



**ASIAN DEVELOPMENT FUND (ADF)**  
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# **Report on the Independence of the Evaluation Function and Evaluation Results for ADF Operations \***

\* This supplementary report presents the independent views of ADB's Operations Evaluation Department. ADB Management may have differing views on certain issues.

*Asian Development Bank*

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## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
ADTA	–	advisory technical assistance
DEC	–	Development Effectiveness Committee
DFI	–	development finance institution
DMC	–	developing member country
DMF	–	Design and Monitoring Framework
ECG	–	Evaluation Cooperation Group
MDB	–	multilateral development bank
MTS	–	Medium-Term Strategy
NGO	–	nongovernment organization
OCR	–	ordinary capital resources
OED	–	Operations Evaluation Department
PBA	–	performance-based allocation
PCR	–	Project Completion Report
PPER	–	Project Performance Evaluation Report
RETA	–	regional technical assistance
TA	–	technical assistance

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## EXECUTIVE SUMMARY

**Independence of the Asian Development Bank's Evaluation Function:** Since 2004, the Operations Evaluation Department (OED) has reported directly to the Board of Directors through its Development Effectiveness Committee (DEC) rather than to ADB Management. The most significant changes were: (i) the Board rather than the President appoints the Director General of OED; and (ii) Management's role in evaluation changed from approving evaluation reports to responding to the reports' conclusions. By 2006, the quality of Management responses had improved and identified commitments to specific actions. OED has extended the scope of evaluations from individual projects to countries, sectors and ADB-wide policies and strategies. Their influence was evident in (i) the sector priorities for ADB operations under the second Medium-Term Strategy; (ii) Management's action program to improve portfolio performance; and (iii) changes in new country strategies and programs directly related to findings of prior country assistance program evaluations. Externally, in 2005/2006, OED chaired the Evaluation Cooperation Group (ECG) of the multilateral development banks (MDBs) that is harmonizing evaluation methodologies, performance indicators, and criteria.

**Evaluation Results for Asian Development Fund Operations:** After Board approval, it takes 5 to 10 years to implement ADB's funded projects. Thus, the results delivered by ADB projects in the new millennium reflect the impacts of projects approved in the 1990s. OED's 2006 *Annual Evaluation Review* concluded that success ratings of ADF-funded projects approved in the 1970s and 1980s were considerably below those of ordinary capital resource (OCR)-funded projects. However, for projects approved in the 1990s, OCR and ADF success ratings converged and both sets improved. Performance was better than average in some ADF-eligible countries and worse than average in others. The sector was a major determinant of project success. Infrastructure projects were more likely to be successful, and agricultural projects were more likely to experience difficulties for both ADF- and OCR-funded projects. In most sectors, outcomes have been similar, but ADF-funded social infrastructure projects and lines of credit to government-owned development finance institutions have been less successful than those funded by OCR. ADF projects are more likely to be directly targeted on poverty than OCR loans and their design may be more complex. Of program loans financed through ADF, less than half were evaluated as successful.

The 2006 *Annual Evaluation Review* reported on the relationship between staff incentives and achieving development results. The analysis found that ADB's current formal and informal incentives reward loan processing and approval and had an insufficient focus on project administration, project success, or achieving medium-term results. Management agreed to look into a feasibility of possible changes in the system. The 2006 *Annual Evaluation Report* also analyzed factors contributing to project quality, including governance, and concluded that the relationship between governance and development effectiveness is complex and not straightforward and that there are problems in measuring governance. OED's *Annual Reports on Loan and Technical Assistance Portfolio Performance* identified some fundamental corporate issues. At DEC's recommendation, Management prepared an action plan to address these issues that is under implementation. The report also found that the quality of design and monitoring frameworks has improved but further progress is needed.

1. This report presents the independent views of the Asian Development Bank's (ADB's) Operations Evaluation Department (OED) in two sections: (i) the new *modus operandi* for evaluation; and (ii) highlights of the annual evaluation and portfolio performance reviews.

### **A. New *Modus Operandi* of Independent Evaluation**

2. With the approval of a new policy by the Board of Directors, structural changes to increase the independence of OED took effect on 1 January 2004. OED now reports directly to the Board through its Development Effectiveness Committee (DEC) instead of to the President.<sup>1</sup> Accordingly, a new responsibility and accountability structure was implemented to evaluate operations. The most significant changes were: (i) the Board rather than the President appoints the Director General of OED (the Board exercised this new responsibility in 2004 with its appointment of the current Director General);<sup>2</sup> and (ii) Management's role in evaluation changed from approving evaluation reports to responding to the reports' conclusions. Management responses have evolved from a "no comment" nature at the outset to carefully considered commitments to specific improvements and actions by 2006. A system to monitor these actions is under development under the leadership of the Managing Director General. This will improve tracking and reporting on actions that result from OED reports.

3. To ensure the independence and transparency of evaluation reports, a new approval, review, and disclosure process was established. Since OED reports are final upon approval by its Director General, the reports are made publicly available immediately upon circulation to Management and the Board. Management is given a specific period in which to formally respond to the findings and recommendations. DEC then considers evaluation reports of country and ADB-wide policies and strategies. Management responses and the DEC chair's summaries of discussion are publicly disclosed as they become available.

4. The Board policy paper establishing the independence of OED identified the need to formalize the unwritten, conventional practices for avoiding conflicts of interest in evaluations. In March 2005, ADB became the first member of the Evaluation Cooperation Group (ECG) of the multilateral development banks (MDBs) to formally adopt Guidelines to Avoid Conflict of Interest in Independent Evaluations, which specify conditions under which OED management, staff, and consultants recuse themselves.

