



**ASIAN DEVELOPMENT FUND (ADF)**  
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## **Governance in ADF Countries**

*Asian Development Bank*

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## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CPA	–	country performance assessment
CPS	–	country partnership strategy
DMC	–	developing member country
GACAP II	–	Second Governance and Anticorruption Action Plan
GMS	–	Greater Mekong Subregion
OECD	–	Organisation for Economic Co-operation and Development
PFM	–	public financial management
PSM	–	public sector management
RAMP	–	risk assessment and management plan
RRP	–	report and recommendation of the President
TA	–	technical assistance

## NOTE

In this report, "\$" refers to US dollars.

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

## CONTENTS

	<b>Page</b>
EXECUTIVE SUMMARY	i
I. INTRODUCTION	1
II. OVERVIEW OF GOVERNANCE PERFORMANCE AND CHALLENGES IN ADF COUNTRIES	1
III. ADB'S STRATEGIC APPROACH AND OPERATIONAL THRUST IN GOVERNANCE	3
A. Policies and Strategies	3
B. Operations	4
C. Networks, Partnerships, and Knowledge Management	15
IV. MOVING FORWARD WITH THE GOVERNANCE AGENDA	17
 APPENDIX	
 Evolving policy and Strategic Context of Governance and Public Sector Management in ADB	 19



## EXECUTIVE SUMMARY

The Asian Development Bank (ADB) assesses the relative performance of Asian Development Fund (ADF) countries through annual country performance assessments (CPAs). The CPA results show variation of governance performance across ADF countries, though the average scores are improving in recent years. ADB recognizes that ADF countries require long term continuous support on governance reforms and capacity development. In 2006 the Second Governance and Anticorruption Action Plan (GACAP II) introduced a risk-based approach to governance assessment for the thematic areas of public financial management, procurement, and combating corruption. Subsequently the adoption of Strategy 2020 as a long term strategic framework redefined the role of governance as driver of change for stimulating growth across all sectors.

GACAP II heralded a shift from specific governance projects to expanding and mainstreaming governance considerations in country strategies and all projects and programs. ADB underscores the importance of country ownership, use of country systems and policy dialogue for promoting the governance agenda in the developing member countries (DMCs). When ADB prepares a country partnership strategy (CPS) in line with the developing member country's development plan, governance concerns are identified through risk assessments and the accompanying risk assessment and management plans (RAMPs) detailing mitigation measures. To mainstream governance in programs and projects, governance risk assessments are cascaded from the country level to the sector and project levels to better guide investment decisions.

ADB also directly supports public sector management projects in many ADF countries, in which it is increasingly focusing on two subsectors—economic and public affairs management, and public expenditure and fiscal management—in line with ADB's comparative advantage in these areas. Technical Assistance (TA) projects are another significant tool used by ADB in promoting good governance in ADF countries. Governance and capacity development themes are also commonly found in most of ADB's sector programs and projects in ADF countries and are a significant component of multisector, agriculture, finance and education sectors.

ADB also delivers its governance program in collaboration with other development partners in ADF countries. Such initiatives and networks include ADB/Organisation for Economic Co-operation and Development (OECD) Anticorruption Initiative for Asia and the Pacific, partnership with academic institutions like the Lee Kuan Yew School of Public Policy in Singapore, collaboration with civil society and expanding regional cooperation on governance issues.

The RAMPs can be further strengthened by linking them more closely with project design so that they can be better implemented and monitored. A comprehensive institutional and political economy analysis will also help strengthen the proposed mitigation measures. The need is to deepen the ongoing engagement and at the same time pursue new areas for better governance outcomes. These include: (i) further strengthening and integrating the governance approach in ADF countries by: (a) expanding and deepening work in thematic areas of public financial management, procurement, and combating corruption; (b) governance support targeting ADB priority sectors focusing on strengthening public sector management (PSM); and (c) long term capacity development interventions targeting weak institutions; (ii) continue providing TA resources for addressing risk mitigation measures and longer term capacity building; and (iii) analyzing a country's unique political and institutional context more thoroughly and factoring them in project designs. ADB will review the approach and implementation of risk assessments with a view to make them more effective as a development tool.



## I. INTRODUCTION

1. During the second Asian Development Fund (ADF) XI replenishment meeting in Dhaka, Bangladesh 5–6 December 2011, the role of good governance in contributing to inclusive growth was highlighted. Some deputies asked the Asian Development Bank (ADB) to prepare a short paper on governance for the next replenishment meeting. This paper aims to present a succinct overview of ADB's governance-related operations in ADF countries.

## II. OVERVIEW OF GOVERNANCE PERFORMANCE AND CHALLENGES IN ADF COUNTRIES

2. The long-term positive relationship between good governance, institutional quality, and economic growth is empirically well established.<sup>1</sup> Some studies have linked governance performance to aid effectiveness as well as to specific development outcomes such as infant mortality and adult literacy, while others have shown that poor governance can aggravate poverty and inequality.<sup>2</sup> Strong governance systems and public institutions are particularly crucial in supporting inclusive delivery of social and infrastructure services.

3. Under its performance-based allocation policy, ADB assesses the relative performance of ADF countries through annual country performance assessments (CPAs). The quality of governance is a key component of the CPA.<sup>3</sup> The governance rating in the CPA is based on the average scores for five indicators that capture aspects of public sector management (PSM) and institutions.<sup>4</sup> The results from recent CPAs show that overall governance scores in ADF countries have improved modestly since 2005 with the efficiency of revenue mobilization subcomponent improving the most (table). As detailed in para 12; CPA forms the basis for ADB's policy dialogue and programming. In addition, CPA has a large weight in resource allocation providing incentive for performance improvement.

**Governance Scores for Asian Development Fund Countries**

	Public Sector Management and Institutions					Average
	Property Rights and Rule-Based Governance	Quality of Budget and Financial Management	Efficiency of Revenue Mobilization	Quality of Public Administration	Transparency, Accountability, and Corruption	
2005	3.3	3.5	3.4	3.1	3.0	<b>3.3</b>
2006	3.3	3.5	3.5	3.2	2.9	<b>3.3</b>
2007	3.2	3.6	3.6	3.2	3.1	<b>3.3</b>
2008	3.3	3.6	3.5	3.2	3.1	<b>3.3</b>
2009	3.3	3.6	3.6	3.2	3.1	<b>3.4</b>
2010	3.4	3.7	3.7	3.3	3.3	<b>3.5</b>
2011	3.5	3.9	3.9	3.5	3.4	<b>3.6</b>

Note: The score range is 1–6 (refer to footnote 4).

Source: Asian Development Bank staff estimates.

