



August 2006

Enhancing Asian Development Bank Support to Middle-Income Countries and Borrowers from Ordinary Capital Resources

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
APFEE	–	Asia-Pacific Fund for Energy Efficiency
CDM	–	clean development mechanism
CMI	–	carbon market initiative
CPS	–	country partnership strategy
CSP	–	country strategy and program
DMC	–	developing member country
EA	–	executing agency
EBRD	–	European Bank for Reconstruction and Development
EEI	–	energy efficiency initiative
GHG	–	greenhouse gas
IADB	–	Inter-American Development Bank
IBRD	–	International Bank for Reconstruction and Development
IEI	–	innovation and efficiency initiative
IFC	–	International Finance Corporation
LIBOR	–	London interbank offered rate
MDB	–	multilateral development bank
MDG	–	Millennium Development Goal
MFF	–	multitranche financing facility
MIC	–	middle-income country
MIGA	–	Multilateral Investment Guarantee Agency
MTS II	–	medium-term strategy II
NGO	–	nongovernment organization
OCR	–	ordinary capital resources
OCRg	–	ordinary capital resources grant
PPMS	–	project performance management system
PRC	–	People's Republic of China
RCI	–	regional cooperation and integration
RD	–	regional department
RM	–	resident mission
TA	–	technical assistance
WFP	–	water financing program

NOTE

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

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SUPPLEMENTARY APPENDIXES (Available upon request)

I. INTRODUCTION

1. **Overview.** Providing effective assistance to borrowers from ordinary capital resources (OCR) is essential if the Asian Development Bank (ADB) is to achieve its vision of an Asia and Pacific region free from poverty. It is also an important part of the institution's broader efforts to enhance its relevance, responsiveness, and results orientation.¹ In June 2004, ADB began exploring how it could enhance its support to borrowers from OCR, also referred to for the purpose of this paper as middle-income countries (MICs). The work focused on three mutually reinforcing objectives: (i) to review the main development challenges facing this diverse group of countries; (ii) to articulate the countries' demands and expectations of ADB's role in helping them meet these challenges; and (iii) to discuss how ADB can improve its services to borrowers from OCR. Similar exercises have been or are being carried out by other multilateral development banks (MDBs), including the World Bank, the African Development Bank, and the Inter-American Development Bank (IADB) and these have been taken account of in this report.

2. **Purpose.** The paper synthesizes findings from this review work and discusses measures to address issues identified. Some of the measures and/or changes discussed in the paper have already been approved by the ADB Board of Directors and are currently being implemented. Others are for consideration in 2006 and 2007. The main objective of the paper is to provide a coherent framework for the various measures being undertaken or considered to enhance support to OCR borrowers. This framework will serve as a benchmark to monitor progress over time in various areas. Details of individual measures are or will be elaborated in more specific policy and strategy papers.

3. **Structure.** The paper has six sections. Section I explains the purpose and structure of the paper, as well as the concepts and methodologies used. Section II provides the strategic rationale for ADB's continued engagement in OCR countries. Section III examines the challenges that ADB faces in delivering effective OCR operations, including feedback from OCR countries. Section IV reviews the experience of external partners. Section V discusses ADB's responses to address the issues that have been identified. Section VI concludes with suggested next steps.

4. **Definitions.** For this exercise, "OCR borrowers," "OCR countries," or "MICs"² are defined as ADB developing member countries (DMCs) eligible for OCR financing. These include countries in groups B1, B2, and C.³ The terms "OCR countries" or "MIC" are used interchangeably throughout the report. The latter term has been used widely within the

¹ See for example, the new medium-term strategy 2006–2008 (MTS II) which was approved in March 2006 (ADB. 2006. *Medium-Term Strategy II*. Manila). The main purpose of MTS II is to strengthen the poverty impact of ADB's assistance programs in the context of key challenges facing the region.

² The term "country," as used in the context of this paper, refers to a member of ADB and does not imply any view on the part of ADB as to the member's sovereignty or independent status.

³ The graduation policy (ADB. 1998. *A Graduation Policy for the Bank's Developing Member Countries*. Manila) classifies DMCs into four categories based on per capita gross national product, debt repayment capacity, and least-developed country status: (i) group A (eligible for Asian Development Fund [ADF] financing only); (ii) groups B1 and B2 (eligible for a combination of OCR and ADF financing); (iii) group C (eligible for OCR financing only); and (iv) high-income countries that have graduated from ADB regular assistance program. This paper focuses primarily on countries in groups B1, B2, and C. Further work and discussion will be needed to assess: (i) whether ADB should re-engage with countries that have graduated from ADB regular assistance program; and (ii) if so, how best to do so.

international development community to describe similar initiatives.⁴ OCR countries are a very diverse group. They include nine B1 countries, seven B2 countries and six C countries. Appendix 1 lists the various OCR countries with their categories and key characteristics.

5. **Methodologies.** The exercise combined: (i) a desk review to examine global and regional trends and operations data; and (ii) extensive consultations with client countries, international and private sector partners, and international and domestic nongovernment organizations (NGOs). Country consultations employed both questionnaire-based surveys and in-country missions.⁵ The missions targeted national and local governments as well as a range of development partners (including NGOs, the private sector, and bilateral development agencies). Other MDBs were consulted closely through the country consultations and the MDB working group on MICs (paras. 45-46). In addition, a regional consultation with Asian MICs was organized by ADB and the World Bank in Manila in April 2006. A preliminary draft of the paper has been posted on the ADB website. In addition, the paper benefited from extensive interdepartmental collaboration, including with resident missions (RMs). Findings were examined with operations and non-operations staff through group discussions and individual interviews, in addition to the formal interdepartmental and regular Management Committee reviews. The internal discussions also included two informal Board seminars in January 2005 and January 2006.

II. DEVELOPMENT CHALLENGES FOR OCR COUNTRIES AND THE ROLE OF ADB

A. Development Challenges

6. OCR countries face significant development challenges, but the nature of these challenges varies greatly across countries.

7. **Poverty.** Poverty is still an important challenge in OCR countries. Despite remarkable growth rates (averaging 8% annually over the past three decades) and major reductions in the percentage of people living in poverty, Asia remains home to 68% of the 1 billion people in the world living below \$1 a day, the majority of whom live in OCR countries (Figure 1).⁶ Inequality has also widened rapidly in many countries, which could threaten socioeconomic stability and countries' ability to sustain further development gains. In addition, progress on the non-income millennium development goals (MDGs) in the Asia and Pacific region has been mixed: 504 million people remain undernourished, 58 children per 1,000 live births die before reaching 5 years old, 260 million adults are illiterate, 7% of primary school children drop out of school, gender disparity persists in education and work opportunities, 596 million people do not have access to safe drinking water, and 1.8 billion people do not have access to sanitation facilities.⁷

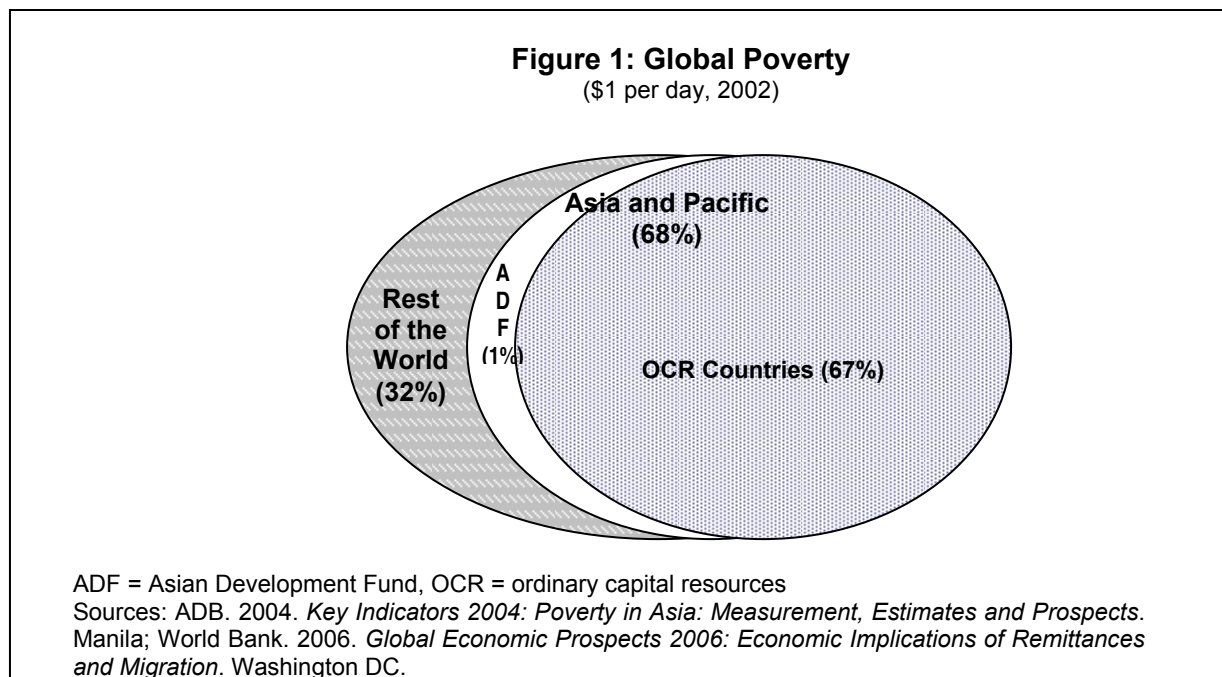
⁴ For example, the World Bank's MIC Action Plan (approved in 2004) refers to MICs as countries eligible for financing from the International Bank for Reconstruction and Development.

⁵ Survey questionnaires were sent to eight countries of which five responded (the People's Republic of China [PRC], India, Indonesia, Kazakhstan, and Pakistan). Consultation missions visited the PRC, India, Indonesia, Pakistan, and the Philippines. The regional departments' (RDs) ongoing dialogue with Malaysia and Thailand also provided additional inputs to the exercise. In addition, a symposium was held in Singapore with the private sector sponsored by the Office of Cofinancing Operations (OCO) (June 2005).

⁶ Using a narrower definition of OCR countries (defined as B2 and C countries only), 59% of the world's poor live in OCR countries (55% of the world's poor live in India and the PRC).

⁷ World Bank. 2005. *World Development Indicators Online* (available: <http://devdata.worldbank.org>) except for: (i) literacy rate (ADB. 2005. *Key Indicators: Labor Markets in Asia: Promoting Full, Productive and Decent Employment*. Manila); and (ii) primary school drop-out rate (ADB, United Nations Development Programme [UNDP], and United Nations Economic and Social Commission for Asia and the Pacific. 2005. *A Future within*

If current trends continue, the Asia and Pacific region is unlikely to meet the non-income MDG targets.



8. **Policy and Institutional Reforms.** Progress on policy and institutional reforms varies considerably across countries, but more needs to be done in all. In many countries, the reform agenda needs to be carried to the subnational level. In some countries, completing basic market-opening reform remains a priority. Others have made progress in removing market impediments and distortions, but need to undertake institutional reforms to complement policy changes that have already been adopted. Reforms are needed in governance systems for addressing financial management, accountability, and transparency and for dealing with corruption. In addition, countries' capacity to manage the reform agenda varies widely. Even the more developed OCR countries face challenges in managing more complex institutional reforms, such as financial system modernization, corporate legal reforms, social security reforms, and environmental regulations. Lack of progress in these areas could render countries more vulnerable to external shocks as they integrate further into the regional and global economies. It could also hinder progress toward further poverty reduction.

9. **Market Access.** While high liquidity in global capital markets has increased capital flows to some OCR countries, access to these capital markets remains uneven. Even when there is access, it may not be at the maturities appropriate for long-term development programs and projects. Furthermore, as the financial crises in Latin America and in Asia in the 1990s showed, global capital markets are volatile and cyclical, and can abruptly change the cost and availability of funds for reasons beyond the control of any country. Developing better and more stable access to international capital markets through reforms that improve the investment climate are important challenges for OCR countries. The development of effective domestic capital markets

should also be pursued to channel untapped domestic savings to investments, and to minimize countries' vulnerability to fluctuations in global markets.