5. OED has strengthened the process used to formulate its workplan. Previously, only annual workplans were prepared, but starting in 2005 a 3-year framework was developed. Consultations for preparing the 2006–2008 workplan were much wider than in the past. For the first time, discussions on institutional priorities for evaluations were held with DEC, the President, and all Vice-Presidents. Inputs were also sought from the heads of operations departments as in the past. The evaluation program has consequently become more strategic and more integrated, with one evaluation feeding into another. For instance, country assistance program evaluations for Bangladesh, Bhutan, People's Republic of China, India, Lao People's Democratic Republic, Mongolia, Nepal, Pakistan, and Sri Lanka were included in the workplan in anticipation of the new country partnership strategies that would be prepared. Evaluations of the effectiveness of ADB's technical assistance operations, micro-credit operations, energy policy, governance and anti-corruption policies, approaches to partnering and harmonization,

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<sup>1</sup> ADB. 2003. *Enhancing the Independence and Effectiveness of the Operations Evaluation Department* (R263-03). Manila.

<sup>2</sup> The term of the Director General is 3 years with a possible 2-year extension. During this period, he/she can be removed only by the Board on the grounds of inefficiency or misconduct. Upon completion of the term, he/she is ineligible for any other staff position at ADB.

policy-based lending modalities, adoption of managing for development results, safeguard policies, and the accountability mechanisms are programmed to feed into reviews of these topics by Management.

6. The impact of evaluations on ADB operations, policies, and strategies was assessed in the *2006 Annual Evaluation Review*. Their influence was most evident in (i) the sector priorities for ADB operations under the new model for selectivity and focus set out in the second Medium-Term Strategy (MTS II); (ii) Management's agreement to implement an action program to improve portfolio performance in response to DEC's recommendation following its discussion of the *2005 Annual Report on the Loan and Technical Assistance Portfolio Performance*; and (iii) changes in new country strategies and programs directly related to specific lessons and recommendations from prior country assistance program evaluations.

7. Through its oversight of OED, DEC is now helping to ensure that appropriate actions are taken on lessons and recommendations that it considers to be of high priority and that Management has accepted. In its annual report to the Board in 2005, DEC went beyond its conventional formal assurance of the adequacy and efficiency of ADB's evaluation activities to include a specific, candid assessment of the system for taking actions. DEC considered there had been some progress but that there was significant room for more progress for ADB to become a full-fledged learning organization using evaluation results systematically to improve future operations. DEC made recommendations to Management on areas for improvement.

8. DEC reported on actions taken by OED and by Management on its recommendations:

- (i) Traditionally, the intended end-users were consulted during and near the completion of an evaluation. Now OED reviews the scope and methodology with the main stakeholders, particularly the ADB operations department and government, *before* starting.
- (ii) OED has introduced the new step of discussing draft evaluation recommendations with ADB operational management and, in the case of country assistance program evaluations, with developing member country (DMC) officials before the evaluations are finalized. The objectives are to ensure that those who will be responsible for implementing the recommendations understand them, to find out which are acceptable and feasible, and to build early commitment.
- (iii) The actions Management commits to in its formal responses to evaluation reports have generally been more specific and time-bound in 2006.

9. To improve consistency and quality, guidelines for the evaluation of public sector projects, program loans, technical assistance grants, and country assistance programs were issued in 2005. Guidelines for evaluating private sector operations will be completed in 2006.

10. The ECG of the MDBs was chaired by ADB in 2005–2006, and in October 2005, an ECG meeting was held at ADB headquarters in Manila for the first time. The purpose of the ECG is for the MDBs to harmonize evaluation methodologies, performance indicators, and criteria. The ECG has developed good-practice standards for evaluating public sector investment operations and in 2006 introduced a benchmarking exercise led by the World Bank. For private sector investment operations, agreement on an updated third edition of good-practice standards was reached in 2006 following a second benchmarking study in 2005. ADB took the lead in developing the standards for evaluating policy-based lending; the report was

endorsed by the ECG in 2005. ADB is also taking the lead in work begun in 2006 to develop ECG good-practice standards for country assistance program evaluations.

11. The ECG is presently examining the feasibility of developing a robust peer review of evaluation functions in the MDBs that will address issues such as (i) the independence of the evaluation office and the role of Management and the Board; (ii) the selection of evaluation topics; (iii) adherence to ECG good-practice standards; (iv) the quality of the evaluation reports; (v) use of evaluation findings and recommendations; and (vi) staffing and budgets. The ECG has appointed ADB, the Inter-American Development Bank and the European Bank for Reconstruction and Development to a task force to develop the methodology for such review.

12. In addition to the ECG and as part of the international harmonization agenda, there is increasing interest in undertaking joint evaluations for greater consensus and usefulness of results. The Joint Evaluation of Global Environment Facility Projects of 2005–2006 is OED's first involvement in such an evaluation. OED is actively looking for opportunities to undertake further joint evaluations though taking into account the increased costs they entail. OED has also closely followed the debate in the international evaluation community on impact evaluations and agrees on the desirability of making them more rigorous subject to data availability, time, and resources. OED is undertaking its first rigorous impact evaluation on micro credit in the Philippines and has programmed one per year from now. OED's Director General represents ADB in the Leading Edge Group, a recently formed group of organizations, foundations, and governments that promotes the use of rigorous impact evaluations of social development programs.

## **B. Highlights of Annual Evaluation Reports**

13. Two annual reports are prepared by OED: (i) the annual evaluation review which includes key conclusions and lessons from performance evaluations of completed operations and of institutional policies and strategies; and (ii) an annual assessment of the performance of the loan and technical assistance portfolio under implementation.

### **1. Annual Evaluation Review**

14. The *2006 Annual Evaluation Review*<sup>3</sup> compared the success rates of completed public sector projects funded through the Asian Development Fund (ADF) with those funded through ordinary capital resources (OCR). Successful projects were those assessed as “highly successful,” “successful,” and “generally successful.” Projects rated as “unsuccessful” were clearly failures. While projects rated as “partly successful” had achieved some results, there were problems with effectiveness, efficiency, or sustainability, so these projects were not counted as successful. The assessment methodology is summarized in Table 1.