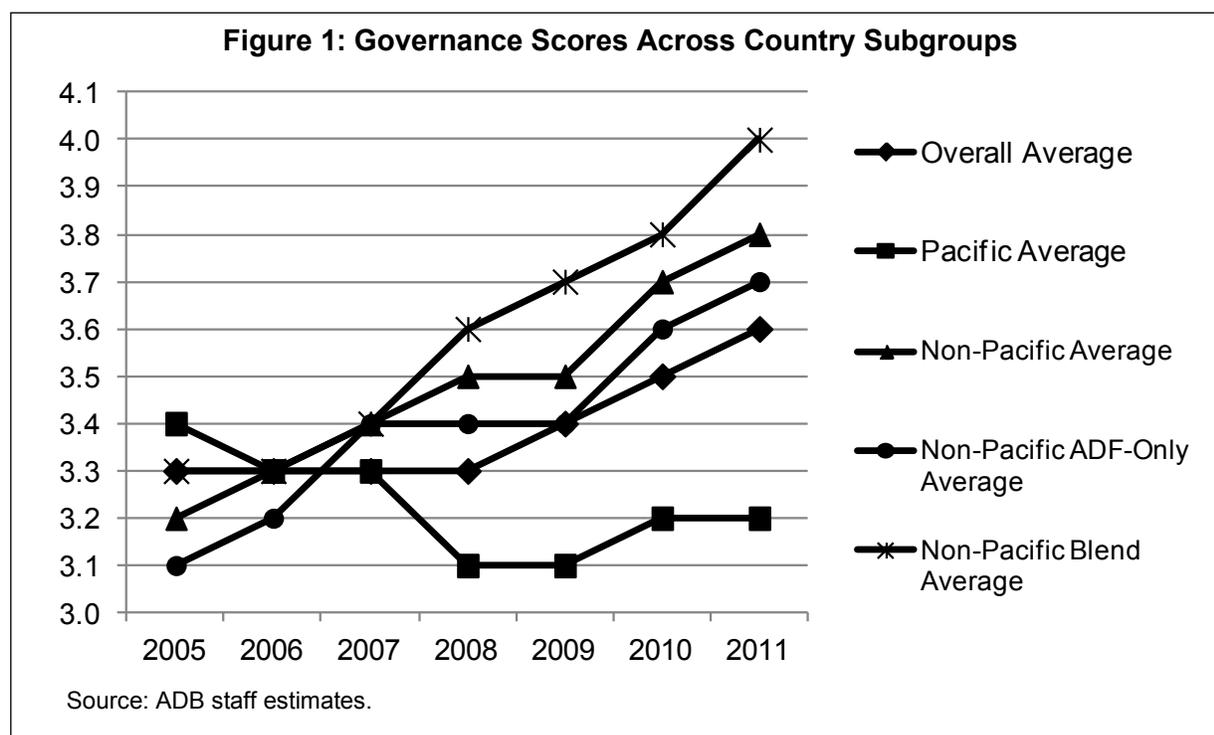
<sup>1</sup> J. Zhuang. 2010. *Poverty, Inequality and Inclusive Growth in Asia; Measurement, Policy Issues, and Country Studies*. Manila: Asian Development Bank.

<sup>2</sup> D. Kaufmann, A. Kraay, and M. Mastruzzi, 2009. *Governance Matters 2009: Learning from Over a Decade of the Worldwide Governance Indicators*. Washington DC: World Bank.

<sup>3</sup> ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development Fund Resources*. Manila.

<sup>4</sup> Countries are rated on a scale of 1 (very weak performance) to 6 (very strong performance) for each indicator/criterion.

4. The CPA results also show considerable variation of governance performance across ADF countries, with the divergence among the different subgroups growing in recent years. Figure 1 presents the average governance scores for various subgroups among ADF countries during 2005–2011. The Pacific region has performed relatively poorly: its governance performance declined markedly during 2005–2008 and has improved only modestly since. In 2011, the average score for Pacific countries was 3.2, compared with 3.6 for all ADF countries, indicating the need for continued support to Pacific countries. Two particular areas of weakness for Pacific countries are (i) the quality of public administration; and (ii) transparency, accountability, and corruption in public sector. The average score among non-Pacific countries rose from 3.5 in 2008 to 3.8 in 2011, driven by improvements in both ADF-only countries and blend countries.<sup>5</sup> However, blend countries showed larger improvements in that period.



5. The CPA results and the country-, sector-, and project-level governance assessments indicate that ADF countries will require long-term continued support for reforms and capacity building in various aspects of governance to achieve inclusive growth and development outcomes. Addressing the common challenges related to delivering quality public services, combating corruption, tackling rapid urbanization, building a fundamentally sound financial sector, protecting citizen rights, and enforcing the rule of law requires high-quality institutions and effective governance both at the central and local levels.<sup>6</sup>

<sup>5</sup> ADF countries are those with access to the ADF. These can be disaggregated into (i) “ADF-only” countries; and (ii) “blend” countries, which have access to both the ADF and ADB’s ordinary capital resources. ADB currently has 15 ADF-only countries (Afghanistan, Bhutan, Cambodia, Kiribati, the Kyrgyz Republic, the Lao People’s Democratic Republic (Lao PDR), the Maldives, Nauru, Nepal, Samoa, Solomon Islands, Tajikistan, Tonga, Tuvalu, and Vanuatu); and 13 blend countries (Armenia, Bangladesh, Georgia, the Marshall Islands, the Federated State of Micronesia, Mongolia, Pakistan, Palau, Papua New Guinea, Sri Lanka, Timor-Leste, Uzbekistan, and Viet Nam). Azerbaijan, India, and Myanmar are eligible for ADF assistance under ADB’s Graduation Policy but currently do not have access to ADF. Thus, they are not considered as ADF in this paper.

<sup>6</sup> ADB. 2011. *Asia 2050: Realizing the Asian Century*. Manila.

### III. ADB'S STRATEGIC APPROACH AND OPERATIONAL THRUST IN GOVERNANCE

#### A. Policies and Strategies

6. Governance has steadily risen in prominence in ADB operations, gaining momentum in the recent years. In 1995, ADB became the first multilateral development bank to adopt a governance policy<sup>7</sup> to ensure that development assistance fully benefits the poor. It recognized that the development process is consistently more successful in environments where decision making is transparent and the application of laws, regulations, and policies is predictability, within a culture of accountability among government officials and meaningful stakeholder participation in decision making. This was followed by the approval of a comprehensive anticorruption policy<sup>8</sup> in 1998, establishing a zero-tolerance stance towards corruption and fraudulent, coercive, and collusive practices in ADB operations.

7. In 2005, ADB reviewed the implementation of its governance and anticorruption policies. The review concluded that the policies were only partially implemented because they covered such a wide range of topics that ADB was unable to respond effectively to given the competing demands on its limited resources. The review led to the preparation of the Second Governance and Anticorruption Action Plan (GACAP II), which became effective in 2006.<sup>9</sup> The purpose of GACAP II is to enhance ADB's implementation of its governance and anticorruption policies by (i) improving identification and management of governance and corruption risks in country partnership strategies (CPSs); (ii) strengthening governance and anticorruption components in program and project design; (iii) strengthening program and project administration and portfolio management; and (iv) improving the organizational structure, human resources, and access to expertise. A risk-based approach to assessment was introduced and applied to three priority governance thematic areas: public financial management (PFM), procurement, and combating corruption.

8. In 2008, ADB adopted Strategy 2020 to serve as its long-term strategic framework.<sup>10</sup> The rationale for the strategy is that the development challenges facing the region—such as increasing disparities, environmental strains, infrastructure deficits, and weak governance—may prevent developing member countries (DMCs) from maximizing the economic opportunities generated by rapid growth in Asia. Strategy 2020 reaffirms ADB's commitment to governance and capacity development, and redefines the role of governance as a driver of change and a catalyst for stimulating growth and synergizing development assistance. As drivers of change, good governance and capacity development will enable ADB to maximize its impact on regional challenges by improving cost-effective delivery of public goods and services, and by promoting inclusive growth. Recognizing the multifaceted and interrelated dimensions of governance, ADB thus adopted a two-pronged approach: (i) governance as a sector reform through its PSM work, and (ii) governance as a theme in sector projects and programs.

9. PSM work constitutes core governance work of ADB with lending to the public sector accompanied by technical assistance (TA) for institutional strengthening. ADB's work in PSM extends to five subsectors: (i) economic management and management of public affairs; (ii) public expenditure and fiscal management; (iii) public administration; (iv) decentralization; and

<sup>7</sup> ADB. 1995. *Governance: Sound Development management*. Manila.

<sup>8</sup> ADB. 1998. *Anticorruption Policy*. Manila.

<sup>9</sup> ADB. 2006. *Review of the Implementation of ADB's Governance and Anticorruption Policies*. Manila.

