production. These factors widely reflect the determining factors of structural vulnerability of SIDS.

4. The EVI scores are relatively stable as some of the parameters (e.g., remoteness from world market, share of population in low elevated costal zones) do not significantly change over time. This means that updates of scores would not cause significant fluctuations in resource allocation from one ADF cycle to the other. Table A6.1 indicates trends of the EVI scores on ADF-eligible countries (five countries were not covered before 2012).

5. Overall, the EVI is deemed to be the most suitable publicly-available index for the purpose of reflecting SIDS’ vulnerability in the ADF grant allocation system, based on its relevance, country coverage, data availability, simplicity, and comprehensiveness. ADB therefore proposes to use EVI scores to determine the size of the proposed economic vulnerability premium.

6. Each SIDS is classified according to its EVI score, which ranges from 0 to 100, with a higher score indicating higher vulnerability. Table A6.2 reports the methodology of classifying SIDS by their EVI scores and the proposed amounts of the economic vulnerability premium according to the classification. The highest group comprises scores 70–80, and countries are allocated an amount of $55 million, while the lowest group comprises scores 40–50 with an allocation of $40 million. Group A countries with moderate risk of debt distress will receive half of the economic vulnerability premium.

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1. Afghanistan will continue to receive special support.
2. Samoa’s EVI score of 39.7 has been rounded to 40.
Table A6.1: Trends in the Economic Vulnerability Index in ADF Eligible Countries

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>39.3</td>
<td>35.1</td>
<td>38.8</td>
</tr>
<tr>
<td>Kiribati</td>
<td>73.7</td>
<td>71.5</td>
<td>82.0</td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>31.3</td>
<td>29.6</td>
<td>-</td>
</tr>
<tr>
<td>Maldives</td>
<td>50.9</td>
<td>49.9</td>
<td>55.2</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>66.1</td>
<td>62.3</td>
<td>-</td>
</tr>
<tr>
<td>Micronesia, Federated States</td>
<td>58.6</td>
<td>55.2</td>
<td>-</td>
</tr>
<tr>
<td>Nauru</td>
<td>58.3</td>
<td>67.9</td>
<td>-</td>
</tr>
<tr>
<td>Samoa</td>
<td>39.7</td>
<td>44.0</td>
<td>51.1</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>51.9</td>
<td>50.8</td>
<td>55.2</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>35.9</td>
<td>36.8</td>
<td>-</td>
</tr>
<tr>
<td>Tonga</td>
<td>56.0</td>
<td>55.5</td>
<td>59.6</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>56.0</td>
<td>54.0</td>
<td>63.9</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>47.0</td>
<td>47.7</td>
<td>46.8</td>
</tr>
</tbody>
</table>

EVI = Economic Vulnerability Index.

Table A6.2: Proposed Economic Vulnerability Premium for ADF 13

<table>
<thead>
<tr>
<th>EVI Score</th>
<th>Country (ADF-Grant Eligible SIDS)</th>
<th>Premium ($ million)$^a$</th>
</tr>
</thead>
<tbody>
<tr>
<td>70–80</td>
<td>Kiribati</td>
<td>55</td>
</tr>
<tr>
<td>60–70</td>
<td>Marshall Islands</td>
<td>50</td>
</tr>
<tr>
<td>50–60</td>
<td>Federated States of Micronesia, Maldives, Nauru, Solomon Islands, Tonga and Tuvalu</td>
<td>45</td>
</tr>
<tr>
<td>40–50</td>
<td>Samoa and Vanuatu</td>
<td>40</td>
</tr>
</tbody>
</table>

ADF = Asian Development Fund, EVI = Economic Vulnerability Index.

$^a$ Maldives, Solomon Islands, and Vanuatu are ADF blend countries (50% grant, 50% concessional ordinary capital resources lending) and their amounts of the premium are reduced by 50%.
Source: Asian Development Bank

7. **Alternative vulnerability indices.** Other relevant indices reflecting SIDS’ vulnerability include the Climate Risk Index (CRI) and the World Risk Index (WRI). The CRI covers 182 countries and is updated every year by Germanwatch, a non-profit organization in Germany. The scores are calculated based on the number of deaths and sum of losses caused by extreme weather events. The CRI country ranking tends to change drastically according to whether actual disasters occurred each year, and is narrowly focused on disasters.

8. The WRI covers 172 countries and is updated every year. The scores are calculated based on (i) exposure to earthquakes, cyclones, floods, drought, and sea-level rise; (ii) susceptibility depending on infrastructure, food supply, and economic framework conditions; (iii) coping capacities depending on governance, healthcare, social and material security; and (iv) adaptive capacities related to coming natural events, climate change, and other challenges. The WRI does not provide scores for the Federated States of Micronesia, the Marshall Islands, Nauru, and Tuvalu, which are among the ADF grants-eligible SIDS. The index consists of 27 indicators which makes calculation complex and prone to the issue of data collection.