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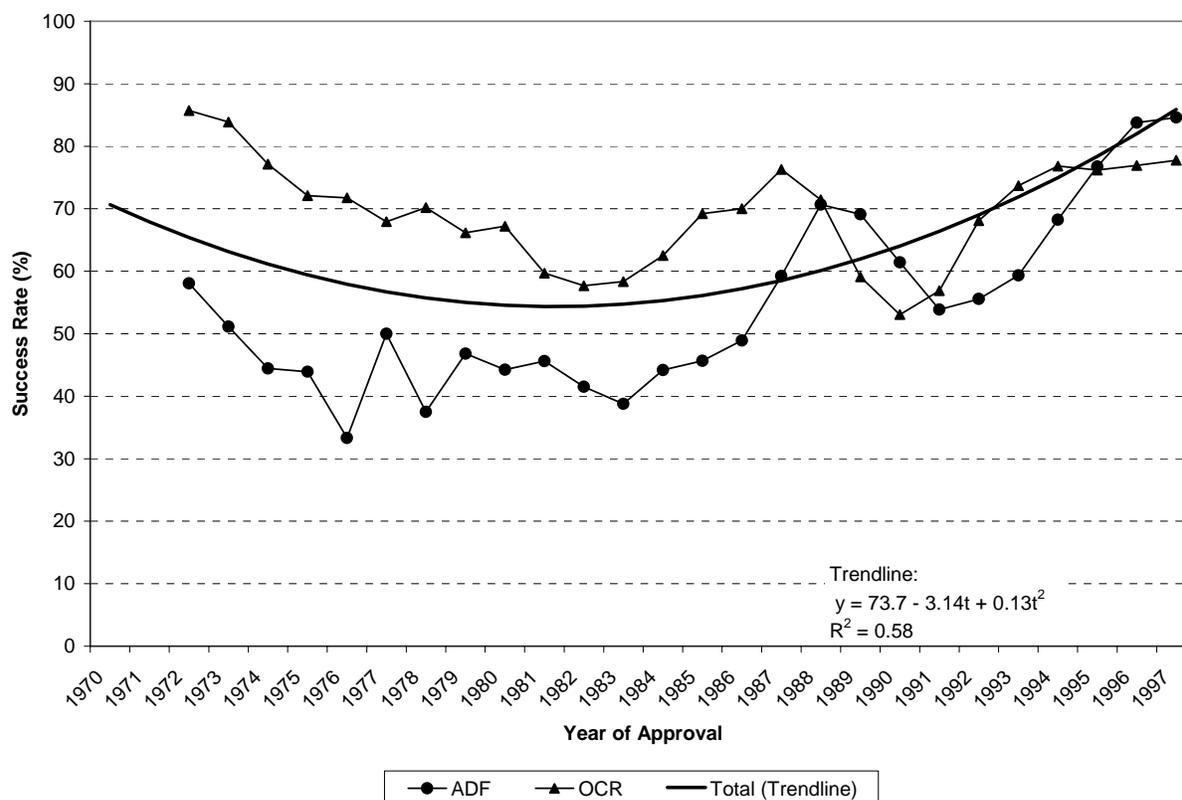
<sup>3</sup> <http://www.adb.org/Documents/PERs/2006-AER.pdf>

**Table 1: Overall Assessment Methodology for Project Performance Evaluation**

Criterion	Weight (%)	Definition	Rating Description	Rating Value
1. Relevance	20	Relevance is the consistency of a project's impact and outcome with the government's development strategy, ADB's lending strategy for the country, and ADB's strategic objectives at the time of approval and evaluation and the adequacy of the design.	Highly relevant Relevant Partly relevant Irrelevant	3 2 1 0
2. Effectiveness	30	Effectiveness describes the extent to which the outcome, as specified in the design and monitoring framework, either as agreed at approval or as subsequently modified, has been achieved.	Highly effective Effective Less effective Ineffective	3 2 1 0
3. Efficiency	30	Efficiency describes, <i>ex post</i> , how economically resources have been converted to results, using the economic internal rate of return, or cost-effectiveness, of the investment or other indicators as a measure and the resilience to risk of the net benefit flows over time.	Highly efficient Efficient Less efficient Inefficient	3 2 1 0
4. Sustainability	20	Sustainability considers the likelihood that human, institutional, financial, and other resources are sufficient to maintain the outcome over its economic life.	Most likely Likely Less likely Unlikely	3 2 1 0
<b>Overall Assessment</b> (weighted average of above criteria)		<b>Highly Successful:</b> Overall weighted average is greater than 2.7. <b>Successful:</b> Overall weighted average is between 1.6 <u>and less than 2.7</u> . <b>Partly Successful:</b> Overall weighted average is between 0.8 <u>and less than 1.6</u> . <b>Unsuccessful:</b> Overall weighted average is less than 0.8.		

15. There is a long feedback loop from the date of loan approval and project completion when development results can be assessed. It takes 7 years or more to implement projects after Board approval and for PCRs and PPERs to be prepared. Thus, virtually all projects that were approved in the mid-1990s were in various stages of implementation after the turn of the millennium. Indeed, many are still under implementation. The PCRs and PPERs for most of the projects approved in the 1990s were prepared between 2000 and 2005. The analysis of project success was undertaken based on the year of project approval, not the date of completion or PCR/PPER preparation. As Figure 1 shows, the success rates of ADF-funded projects approved before the 1990s tended to be considerably lower than OCR-funded ones, and average ADF ratings were much more volatile. In the 1990s, however, the OCR and ADF ratings have converged, and both have improved. Given the development challenges faced by ADF-eligible countries, this is a positive finding. The long-term trend of the ratings suggests that the design and/or implementation of ADB-funded projects have progressively improved whether funded by OCR or by ADF. This indicates successful, gradual institutional learning from lessons of past operations. This improvement in project outcomes needs to be continuously monitored to ensure that the trend is sustainable.