<sup>10</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

(v) law and judiciary. As countries take more leadership in determining their development course and use their own country systems, PSM reforms continue to be of fundamental importance to developing capacities in core institutions of DMCs. Governance as a theme addresses strategic development objectives related to financial governance, economic governance, public administration, civil society participation, and anticorruption efforts. Sector programs and projects with significant governance interventions are termed governance-themed projects. The appendix outlines the evolution of the policy and strategic context of governance and public sector management in ADB.

## **B. Operations**

10. GACAP II heralded a shift from specific governance projects to expanding and mainstreaming governance considerations in country strategies and all projects. Under the risk-based approach, governance risks are identified and prioritized in terms of likelihood of occurrence and their likely negative impact on development effectiveness. Mitigation measures for major risks are also proposed. This prioritization process is important as ADB has limited resources to respond to all governance risks. In line with the 2005 Paris Declaration on Aid Effectiveness, ADB underscores the importance of country ownership, alignment of support to country strategies, use of country systems, policy dialogue, and stakeholder participation in promoting the governance agenda in DMCs.

11. ADB supports strengthening country systems with a holistic view of country development challenges and capabilities, institutions, and social and economic environments. This integrated approach allows ADB development priorities to be strategically aligned with more responsive programming based on country needs. Using and strengthening country systems by investing in governance reforms is a long-term process. ADB uses various instruments and makes investments to mainstream governance in country operations, as described in paras. 12–36.

### **1. Addressing Governance in Country Partnership Strategies**

12. ADB prepares a CPS in line with a country's development plan and poverty reduction goals as well as ADB's strategic priorities. Governance performance of ADF countries, determined by assessing PSM and institutions as part of the annual CPA, is given significant weight in ADB's performance-based allocation policy.<sup>11</sup> The large weight for governance scores provides incentives for good governance as it links availability of ADF resources to CPA scores. ADB, therefore, engages very closely with governments in undertaking the assessments and sharing the findings. Policy dialogue with ADF countries during country strategy formulation and programming focuses on the need to strengthen governance at the macro and sector levels to enable access to larger ADF allocations.

13. The sector and thematic assessments inform the preparation of the CPS.<sup>12</sup> Governance concerns are identified through risk assessments and the accompanying risk assessment and management plans (RAMPs), which detail mitigation measures. The RAMPs point out governance weaknesses affecting the reform process that compromise the development

<sup>11</sup> After a review in 2004, the weight of governance in the CPA rating and allocation was increased from 30% to 50%.

<sup>12</sup> ADB. 2007. *Country Partnership Strategy Guidelines*. Manila. Under the guidelines, analyses and assessments before the CPS normally must include (i) macroeconomic and poverty analyses; (ii) thematic analytical work such as gender and social development, capacity development (including capacity for results management), environment, private sector, debt sustainability, disaster vulnerability, and regional cooperation and integration, if applicable; (iii) risk assessment and risk management plan including public financial management, procurement, and corruption; and (iv) key sector diagnostics.

effectiveness of the country. An analysis of CPSs of ADF-only, blend, and recent ADF graduate countries shows that increasingly countries identify better governance as a strategic priority or a cross-cutting theme to achieve development objectives.<sup>13</sup> Country-level risk assessments and management plans have been completed for 21 ADF countries. For example, the CPS for Nepal, 2010–2012 considers good governance a pillar to strengthen (i) local governance; (ii) transparency and accountability of the public sector; (iii) monitoring of public service delivery; and (iv) the capacity of key public institutions, including mainstreaming of management for development results. Support for strengthening country governance systems is manifested in the ADB assistance pipeline through a two-phase loan for strengthening public management (\$61 million) and an attached capacity development TA for \$0.5 million.<sup>14</sup>

14. Another example is the CPS for Papua New Guinea, 2011–2015, which considers strengthening PFM vital to broader public sector reform. A capacity development TA project (\$4 million) is included in the ADB pipeline.<sup>15</sup> The CPS for the Lao People's Democratic Republic, 2012–2014 supports the government's governance and anticorruption strategies through long-term capacity development efforts, particularly in PFM and decentralized settings. The ADB pipeline includes a loan for a governance and capacity development project (\$11 million).<sup>16</sup>

## 2. Mainstreaming Governance in Programs and Projects

15. The systematic process of cascading governance risk assessments from the country level to the sector level and the project level under GACAP II provides an understanding of vulnerabilities to better guide investment decisions and strengthen development interventions in ADF countries. The RAMPs identify and respond to risks in ADB's three thematic priority areas: PFM, procurement, and combating corruption.<sup>17</sup> In conjunction with policy, legal, regulatory, and capacity risks identified through broader sector diagnostics, the RAMPs inform the preparation of the CPS as well as programs and projects. The cascading framework has been a significant step towards embedding appropriate governance and anticorruption measures in ADB country and sector operations to strengthen sector-specific country systems (Figure 2). Project-level assessments are prepared for projects in priority sectors.

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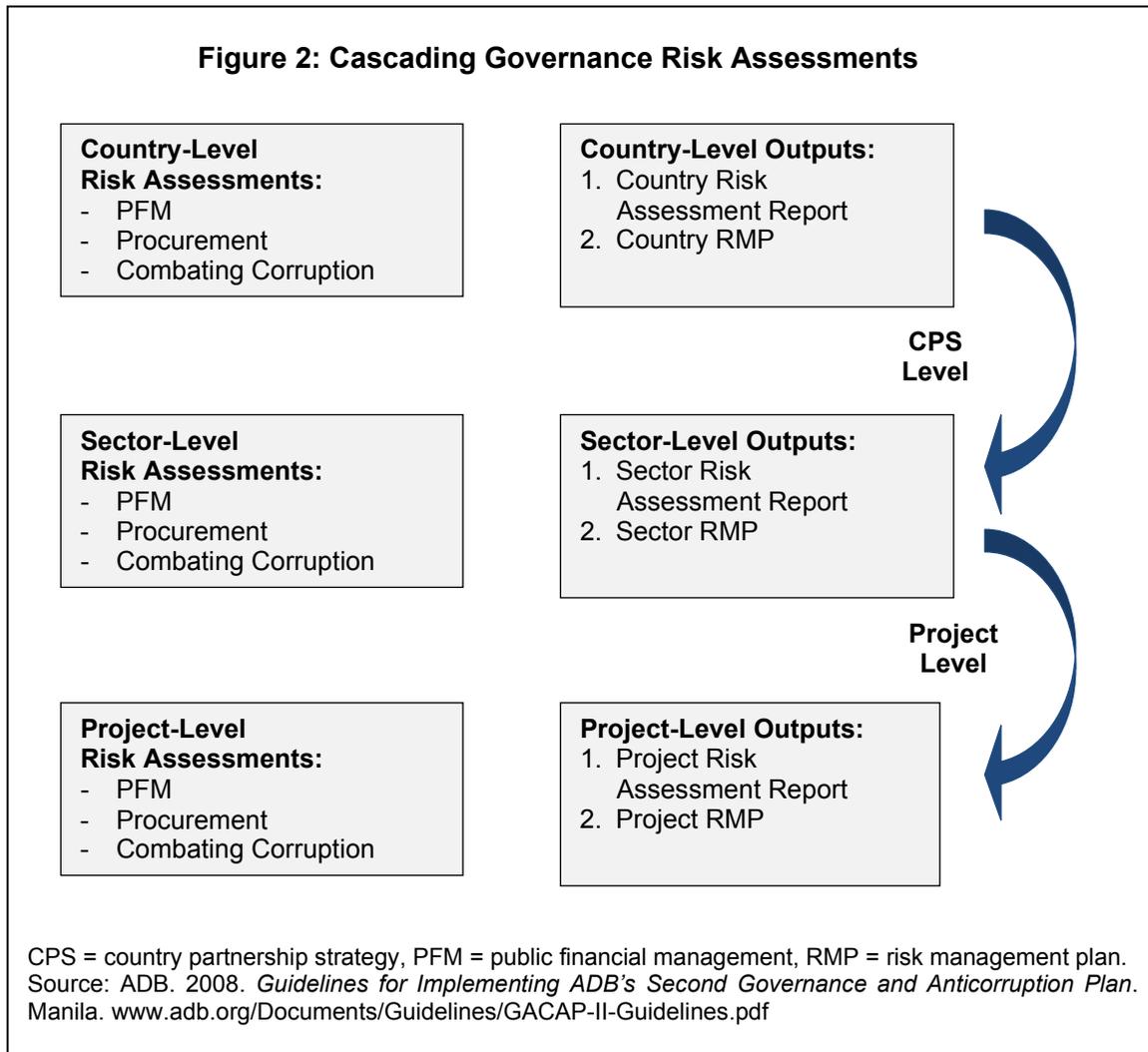
<sup>13</sup> The CPSs prepared during 2006–2009 for the following countries identified improved governance as a thematic focus necessary to achieve their development goals: Afghanistan, Armenia, Bangladesh, Indonesia, Kyrgyz Republic, Lao People's Democratic Republic, Nepal, Pakistan, Papua New Guinea, Philippines, Timor-Leste, and Viet Nam.