10. **Environmental Concerns.** OCR countries' environmental record nowhere near matches their economic performance over the past 30 years. For many years, the environmental impact of development was ignored in most of the region and a price is now being paid for this neglect. Environmental degradation constrains agricultural and industrial productivity; causes increasingly frequent disasters, such as floods and landslides; and has become a serious threat to the region's prospects for further development and poverty reduction. It also affects the quality of life of everyone in the region, particularly the poor. OCR countries have a large impact on the state of the world environment.⁸ These effects are likely to worsen as industrialization and urbanization accelerate.

11. **Regional Public Goods.** The development challenges facing OCR countries have implications for the rest of the region. OCR countries have attracted significant foreign investments and offer sizable labor, products and services to the regional economy. They are thus particularly important in relation to a range of regional public goods: poverty reduction, financial stability, protection of regional and global environmental goods, efficient use of natural resources and energy, prevention and management of natural disasters and epidemics (e.g., severe acute respiratory syndrome [SARS] and avian influenza), generation and transmission of knowledge and best practice, and economic governance. OCR countries have critical roles to play in these undertakings, which will bring benefits to their less developed neighboring countries (i.e., countries that borrow from the Asian Development Fund [ADF]) as well.

B. ADB's Role and Value

12. ADB, as a regional development bank, should be able to provide assistance in the specific areas that present development challenges for OCR countries. However, ADB's assistance will need to be customized to meet the needs of each OCR borrower.

13. **Resource Mobilization.** The financing requirements of the region far exceed the resources that DMC themselves are able to provide. Although domestic resources and private external finance will increasingly provide the bulk of financing needed by OCR countries, particularly in the more developed countries, ADB can still play an important role in supporting development, catalyzing private finance and accelerating progress toward meeting the MDGs and delivering other important regional and global public goods. To do so, ADB must adopt a strategic approach to resource mobilization, bundling lending instruments with practical and focused policy advice. For countries with incomplete market access, ADB financial support can leverage reforms that lead to faster and more equitable growth. In this respect, ADB's role should be primarily that of a catalyst. There is a considerable pool of capital both globally and within Asia that remains largely untapped for socioeconomic development purposes. If the MDGs are to be achieved, official efforts need to be supplemented by the effective mobilization of foreign and local commercial resources via direct investments and public-private partnership arrangements.⁹

⁸ The PRC and India together are estimated to account for 19% of global carbon dioxide emissions (World Bank, 2006. *The Little Green Data Book 2006*. Washington, DC).

⁹ The Monterrey Consensus was reached at a United Nations sponsored international conference on Financing for Development in Monterrey, Mexico, in 2002 and concluded that greater cooperation between public and private actors will be required to overcome the inadequacies of development finance and achieve internationally agreed development goals – the Millennium Development Goals. Available: <http://www.un.org/millenniumgoals>.

Box 1:
How Financial Support from Ordinary Capital Resources Leveraged Successful Reforms in the People's Republic of China, India, and Indonesia

People's Republic of China: Transportation Network. Economic growth in the People's Republic of China (PRC) has been driven, among other things, by the success of manufacturing industries whose production processes rely heavily on efficient road and transport networks. Within the framework of the PRC's highway network expansion program, the Asian Development Bank (ADB) has developed about 3,900 km of expressway, together with 7,100 km of associated local road networks (loans from ordinary capital resources have provided about \$5.6 billion for 30 projects, of which 18 have been completed). In parallel, technical assistance supported: (i) the adoption of highway design standards; (ii) a new traffic safety law; (iii) banning of leaded fuel; and (iii) expressway commercialization and corporatization. An important outcome has been progress toward environmental improvement, via policy, legal and regulatory frameworks and better environmental impact assessment processes.

India: Power Sector Development. ADB's investment support for the power sector in India during 1986–1992 contributed to more reliable supply and fewer electricity shortages. However, the long years of ADB engagement in the sector revealed the underlying need for reforms. The power sector was in severe financial crisis in many states and required heavy state budget support. This crowded out public expenditures and investments in other sectors. Between 1996 into 2000s, ADB focused on two states, Gujarat and Madhya Pradesh, with a series of investment, policy loans, and technical assistance, leading to the successful reorganization and rationalization of the power sector in these states. Through a mix of policy and project support, ADB's assistance improved public and private resource allocation by increasing operational efficiencies and delivery capacity, progressively reducing the demands on the state budget for the power sector, and thereby allowing a shift in state government expenditures to other sectors, such as education and health.

Indonesia: Education and Social Protection. Indonesia enacted a universal 9-year basic education law in 1993. From 1993 to 1999, junior secondary school gross enrollment increased from 68.9% to 79.1% (from 5.8 million to 7.6 million students). ADB loans (\$280 million) actively supported this process. During the 1997 financial crisis, Indonesia was particularly concerned to prevent a deterioration in social services. ADB quickly responded with the Social Protection Sector Development Program.^a Later joined by the World Bank and bilateral donors, this program succeeded in keeping schools open and children in school. Indonesia used the Program to lay the groundwork for major sector reforms, such as changes in the school financing system and increasing local autonomy, which have been fully internalized, allowing more efficient budget flows to local governments and schools. In 2003, 10 years after the law was enacted, 9.6 million Indonesian students attended junior secondary education.

^a ADB. 1998. *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grants to the Republic of Indonesia for the Social Sector Development Program*. Manila.

14. **Risk Control and Mitigation.** There is increasing recognition that the private capital required for investment in many countries will not be forthcoming unless political, regulatory, contractual, credit, and environmental risks are effectively mitigated. MDBs are well positioned to address such risks because of their unique shareholding structures and privileged relationships with DMCs. By partnering with other sources of finance, MDBs can mobilize additional financing that would not flow otherwise. The potential of MDBs to create value addition, in particular by expanding risk-sharing and mitigation activities in partnership with the private sector, has been increasingly recognized and documented.¹⁰

¹⁰ See (i) OECD. 2005. *Guaranteeing Development? The Impact of Financial Guarantees*. Paris; (ii) UNDP. 2004. *Guarantees: Options for Infrastructure Finance*. New York; and (iii) World Economic Forum. 2006. *Building on the*

15. **Advice and Knowledge Transfer.** As the only MDB exclusively focused on the Asia and Pacific region, ADB, with its wide range of experience across sectors and countries, is uniquely positioned to help countries prioritize and schedule their responses to the broad range of development challenges they face. Hence, the importance of ADB's analytical and knowledge products to (i) help clients assess social and structural policy constraints to poverty reduction in an integrated way; and (ii) sustain ADB's engagement with OCR countries through economic, sector, and thematic work and policy dialogue, even when lending operations are not continued. Even more developed MICs, which may not require regular financing assistance, value the contribution that knowledge transfer can make to addressing their development challenges. ADB recognizes the need to underpin its country dialogue and lending operations (if applicable) with solid analysis of a country's development conditions and challenges. The benefits of such work are reflected in the quality of ADB's lending operations, the effectiveness of country programs, and the adoption of policy reforms by client countries. In doing so, ADB should work closely with clients and partners to support domestic analysis and debate and use studies produced by others. The extensive development experience of OCR countries, particularly more developed ones, makes them valuable partners in extrapolating and sharing the wealth of good practices and lessons learned across the region.

III. CHALLENGES TO ADB: EVOLVING WITH THE DYNAMIC REGION

16. To maximize the contribution it can make, ADB must improve the way it delivers its services to OCR countries.

A. Operational Trends in OCR countries

17. This section highlights key trends in public sector, private sector and technical assistance (TA) operations in OCR countries in recent years. A more detailed analysis of OCR operations is provided in Appendix 1.

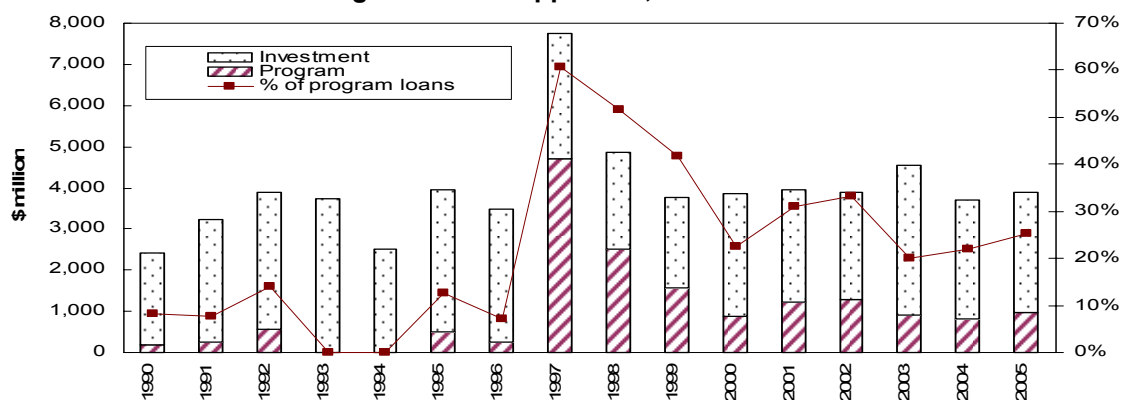
1. Public Sector Operations

18. **Volume of New Approvals.** Since the early 1990s, new OCR approvals for public sector projects and programs have been relatively constant, at around \$4 billion per year.¹¹ However, these aggregate trends mask significant changes. During the 1990–2005 period, there was a large increase in program lending (brought about by the Asian financial crisis) which lasted even after the crisis, with a corresponding decline in the volume and proportion of investment loans (Figure 2).

Monterrey Consensus: The Untapped Potential of Development Finance Institutions to Catalyze Private Investment. Geneva.

¹¹ There was a significant increase in OCR loan approvals in response to the Asian financial crisis during 1997; however, the effect of the crisis on lending dissipated quickly during 1998.

Figure 2: OCR Approvals, 1990–2005



OCR = ordinary capital resources.

Source: ADB. Loan, TA and equity approvals database.

19. **Country Concentration.** Over the past decade, lending to group C countries has declined significantly. This is primarily because of a major decrease in lending to the Philippines after the crisis as well as no new lending to Malaysia since 1997 and no new public sector lending to Thailand since 1999. Lending to B2 countries has remained relatively constant, although there have been gradual and steady increases in lending to the People's Republic of China (PRC), which leveled off during 2003–2005; significant increases in lending to India during late 1990s and early years of the 21st century, followed by decreases since the maximum lending levels of 2001–2003; and significant decreases in lending to Indonesia after the crisis. Lending to B1 countries has increased significantly (mostly driven by lending to Pakistan and to a lesser extent to Bangladesh and Viet Nam).¹² As a result of these trends, OCR approvals have been increasingly concentrated on a limited number of countries. Since 2000, the PRC, India, and Pakistan have accounted for about 80% of total OCR public sector lending (see Figure A2.1, Appendix 2).

20. **Sector Concentration.** Over the years, OCR approvals have concentrated heavily (over half of total annual approvals) on two sectors (energy and transport), except during the crisis years when lending to the industry, finance and law sector increased, with proportional reductions in the share of loans to other sectors. Since 2000, energy and transport have accounted for about 60% of total new OCR approvals (see Figure A2.2, Appendix 2). In contrast, lending to the agriculture sector has decreased over time (from 19% of total approvals in the 1980s to just 4% of total approvals since 2000). OCR lending to the social sectors (health and education) has been modest (averaging about 6% of total approvals over the past 3 decades).¹³

21. **Lead Time to Loan Signing and Effectivity.** The average lead time from loan approval to loan signing and effectiveness has increased significantly in recent years (see para. 3, Appendix 2). The reasons for the long lead times are unique to each project and program, but

¹² While Pakistan is classified as a B1 country, 68% of loans approved over the period 2000–2005 have been funded by OCR.