**Figure 1: Trends in Project Ratings by Source of Funding**  
(Combined Project Performance Evaluation Report and Project Completion Report Results)



**Note:** % success rate for OCR and ADF based on 3 year-moving average.

Source: OED

16. While project performance has varied significantly across countries, it did not vary significantly by country classification (i.e. degree of eligibility for ADF funding). The analysis by country classification in Table 2 shows improvement from the 1970s to the 1990s across all country groupings though patterns of progress differ. By the 1990s, the success rate of each group with access to ADF had gradually increased. By the 1990s, Group A countries (with the exception of Nepal) were performing better than countries in Groups B1 and B2.

**Table 2: Project Success by Country Classification**

Country Classification	Proportion of Projects Rated Successful		
	1970s	1980s	1990–1997
Graduated Economies	85	90	none
C	66	55	77
B2	55	59	68
B1	40	60	71
A	58	50	74
Total	60	58	71

17. The averages by classification mask important country differences. Within all groups, there are outliers in both directions. The country variation holds for source of funding. For some OCR borrowers, projects are more likely to be successful than in ADF-eligible countries, but ADB's portfolios perform better in some countries that have access to ADF than in some OCR borrowers.<sup>4</sup> In Group B2, the People's Republic of China stands out as one of ADB's best performing portfolios achieving an 82% success rate in the 1990s. In contrast, Papua New Guinea had a 22% success rate in the 1990s, the weakest portfolio performance in ADB. In Group B1, the success rates of the portfolios in Bangladesh (84%) and Viet Nam (91%) significantly exceeded both group and ADB averages for projects approved in the 1990s. In contrast, only 57% of projects approved for Pakistan in the 1990s were rated as successful. In Group A, the portfolio success rates of Bhutan, Cambodia, Kyrgyz Republic, Lao People's Democratic Republic, Maldives, Mongolia, and Solomon Islands exceeded Group A and ADB averages in the 1990s. On the other hand, the success rates for Nepal as well as Kiribati, Samoa, and Vanuatu were below average for the Group A countries.

18. There is a school of thought that country ownership, which is a key factor for project success, increases with a country's share in the financing of a project. This hypothesis was tested by comparing project success rates to the percentage of project costs financed by the executing agency after controlling for sector differences. No significant statistical relationship was found, nor was there any clear pattern to suggest that project success improved with the share of government financing. Since the likelihood of project success is not compromised as the share of ADB funding increases, it is reasonable for ADB to address the greater fiscal constraints faced by lower income countries by increasing the allowable financing limit.

19. Project performance varied more significantly by sector than by country category. The likelihood of project success by sector is shown in Table 3. The findings indicate that both OCR- and ADF-funded projects generally perform similarly in the same sectors, with certain important exceptions. It is also evident from the table that the ratings of ADF-funded projects eventually converged with those of OCR-funded project across sectors from 1970 to 1997.

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<sup>4</sup> Since 1998, country assistance program evaluations have been completed for the People's Republic of China (PRC) (1998), [Viet Nam (2000), Mongolia (2002), Philippines (2003), Bangladesh (2003), Papua New Guinea (2003), Cambodia (2004), Nepal (2004), Bhutan (2005), Indonesia (2005), Uzbekistan (2006), and Lao People's Democratic Republic (2006). Evaluations of the country assistance programs for Pakistan, Sri Lanka, and India and a second evaluation for PRC will be completed in 2007.

**Table 3: Project Performance by Sector and Source of Financing**  
(% of Projects Rated Successful)

Major Sector	ADF				OCR				Total			
	1970s (%)	1980s (%)	1990-1997 (%)	Total (%)	1970s (%)	1980s (%)	1990-1997 (%)	Total (%)	1970s (%)	1980s (%)	1990-1997 (%)	Total (%)
Agriculture	36	53	52	47	41	38	52	42	37	47	52	46
Energy	68	80	87	78	87	77	86	84	78	78	87	81
Government-owned												
DFIs	0	31	63	26	67	82	29	64	42	52	47	46
Social Infrastructure	50	31	67	55	74	63	82	73	65	48	72	63
Transport and												
Communications	79	73	90	82	86	76	85	83	84	74	87	83
Industry	67	100	50	67	78	100	50	74	75	100	50	72
Multisector/Others	100	64	74	71			45	45	100	64	63	64
<b>Total</b>	<b>46</b>	<b>54</b>	<b>69</b>	<b>58</b>	<b>72</b>	<b>63</b>	<b>74</b>	<b>70</b>	<b>60</b>	<b>58</b>	<b>71</b>	<b>64</b>

ADF = Asian Development Fund, DFI = development finance institution, OCR = ordinary capital resources.

Source: OED.

20. ADB's experience has been best in the transport and energy sectors with project success rates reaching 87% for both in the 1990s; the success rates are high for both ADF- and OCR-funded projects. In the transport sector, road projects have dominated the portfolio for both sources of funding. Project success has also been high for port, airport, and telecommunication projects, again regardless of the source of funding. The performance of the relatively small railway portfolio was considerably weaker than that of the other transport modes. Successful road projects have been associated with the following factors: (i) traffic growth related to economic growth; (ii) adequate levels of traffic on the completed roads; (iii) reduced vehicle operating costs and journey times and improved transport services; and (iv) an adequate maintenance regime.