<sup>14</sup> ADB. 2011. *Country Operations Business Plan: Nepal, 2012–2014*. Manila.

<sup>15</sup> ADB. 2011. *Country Operations Business Plan: Papua New Guinea, 2012–2014*. Manila.

<sup>16</sup> ADB. 2011. *Country Operations Business Plan: Lao People's Democratic Republic, 2012–2014*. Manila.

<sup>17</sup> ADB. 2008. *Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan*. Manila.



16. RAMPs have been undertaken for many sectors, including transport, energy, water supply and other municipal infrastructure services, education, agriculture and natural resources, health, and finance. ADB has prepared 44 sector-level RAMPs in 15 ADF countries and 38 project-level RAMPs in 12 ADF countries.<sup>18</sup>

17. Governance risks featured in the RAMPs have generally centered on weak capacity in PFM, procurement, and combating corruption. In addition, nontransparent systems and practices were identified, along with weak internal controls, poor sector planning, inadequate financing to sustain sector investments (e.g., road transport, energy, and water supply), and corrupt practices (road transport and energy). These risks were seen to undermine effective service delivery, efficient use of resources, and accountability. RAMPs that have followed the cascading process from the country to the sector level may have the advantage of clearly

<sup>18</sup> ADB. 2011. *Second Governance and Anticorruption Action Plan (GACAP II)—Progress Report for April to September 2011*. Manila.

identifying country and sector governance issues that would better inform project-level risk assessments and project design. Major risks and risk mitigation measures identified in the RAMPs could be translated with more specificity to outcomes and outputs at the CPS and project levels.

18. In general, the proposed risk mitigation measures in the sector road maps have included (i) capacity development TA to strengthen institutions, (ii) policy dialogue, (iii) programs for governance reforms, (iv) advisory support for improvements in systems and business practices, (v) preparation and use of manuals and reference guides in financial management and procurement, and (vi) better monitoring and evaluation. At the project level, risk mitigation has included additional measures such as (i) disclosure of project information on the website in support of transparency, (ii) electronic procurement, (iii) independent spot-checks, (iv) intensive project supervision, (v) technical and forensic audits, and (vi) blacklisting of corrupt contractors and suppliers.

19. Nepal has adopted the full-scale cascading risk assessment approach, which flows from the country to the sector level and then to the program and/or project level. Box 1 illustrates this cascading risk assessment approach in Nepal and highlights how RAMPs at the country, sector, and project levels led to the incorporation of measures in the CPS, sector road maps, and projects. Cambodia is cascading the education sector RAMP to the program level by providing inputs to the design of the third education sector development program loan.

### **Box 1: Applying the Cascading Risk-Based Approach at the Country, Sector, and Project Levels in Nepal**

#### **Country Level**

The country-level governance risk assessment and management plan (RAMP) for Nepal (2009) informed the country partnership strategy (CPS), 2010–2012. Risks that were incorporated into the CPS included the lack of a sound financial management system, corruption, weaknesses in the capacities of the central and local government bodies, and weak partnerships with civil society and the private sector. The CPS highlighted support for good governance and strengthening of the managerial and institutional capacity of key public sector agencies as key areas for Asian Development Bank (ADB) assistance.

#### **Sector Level**

##### **A. Rural Infrastructure**

In 2009, a RAMP was prepared for the rural infrastructure sector, one of ADB's priority sectors in Nepal. The sector-level RAMP identified major risks, which partly echoed the findings of the country-level RAMP. Sector risks included (i) corruption that leads to acceptance of substandard work and use of inferior materials; (ii) political patronage that results in the misuse of public funds, resources, and authority; and (iii) weak capacity in public financial management (PFM), procurement, and combating corruption. In line with these findings, the sector road map for rural infrastructure emphasized stronger sector governance.

##### **B. Urban Development**

The sector-level RAMP (2009) informed the road map for urban development, which covered urban transport. Financial constraints, low institutional capacity, and a lack of qualified human resources have hampered the capacity of urban authorities to keep pace with the growing demand for services. Risks from corruption, political interference, and nontransparent procurement have undermined the effective use of resources. In response, the sector-level road map recognized the need to build the management skills of local entities, improve service delivery, and support good sector governance.

#### **Project Level**

##### **A. Community Irrigation Project**

The project-level RAMP informed the report and recommendation of the President (RRP) for the grant-financed Community Irrigation Project, which sought to develop and/or improve small-scale irrigation systems in Nepal. Major risks that were carried forward from the RAMP to the RRP included (i) weak compliance with PFM systems and procedures; (ii) weak procurement controls that threatened transparency; (iii) inadequate oversight and monitoring of contractors and suppliers; and (iv) external interference, kickbacks to officials, collusion, and fraud. To mitigate such risks, the RRP proposed several measures: (i) capacity development in financial management, (ii) random contract reviews, (iii) independent spot-checks, (iv) support for the anticorruption agenda, and (v) blacklisting of contractors and suppliers proven to engage in malfeasance.

##### **B. Kathmandu Sustainable Urban Transport Project**

The RRP for the Kathmandu Sustainable Urban Transport Project acknowledged the sector-level RAMP for urban development. It also drew risks from the subsequent project-level RAMP (2010), which reiterated risks from uneven institutional capacity, weak compliance with PFM systems and procedures, limited procurement experience, and a lack of transparency in the procurement process. To mitigate these risks, the RRP proposed capacity development, system improvements, and operation of a project website to boost transparency.

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Source: ADB. 2011. *Governance Thematic Report, 2008–2010*. Manila.

20. The Governance Cooperation Fund, a multi-donor umbrella facility to support government-led governance reforms through regional TA, supports the implementation of GACAP II with resources for (i) project-level RAMPS in ADB priority sectors; (ii) subprojects addressing risk mitigation at the country, sector, and project levels in priority areas for ADB operations; and (iii) the provision of long-term national governance consultants in resident missions (Bangladesh, Indonesia, Mongolia, and Nepal have received long-term support; Cambodia will receive support in 2012).