¹³ OCR lending to social sectors increased significantly during 1996–2000 (to 10% of total OCR approvals) because of large loans to social sectors in Indonesia in response to the crisis (the Social Protection Development Program in 1998 worth \$300 million and the Health and Nutrition Development Program in 1999 worth \$300 million) and Thailand (the Social Sector Program worth \$500 million). Excluding these three loans, the share of OCR lending to social sector was 4.5% over the period 1968–2005.

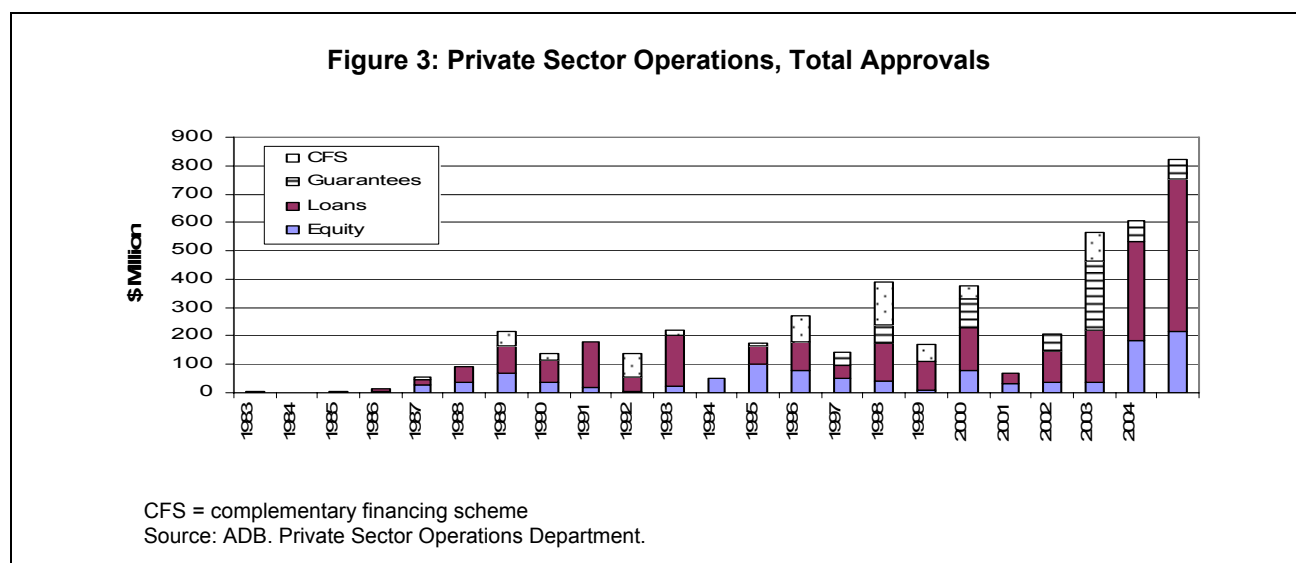
the most common reasons cited include difficulties in (i) ensuring “project readiness” and preparation for procurement, (ii) making fiduciary and safeguard arrangements, and (iii) fulfilling conditions (particularly for program loans). This may imply that projects are brought to the Board for consideration too early.

22. **Disbursement and Tranche Releases.** There has been a steady decline in the average annual disbursement of OCR project loans. Out of about \$17.6 billion OCR investment loans approved in 2000–2005, \$12.7 billion has not yet been disbursed (see Figure A2.3, Appendix 2). The notably positive performance in the PRC masks the large portion of approved loans in other countries that has not been disbursed. Two key reasons cited for slow disbursement are the selection of challenging project sites and the low capacity of executing and implementing agencies, coupled with complex designs and/or implementation arrangements. The backlog of delayed program loan tranche releases has also been an issue (see Figure A2.4, Appendix 2). This implies that one or more of the following factors may be at work: (i) countries’ ownership of and commitment to the reform agenda may not be strong enough; (ii) the reform agenda may be overly complex and ambitious; and (iii) the time and effort required to implement the reform program may have been underestimated.

23. **Cancellation.** Cancellation rates have also been very high. On average, \$800 million worth of OCR loans are cancelled each year from the active portfolio (Table A2.1, Appendix 2). The reasons for cancellations vary across countries but often include (i) changes in financing sources; (ii) a change in project scope; (iii) cost underruns; and (iv) the cleaning up of loans with slow progress.

2. Private Sector Operations and Commercial Cofinancing

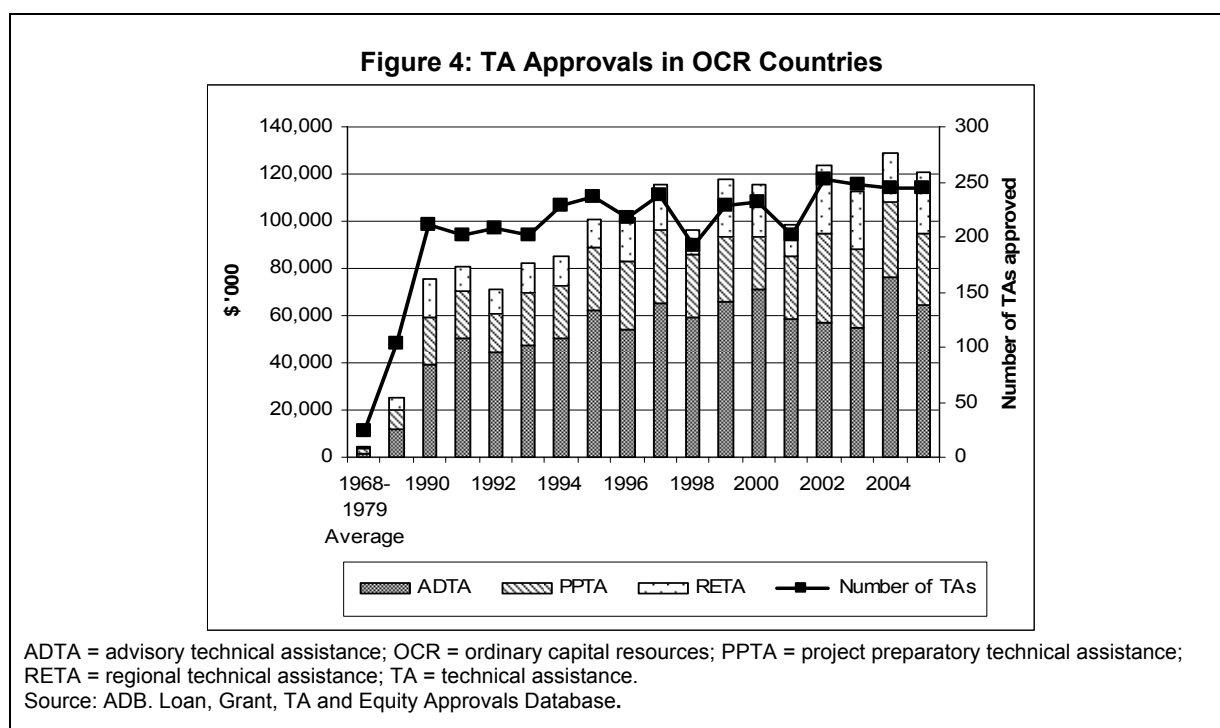
24. In contrast to the public sector portfolio, new approvals for private sector operations (year-by-year fluctuations notwithstanding) increased by almost six times from \$138.8 million in 1990 to \$821.5 million in 2005 (see Figure 3). ADB private sector operations focus primarily on two key areas: (i) finance and capital markets; and (ii) infrastructure (mostly in the energy sector). In terms of country concentration, the top five borrowers over the period 1983–2005 were: the Philippines (\$849 million), India (\$643 million), the PRC (\$586 million), Indonesia (\$519 million), and Pakistan (\$505 million).



25. Since the mid-1990s, private and commercial entities have also become increasingly involved in OCR operations as cofinanciers. The commercial sector is now a major cofinancier of private and public sector operations, compared with the past when public entities were ADB's major cofinanciers (see Figure A2.7, Appendix 2).

3. Technical Assistance Operations

26. TA approvals for OCR countries increased gradually from 1970 to 1995. Since then they have leveled off at \$100 million–\$120 million for 200–250 TA projects annually (Figure 4). Advisory TA grew most quickly and comprised over 50% of annual TA approvals for OCR countries. This trend (which is more pronounced in group C countries, where advisory TA accounted for 77% of total TA approvals over the period 2000–2005) reflects the increased importance given to policy and institutional reforms, capacity building, and knowledge transfer in ADB's operations with OCR countries.



27. The sector concentration of TA projects is closely linked to the OCR lending program (Figure A2.8, Appendix 2). The most significant changes in terms of sector composition have been the large reduction in the share of TA resources allocated to agriculture and the large increase in the share allocated to industry and trade, finance and law. These changes reflect changes in emphasis in ADB's assistance program, and responses to external factors. For example, the large increase in the share of TA provided to industry, finance and law was triggered by the financial crisis in 1997. Since then, TA to this sector has continued, reflecting the greater emphasis being placed on improving governance in client countries. In terms of country concentration, PRC, Indonesia and Pakistan are the top three recipients of TA and received about 35% of TA approvals for OCR countries from 1996 to 2005 (Table A2.2, Appendix 2).

4. Emerging Trends

28. The analysis highlights the following trends in OCR public sector lending: (i) flat new approvals; (ii) concentration of new OCR approvals on a few countries and sectors; (iii) delayed start-ups; (iv) slow disbursement of investment loans approved after 2000; and (v) cancellation of a large portion of approved OCR loans. While private sector operations have been increasing, both in terms of approvals and asset size, they account for a relatively small share of the total OCR portfolio (averaging only about 10% of total loan approvals and 2.6% of total loans outstanding for the period 2000–2005). These broad trends are cause for concern; ADB's traditional lending products and systems may no longer be meeting the needs of its OCR clients effectively.

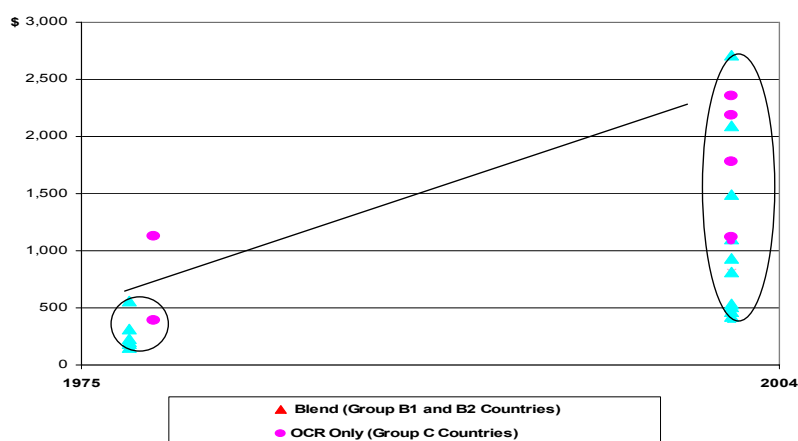
B. Change in OCR Countries Contexts

29. ADB's approach toward OCR countries needs to be adapted to the changing development context. Not only is ADB dealing with a much broader, more diverse and more sophisticated set of client countries, even within each country, it is now dealing with an increasing number of development partners. These changes have highlighted the need for greater ability and flexibility to work (i) on more complex issues, and (ii) with a wider range of in-country partners.

1. Greater Diversity across Countries

30. As a result of the rapid development in the region, ADB deals with a significantly more diverse set of OCR countries today than it did a few decades ago (Figure 5). According to the World Bank income group classification, OCR countries encompass lower MICs, such as Indonesia, Philippines, the PRC and Sri Lanka, with annual per capita incomes ranging from \$826 to \$3,255; more developed MICs such as Malaysia and Palau, with annual per capita incomes above \$3,255; and several low-income countries such as Bangladesh, India, Pakistan and Viet Nam, with annual per capita incomes at or below \$825 (see Appendix 1). The group includes very large countries such as India, the PRC and small island countries such as Marshall Islands and Micronesia. It includes transitional economies (which joined the group in the 1990s) and developing economies that vary substantially in terms of their institutional development. Some ADF countries have recently started OCR operations for high-revenue-generating investments. If the region's current growth trends continue, more ADF countries will soon access OCR. Yet, despite past successes, some OCR countries continue to be challenged by prolonged debt management problems and limited fiscal space. The uniqueness of each OCR country must be explicitly recognized when assessing whether ADB has the right overall approach and menu of instruments.