21. Evaluations of ADB's energy portfolio have found generally good project outcomes regardless of funding source. Power projects dominate the portfolio. Difficulties are sometimes experienced in complying with financial covenants and with ADB's environmental and resettlement safeguard policies, particularly for hydropower projects. Nongovernment organizations (NGOs) have raised concerns on the latter. In successful power projects (i) benefits were immediate once the projects were completed due to existing unsatisfied demand; (ii) increased electricity facilitated economic growth and contributed to a better quality of life; (iii) financial policy dialogue and tariff reform helped to ensure sufficient funding for investment, operation, and maintenance; and (iv) there was a strong project management team in the executing agency that had learned lessons from previous projects.

22. The agriculture and natural resource sector had poor outcomes for both ADF- and OCR-financed projects. By the 1990s, project success rates were only 52% across funding sources. For ADF-funded projects, the success rate slightly exceeded the average for irrigation and rural development projects and for a small number of fertilizer plant projects. The difficulties faced in the sector were examined in 2005 in the evaluation of the partly satisfactory agriculture operations in the Lao People's Democratic Republic. Problems experienced included (i) inadequate project design, including an inadequate understanding of the problems and opportunities viewed from the perspective of beneficiaries; (ii) no clear distinction between addressing the needs of subsistence farmers and options for commercialization of agriculture; (iii) project complexity; (iv) weak institutions; (v) shortfalls in operation and maintenance; (vi) marketing impediments confronting farmers and agribusinesses; and (vii) adverse impact of external factors (e.g., climate; declining farm gate prices through much of the 1980s and 1990s).

These problems are pervasive throughout the agriculture sector in both OCR- and ADF-funded projects.

23. Nevertheless, since the livelihoods of about 80% of the population in the region depend directly or indirectly on agriculture, the sector remains important for virtually all DMCs. Some ADB irrigation and drainage projects have achieved good results. When successful, such projects bring significant gains to the beneficiaries. For irrigation projects, the key success factors were (i) an enabling policy environment; (ii) involvement of stakeholders and beneficiaries at all project phases particularly operation and maintenance; (iii) participatory techniques to develop a sound understanding of the roles and responsibilities of farmers and water user associations and to create a climate in which participants are willing to pay irrigation fees; and (iv) adequate water supply reaching tail-end users, who are usually small farmers.

24. ADF-funded projects in social infrastructure and lines of credit have been less successful than those funded by OCR. Social infrastructure includes a diverse group of subsectors (urban development, water supply and wastewater treatment, sanitation, education, health and population). In the 1990s, 67% of the ADF-funded social infrastructure projects were rated as successful, lower than the 82% success rate for OCR-funded projects. The difference in project outcomes by source of funding was evident in all subsectors. Among ADF-funded projects, urban development performed best (78% success rate in the 1990s), followed by education (70%), water supply and sanitation (69%), and health and population (50%).

25. The difficulties in achieving successful project outcomes in the social sectors were illustrated in the 2005 social sector evaluation in Pakistan. Relative to the performance of operations in most other sectors in the country, the social sector outcomes have been poor. According to the evaluation, only 8% of 24 projects were rated as successful, 58% were partly successful, and 33%, were unsuccessful. Although the performance of more recently approved projects was better, performance remains unsatisfactory particularly in light of ADB's commitment to managing for development results.

26. Lessons that can be drawn from successful water supply projects include (i) their positive impacts on intended beneficiaries, particularly women; (ii) technical innovation and a positive impact on the environment; (iii) long-run sustainability through proper operation and maintenance; (iv) financially self-sustaining water supply institutions, operational water user committees, and adoption of the "user pays" principle; and (v) project formulation through extensive consultations with local government staff and the local community, including NGOs.

27. In successful projects in the education sector (i) participatory approaches were used for project design and implementation to build alliances and share ownership by engaging with stakeholders; (ii) basic and secondary education projects were generally not able to recover costs, so adequate budgetary support was essential for project sustainability; (iii) technical, vocational, and higher education projects recovered some costs and generated revenues; and (iv) cross-cutting themes, especially poverty reduction and gender concerns, were emphasized.

28. The ratings of projects in the financial sector reflect the performance of loans to government-owned development finance institutions (DFIs). There are clear differences in the performance of ADF- and OCR-financed DFI lines of credit. Only 26% of the ADF-financed lines were rated as successful while for OCR-financed lines (after excluding projects in graduated economies approved in the 1970s and 1980s) the success rate was 52%. The findings suggested that ADB should refrain from financing lines of credit in ADF countries, and MTS II

includes DFI lines of credit among the sectors from which ADB should exit. Generally, the strength of financial institutions, depth of the financial markets, and quality of regulation improve as countries develop. ADB's current approach is to focus on financial sector reform rather than channeling funds through DFIs.

29. In countries blending ADF and OCR funds, the success rate of OCR-financed projects (66% overall) has been higher than that of ADF financed projects (52%). That held for projects approved in the 1970s, 1980s, and 1990s with no evidence of a convergence in success rates. A significant difference in sector mix provides part of the explanation. Agriculture and the social sectors, which have modest success rates, accounted for 79% of ADF projects in blending countries compared to 42% of OCR projects. In contrast, transport and energy, sectors with high success rates, accounted for 45% of the OCR projects but only 18% of the ADF projects.

30. *Program lending:* While project lending has constituted the majority of ADB's assistance, program loans are also important and were used extensively in response to the 1997 Asian financial crisis. Program loans are disbursed relatively quickly to cover the adjustment costs of policy reforms. Program loans have been made to 31 DMCs, although the bulk of program lending is concentrated in a few countries. From 1978 to 2002, 133 program loans were approved for a combined total OCR and ADF of \$18.1 billion. Of these, 92 have been evaluated; 48% were rated successful, 49% partly successful, and 3% unsuccessful.