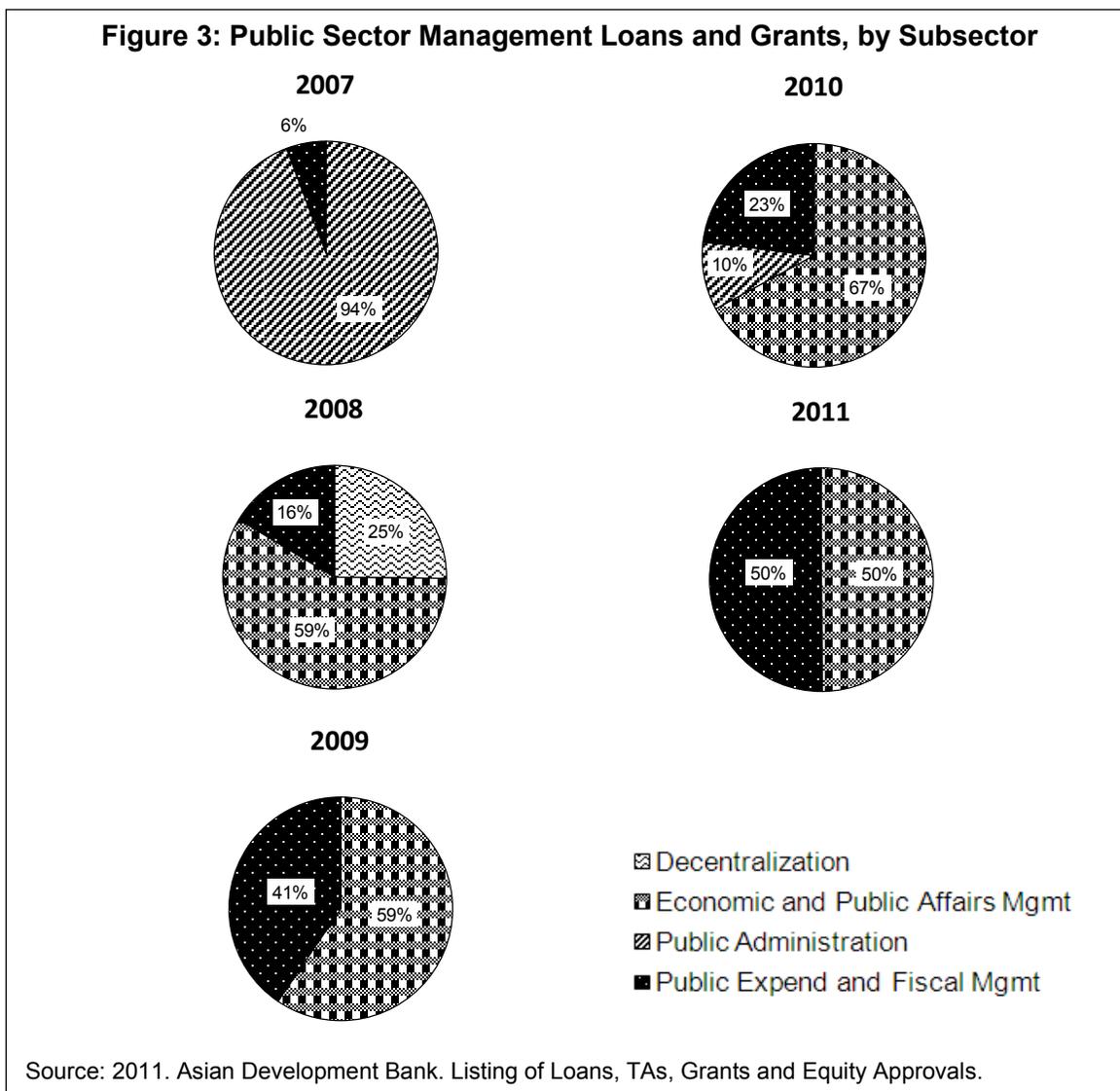
21. Some subprojects in ADF countries have been funded by the Governance Cooperation Fund to implement risk mitigation measures identified through country- and sector-level assessments. These include the following:

- (i) **Mongolia.** Through support for the implementation of the education sector risk assessment, a procurement manual has been developed for the first time in Mongolia with associated training programs for government officials.
- (ii) **Armenia.** Support was provided to build the capacity of PFM professionals in accounting and internal auditing in public sector organizations.
- (iii) **Bhutan.** Support was provided to strengthen the institutional capacity, as well as the managerial and leadership capabilities, of selected central agencies and local government administrations.
- (iv) **Viet Nam.** Support is being provided for the preparation of a new procurement law to enable Viet Nam's Public Procurement Agency to examine and prepare new elements and components that will be reflected in the revised public procurement law and related decrees and circulars.

22. The implementation of GACAP II since 2007 suggests that the RAMPs need to be strengthened further. The risk assessments need to be linked more closely with the project design to allow them to be implemented and monitored better. The risk assessments do not assess broader institutional weaknesses, such as the legal and regulatory frameworks governing the sectors. A comprehensive institutional and political economy analysis will help contextualize the identified risks and strengthen proposed mitigation measures by considering both formal and informal institutions and processes within countries and/or sectors. The integration of a results dimension in governance initiatives will facilitate ownership and goal-setting, and increase consultation, participation, transparency, and accountability. Efforts are being made to integrate a results dimension into ADB's PSM and other governance-related portfolios through the use of results-based lending and managing for development results. Using country systems entails strengthening them and building capacities of governance institutions over the long term.

### 3. Stand-Alone Public Sector Management Projects

23. Since 2005, ADB has approved 43 ADF-funded projects (loans and grants) under the PSM classification. These projects covered 14 ADF countries and totaled about \$1.65 billion, or 10% of ADF grants and loans. Figure 3 shows the distribution of PSM subsectors for projects approved during 2005–2011. Figure 4 maps the trend of governance loans, including PSM loans to ADF countries since 2005.



24. The Governance Support Program in Nepal, Subprogram 1, approved for \$106.3 million in October 2008, supports the Government of Nepal's Local Governance and Community Development Program, which aims to contribute to poverty reduction through inclusive, responsive, and accountable local governance and participatory, community-led development. Subprogram 1 contributes to three main outcomes: (i) engagement of citizens and communities with local bodies to hold them accountable; (ii) better management of resources and delivery of services in an inclusive and equitable manner by capable local bodies; and (iii) strengthened policy and national institutional frameworks, including legal frameworks, for decentralization, devolution, and community development.<sup>19</sup>

25. In terms of loan and grant amounts, ADB's focus has increasingly shifted to two subsectors: economic and public affairs management, and public expenditure and fiscal management. The third important subsector is decentralization. The factors explaining the shift

<sup>19</sup> ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster and Grant for Subprogram 1 to Nepal for the Governance Support Program*. Manila.

to these subsectors may include the following: (i) preferential demand driven by the unique economic and political conditions of the countries; (ii) ADB's comparative advantage in these subsectors in terms of expertise and resources because of its long-term engagement; (iii) the increased flexibility that is required of ADB in view of supporting reforms that are considered priorities by the DMCs; and (iv) the more effective engagement of other development partners in the other subsectors. Box 2 describes projects in ADF countries focusing on economic and public affairs management, and public expenditure and fiscal management.

### **Box 2: Governance Projects Focusing on Economic, Public Expenditure, and Fiscal Management**

**Cambodia: Public Financial Management for Rural Development Program (Subprogram 2).** Approved in September 2010, subprogram 2 aims to strengthen the public financial management (PFM) framework by increasing accountability, improving PFM in rural priority sectors to improve service delivery, and develop external audits as a pillar of accountability. The program will also support the capacity development needs of the ministries in the areas of PFM subsystems and assist the National Audit Authority with the implementation of key public policy audit reforms.