Figure 5: GNI per Capita in Middle Income DMCs, 1975 and 2004



GNI = gross national income, OCR = ordinary capital resources.

Note: 1975 GNI figures cover varying years (1975 to 1978) depending on data availability by country.

Source: World Development Indicators online.

2. Changing Roles within Countries

31. While traditionally central governments have been the primary clients of ADB, today the region offers a much larger and diversified range of partners.

32. **Growing Roles of the Private Sector.** The private sector is expanding and is now the main engine of growth in Asia. In most OCR countries, the private sector has greater responsibilities for financing, management and delivery of services than in the past. This is particularly the case in sectors like transport, energy, and utilities. Consequently, government responsibilities are shifting to policy and regulatory functions in these sectors, inducing changes in the scope of OCR operations and demanding greater synergy between public and private sector operations.

33. **Changing Roles of National and Subnational Governments.** Most OCR countries, to various degrees, have decentralized the planning, financing, management and delivery of basic public services to local governments. In countries with advanced decentralization programs, there are emerging business opportunities at the provincial and municipal levels. Local governments have been accorded greater responsibilities over public services and projects. Without commensurate levels of financial and technical support, many local governments are facing severe constraints. ADB should be well placed to help advance reforms at this level, although it has to be recognized that needs vary greatly both across and within countries.

34. **More Active Role of Civil Society.** Civil society has also become more involved in defining the global development agenda. Its demand for improved governance (i.e., greater accountability, transparency, and participation) has already made a major impact on the way development organizations like ADB operate. Opportunities for collaboration between ADB and civil society in policy- and project-related areas are also growing. In this rapidly changing environment, ADB's relevance will depend increasingly on how it can build and work in partnership with these entities and how it can efficiently mobilize private funds for sustainable development.

C. OCR Countries' Concerns about ADB Services

35. ADB has carried out a series of country consultations with key OCR borrowers to further examine the possible reasons behind the stagnating OCR public sector portfolio (see para. 5). The findings from these consultations are summarized below. Overall, OCR countries broadly appreciate ADB's past services and see substantial potential for, and interest in, continuing engagements with ADB. Most cited the continued challenges (discussed in Section II.A) and emerging opportunities for regional cooperation and integration (RCI) as two primary reasons for valuing continued engagement with ADB. However, OCR countries also consistently expressed concerns over the deteriorating quality of recent services from ADB. Their concerns can be classified into three broad areas: (i) increased costs, (ii) limited choices of modalities and instruments, and (iii) deteriorating quality of services. The underlying causes are largely internal factors to ADB, pertaining to the framework of OCR operations (i.e., operations policies and guidelines, modalities and instruments, approaches to operations planning and monitoring, among others). These concerns need to be addressed if ADB is to remain a relevant and responsive partner with OCR countries.

1. Increasing Costs of Doing Business with ADB

a. Financial Costs

36. Some OCR borrowers have raised concerns over the financial costs of ADB services. For example, some OCR countries have argued that ADB's commitment charge compares unfavorably with the charges levied by other MDBs and should be reduced and/or eliminated altogether. This would help to reduce borrowers' financing costs. Other countries have complained that the progressive structure of ADB commitment charge is too complex. As a result, borrowers cannot calculate the commitment charge properly and have to depend on ADB's accounting records to maintain their account. In addition, several OCR countries asked for access to softer terms and conditions to support investments in public goods and social services. They are of the view that, although OCR terms and conditions remain relatively attractive for revenue-generating infrastructure operations, they are less appropriate for investments that are economically viable but have low or negative financial rates of return.

b. Non-Financial Costs

37. For the most part, however, DMCs' concerns have focused on the rising non-financial costs (or transaction costs) of doing business with ADB, which are mainly driven by the proliferation of policies and strategies, and on their complex applications (Supplementary Appendix A). Interpretations and applications of various policies have often been inconsistent because responsibilities are dispersed across several departments, increasing countries' transaction costs through repetitive business processes. OCR countries perceive that ADB's numerous operational policies and strategies have resulted in overly rigid procedures and complex project goals and designs. ADB-financed projects now have numerous components leading to complex institutional arrangements, increased project costs, and, at times, serious implementation problems and delays. These are all perceived by countries as "hidden" costs of ADB financing. The countries consulted indicated that they would prefer simple and realistic project designs in congruence with their own systems, institutions and capacities. If more complex approaches and systems are to be introduced, they will require realistic timeframes and well-sequenced institutional and capacity building.

38. In particular, several OCR clients expressed concerns about ADB's safeguard policies. When properly implemented, these policies add value by improving the design of operations to mitigate environmental and social impacts, improve participant ownership, and ensure financial integrity. However, the costs of complying with these policies (including the costs of delays) are perceived to be excessive. For OCR countries which have the option of borrowing from commercial sources, these costs and associated requirements can make ADB loans effectively more expensive than those of commercial financing, even with ADB's lower interest rates.

39. Several countries also noted that ADB country programming and project processing cycles (which are primarily driven by ADB's fiscal and planning calendar) are too rigid. Each country has its own economic planning, fiscal and administrative process and timeframes. ADB needs to align its activities more closely with countries' development program cycles, and the pace of local administrative and political processes. For example, the annualized allocation of loan and TA resources limits the ability of operations units to align their schedules to client countries' planning, fiscal and administrative cycles. It also encourages shorter-term operational planning and bunching of loan and TA approvals to the end of ADB's fiscal year. This results in seasonal overloads in demands for ADB staff time, as well as a mismatch of incentives between ADB and client countries.

2. Limited Choices of Modalities and Instruments

40. ADB offers fewer modalities and instruments than other MDBs (Supplementary Appendix B). ADB has introduced four new instruments over the past decade: (i) sector development programs—a hybrid of policy and investment loans (1996), (ii) TA clusters (1997), (iii) program cluster loans (1999), and (iv) the London interbank offered rate (LIBOR) based OCR product (2001). Several countries noted that the current range of instruments available within ADB is not fully responsive to their needs or to ADB's wider operations coverage and strategic commitment. Lending instruments (which were designed primarily for nationally executed infrastructure operations) are less relevant to today's infrastructure operations, which are heavily decentralized. These instruments are also not fully responsive to the needs of other sector operations, which may require greater flexibility and adaptability during implementation (e.g., agriculture and natural resources, social services, institutional and policy reform). Instruments intended for country operations are often applied to regional projects. Several OCR countries requested additional new instruments along with a review of current instruments.

3. Deteriorating Quality of Services

a. Erosion of Country and Sector Knowledge

41. OCR countries find that the quality of services from ADB has recently been deteriorating. They also think that ADB staff's country and sector knowledge has eroded. They attribute this to several factors. First, ADB's knowledge services have been hampered by the excessive use of consultants (along with inflexible guidelines for mobilizing high-caliber consultants and long lead times for fielding them). Most countries prefer ADB staff members to be more actively engaged as conduits of knowledge transfer. Second, frequent staff turnovers have destabilized country and project team assignments. OCR countries require more continuity in assignments of ADB line managers and sector specialists to country operations. Staff changes are costly. They involve changes in technical approaches and differing interpretation of ADB guidelines. ADB's relationship with its clients must be continuous to enable gradual but systematic progress toward development objectives and goals. This is particularly important with program loans. The long-term engagements of a critical mass of ADB staff members, leading to solid country and

sector knowledge, is essential for realistic design and pace of institutional, policy, and sector reforms. OCR countries consistently requested more realistic policy and institutional conditions, and exclusion of items involving legislative actions beyond the control of the executive branch of government. Third, the dispersal of staff across many operations and nonoperations departments has limited ADB's ability to maintain a critical mass of expertise in key sectors.

b. Inadequate Attention to Project Implementation

42. OCR countries felt that attention across the operational cycle should be more balanced. While ADB is intensely involved during loan processing, its attention to implementation has been inadequate. Countries have consistently noted that this is one of ADB's major drawbacks when compared with other development partners. There was strong demand (in several countries) for increased delegation of authority to the resident missions (RMs) to address portfolio management issues.

IV. EXPERIENCE OF OTHER DEVELOPMENT PARTNERS

43. The trends discussed in Section III.B of the paper are not unique to ADB. In fact, the growing mismatch between client expectations and traditional operational approaches has affected the nonconcessional operations of most MDBs (see Appendix 2), prompting a variety of responses. The growing presence of commercial financiers in the region has also opened a new avenue of partnership for ADB and OCR client countries. The experience and perceptions of these partners are highly relevant to ADB's exploration of new approaches to OCR operations.

A. Multilateral and Regional Development Banks

44. New commitments of nonconcessional loans at most MDBs have fluctuated, particularly since the late 1990s, and changing expectations of client countries have prompted major updating of operations policies, modalities, and instruments across MDBs. The 2005 Global Monitoring Report called on international financial institutions to take "bold actions to accelerate progress towards MDGs" including (i) adopting approaches and instruments to respond to the evolving and differentiated needs of MICs, including further streamlining of conditions and investment lending; (ii) sharpening the strategic focus and improving the effectiveness of international financing institutions' support for global and regional public goods; and (iii) enhancing operational flexibility to promote the development and use of country systems.¹⁴ Individual MDBs have taken the following actions since 2000.

- (i) The IADB serves the Latin America and Caribbean region, which is mainly composed of MICs. Its new lending framework introduced in 2000 consisted of a series of new instruments (19 new instruments had been introduced by 2004) to permit differentiated approaches to country- and sector-specific requirements. Some instruments carry waivers of IADB policies. IADB has also updated its operational policies and procedures to speed up project approval and reward country performance.
- (ii) The World Bank began implementing an MIC action plan in 2004, following an in-depth review of the operations of the International Bank for Reconstruction and

¹⁴ World Bank. 2005. *Global Monitoring Report 2005. Millennium Development Goals: From Consensus to Momentum*. Washington, DC.

Development that started in 2000. The plan aims to (a) reduce transaction costs of delivering new loans; (b) relax eligible items for loan financing; (c) use country systems for procurement, safeguard and fiduciary arrangements; (d) use new approaches to policy lending; and (e) introduce additional financing options during implementation. These measures have required extensive resources, especially the fast-tracking of approvals, which requires an experienced country-based team and intense support from headquarters. At the most recent meeting of the Development Committee in April 2006 in Washington, DC, the committee reaffirmed the importance of continued development progress in MICs and asked the World Bank to further refine and enhance its strategy in these countries. A new strategy is currently being developed and should be finalized by third quarter of 2006.

- (iii) The African Development Bank MIC strategy introduced in 2005 covers four major policy changes: (a) increasing the TA ceiling per project, (b) revising the commitment fee structure, (c) simplifying loan pricing for sovereign borrowers, and (d) reducing the required public disclosure of environmental impact assessment for private sector projects from 120 to 60 days. The strategy has been accompanied by several internal measures to systematize and simplify the operations process.

45. The World Bank 2004 MIC action plan also recommended the creation of an inter-agency working group to explore approaches, mechanisms, and instruments to support MICs. The establishment of the working group was endorsed at the heads of MDBs meeting in March 2005. ADB has been an active member of this working group. In September 2005, the heads of multilateral financial institutions continued the discussions and reconfirmed the strategic importance of the institutions' continued engagements with MICs. The subsequent meeting of the MDB senior staff members (in September 2005 during the World Bank's annual meeting) examined operations issues and options. This meeting also confirmed that the issues facing OCR operations in Asia also apply to other MDBs, especially the World Bank.