31. The success rates of programs by year of approval are shown in Figure 2. The success rate became unacceptably low for program loans approved through 1991, particularly for those approved from 1989 to 1991 when none of the 15 programs was rated successful.<sup>5</sup> However, the probability of success improved for programs approved after 1991, reflecting the positive effect of initiatives to improve quality, greater experience with the use of a policy-based lending modality, and the revision of ADB's program lending policies in 1996.

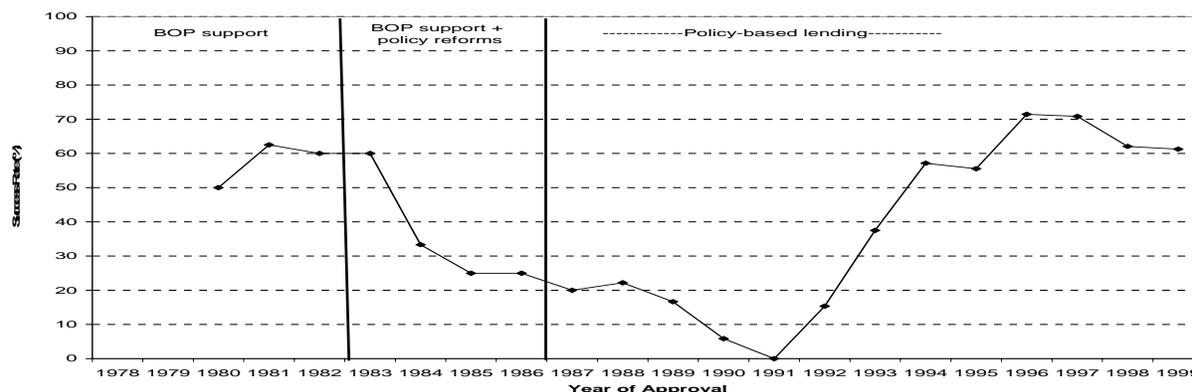
32. Program loans are a more common lending modality in ADF countries than in OCR countries. Nearly 75% of program loans rated (68 out of 92) were financed by ADF loans. This is not surprising as the need for policy and institutional reform is greatest in countries that are eligible to borrow from ADF. The analysis confirms that country factors such as economic performance, development priorities, quality of governance, and strength of institutions contributed to the success rates of programs. In all, 67% of the OCR-funded programs were rated successful compared with 41% of ADF-funded programs. These results highlight the difficulty of formulating successful program loans in ADF countries.

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<sup>5</sup> Ten of these were in the agriculture sector, two in finance (both first in the country), one in transport (first in the sector), one in energy (first in the sector), and one in the industrial sector.

**Figure 2: Trends in Program Ratings By Year of Approval**

(% Success Rate Based on 3-Year Moving Average)



BOP = Balance of Payment

33. Program lending has been most commonly used in the agriculture and finance sectors and has rarely been used in the transport and energy sectors; however, the sector distribution has changed significantly. More than 75% of the 78 program loans approved since 1996 have been concentrated in three sectors: law/economic management/public policy, finance, and multisector. Success ratings by sector and source of funding (Table 4) are difficult to compare because of the small numbers of OCR-financed program loans in most sectors. Most agriculture, industry, and social infrastructure program loans were in ADF-eligible countries, and there was no OCR-funded transport program loan. On average, ADF-financed agriculture programs performed poorly (worse than agriculture projects) with a low success rate of 30%; however, from 1995 onwards, significant improvements were achieved. The financial sector is the one sector that had a comparable number of program loans financed by OCR and ADF. In this sector, the success rate for ADF-financed program loans (53%) was significantly lower than for those financed through OCR (90%). The disappointing performance of program lending, in general, has been attributed to (i) the absence of government commitment to the principles and concepts underlying the reforms; (ii) the lack of a comprehensive sector analysis prior to the formulation of the policy reform package; (iii) a lack of clarity in program objectives and policy measures and their interrelationships; (iv) inadequate capacity of the executing agencies to carry out the required studies and monitoring; and (v) non-sustainability of the policy reforms introduced.

**Table 4: Program Loan Performance by Sector and Source of Financing**  
(% of Programs Rated Successful, Loans Approved from 1978 to 2002)

Sector	Asian	Ordinary	Total
	Development Fund	Capital Resources	
	%	%	%
Agriculture	30	50	32
Energy	0	0	0
Finance	53	90	68
Social Infrastructure	60	100	67
Transport and Communications	0	-na-	0
Industry	63	100	67
Multisector/Other	43	60	50
<b>TOTAL</b>	<b>41</b>	<b>67</b>	<b>48</b>

34. The *2006 Annual Evaluation Review* also reported on two themes that are consistent with the commitments made by ADB to ADF donors: (i) relating staff incentives to achieving development results; and (ii) factors contributing to project quality, including governance.

35. *Relating staff incentives to achieving development results:* This was the first systematic attempt at ADB to examine staff accountability for project success. The study confirmed that ADB's current formal and informal incentives reward loan processing and approval with insufficient focus on project administration, project success, or achieving medium-term results. Adjusting ADB's incentive systems to encourage more focus on project results and success is consistent with commitments made in both the 2004 Human Resources Strategy and MTS II. The question is not whether to change the incentive systems but how to do it.

36. The present staff performance evaluation system needs to be complemented by a chain of accountability for achieving development results that begins at the top with Management and senior staff and cascades down to all staff. Incentives need to be fully aligned with accountability throughout the chain. The study recommended that ADB explore the feasibility of providing stronger incentives for staff to focus on project quality-at-entry and project administration and supervision. Initial work could include an assessment of best practices in comparable institutions and developing indicators for measuring the achievement of development results. Management agreed to study the feasibility of this approach.