**Kyrgyz Republic: Tax Administration Reform and Modernization Project.** Approved in June 2007, the project aims to help the government increase tax revenues by introducing modern technology in tax administration and improve staff skills to promote sustained fiscal consolidation and macroeconomic stability and reduce corruption. The project financed (i) the acquisition of equipment and software to develop a central database and management information system for the State Committee for Taxes and Collections; (ii) the development of a communication infrastructure to link the central database to tax offices; and (iii) the establishment of modern central facilities for the Large Taxpayers Unit, Bishkek tax office, taxpayer service center, and the staff development center of the State Committee for Taxes and Collections.

**Bangladesh: Strengthening Governance Management Project.** The project aims to improve the transparency and accountability of public service delivery in tax and land record administration in Bangladesh with the help of information and communication technology. Specific anticipated outputs of the project are (i) online filing of tax returns by designing the software and strengthening the capacity of the income tax circles; (ii) digitized land record management systems in selected districts; (iii) design, setup, and management of 20 tax information and service centers at the major income tax circles; and (iv) digitized land record management system for 20 land information and service centers in the selected *upazilas* (sub-districts).

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Sources: ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant for Subprogram 2, and Grant Assistance to the Kingdom of Cambodia for the Public Financial Management for Rural Development Program*. Manila (Loan 2674 for \$10 million); ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant and Technical Assistance Grants to Kyrgyz Republic for the Tax Administration Reform and Modernization Project*. Manila (Grant 0077 for \$10 million); ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the People's Republic of Bangladesh for the Strengthening Governance Management Project in Bangladesh*. Manila (Loan 2666 for \$25 million).

## **4. Public Sector Management and Regional Technical Assistance Projects**

26. ADB's TA and regional TA are significant tools in promoting good governance in DMCs. Particularly for ADF countries, where borrowing for PSM is a lesser priority, TA offers an opportunity to initiate much-needed governance reform and capacity development.<sup>20</sup> By helping countries identify and design new projects and programs, TA projects raise awareness and

<sup>20</sup> Since 2007 the level of TA to support governance has been declining due to resource constraints.

allow for continuity in supporting reforms. TA projects promote cross-cutting themes, such as improving governance and combating corruption, as well as engaging in fragile states and small island countries.

27. TA projects contribute to long-term governance efforts by providing an opportunity to engage DMCs and prepare them for needed public sector reforms, as shown by the Good Governance Program in Bangladesh approved by ADB in 2007.<sup>21</sup> The loan, which focused on judicial reforms and strengthening the Anticorruption Commission, was supported by TA grant for \$1.5 million. The TA supported implementation of reforms and related actions in legal, judicial, and institutional development work and capacity development to enhance the capability of relevant agencies to implement the policy reforms, and to more effectively manage the program.

28. A regional TA project, Strengthening Governance and Accountability in Pacific Island Countries for \$2.4 million, supports the implementation of the Pacific Regional Audit Initiative. The initiative's objective is to raise public auditing in the Pacific to uniformly high standards. This, in turn, will contribute to good governance through more transparency, accountability, and efficiency in managing and using public resources in the Pacific. The Pacific Association of Supreme Audit Institutions, which has 26 country and state members, has guided the design of the initiative with support from ADB and the Australian Agency for International Development under the oversight of the Pacific Islands Forum Secretariat.<sup>22</sup>

29. TA projects focusing on capacity development in procurement are being provided to ADF countries in order to address (i) legal and regulatory frameworks, (ii) the development of standard bidding documentation, (iii) the establishment of public procurement and related authorities, (iv) training of procurement professionals, and (v) electronically enabled procurement. For example, TA for Procurement Capacity Development for Project Implementation and Administration helped identify, design, and implement procurement interventions at various stages of the ADB project cycle to improve the effectiveness and efficiency of projects. E-learning processes were also introduced.<sup>23</sup>

## 5. Governance-Themed Projects

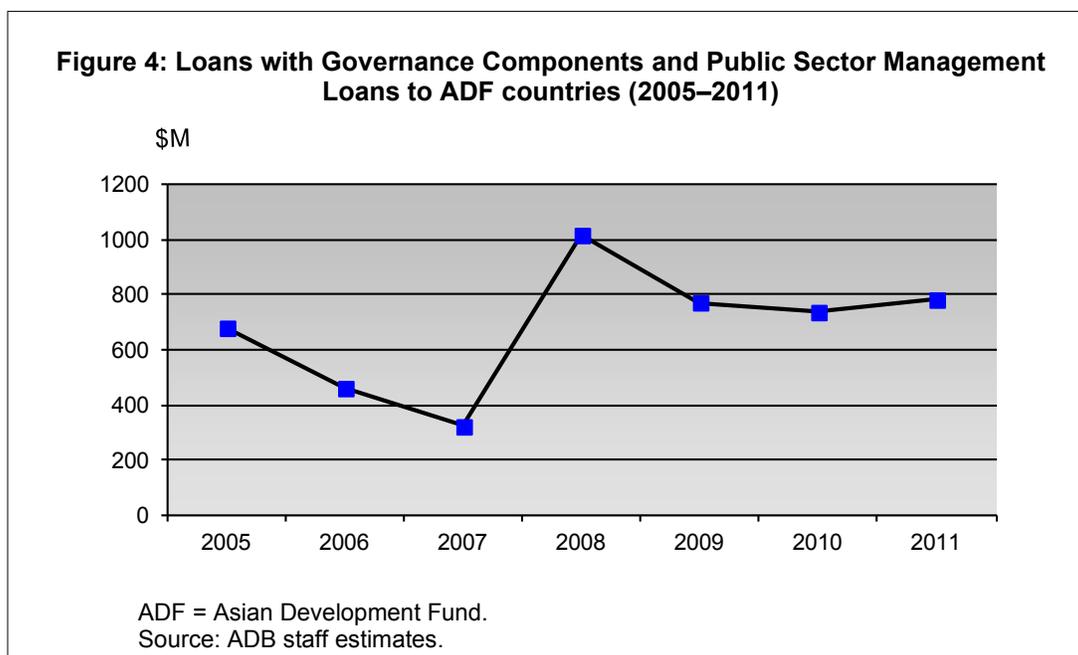
30. In addition to PSM programs and projects, governance and capacity development themes are found in most of ADB's sector programs and projects in ADF countries. These themes are important to achieve development effectiveness and for graduating countries from ADF-only to blend or ordinary capital resources status. However, loans with governance components, including PSM, have shown an inconsistent trend since 2005 and a decline since 2008 (Figure 4).

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<sup>21</sup> ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to the People's Republic of Bangladesh for the Good Governance Program*. Manila (Loan 2362-BAN).

<sup>22</sup> ADB. 2008. *Technical Assistance for Strengthening Governance and Accountability in Pacific Island Countries*. Manila.