46. At the meeting of MDB heads in February 2006, the presidents agreed to move ahead on two main fronts: (i) conducting joint MDB consultations with client countries in each region over the coming months; and (ii) preparing a joint policy paper on "blending" in MICs (para. 48). ADB and the World Bank jointly organized a consultation meeting with Asian MICs in Manila on 7 April 2006. The objectives of the consultation were to: (i) assess whether the current set of reforms under adoption and/or implementation by MDBs are sufficient to meet MIC development needs; (ii) identify challenges in implementing the reforms; and (iii) identify areas where policy and procedures may need further adaptation to MIC and MDB needs.

47. The event promoted an active exchange of views. Nine countries participated in the consultations, together with senior staff from ADB and the World Bank, as well as representatives from the European Bank for Reconstruction and Development and the European Investment Bank. Overall, there was strong consensus that MDBs can continue to play an important role in supporting the growth and development agenda of Asian MICs. MICs appreciated MDB's ongoing efforts, which did respond to MICs concerns, but noted that the pace of reforms needed to be accelerated. The primary challenge now will be to implement the reforms and address the most difficult areas to improve effectiveness and responsiveness, particularly with respect to (i) harmonization and the need to align with country systems, and (ii) upgrading service and staff quality. MICs also emphasized the need to monitor progress periodically.

48. As for “blending”, work is currently underway to explore the possibilities of blending bilateral grant and multilateral lending resources to support interventions that will have a significant impact on poverty, taking into account the credit worthiness constraints faced by some borrowers and in providing financing for global public goods. The working group (with the World Bank taking the lead) is currently working on a draft paper to help forge a common approach. The paper will serve as a basis for discussion with interested donors.

B. Private Sector and Commercial Financiers¹⁵

49. Asia’s investment requirements and growth potential represents a strategic opportunity for OCR operations to partner with private and commercial resources. The complementarities are explained below.

- (i) **Advantage of the private sector.** The private sector can mobilize large amount of funds on its own. It can also conclude transactions much more quickly than an institution like ADB can. The prevailing financial environment in industrialized economies also permits the private sector to offer attractive loan terms and conditions.
- (ii) **Limitations of the private sector.** The private sector can quickly withdraw financing if a project becomes commercially nonviable. A private firm tends not to shoulder the full risks, especially if it lacks country experience or confidence in the investment climate (e.g., if there are political risks or an immature regulatory framework). Private financiers are generally unwilling to address crises or to invest in public goods that are not commercially viable or do not generate revenue.
- (iii) **Incentives to partner with ADB.** Private and commercial financiers and operators would benefit from partnering with ADB because of its (a) country and sector experience and knowledge, (b) credit enhancement capacity, (c) permanent presence in countries (via RMs), (d) access to and confidence of governments, and (e) risk-mitigating ability (debt and equity).
- (iv) **Expectations of ADB.** Private and commercial financiers and operators value ADB’s support for (a) the creation of an attractive investment and business climate, and (b) the design and provision of creative financial solutions to promote investment opportunities in regional and local markets.

V. ADB’S RESPONSES

A. Overall Approach

50. ADB’s role in OCR countries should continue to be driven by its poverty reduction mandate. ADB support also needs to be consistent with ADB’s second medium-term strategy (MTS II) 2006–2008 (footnote 1), which seeks to strengthen the poverty reduction impact of

¹⁵ This section synthesizes the feedback received from private sector counterparts during the symposium organized by OCO in June 2005 in Singapore.

ADB's assistance programs in the context of the key challenges facing the region. The five strategic priorities identified under the MTS II are very relevant in the OCR context.

51. **Catalyzing Investment.** A large share of ADB operations in OCR countries consists of infrastructure investment. Although growth and poverty reduction depend on much more than infrastructure investments alone, the contribution of infrastructure to Asia's macroeconomic story (in OCR countries in particular) has been considerable. Yet, there is still much room for improvement and supply needs to keep pace with rapidly increasing demand (infrastructure needs in East Asia alone are estimated at approximately \$200 billion annually over the next 5 years).¹⁶ Given the importance of the private sector in OCR countries, ADB's role should be to catalyze private investment, adding value where private markets cannot. Because ADB has both public and private sector operations within the same institution, it is uniquely positioned to broker, through its lending and nonlending operations, public and private links to support the development process. ADB will put particular emphasis on strengthening the capacity of individual countries to (i) create an effective environment for the private sector; and (ii) involve the private sector and encourage the development of innovative public-private partnerships. To support this involvement, greater integration of ADB's public and private activities will be needed. In 2005, ADB private sector development strategy was reviewed. A revised strategic framework was approved in February 2006¹⁷.

52. **Strengthening Inclusiveness.** Poverty reduction is more effectively accomplished if a comprehensive program for social development complements policies for accelerating broad-based economic growth. If current trends continue, economic growth alone will not be sufficient to achieve the MDGs in OCR countries. Yet OCR operations for social development have been limited. This is largely because of the financial cost of OCR resources, which is considered to be too high and inappropriate for such sectors. Nevertheless, the rationale for ADB intervention in the social sectors remains strong. Some non-income dimensions of poverty seem to lag behind in the Asia and Pacific region, putting into question the likelihood of achieving the non-income MDGs. Investment in education and health has great intrinsic value as an end in itself and great instrumental value in raising productivity. Because of the nature of those social sector goods, private sector involvement may be more difficult and therefore, organizations like ADB may have an important role to play. ADB will seek innovative approaches to address social services in OCR countries. In addition, and to be consistent with MTS II, ADB's efforts to tackle poverty through inclusive growth will also focus on rural development (since over 70% of Asia's poor live in rural areas).

53. **Promoting Regional Cooperation and Integration.** Over the last decade, parts of the region have become more integrated because of closer economic and political ties. Regional cooperation and integration (RCI) enhances the growth potential of individual countries, thereby strengthening their capacity to reduce poverty. Integration also helps to link and better align the more slowly growing countries in the region with the more quickly growing economies, thereby helping to reduce inter-country disparities. RCI also serves as a platform for regional initiatives to manage cross-border environmental and health risks. Many OCR countries have expressed interest in greater involvement in RCI activities. ADB is well placed to respond to this growing momentum, because of its mandate and strong reputation in this field. ADB's success, however, will depend critically on effective cooperation between the recently established Office of

¹⁶ ADB, Japan Bank for International Cooperation and World Bank. 2005. *Connecting East Asia: New Framework for Infrastructure*. Washington, DC.

¹⁷ ADB. 2006. *Private Sector Development: A Revised Strategic Framework*. Manila.

Regional Economic Integration and related departments, including RDs. ADB's new RCI strategy lays out in greater detail how ADB plans to intensify its support for regional cooperation in the region.

54. **Managing the Environment.** OCR countries have a large impact on the state of the world environment. Measures to protect the environment raise investment costs considerably, and there is an expectation from OCR and poorer countries alike that they be compensated for taking conservation measures that are of global interest. Although progress has been made, there is a need for innovative financing and transfer solutions to foster investment in the environment in OCR countries. In July 2005, ADB launched the energy efficiency initiative (EEI) to promote more sustainable energy patterns and contribute to energy security in the region. The core objective of the EEI is to expand ADB's investment in clean energy projects. Together with similar approaches, such as the water financing program (WFP) and the carbon market initiative (CMI), this initiative should be pursued.

55. **Improving Governance and Preventing Corruption.** Good governance is critical to poverty reduction, as weak governance hurts the poor disproportionately. ADB recognizes the essential role of governance in the development process. Governance correlates closely with equitable and inclusive growth. It is also important for the efficient functioning of the private sector, both through the creation of conditions for efficient markets and through effective corporate governance. ADB will focus on promoting good governance in partnership with OCR countries to allow for diversity of circumstances and requirements across countries. The trend toward greater decentralization of government services has increased the need to build capacity and strengthen subnational institutions, including provinces, states, municipalities and local communities. A core element of ADB's governance-related activities in OCR countries will be to enhance institutional capacity and capability, including those of government and public institutions at national as well as subnational levels. To enhance ADB support in these areas, a review of the implementation of ADB's governance and anticorruption policies is currently ongoing and a governance action plan is being developed. The review report and action plan are tentatively scheduled to be finalized in July 2006.

B. Guiding Principles

56. While the broad framework of the enhanced poverty reduction strategy and the MTS II are relevant in the OCR context, ADB should be guided by the following important principles in carrying out its broad mandate.

- (i) **Country diversity.** OCR countries vary widely with regard to income, poverty incidence, capital market access, and the progress they have made in policy reforms and institution building. ADB support therefore needs to be highly customized to the development needs of each country.
- (ii) **Selectivity and focus.** In moving from a country vision and policy dialogue based on a comprehensive diagnosis of country challenges to the specifics of individual country programs, ADB must be highly selective in the interventions it supports, and should be mindful of important contributions by other partners, including the private sector. ADB should focus only on areas where it can clearly make a difference through its unique set of attributes, and should, whenever possible seek to catalyze the efforts of others, not only in the provision of finance, but also in terms of policy analysis, advice, and capacity building. ADB recognizes that it cannot be effective in all sectors and in all countries. Selectivity

and focus are important determinants of ADB's ability to deliver quality development results. The new MTS II identifies core operational sectors where ADB will focus its operations and for which it will build a critical mass of expertise. ADB operations in OCR countries must be consistent with the priority classification of sectors proposed under the MTS II.

- (iii) **Stronger donor collaboration.** ADB should encourage more active and effective collaboration with other donors (both through the provision of financial resources and TA) in OCR countries. Through increased collaboration, MDBs can leverage the impact of assistance in support of MDGs, infrastructure and regional public goods. There is broad agreement among MDBs that there would be merit in exploring the scope for extending and enhancing such collaboration in future, recognizing that different mixes of modalities and instruments will be relevant in different countries and different sectors.

C. Specific Responses¹⁸

57. OCR countries have clearly expressed a number of concerns about ADB services (as discussed in Section III.C) which need to be addressed if ADB is to remain a relevant and responsive partner in these countries. A number of measures have been initiated, which can be grouped into three broad areas: (i) reducing the costs of doing business with ADB; (ii) enhancing and expanding the range of instruments available; and (iii) enhancing service quality. Some measures have already been approved by the Board of Directors and are currently being implemented. Others are for consideration by Management or by the Board in 2006 and 2007. This paper provides a broad picture of the various initiatives; more detail on individual measures is available in separate papers for management or Board approval. Appendix 3 provides an overview and timetable of the various activities.

1. Reducing the Costs of Doing Business with ADB

a. Ensuring that ADB Financial Costs Remain Competitive

58. The financial terms of OCR loans are determined by various factors. As well as the interest spread over LIBOR, ADB normally charges clients front-end and commitment fees. In some instances, these charges can be waived temporarily. Public sector borrowers have consistently received the benefits of ADB's sub-LIBOR borrowing costs through rebates. Overall, ADB's pricing of OCR loan charges is competitive compared to those of other MDBs.¹⁹ Through the annual loan charge review process, the Treasury Department continually monitors the loan pricing level and structure to ensure its competitiveness. In April 2006, the Treasury Department recommended, and the ADB Board of Directors approved, (i) the waiver of 20 basis points on the lending spread on public sector loans outstanding from 1 July 2006 to 30 June 2007; and (ii) the continued waiver of the entire 1% front-end fee on all new public sector loans approved over the same period. In addition, in 2006, the Treasury Department is also undertaking a comprehensive review of its LIBOR-based product to ensure that it remains attractive and/or competitive to ADB clients.

¹⁸ Many of the proposed activities are relevant for the Bank as a whole and do not concern OCR countries exclusively. However, some measures are more likely to be applicable in OCR countries, at least initially.