37. *Factors contributing to project quality, including governance:* Good governance and the control of corruption have become important parts of the international development agenda. The analysis undertaken in the *2006 Annual Evaluation Review* concluded that the relationship between governance and development effectiveness is complex and not straightforward. There are many definitions of governance, and there are many measurement problems that make the data less than fully reliable. The analysis of the relationship between measures of governance and macroeconomic indicators suggested the following.

- Although there is a strong, positive relationship between the level of economic development and governance variables when a worldwide data base is used, the relationships are much weaker if only countries in which the per capita gross domestic product is lower than \$5,000 are analyzed.
- No significant relationship was found between good governance and the rate of economic growth from 1996 to 2004.
- Although Asia and the Pacific is the fastest growing economic region in the world, governance in many countries is weak according to standard governance indicators.
- Some DMCs in the region with relatively good governance had lower growth rates than countries with lower governance ratings.

38. The analysis of projects approved in the 1990s suggests that there is some evidence of a relationship between some of the dimensions of governance and good project outcomes; however, it is not clear how strong or robust the relationships are. Other factors are also important, perhaps more so than governance, in determining project success (e.g., sector, country characteristics, macro economic climate, country ownership, capacity of the executing agency). The relationships between good governance at the macro level and project success may be somewhat weaker than is conventionally assumed. It may be that governance issues at the sector level have a more direct bearing on project success.

39. Subsequent to ADF IX replenishment, ADB harmonized its performance-based allocation (PBA) procedures with those of the World Bank. ADB's 2004 PBA policy for ADF resources increased the weight given to governance in measuring country performance from 30% to 50%, although this is still lower than the 66% assigned in the World Bank formula. There was, however, no analysis undertaken by ADB that demonstrated that good governance is the key binding constraint for development in all DMCs and that it merits such a high weight in the PBA formula. ADB has not undertaken a rigorous study that links good governance as a causal factor in good economic performance, in reducing poverty, in achieving development results, in good portfolio performance, or in project success.

40. The *2006 Annual Evaluation Review* recommended that ADB undertake such a study. Depending on the results, consideration may have to be given to including sectoral governance variables in the formula or to reducing the weight for governance in the PBA formula. Benchmarking a country's governance performance and then rewarding progress in improving governance would be more consistent with managing for development results than making major decisions on ADF allocations based on the governance score in any one year. Steps also need to be taken to improve the consistency of what is meant by governance in ADB's various governance-related policies and country governance assessments. Reducing the weight might be perceived as sending the wrong message given that ADB has recently adopted MTS II which places priority on good governance and controlling corruption. However, this must be balanced against the potential harm that may be caused to DMCs whose ADF allocation is reduced because of a score on a variable that is difficult to define, measure, and compare over time and across countries.

41. Clearly, good governance and efforts to control corruption are important. The issues identified by the review related to a lack of clarity of definition, difficulties of measurement, a lack of rigorous analysis of the subject at ADB, and questions about whether governance is the most important binding development constraint in all DMCs. These issues are important because in the PBA formula, ADB purports to be able to accurately define and measure governance on a numeric scale and uses the results to allocate more or less ADF funding to DMCs.

## **2. Annual Report on Portfolio Performance**

42. OED's Annual Report on Portfolio Performance<sup>6</sup> provides real time feedback on the performance of the active loan and TA portfolio. In 2005, the *Annual Report on Loan and Technical Assistance Portfolio Performance for the Year Ending 31 December 2004* highlighted serious, fundamental issues. The 2006 report covered all loans, both OCR and ADF funded, and TAs that were active during the decade 1996–2005. It confirmed the following trends:

- Stagnation in total public sector lending in nominal terms continued. If the increase in lending during the Asian financial crisis is excluded, combined OCR and ADF loan public sector approvals remained constant throughout the decade at about \$5.2 billion per year, although there was an increase from \$4.9 billion in 2004 to \$5.3 billion in 2005. In contrast to public sector operations, private sector operations have increased
- Delays in project implementation continued. Of the 662 loans that were closed during the decade, more than 80% were closed behind schedule, and the average loan extension was 2.1 years.

<sup>6</sup> [http://www.adb.org/Documents/Reports/Portfolio\\_Performance/2006/LTAPP.asp](http://www.adb.org/Documents/Reports/Portfolio_Performance/2006/LTAPP.asp)

- The declining trend in loan disbursements may have come to an end in 2004, given the upturn in 2005, but confirmation of a trend reversal will have to await an evaluation of results achieved in 2006 and 2007.
- Many DMCs found it difficult to meet the conditions for second and subsequent program loan tranche releases.
- Delays in project start up were the norm, and the average time taken for loans to proceed from approval to effectiveness increased.
- The inadequacy of loan and technical assistance supervision continued.
- ADB lending was heavily concentrated in a few DMCs. Bangladesh, the People's Republic of China, India, Indonesia, Pakistan, Philippines, Thailand, and Viet Nam together received 88.5% of the total.
- The negative net resource transfer from ADB to the DMCs continued but at a reduced level, primarily due to a decline in the unusually large OCR loan prepayments.
- Income from loans was almost unchanged from 2004 to 2005 suggesting that the drop in income due to the large OCR loan prepayments of recent years may have stabilized.

43. Because of its concern about the weaknesses in the loan and technical assistance portfolios, DEC recommended that Management formulate a corporate action plan to improve portfolio performance. Management responded affirmatively. The action plan calls for the time-bound implementation of 30 specific measures: 20 are linked to the broader Reform Agenda and the Innovation and Efficiency Initiative or involve more efficient use of existing procedures and 10 represent new initiatives. An assessment by Management in mid-2006 indicated a satisfactory start had been made in implementing this action plan.