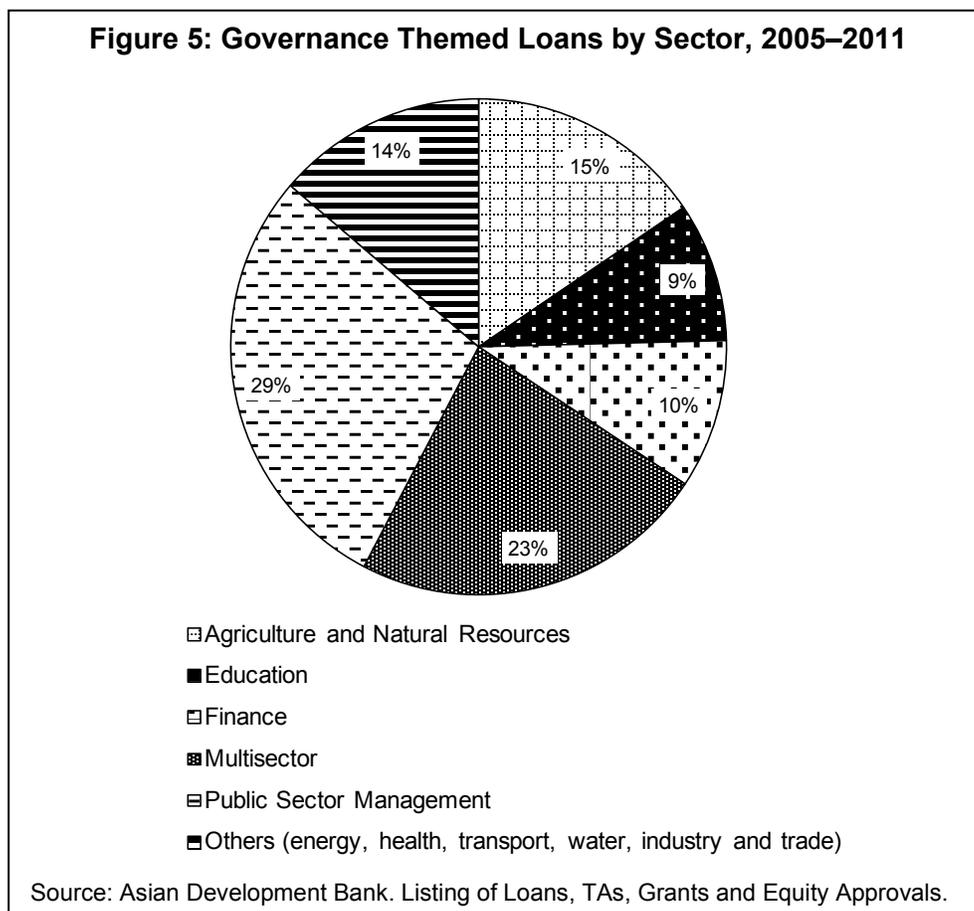
<sup>23</sup> ADB. 2009. *Technical Assistance for Procurement Capacity Development for Project Implementation and Administration for 2009–2011*. Manila (7303-REG).



31. Since 2005, governance themes have been a significant component of multisector (23%), agriculture (15%), finance (10%) and education (9%) projects, as shown in Figure 5. For example, the Third Financial Sector Program Loan to Viet Nam, approved in 2007 for \$75 million, has aimed to create a more diversified, deeper, and more resilient financial sector. In line with good governance, its core program components include more transparency and focus on investor and consumer protection. These are expected to help reduce corruption in the financial sector and capital markets. Specific measures include (i) introducing higher standards of disclosure and quality of accounting and auditing services, (ii) strengthening regulators to enhance surveillance and monitoring of securities markets, and (iii) increasing coordination among regulatory agencies.<sup>24</sup> In Mongolia, the Customs Modernization Project, approved in 2006 for \$5 million, has sought to strengthen the implementation of customs legal reforms and business process reengineering. It is in line with assisting the government in moving toward an e-government, and is regarded as an important step in mainstreaming governance in ADB operations in Mongolia.<sup>25</sup> Improved governance and efficiency are expected to boost revenue collection by customs.

<sup>24</sup> ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Subprogram 2 to the Socialist Republic of Viet Nam for the Third Financial Sector Program Loan*. Manila (Loan 2377-VIE).

<sup>25</sup> ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant Administration to Mongolia for the Customs Modernization Project*. Manila (Loan 2307-MON).



32. **Sector operational plans.** In line with Strategy 2020's emphasis on governance as a driver of change, the sector operational plans now include governance and capacity development as significant themes and issues. Health, education, water, environment, urban development, and financial sector projects in ADF countries have been incorporating components on public expenditure management, decentralization, asset management, community and civil society engagement, economic governance, anticorruption measures, legal and regulatory reform, performance-based management, procurement, and public-private partnerships.

33. For example, the education sector operational plan approved in 2010 promotes decentralized approaches and partnerships with local communities, along with broad policy reforms and capacity development. ADB will increasingly use public-private partnerships and other forms of cooperation with the private sector to improve the diversity, quality, and cost efficiency of education service delivery. The ongoing Secondary Education Development Program in Viet Nam supports policy reforms and addresses major constraints in (i) equity and access, (ii) sector management and accountability, and (iii) quality and relevance.<sup>26</sup> In higher education, the ongoing grant-financed Strengthening Higher Education Project in the Lao People's Democratic Republic is seeking to improve the higher education system and

<sup>26</sup> ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Sector Development Program Loans to the Socialist Republic of Viet Nam for the Secondary Education Sector Development Program*. Manila (Loan 2582-VIE).

institutions by establishing an effective and functional governance structure, financial management, and quality assurance systems, among others.<sup>27</sup>

34. The water operational plan approved in 2011 supports mainstreaming governance and capacity development in ADB operations.<sup>28</sup> Strengthening financial management, including revenue, trading, expenditure, and asset management, is emphasized in water operations. Policy reforms support the design and implementation of enhanced water agendas that are suited to the requirements of each country. Establishing appropriate regulatory regimes and effective enforcement are potential reform areas. The Water Resources Management Sector Development Program in Cambodia, for example, aims to assist the government in addressing priority policy, legislative, and institutional reforms in the water sector. The program's alignment with the government's public financial management reform process and its decentralization initiatives are anticipated to improve governance and reduce corruption.<sup>29</sup>

35. Under the draft urban operational plan, urban governance is considered crucial to systemic improvement and reform in environment, economy, and equity dimensions. The implementation of such investments requires the governance systems within each sector to have the capacity for effective planning, design, financing, construction, and sustained operation. Moreover, these systems need to be efficient, transparent, and accountable. The City Region Development Project in Bangladesh supports municipal capacity building in property tax collection, public participation, and urban planning. It recognizes that effective improvement of municipal management can be achieved when capacity development programs are combined with fund allocation based on performance and rigorous performance monitoring.<sup>30</sup>

36. It is difficult to determine precisely if funding allocated for governance activities in governance-themed loans has decreased because loan amounts in the reports and recommendations of the President are not always broken down by component. In addition, many risk mitigation measures do not lead to specific governance-themed loans or TA projects. Such measures include policy reforms, better monitoring, preparation of manuals, and more transparent procurement procedures.

### **C. Networks, Partnerships, and Knowledge Management**

37. ADB delivers its governance program in collaboration with other development partners. In Cambodia, ADB is one of the leading development partners supporting the multiyear Public Financial Management Reform Program, and is supporting strengthening of PFM subsystems including internal audit in three rural development ministries through an ongoing capacity development grant project. ADB participates in global collaborative governance initiatives and networks to the mutual benefit of DMCs, including ADF countries. The Anti-Corruption Initiative for Asia and the Pacific, under the joint leadership of ADB and the Organisation for Economic Co-operation and Development (OECD), supports members' efforts to combat corruption, conduct thematic analyses, strengthen capacity, and foster dialogue through regular regional

<sup>27</sup> ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant to the Lao People's Democratic Republic for the Strengthening Higher Education Project*. Manila (Grant 0166-LAO).

<sup>28</sup> ADB. 2011. *Water Operational Plan, 2011–2020*. Manila.

<sup>29</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loans, Grant, Technical Assistance Grant, and Administration of Loan and Technical Assistance Grants to the Kingdom of Cambodia for the Water Resources Management Sector Development Program*. Manila (Loan 2672-CAM).

<sup>30</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grants to the People's Republic of Bangladesh for the City Region Development Project*. Manila (Loan 2695-BAN).

seminars and conferences within the framework of the United Nations Convention against Corruption. Most of the 28 members of the initiative are national anticorruption agencies and 14 members are ADF countries.<sup>31</sup> One of the core activities of the initiative is building the capacity of national anticorruption agencies to prevent, investigate, and prosecute acts of corruption.