¹⁹ ADB. 2006. *Review of ADB's Loan Charges and Allocation of 2005 Net Income*. Manila.

b. Exploring Means to Soften Terms for Regional Public Goods and Social Services

59. OCR countries are critical for the achievement of the MDGs in the region. Yet, only small portions of aid flows to these countries are at present directed towards MDG purposes. While the extent to which OCR countries achieve the MDGs depends primarily on the policy choices taken by the countries themselves, the international community can contribute in a number of ways, by (i) building a supportive international policy environment, (ii) providing access to finance for targeted investments, (iii) supporting the development of institutional capacity, and (iv) supporting the development of knowledge capital around difficult issues of economic and social policy (including the perspective of international experience).

60. Toward this end, work is currently underway to explore more proactive approaches to concessionality for MDG purposes, specifically to address public goods and social services in MICs. For example, through the use of blending with concessional and/or grant financing from other sources, the effective terms of OCR lending can be softened. The primary use of blending mechanisms would be to encourage countries to make special efforts in selected sectors as part of the push to achieve the MDGs. In the case of global or regional public goods with significant externalities, the mechanisms would respond to situations where individual countries typically invest less in the provision of a public good than what is optimal from a global perspective. In this context, ADB is an active member of the MDB task force on blending (para. 48). Work has begun to explore the possibilities of blending bilateral grant and multilateral lending resources and forging a common approach by MDBs on these issues. A paper is currently being drafted (with the World Bank taking the lead). The paper is expected to be finalized by third quarter of 2006 and will serve as a basis for discussion with interested donors.

61. In parallel, ADB has been discussing the possibility of developing specific facilities to support regional public goods and social services in OCR countries. A public good and social investment facility would offer a “third window”, or subsidized OCR loans for public goods and social investment. All countries eligible for OCR operations (both OCR-only and blend countries) would be eligible. The facility would top-up rather than replace ADF allocations and would reflect the need for significant extra efforts to attain non-income MDGs in blend countries. The following sectors and themes would be targeted: health (including HIV/AIDS), education, rural water supply, gender, environment (capacity building), and urban development (slum upgrading).

62. The ordinary capital resources grant facility (OCRg) in the water sector would complement the higher levels of OCR lending envisaged under the proposed WFP, and improve the quality of ADB investments in efforts to reach MDG target 10: halve by 2015 the proportion of people without sustainable access to safe drinking water and sanitation. The facility will address (i) water utilities’ inability to meet service requirements and implement tariff reforms; (ii) social and cultural issues of using rivers, groundwater and other sources for free for agriculture, domestic, and other uses; (iii) political interference in utility pricing and operations; (iv) lack of consumer understanding of total costs of systems; and (v) inappropriate or weak regulatory, monitoring and governmental planning agencies, as well as utility structures and incentives. OCRg will offer the same advantages, in terms of interest rate rebates as the public goods and social investment facility. Its main function will be to support implementation of reforms to achieve full cost recovery in the water sector.

63. ADB is also considering establishing an Asia-Pacific Fund for Energy Efficiency (APFEE) under the EEI. Its objective will be to reduce energy intensity in developing countries in the Asia and Pacific region. Energy efficiency projects in developing economies are often small and

distributed across a large number of end users. ADB's existing processes and products involve high transaction costs and therefore limit demand. APFEE aims to overcome these limitations and to accelerate implementation of energy efficiency projects. APFEE will have three main functions: (i) mitigating risks of energy efficiency projects to improve access to capital; (ii) increasing access to innovative and effective energy efficiency technologies, by providing concessional loans to make such projects financially viable; and (iii) building capacity through grant assistance for non-lending measures, such as developing the knowledge base and incentive mechanisms, advocacy, institution capacity building, project preparation, and establishment of monitoring and evaluation mechanisms.

64. In November 2005, the ADB President approved a proposal to explore the carbon market initiative (CMI) in order to help mitigate climate change. While many countries and institutions have launched funds to purchase carbon credits on payment-on-delivery terms from projects, there are still very few funds available upfront to cofinance projects that promote greenhouse gas reduction. The CMI will seek to fill in this gap. The proposal is to explore three interrelated activities: (i) establishment of a targeted project cofinancing facility; (ii) provision of marketing and brokerage support to developers of projects with carbon credit contents; and (iii) technical services to operating departments—covering work at the country strategy and program (CSP), project processing, and implementation levels. CMI's upfront financing scheme will benefit the project developers in DMCs by reducing their budget commitments for project development and providing technical support for the preparation and implementation of projects. The investors or carbon credit buyers in developed countries will benefit from lower credit delivery risks as they will be able to tap into ADB's stable and diversified portfolio. Their compliance costs will be reduced and they will be able to participate in projects with high developmental impact.

65. These facilities will be financed from a variety of sources, including cofinancing and additional investments from governments, the private sector, and multilateral and bilateral partners, as well as from OCR net income (or a mixture of these sources). The proposed financing arrangements will need to be carefully considered in the context of ADB's overall net income, as there are also discussions on the need for and possibility of creating other types of ADB-wide facilities such as the RCI facility and the Disaster and Emergency Assistance Facility. This calls for careful consideration of the best use of OCR net income. In addition, some ADB Board members have expressed concerns about some of the proposed facilities. For example, blending arrangements and the public good and social investment facility may send inappropriate signals to borrowers, such as reinforcing the view that returns on social sector expenditures are low, or undermining country-owned investment choices. Blending arrangements may also have their own risks, unless they are in addition to existing aid flows (for example, they could divert funding from poorer countries). These concerns will need to be carefully considered and addressed as work on these various facilities proceeds.

c. Introducing Greater Flexibility in the ADB Programming Cycle

66. OCR countries have expressed some concerns over the ADB programming cycle, which is perceived as being too rigid. A comparative internal evaluation of ADB's country strategy and programs (CSPs), conducted over the period 2002–2004, highlighted the following shortcomings (which are consistent with feedback from OCR borrowers): (i) a lack of clarity about strategic direction and differences in the quality of underlying assessments; (ii) insufficient attention to results and development effectiveness; (iii) lack of selectivity in many CSPs, reflecting the fact that ADB remains broadly based in most countries; (iv) very few private sector development activities identified in the context of sector road maps; and (v) a rigid country

assistance operations program that is not always well aligned to individual countries' planning calendar.

67. To overcome these weaknesses and ensure better country ownership, harmonization and alignment, and focus on results, the following measures are being considered under the current CSP reform process: (i) mainstreaming results-based CSPs; (ii) strengthening the strategic focus of CSPs and giving greater flexibility to operations programs (e.g., formulating country operations programs as rolling annual business plans to be undertaken over a 3-year period, with more flexibility to change the amounts between years); and (iii) ensuring an integrated business platform approach to CSPs that includes both public and private sectors operations and aligns these with the relevant regional cooperation strategy and program as far as possible. Under the new process (which is expected to become effective in the third quarter 2006), ADB will rename CSPs into country partnership strategies (CPSs) to reflect the principal nature of its relationship with DMCs.

68. The new CSP process will allow for greater flexibility in order to properly reflect the diverse needs of DMCs. For example, in the case of Thailand, a CPS is currently being prepared, building heavily on (i) numerous analytical studies and policy reviews already available, and (ii) mature national systems for formulating and managing development strategies and investment programs. Thailand sees a wider horizon of partnership opportunities with ADB beyond traditional projects, emphasizing synergies between the country and regional operations as well as between private and public sector operations.

d. Delegating Operational Services and Decisions

69. Since the adoption of its RM policy in 2000, ADB has doubled the number of RMs and delegated more responsibilities to them. RM operations have become an integral part of ADB's operations and external relations. Some RMs have played important roles in responding to emergencies and have facilitated the establishment and operations of extended missions. Recently, non-regional departments have or are planning to post staff to RMs to enhance country-based collaboration (e.g., staff with expertise in private sector operations, law, governance, and procurement). Most major OCR countries now have well established RMs and are equipped to absorb more responsibility and accountability for countries' operations. Although the value added of having field offices in each OCR country has not been fully studied, the positive impact in terms of better coordination and implementation of ADB-financed projects, involvement in country-led initiatives, and increased visibility are generally accepted. The cost implications of decentralization need to be carefully examined and in 2006 ADB began a review of its RM operations. As part of this exercise, ADB will assess whether there is room to further decentralize its operations.

e. Streamlining Operational Policies, Strategies and Business Processes

70. In line with ADB's commitment to the Paris Declaration on Aid Effectiveness,²⁰ it is currently updating, streamlining, and consolidating (where possible) operational policies and guidelines to provide (i) greater clarity and consistency across policies; (ii) a realistic and

²⁰ The 2005 Paris Declaration on Aid Effectiveness promotes (i) country ownership, leadership, and the use of country systems to foster development effectiveness; (ii) streamlining of operational policies; and (iii) differentiation of approaches to MICs. These principles are relevant to OCR countries with capacities and systems to manage their development process.

results-oriented approach to their application, with a sharper focus on capacity building; (iii) greater harmonization with comparator institutions; and (iv) more alignment with country systems and procedures, when feasible. Box 2 lists the key strategies and policies recently revised or under review in ADB.

Box 2: Key Operational Policies and Strategies Recently Revised or under Review

A. Operational Policies

1. Cost Sharing and Eligibility of Expenditures for ADB Financing: A New Approach (approved June 2005)
2. Review of the Policy on Supplementary Financing of Cost Overruns of ADB-Financed Projects (approved November 2005)
3. Review of ADB's 1998 Graduation Policy (fourth quarter 2006)
4. Review of TA Management (first quarter 2007)
5. Guidelines on the Use of Consultants by ADB and its Borrowers (approved February 2006)
6. Procurement Guidelines (approved February 2006)
7. Review of ADB's Credit Enhancement and Operations (third quarter 2006)
8. ADB Policy Statement on Environment and Social Safeguards (fourth quarter 2007)

B. Operational Strategies

1. ADB's Financing Partnership Strategy (third quarter 2006)
2. Energy Sector Strategy (second quarter 2007)
3. Regional Cooperation and Integration Strategy (third quarter 2006)

C. Business Processes

1. Further Enhancing CSP and Business Processes (third quarter 2006)
2. ADB Financial Management Guidelines (updated December 2005)
3. ADB Loan Disbursement Handbook (third quarter 2006)

ADB = Asian Development Bank, CSP = country strategy and program, TA = technical assistance.
Source: ADB. Strategy and Policy Department.

71. For example, ADB's new approach for cost sharing and expenditure eligibility (approved in August 2005) establishes a new policy framework to determine how much, and what ADB can finance under its public sector development programs. The new framework is (i) more closely aligned with the actual expenditures requirement of borrowers, (ii) in harmony with the approaches of other development partners, and (iii) consistent across lending instruments. Simpler and more uniform cost sharing and expenditure eligibility will help reduce transaction costs for borrowers and ADB.

72. Likewise, ADB's safeguard policies (environment, indigenous people and involuntary resettlement) are being reviewed to ensure better integration of the three policies and to improve coherence and consistency among them. Through this exercise, compliance costs must be carefully weighted in against developmental benefits. Overall, ADB should seek to ensure that its policies and procedures are integrated into borrowers' regular business processes by emphasizing the development of national systems and recognizing that the ultimate safeguard is in building and sustaining strong client institutions with effective internal oversight. In the meantime, the current focus on compliance will continue, but it must be complemented by a capacity building approach designed to help borrowers develop their own effective safeguard systems.

73. Over the years, ADB has refined the way it processes and implements projects to improve their quality and efficiency. However, feedback from client countries indicates that it must do better.²¹ Under the current reform of CSPs and business processes, further improvements to business processes covering project processing for both sovereign-guaranteed public sector projects and nonsovereign projects are proposed to complement the modified CSP process. More specifically, the forthcoming paper on “Further Enhancing CSP and Business Processes” will recommend a number of measures to enhance quality-at-entry of projects and improved analytical work at the “upstream” stage of country planning and programming. The proposed new approaches should support a more strategic approach to project identification and speed up processing.