44. The ADF and OCR portfolios in 2005 were compared using the standard set of portfolio indicators in Table 5. The key findings were the following:

- (i) The average OCR loan was about 4.3 times larger than the average ADF loan;
- (ii) ADB developed a new project classification system after the review of the poverty reduction strategy in 2004. In 2004 and 2005, ADF projects were much more likely to be directly targeted on poverty (56% and 46% respectively) than were OCR loans (12% and 14%). OCR projects were general interventions in 2004 and 2005 (88% and 86%).
- (iii) Projects can address more than one of ADB's thematic areas. There are clear differences in the thematic classification of ADF and OCR projects. Although ADF-funded projects were largely designed to facilitate sustainable economic growth in 2004 and 2005 (67% and 80%), most addressed multiple thematic areas—40% and 49% in 2004 and 2005, respectively, addressed governance, and 29% and 41% supported inclusive social development. Only 3% of ADF funded projects focused on capacity development (a category added in 2005). While OCR projects were also largely designed to facilitate sustainable economic growth (82% in 2004, 78% in 2005), fewer addressed multiple thematic areas. These findings suggest that the design of ADF projects may be more complex than the design of OCR projects. It remains to be seen whether project complexity will adversely affect project success rates.
- (iv) Start up delays, averaging nearly 8 months from approval to loan effectiveness, are the norm for both ADF and OCR funded projects; this has been a long-standing issue that affects all projects, regardless of source of funding.
- (v) The ratio between the actual and projected disbursements is better for OCR loans (101%) than for ADF loans (96%), but the difference is not large.

- (vi) OCR cancellations are more frequent than for ADF loans; the higher pricing of OCR loans provides an incentive to cancel funds that are not needed.
- (vii) Delays in project implementation and loan closing are the norm for ADB projects. However, the average delay in loan closing did not differ significantly by source of funding. ADB has not yet learned how to prepare realistic project implementation schedules.

**Table 5: Comparison of Ongoing Asian Development Fund and Ordinary Capital Resource Portfolios**

Comparator	Asian Development Fund	Ordinary Capital Resources	Total
<b>Average Loan Size, 2000–2005 (\$ million)</b>			
Project Loans	29	127	63
Sector Loans	47	191	111
Program Loans	35	145	87
All Loans	31	132	70
<b>Targeting Classification of Loans by Amount, 2005 (%)</b>			
Targeted Intervention	46	14	23
General Intervention	54	86	77
<b>Thematic Classification of Loans by Amount, 2005 (%)</b>			
Sustainable Economic Growth	80	78	79
Governance	49	23	30
Inclusive Social Development	41	12	20
Capacity Development	3	18	14
<b>Loan Start-up Time – Approval to Effectiveness, 2000–2005 (days)</b>	230	240	234
<b>Loan Disbursement Ratio – Actual vs. Projected, 2000–2005 (%)</b>	96	101	99
<b>Average Annual Loan Cancellations, 2000–2005 (% of principal)</b>	1	4	3
<b>Loans Approved Since 1990 that Have Been Closed</b>			
Loans closed within 3 months of schedule, ( <i>no.</i> )	(34)	5%	(36) 7%
Loans closed 3 months or more late ( <i>no.</i> )	(249)	40%	(208) 43%
• Average delay to closing (years)	1.8	1.9	1.8

### 3. Quality of ADB's Design and Monitoring Frameworks

45. OED is attempting to shorten the feedback cycle from the time of approval of an operation to the time that evaluation results are available. In addition to the annual review of the portfolio of loans and TAs under implementation, OED examines both ongoing and completed operations when undertaking country assistance program evaluations, sector assistance program evaluations, and thematic evaluations. OED's work program includes one real time evaluation per year.

46. OED undertook real time evaluation to assess the quality of ADB's design and monitoring frameworks (DMFs), a results-based tool for designing, implementing, monitoring, and evaluating projects. DMFs should contain: (i) a hierarchy of results (impacts, outcomes,

outputs) and the means to produce them (activities and inputs); (ii) performance targets and indicators at each level that are specific, measurable, attainable, relevant, and time-bound, by which progress toward achieving the respective result level—impacts, outcomes, outputs—is monitored and measured; (iii) data sources and reporting mechanisms for each indicator; and (iv) assumptions and risks covering external events and actions that influence project success but are outside the project's direct control.

47. OED assessed the quality of DMFs for project and program loans and regional TA and advisory TA grants. OED rated the DMFs for 163 loans, 284 advisory TAs, and 142 regional TAs spread over 2000, 2002, 2004 and 2005. The analysis covered DMFs for all loans, advisory TAs, and regional TAs approved during 2004 and all loans approved during 2005; for the other years, random samples were taken.

48. The evaluation found that there has been continual improvement in the quality of almost all aspects of the DMFs prepared since 2000 for project and program loans and for advisory and regional TAs, although the average quality of the DMFs prepared for loans is considerably better than that of the DMFs prepared for TAs. For loans, the proportion of DMFs rated as satisfactory or better increased steadily from 32% in 2000 to 83% in 2005. The proportion of DMFs rated satisfactory for advisory TAs and regional TAs was unacceptably low (under 20%) in both 2000 and 2002. The quality of DMFs for TAs improved in 2004 and 2005. In 2005, the DMFs for 64% of advisory TAs and 56% of regional TAs were rated as satisfactory or better.

49. In 2005, a goal was set to have to least 80% of the DMFs prepared for loans and at least 50% of the DMFs prepared TAs rated satisfactory or better. Those targets were achieved. However, the ultimate target in the short to medium term must be to have all of the DMFs prepared during the project design phase, for both loans and TAs, rated as satisfactory or better. While the average quality has clearly improved, there is still ample room for additional improvement.

50. It has proven difficult to get all of ADB's mission leaders to fully adopt and implement the DMF process, and there still are instances where the DMF is being developed late in the project design phase and essentially retrofitted to the findings of the project's feasibility study, rather than being used as a tool to guide project design.