38. ADB is seeking to strengthen its partnerships with academic institutions, such as the Lee Kuan Yew School of Public Policy in Singapore. ADB and the school have formed a partnership to deliver leadership and public policy management programs in Southeast Asia and Central Asia Regional Economic Cooperation countries, as well as a number of research and capacity development initiatives on governance in the water sector. The school's research products will cover the natural resource sector in Mongolia and microfinance in Pakistan to inform sector reform initiatives in those countries. ADB participates in the Governance Network of the OECD Development Assistance Committee, the OECD Task Force on Public Financial Management, Procurement, and Tax and Development. In 2008, ADB endorsed the Extractive Industries Transparency Initiative.<sup>32</sup>

39. **Civil society.** Recognizing the importance of demand-side governance initiatives, ADB is working with civil society to strengthen the accountability and transparency of governments to their citizens. Engagement with stakeholders, including civil society consultations, continues to be an integral part of developing the CPS in ADF countries. In 2010, 81% of ADF loans, grants, and related project preparatory TA included documented and planned civil society participation in project consultation, implementation, and monitoring—up from 75% in 2009.<sup>33</sup> Two measures aided the greater participation of civil society in ADF projects in 2010. First, some regional departments, with support from ADB's NGO and Civil Society Center, strengthened their nongovernment organization focal point networks, enhancing engagement with civil society. Second, business processes were strengthened to include mandatory stakeholder communications strategies.<sup>34</sup>

40. **Regional cooperation and integration.** ADB underscores the importance of regional cooperation and integration, recognizing it both as a pillar of the strategic agenda and as one of five core areas of operations under Strategy 2020. ADB supports regional and subregional programs that develop cross-border institutions, trade and investment, and cooperation in regional public goods. The Pacific Financial Technical Assistance Center, for example, was established to address the lack of technical skills and institutional capacity to formulate and implement economic and financial policies in Pacific island countries.

41. ADB is working with countries in the Greater Mekong Subregion (GMS) to improve the business environment by removing governance limitations that lead to overregulation of business. The regional cooperation strategy for the GMS<sup>35</sup> addresses anticorruption efforts, public administration reforms, and decentralization in support of economic governance. The regional cooperation strategy for South Asia<sup>36</sup> promotes regional integration and economic governance by supporting an enabling environment for greater private sector involvement. The

<sup>31</sup> The countries are Bangladesh, Bhutan, Cambodia, Mongolia, Nepal, Kyrgyz Republic, Palau, Papua New Guinea, Pakistan, Samoa, Solomon Islands, Sri Lanka, Viet Nam, and Vanuatu.

<sup>32</sup> The Extractive Industries Transparency Initiative is a coalition of governments, companies, civil society groups, investors, and international organizations. It supports governance improvements in resource-rich countries through the disclosure of revenues in the extractives industries sector. <http://eiti.org/>

<sup>33</sup> ADB. Forthcoming. *ADB Cooperation with Civil Society Annual Report 2010*. Manila.

<sup>34</sup> ADB. 2011. *Development Effectiveness Review 2010*. Manila.

<sup>35</sup> ADB. 2004. *The Greater Mekong Subregion—Beyond Borders (2007–2009). Regional Cooperation Strategy and Program*. Manila.

<sup>36</sup> ADB. 2006. *South Asia (2006–2008). Regional Cooperation Strategy and Program*. Manila.

Pacific regional operations business plan promotes governance by supporting the Pacific Regional Audit Initiative.<sup>37</sup>

42. **Knowledge products.** ADB underscores the importance of knowledge products that are critical to engagement with DMCs as well as in contributing to the design, implementation, and impact of governance tools and projects. Since 2005, ADB has published its Annual Country Performance Assessment (CPA) Report on its website.<sup>38</sup> Broader knowledge initiatives include sector, thematic, and regional and country studies on governance and PSM undertaken by various departments and divisions. The types of knowledge products include books, reports, working papers, awareness raising materials, training and instructive materials, and newsletters. Topics covered include political economy analysis in countries and regions, inclusive growth and governance, public sector reform, PFM, procurement, decentralization, urban governance, access to justice, law and policy reform, combating corruption, e-governance, civil society and demand-side governance, sector legal and regulatory frameworks, sector risk assessment guidance notes, and gender and governance.<sup>39</sup>

#### IV. MOVING FORWARD WITH THE GOVERNANCE AGENDA

43. The implementation of the good governance agenda of Strategy 2020 requires sustained long-term investments in building development capacities in ADF countries for achieving inclusive growth and effective service delivery. PSM improvement across sectors is essential as all sectors require strong institutions to deliver public services. ADB is engaged with ADF countries on governance reforms and capacity development issues. ADB needs to deepen these engagements, while pursuing new areas for better governance outcomes along the lines as suggested below.

- (i) Greater understanding of political economy issues helps to identify constraints and points to opportunities for leveraging reforms. Better identification of unique country conditions, competing interests, and interaction of socioeconomic factors ensures broader stakeholder support. ADB needs to strengthen such analysis during country and sector programming by factoring in the political and institutional context in project and program designs.
- (ii) ADB needs to further strengthen and integrate the governance approach in ADF countries by (a) expanding and deepening work in governance thematic areas of PFM, procurement, and combating corruption; (b) providing governance support targeted at ADB priority areas of operations, focusing on strengthening PSM; and (c) carrying out long-term capacity development interventions, targeting weak institutions.<sup>40</sup>

<sup>37</sup> Pacific Association of Supreme Audit Institutions. 2005. *The Pacific Regional Audit Initiative*. <http://www.pasai.org/About+Us/The+Pacific+Regional+Audit+Initiative+PRAI.html>

<sup>38</sup> Asian Development Bank. Country Performance Assessment. <http://beta.adb.org/site/adf/country-performance-assessment>

<sup>39</sup> These recent governance knowledge products on ADF countries have helped shape policy dialogue and project design: (i) *Deconcentration and Decentralization Reforms in Cambodia: Recommendations for an Institutional Framework*; (ii) *Fiscal Decentralization in Asia: Challenges and Opportunities*; (iii) *Supporting the Fight against Corruption in Asia and the Pacific: The ADB/OECD Anti-corruption Initiative 2007 Annual Report*; (iv) *The Impact of Fiscal Decentralization: Issues in Theory and Challenges in Practice*; (v) *The Criminalisation of Bribery in Asia and the Pacific*; (vi) *Fiscal Decentralization and Fiduciary Risks: A Case Study of Local Governance in Nepal*; (vii) *The Political Economy of Economic Reform in the Pacific*; and (viii) *Transparency to the People: Using Stakeholder Participation to Support Public Sector Reform in Nauru and the Republic of the Marshall Islands*.

<sup>40</sup> ADB. 2012. *Stocktake and Review of ADB's Governance and Public Sector Management Operations*. Manila.

- (iii) ADB needs to continue providing TA resources for (a) preparation of governance risk assessments and risk management plans; (b) addressing risk mitigation measures; (c) national governance consultants based in resident missions; and (d) learning events and knowledge products on combating corruption, capacity building, e-governance, and tax issues. Resources for long-term TA projects need to be secured to support the governance and institutional capacity building work carried out by the regional departments.
- (iv) ADB plans to review the approach, implementation, and monitoring of RAMPs to make them more effective as a development tool. The quality of governance risk assessments can also benefit from incorporating political economy and institutional analysis, and strengthening and deepening links of PSM and governance initiatives to results.
- (v) ADB will continue to strengthen initiatives and systems that emphasize prevention of corruption by utilizing the framework embodied in United Nation Convention against Corruption through support to the Anticorruption Initiative for Asia and the Pacific jointly led by ADB and OECD.

# EVOLVING POLICY AND STRATEGIC CONTEXT OF GOVERNANCE AND PUBLIC SECTOR MANAGEMENT IN ADB