74. The project implementation process is also being streamlined. ADB financial management guidelines were updated in December 2005. New guidelines on procurement and the use of consultants were approved in February 2006. The new procurement guidelines seek to (i) streamline procurement processes, (ii) harmonize ADB regulations with those of other multilateral institutions, (iii) enhance transparency, and (iv) allow greater flexibility and innovation in the procurement procedures of borrowers. The improvements in the guidelines on the use of consultants are: (i) increased flexibility and performance monitoring, (ii) more assessment of executing agency (EA) and country procurement capacity, (iii) promotion of country ownership, (iv) more focus on developing national consulting industries, and (v) a simpler selection process for smaller (including national) NGOs. In addition, ADB’s loan disbursement handbook is currently being revised (a revised handbook is expected to be issued by the third quarter of 2006). The recently approved policy on supplementary financing²² will also ease adjustment of the project costs and design required by the changing operations contexts.

2. Expanding and Enhancing Operational Instruments

75. The second group of measures aims to provide a range of instruments that are more responsive to the varied nature and needs of OCR operations. Depending on the type of operations, ADB works with different sets of partners: national or local governments, and state-owned, newly privatized, private, non-profit, or nongovernmental entities. This section describes instruments to be enhanced or introduced, based on requests made during the country consultations.

a. Piloting New Instruments and Financing Modalities under the Innovation and Efficiency Initiative

76. Under the innovation and efficiency initiative (IEI), ADB has piloted a number of new products or financial instruments to enable it to respond more flexibly and innovatively to MIC clients’ complex development needs.²³ Together, these new pilot products offer a greater choice

²¹ It is estimated that it takes on average 22–32 months to get projects from the project preparation TA (PPTA) stage to Board approval. At least 12 of these months are associated with getting PPTAs off the ground (ADB. 2006. *Further Enhancing Country Strategy and Program and Business Processes*. Draft under Preparation. Manila).

²² ADB. 2005. *A Review of the Policy on Supplementary Financing: Addressing Challenges and Broader Needs*. Manila.

²³ (i) ADB. 2005. *Innovation and Efficiency Initiative: Pilot Financing Instruments and Modalities*. Manila; and (ii) ADB. 2005. *Introducing the Local Currency Loan Product*. Manila.

of financing options and allow ADB to reach a greater range of clients. These new instruments should be actively pursued in OCR countries.

77. **Multitranches Financing Facility.** The multitranches financing facility (MFF) will include the establishment of a debt financing facility to target (i) sequential components of large stand-alone projects, (ii) tranches of sector investment programs over a longer time frame than the current norm, (iii) financial intermediary credit lines, and (iv) guarantees. The MFF facility incorporates features of sector and cluster loans, although with the client and ADB adhering to sounder cash and balance sheet principles. Through a more programmatic approach, ADB aims to increase its productivity, provide critical mass and continuity, and improve quality (through greater attention to implementation and policy dialogue, instead of focusing on repetitive processing tasks).

78. **Subsovereign and Nonsovereign Public Sector Financing.** The subsovereign and nonsovereign public sector financing facility permits ADB to provide loans directly to selected municipalities and other forms of local governments and state-owned enterprises that meet a minimum set of financial, operational and reform criteria, without the guarantee of the national government.

79. **Refinancing and Restructuring Modality.** This facility aims to salvage projects that, although technically, legally, socially and financially sound, may be impaired by problems with the original financing plan. The facility will enable such projects to continue, possibly with a new investment.

80. **Local Currency Loan Product.** Local governments, state-owned enterprises, and public financial institutions would benefit considerably from the availability of local currency financing. Currency risks would be reduced, especially for those clients unable to hedge against them on their own. A local currency loan product would also allow ADB to lend directly to local governments, state-owned enterprises, and public financial institutions, either with or without guarantee from the central government. Such direct lending would help support the process of decentralization and allow ADB to encourage involvement of the private sector in the delivery of key services.

b. Improving Existing Instruments

81. **Technical Assistance.** There is a strong demand for technical assistance (TA) in OCR countries, particularly for advice on policy reform, capacity building, and promotion of knowledge management and transfer. However, some OCR countries have concerns with TA, specifically: (i) lack of strategic focus; (ii) weak links with the CSP, (iii) lack of country ownership, (iv) lack of flexibility (to respond to clients' needs in a timely manner), and (v) insufficient attention (and resources) devoted to administration.

82. The recent review of the management and effectiveness of ADB's TA operations²⁴ highlighted the value of increased ownership by DMCs as a means of improving sustainability of project benefits. Some DMCs feel that such ownership would depend on their playing a more direct role in consultant selection and supervision. An ADB pilot study (approved in 2003)²⁵

²⁴ ADB. 2002. *Review of the Management and Effectiveness of TA Operations of ADB*. Manila.

²⁵ ADB. 2003. *A Pilot Study for Delegation of Consultant Recruitment and Supervision Under Technical Assistance to Executing Agencies*. Manila.

allowed DMCs to select and manage consultants under ADB TA. Twenty pilot projects were selected (five from the PRC, five from India, and the other ten from other countries, mostly OCR borrowers). However, the results have not been encouraging. As of December 2005, only four EAs, all from the PRC, had completed the recruitment and engagement process. The experience gained in these pilot studies highlights the need for an accurate assessment of EA capacity to expedite the process of consultant recruitment. ADB's new guidelines on the use of consultants provide more flexibility to delegate consultant recruitment and supervision to EAs with proven capacity (as demonstrated through detailed capacity assessment).

83. More recently, ADB has begun a review of its TA program to make it more responsive to clients' needs, more focused and better integrated into ADB's operations at the country level. The objectives of the reform are to (i) make more strategic and efficient use of TA resources; (ii) reduce the number of TA projects to ensure quality and manageability; and (iii) increase effectiveness by improving the links between TA and lending and/or other grants operations. Three-year allocation of TA resources is also being considered to permit greater flexibility for DMCs and operations units to plan and distribute TA activities over the medium term. This work should be intensified (see Box 3). ADB must strengthen its TA and economic and sector work program in OCR countries, while working closely with clients and partners and using studies produced by others as much as possible. Such work should help strengthen ADB country and sector knowledge. More specifically, ADB should focus on (i) core country assessments as part of the CSP process; (ii) other diagnostic economic and sector work for future policy dialogue, capacity building and lending; and (iii) customized economic and sector work produced at the request of clients. In addition, ADB's research program should contribute both to a better understanding of the development challenges that OCR countries face and the role that ADB can play in addressing them.

Box 3: Innovative Use of TA Resources in OCR Countries

Facility for Reform Support and Capacity Building in PRC^a

The Facility for Policy Reform Support in the People's Republic of China (PRC), approved in August 2004, proposed a flexible mechanism to undertake a number of discrete and focused interventions to address specific development and capacity building requirements of the PRC Government. The technical assistance (TA) project has financed 10 components, including a private sector study, a budget law amendment, corporate pension, housing finance, and environment impact assessment. The components under this TA addressed the urgent demands of the implementing agencies. In addition, they supported reforms that were not provided for in the TA pipeline. The components were selected in close coordination with the Ministry of Finance and the ADB Resident Mission (RM) based on a set of criteria identified in the TA. The candidate implementing agencies proposed the design of the components and the RM or ADB department closely monitored their implementation. Several lessons can be drawn: (i) ADB adds considerable value by providing such selective small-scale, short-term assistance to complement its long-term and systematic efforts in selected strategic areas; (ii) a quick and timely response can enable early involvement in policy formulation; and (iii) capacity building needs to be included to address challenges arising from the Government's evolving policies and procedures, as well as ADB's strategic requirements.

^a ADB. 2004. *Technical Assistance to the People's Republic of China for the Facility for Policy Reform*. Manila.

84. **Program Lending and Use of Conditions.** Program lending is important in many OCR countries to support policy and institutional reforms. The analysis of operational trends clearly shows that a number of OCR countries are moving from project to program loans, even now that the financial crisis of the late 1990s has passed. However, the conditions placed on loans

are often perceived by OCR countries to be excessive and unrealistic. OCR countries have highlighted the importance of understanding their political economies to ensure that conditions are both relevant and feasible. For example, conditions that require parliamentary approval should be avoided in countries where such decision making is very lengthy, as fulfillment of loan conditions is often delayed as a result. OCR countries also noted the potential danger of conditions that undermine government ownership and the risks of making conditions for tranche disbursements that may depend on factors beyond the control of the government. In 2006, ADB will review the use of its program loan instrument, with a particular emphasis on ADB's approach to loan conditions, and will decide whether there is a need for a formal review of the program lending policy.

85. Credit Enhancement and Risk Management Products. The private sector is an important growth engine in OCR countries, and public-private partnerships are likely to become increasingly common. ADB has an opportunity to expand its operations in these areas and private entities would value partnership arrangements with ADB (see Section IV.B). For example, ADB can help sovereign and nonsovereign entities in OCR countries by offering credit enhancement products such as guarantees. Such products support ADB's developmental objectives by catalyzing investment, trade, and capital flows into ADB's client countries. ADB has a comparative advantage over its public and private sector financing partners in this area, because of its regional focus, AAA rating, and willingness and ability to participate in transactions with high perceived political or commercial risk. ADB has to a limited degree been able to leverage these advantages successfully by issuing guarantees for projects in its DMCs. Further enhancements to ADB guarantee products are being explored as part of the current review of the ADB credit enhancement operations. A new cofinancing strategy is also being finalized to improve project-specific resource mobilization through financing partnerships. ADB can also strengthen the abilities of various stakeholders in public-private partnerships to configure appropriate technical, financial and risk allocation structures of the projects and to frame and implement procurement strategies (see Box 4).

Box 4: Infrastructure Investment Advisory Assistance to the Government of Thailand^a

Asian Development Bank (ADB) is providing technical assistance (TA) to the Government of Thailand to evaluate institutional, financial, and regulatory issues associated with plans to invest more than \$10 billion to expand Bangkok's urban rail mass rapid transit (MRT) system. This TA represents a good example of how the transfer of knowledge and expertise to middle-income countries (MICs) such as Thailand can contribute to the public sector's capacity to understand, structure, finance and manage public-private partnerships for large-scale and complex infrastructure investments.

To promote private sector participation and investment in the proposed MRT extensions, the TA is evaluating different concession arrangements for the provision of the rolling stock and for operation and maintenance activities. This analysis is helping the Government to understand how to best allocate and manage risks across the public and private sectors, and means to maximize private investment. As an integral element of this process, the TA is also developing a detailed financial model to enable the Government to analyze the operating costs of the existing and proposed rail lines and to examine the interrelationships among (and sensitivities across) critical parameters such as fare levels, travel demand, fare revenues and operating costs.

By focusing on the complex institutional, financial and regulatory issues of integrating and expanding Bangkok's MRT system, ADB is ultimately strengthening the Government's capacity to apply public-private partnerships as a means to maximize private participation, encourage the use of technologically advanced designs and systems, promote operational efficiencies and ensure that public resources are used effectively to support financially viable and sustainable investments.

^a ADB. 2006. *Infrastructure Investment Advisory Assistance to the Public Debt Management Office of Thailand—Major Change in Scope, Increase in Technical Assistance Budget, and Extension of Completion Date*. Manila.

3. Enhancing Service Quality

a. Enhancing Knowledge Management within the Organization

86. OCR countries are increasingly asking ADB to complement its role as a financial intermediary by making available insights and experience that will help them pursue their development objectives. However, in the view of many, ADB's technical expertise is eroding. To remain relevant to the needs of a rapidly changing region, ADB must expand its role in catalyzing knowledge for innovation and development. In recent years, ADB has taken a number of steps to enhance its capacity to process knowledge products and services.

87. The 2002 reorganization created a Regional and Sustainable Development Department, with a mandate to advance ADB's knowledge agenda internally and externally. A new ADB-wide knowledge management framework was approved in June 2004. In 2004 and 2005, other strategies²⁶ were approved. Although it is too early to see significant tangible outputs, a number of initiatives under these are worth mentioning. Under the new knowledge management framework, a system was put in place to plan and manage knowledge products and services more systematically across ADB. This should help ADB take a more strategic and systematic approach to economic, thematic and sector work in OCR countries. Likewise, the establishment

²⁶ The Information Systems and Technology Strategy II was approved by the Board in June 2004; the new Human Resources Strategy was approved by the President in October 2004; and the Public Communications Policy was approved by the Board in May 2005.

of “knowledge hubs” (Box 5) was approved in 2005, paving the way for mainstreaming innovative concepts to promote regional knowledge and information exchange.