9. In summary, neither the CRI nor WRI are deemed to properly reflect the structural vulnerability of SIDS.
10. **Alternative approach of augmenting the performance-based allocation formula.** Simulations of the PBA formula augmented by the EVI and the Human Assets Index (HAI)\(^3\) were carried out as alternative approach to introduction of the economic vulnerability premium.

11. The PBA formula was augmented by a vulnerability index consisting of the EVI and a weighted average of EVI and HAI. The vulnerability index was simulated with an exponent of 1 and 2. For each country, the share of the allocated ADF grants \(S_i\) was determined by the formula below, wherein CCPR denotes the composite country performance rating, PCI denotes per capita income, POP denotes population, and VI denotes vulnerability index. The simulations were carried out for the ADF eligible countries.

\[
S_i = \text{CCPR}_i^{(2.00)} \times \text{PCI}_i^{(-0.25)} \times \text{POP}_i^{(0.60)} \times \text{VI}_i^{(1.00 \text{ or } 2.00)} \times C
\]

The scaling factor, \(C\), is a constant term where

\[
C = 1 + \sum_i (\text{CCPR}_i^{2.00} \times \text{PCI}_i^{-0.25} \times \text{POP}_i^{0.60})
\]

12. The following assumptions for the composition of VI were applied:

(i) \(\text{VI} = 1.00 \times \text{EVI}\)

(ii) \(\text{VI} = 0.75 \times \text{EVI} + 0.25 \times \text{HAI}\)

(iii) \(\text{VI} = 0.50 \times \text{EVI} + 0.50 \times \text{HAI}\)

13. Simulation results were compared to country allocations under ADF 12 (baseline). Including EVI in the formula generally increased individual allocations for SIDS, but with high variation among the SIDS. In some cases, the allocations were lower than the amounts that respective countries have received under ADF 12. Adding HAI in the formula, decreased allocations for SIDS, which have a comparatively high scores for HAI. For simulations with the combination of EVI and HAI, the allocations for several SIDS remained below the baseline amounts under ADF 12.

14. The above results of the simulations either through alternative vulnerability indices or through the PBA approach do not provide sufficient amounts for SIDS as compared to their country allocations under ADF 12. It is therefore recommended to introduce the economic vulnerability premium using the economic vulnerability index as explained in paragraphs 2–6 of this appendix.

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\(^3\) The Human Assets Index (HAI) is a composite index of education and health used as an identification criteria of the Least Developed Countries by the United Nations committee for Development Policy. It is considered to be most appropriate to represent DMCs’ human capital and needs for development.
ADF 13 THEMATIC POOL OF GRANT RESOURCES: CONCEPT AND PROCESS

1. Under ADF, it is proposed to pool the existing set-asides under ADF 12 together to create a single thematic pool, and expand the thematic use of ADF grants to address Sustainable Development Goal (SDG) 5’s transformative gender agenda and climate change adaptation.

2. The proposed thematic pool will cover three thematic priorities:

   (i) achieving the SDG 5’s transformative gender agenda;

   (ii) supporting climate change adaptation and disaster risk reduction; and

   (iii) fostering regional cooperation and integration (RCI) including provision of regional public goods (RPGs), regional health security (preventive actions), and ocean health actions, among others.

3. **Project selection process.** The resources will be allocated to projects through an annual project submission and selection process using a two-step approach (Table A7.1 and A7.2).

   **Table A7.1: STEP 1: Project Eligibility Criteria**

<table>
<thead>
<tr>
<th>Addressing the SDG 5’s transformative gender agenda</th>
<th>Building climate change adaptation and disaster risk reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For Group A Countries</strong></td>
<td><strong>For Group B Countries</strong></td>
</tr>
<tr>
<td>ADF grants from the thematic pool will be used to go beyond standard gender mainstreaming activities and support projects or components of projects to achieve the SDG 5’s transformative gender agenda and address deep-rooted gender inequalities and discriminations.</td>
<td>In addition to the criteria for group A countries, projects in group B countries will have to meet at lone or more of the following criteria:</td>
</tr>
<tr>
<td>Only stand-alone gender equity projects focusing on the transformative gender agenda or projects with a dedicated output focusing on the transformative gender agenda will be supported (Appendix 2).</td>
<td>The project should pilot innovative solutions; and/or</td>
</tr>
<tr>
<td>Examples of activities to be supported: (i) promotion of agriculture and housing land and other asset ownership for women, (ii) gender-responsive budgeting in governance reform programs, (iii) support for women’s reproductive and sexual health and rights, (iv) affordable child and elderly care services, (v) harassment prevention in an integrated urban project; and (vi) a menstrual hygiene assistance output included in a water supply project to enhance both girls’ school attendance and stop harmful cultural practices in segregating menstruating women in rural areas.</td>
<td></td>
</tr>
</tbody>
</table>

   **b**
The ADF 13 grant resource will address one of the four key aspects of resilience laid out in Strategy 2030: physical resilience; financial resilience; social and institutional resilience; and eco-based resilience.

Examples of operations to be supported:
- Stand-alone projects with climate change adaptation or disaster risk reduction as their primary objective (e.g., a school seismic retrofitting or coastal defense project)
- Discrete components of projects (e.g., development of a flood early warning system as part of an urban development projects).
- Incremental cost in strengthening the resilience of infrastructure investments (e.g., elevation of roads constructed through a transport project in flood-prone areas).

Based solutions for coastal defense, use of high-level technology to improve early warning systems, use of traditional earthquake resistant construction techniques to retrofit schools and hospitals); and/or

The project should leverage additional climate/disaster finance, including finance from the private sector, to strengthen resilience.

| Fostering Regional Cooperation and Integration Including the Provision of Regional Public Goods |
| --- | --- |
| **For Group A Countries** | **For Group B Countries** |
| Projects pertaining to the 3 strategic priorities outlined in the new regional cooperation and integration Operational Plan 2019–2024 will be supported, namely, (i) greater and higher-quality connectivity between economies, (ii) expanded global and regional trade and investment opportunities, and (iii) increased and diversified regional public goods. | Only regional public goods will be supported. |
| **Examples of operations to be supported:** | |
| - Examples for (i): Cross-border infrastructure projects and multimodal and sustainable transport | |
| - Examples for (ii): Implementation of global and regional agreements for trade and investment and policy reforms | |
| - Examples for (iii): Mitigation of regional risks related to climate change, disasters, transboundary diseases, and ocean health projects | |

SDG = Sustainable Development Goal.

b There is no single indicator with data for all countries. Data sources include OECD Social Institution and Gender Index, World Economic Forum Global Gender Gap Report and other country gender assessments.

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Source of the score</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Projects in countries with prudent or improved fiscal, debt and budget management are given higher score</td>
<td>Aggregate of criteria 2-3 (fiscal, debt and budget management) and criteria 13-14 (budget and revenue) from the CPA</td>
<td>30%</td>
</tr>
<tr>
<td>2. Projects with higher development impact in the relevant thematic area(s) and/or strong positive regional spillover effects, in particular for SIDS are given higher score</td>
<td>Rated by the committee</td>
<td>25%</td>
</tr>
<tr>
<td>3. Projects in countries with higher country portfolio performance are given higher score</td>
<td>Criteria 17 of the CPA</td>
<td>15%</td>
</tr>
<tr>
<td>4. Projects involving two or more countries and cutting across multiple thematic areas are given a higher score</td>
<td>Rated by the committee</td>
<td>10%</td>
</tr>
<tr>
<td>5. Projects leveraging external funding or with enhanced buy-in of the government are given a higher score</td>
<td>Rated by the committee</td>
<td>10%</td>
</tr>
<tr>
<td>6. Projects that are more innovative are given higher score</td>
<td>Rated by the committee</td>
<td>10%</td>
</tr>
</tbody>
</table>

CPA = country performance assessment, SIDS = small islands developing states
PROBLEM OF CURRENT SYSTEM OF LINKING ALLOCATIONS OF ADF GRANTS AND CONCESSIONAL ORDINARY CAPITAL RESOURCES LENDING BASED ON PERFORMANCE BASED ALLOCATION

1. Prior to the combination of the Asian Development Fund (ADF) lending operations with the ordinary capital resources (OCR) balance sheet (the Merger), the concessional assistance resources were allocated as a pooled fund where the proportion of grants to loans was determined through the allocation process (Figure A8.1).

![Figure A8.1 Illustrative Allocation of CA Funds into Loans and Grants Prior to Merger](image)

ADF = Asian Development Fund, CA = concessional assistance, COL = concessional ordinary capital resources lending.

2. After the ADF-OCR combination, the previous allocation process was retained. The separate amounts of grants from the ADF and concessional ordinary capital resources lending (COL) from the OCR balance sheet are pooled together and allocated jointly as before. But with the additional constraints (e.g., predetermined amounts for grants and COL), a mismatch between the available amounts of the separate fund sources (Figure A8.2) and the resulting formula-based allocation is inevitable.

![Figure A8.2 Illustrative Availability of Loans and Grants Post-Merger](image)

ADF = Asian Development Fund, CA = concessional assistance, COL = concessional ordinary capital resources lending.
3. To adjust both to available resources means that only one of the two fund sources can be fully allocated but the other would not be fully allocated (Figure A8.3).

![Figure A8.3 Illustrative Adjustment of Allocation of CA Funds Post-Merger](image)

ADF = Asian Development Fund, CA = concessional assistance, COL = concessional ordinary capital resources lending.