Box 5: Establishment of Regional Knowledge Hubs for Developing Countries^a

The project will be funded by an ADB technical assistance (TA) grant of \$990,000. Four to six knowledge hubs will be set up over a two-year period, the first two or three by the end of 2006. The People’s Republic of China, India, and Thailand have expressed interest in being among the first to host such knowledge hubs.

These knowledge hubs will act as centers of excellence on emerging development topics, such as the clean development mechanism, use of compressed natural gas and hybrid technologies in the transport sector, renewable energy, environmental technology, information and communications technology, as well as management techniques.

ADB will provide the technical and training support needed to build the capacity of the selected organizations to capture and generate knowledge and to disseminate it nationally and regionally. To ensure synergy and knowledge sharing, these knowledge hubs will be linked with each other, as well as with relevant national organizations. To promote regional cooperation and integration, they will collaborate with existing knowledge networks in the region. They will be linked to international academic and research organizations so they can learn the latest international development concepts and adapt them to regional or local needs and demands.

It is envisioned that these knowledge hubs will become reservoirs of expertise, providing decision makers and the development community in the Asia and Pacific region with up-to-date knowledge products and services tailored to client or regional needs.

^a ADB. 2005. *Technical Assistance for Establishment of Regional Knowledge Hubs*. Manila.

b. Improving Human Resources Management

88. Some OCR clients have complained about the lack of technical skills and sectoral competence among ADB staff. These complaints must be taken seriously. Under the broad framework of the new human resources strategy approved in October 2004, the Budget, Personnel, and Management Systems Department is developing a high-level skills inventory of ADB staff which is to be completed in third quarter 2006. The results are expected to provide the basis for consultations with department heads on their workforce planning and for action on changing ADB’s staff profile to bring it into line with operational requirements. In 2005, ADB also developed a new institution-wide competency framework to serve as the foundation for the design and improvement of all human resources processes. Implementation of the framework will provide the basis for a more uniform approach to recruiting, selecting, and promoting staff, as well as to evaluating performance and facilitating staff development.

89. The ADB-wide roll-out of a new performance management system was completed in April 2005. The first cycle of the performance development plan has now been concluded and overall implementation was considered satisfactory. Further refinements were made for the 2006 cycle. An enhanced separation package, which is another key action under the human resources strategy, was approved by the Board of Directors on 19 May 2005. A total of 32 professional staff and 85 local staff have accepted the package. The vacancies created by the enhanced separation package are closely being reviewed in terms of ADB’s skills requirements before these are advertised.

90. A Learning and Development Unit was established in 2005 to optimize the use of learning and development resources. A full review of current training programs was also undertaken. The focus of the unit is primarily on developing ADB as a knowledge organization, promoting institutional efficiency and effectiveness, redesigning leadership programs, and improving technical programs. To determine ADB's learning needs, an ADB-wide training needs assessment was implemented as part of the new performance management system in order to assess the learning needs of all ADB staff. This provided the basis for a complete revamp of ADB training programs in 2006. The 2006 program is expected to enhance organizational capability, technical and operational skills, and leadership skills.

c. Increased Emphasis on Quality-at-Entry, Development Effectiveness and Results

91. OCR countries have complained about the deteriorating quality of ADB services. In assessing the quality and overall effectiveness of ADB's development efforts, attention should be increasingly focused on results (mostly at the country level through country outcomes). Substantial progress has been made in introducing results-based performance evaluation systems at various levels within ADB, including corporate (work program and budget framework), departmental and individual work plans (performance development plan), country operations (CSP results framework), and project design and implementation (project performance management system [PPMS]). The proposed mainstreaming of results-based CSPs under the CSP and business processes reform aims to support programming processes that ensure alignment with country priorities and, at the same time, provide concrete tools (such as a results framework) for reporting and monitoring ADB contributions to country outcomes.

92. Enhanced quality-at-entry of projects and improved analytical work at the "upstream" stage of country planning and programming (which are being addressed as part of the reform of business processes) are also prerequisites for successful and timely delivery of ADB assistance. In January 2006, the President approved the formation of a panel of senior staff to conduct ADB's first quality-at-entry assessment of CSPs and projects. This work will seek to establish an objective quality-at-entry criteria and standards for CSPs and projects. This will help country and project teams by giving them clear guidance on what constitutes quality (something that is not provided in the current template-driven approach). The panel report is expected to be completed by the third quarter of 2006. It is envisaged that future quality-at-entry assessments will take place every 2 years.

93. In addition, the PPMS has been improved to make it more results-focused. New PPMS guidelines were issued in December 2005. These emphasized the use of a design and monitoring framework for conceptualizing, designing, implementing, monitoring, and evaluating projects. Training programs have familiarized staff with the features of the new PPMS and increased their proficiency in using the design and monitoring framework. These initiatives need to be further refined and complemented by more rigorous and systematic country portfolio reviews, regular midterm reviews of individual programs and projects, and their timely evaluation, all of which are important means to monitor operations progress and outcomes.

94. In addition to these efforts, more systematic and regular capture of client feedback is needed to measure the progress and effectiveness of service enhancement efforts. Periodic surveys and country and regional discussions are proposed to capture the broader dimensions of client feedback. In this context, the recent regional consultation organized by ADB and the World Bank in Manila on 7 April 2006 was very helpful (para. 47). ADB's Department of External Relations also launched a global perception survey in the first quarter of 2006. The survey will

poll 700 stakeholders and opinion leaders in 24 countries. Preliminary results are expected by the third quarter of 2006. The survey will be repeated every 3 years.

D. Resource Implications and Results Framework

95. Implementation of updated policies, guidelines, and initiatives do require start-up costs for coordination units, administrative and information technology units, and operational units. Gradual applications of the various measures are planned over a period of 3 years, with carefully managed and monitored pilot-testing of new instruments and modalities in a selected number of countries. Appendix 3 provides an overview and timetable of the activities. The planned gradual approach seeks to minimize resource intensity, and to allow for corrective measures, and more manageable implementation of activities and initiatives. This process will also provide a more reliable basis for realistic resource estimates for expanded applications, and, in turn, will increase the probability of positive outcomes for OCR countries.

96. A broad provisional results framework is provided in Appendix 4. More detailed results frameworks have been or will have to be developed in separate papers for each initiative (see Appendix 3 for the list and timetables of various papers) and monitored separately.

VI. CONCLUSION AND NEXT STEPS

97. The paper synthesized key findings from a review of OCR operations and provided an overview of various ADB-wide activities to enhance ADB support to MIC and OCR borrowers. These measures can be grouped into three broad areas: (i) reducing the costs of doing business with ADB; (ii) enhancing and expanding the range of instruments; and (iii) enhancing service quality. Some measures have already been approved and are currently being implemented. Others are for consideration in 2006 or 2007. The main challenge now will be to maintain the reform momentum and to implement the various reforms. The recent regional consultation meeting with Asian MICs held in Manila in April 2006 also emphasized the need to monitor progress regularly. In this respect, annual progress reports will be prepared as a follow up to this paper to inform the Board on: (i) the progress of various initiatives that have yet to be approved; (ii) implementation reports for items that have already been approved; (iii) a progress report on the work of the MDB working group; and (iv) other relevant items or developments. The first such report is expected to be circulated in third quarter of 2007.

CLASSIFICATION AND CHARACTERISTICS OF OCR COUNTRIES

Country	ADB Country Classification	Average GDP Growth Rate 2000-2005 (percent) ^c	GNI per capita, 2004 (in \$) ^d	World Bank Country Classification, by Income (April 2006) ^e	Poverty Incidence (using \$1 a day threshold), 2003 ^f	Level of Institutional Development ^g
Azerbaijan	B1	13.8	940	Lower middle-income	1.9	Medium
Bangladesh	B1	5.5	440	Low income	30.3	Low
Cook Islands	B1	5.5	–	–	–	–
Marshall Islands	B1	0.7	2,320	Lower middle-income	–	–
Micronesia	B1	1.4	2,300	Lower middle-income	–	–
Pakistan ^a	B1	4.8	600	Low income	19.7	Low
Sri Lanka	B1	4.3	1,010	Lower middle-income	1.0	Low
Tonga	B1	3.0	1,860	Lower middle-income	–	–
Viet Nam	B1	7.4	540	Low income	9.7	Low
China, People's Republic of ^b	B2	8.8	1,500	Lower middle-income	13.4	Medium
India ^b	B2	6.3	620	Low income	30.7	Medium
Indonesia	B2	4.8	1,140	Lower middle-income	6.5	Low
Nauru	B2	0.4	–	–	–	–
Palau	B2	1.3	6,870	Upper middle-income	–	–
Papua New Guinea	B2	2.2	560	Low income	–	–
Uzbekistan	B2	5.2	450	Low income	13.3	–
Fiji Islands	C	2.5	2,720	Lower middle-income	–	–
Kazakhstan	C	10.2	2,250	Lower middle-income	0.0	Low
Malaysia	C	5.2	4,520	Upper middle-income	0.1	High
Philippines	C	4.4	1,170	Lower middle-income	14.1	Low
Thailand	C	4.9	2,490	Lower middle-income	0.7	Medium
Turkmenistan	C	18.8	–	Lower middle-income	4.5	–

Country	Degree of Market Access ^h	Quality of Infrastructure Facilities ⁱ	Human Development Index, 2003 ^j	Debt Burden ^k	Debt Repayment Capacity ^l	Corruption ^m
Azerbaijan	C	3.73	0.729	Less indebted	Limited	2.2
Bangladesh	—	2.38	0.520	—	Limited	1.7
Cook Islands	—	—	—	—	Weak	—
Marshall Islands	—	—	—	Debt not classified	Weak	—
Micronesia	—	—	—	Debt not classified	Weak	—
Pakistan	D	3.07	0.527	Moderately indebted	Limited	2.1
Sri Lanka	—	2.87	0.751	Moderately indebted	Limited	3.2
Tonga	—	—	0.810	Less indebted	Weak	—
Viet Nam	—	2.69	0.704	—	Limited	2.6
China, People's Republic of ^b	A	3.44	0.755	Less indebted	Adequate	3.2
India ^b	A	3.21	0.602	Less indebted	Adequate	2.9
Indonesia	D	3.12	0.697	Severely indebted	Limited	2.2
Nauru	—	—	—	—	Limited	—
Palau	—	—	—	Debt not classified	Limited	—
Papua New Guinea	D	—	0.523	Severely indebted	Limited	2.3
Uzbekistan	D	—	0.694	Moderately indebted	Adequate	2.2
Fiji Islands	C	—	0.752	Less indebted	Adequate	4.0
Kazakhstan	B	3.54	0.761	Moderately indebted	Adequate	2.6
Malaysia	A	5.24	0.796	Moderately indebted	Adequate	5.1
Philippines	B	3.21	0.758	Moderately indebted	Adequate	2.5
Thailand	A	4.22	0.778	Moderately indebted	Adequate	3.8
Turkmenistan	D	—	0.738	Moderately indebted	Adequate	1.8

ADB = Asian Development Bank, GDP = gross domestic product, GNI = gross national income, OCR = ordinary capital resources.

— = Data not available.

^a While Pakistan is classified as a B1 country, 67.52% of ADB lending to Pakistan in the last 5 years has been funded by OCR.

^b While the People's Republic of China (PRC) and India are classified as B2 countries, their operations have been funded only by OCR.

^c For 2000–2004 data, see ADB. 2005. *Key Indicators 2005: Labor Markets in Asia: Promoting Full, Productive, and Decent Employment*. Manila. For 2005 data, see ADB. 2006. *Basic Statistics 2006*. Manila.

^d World Bank. 2005. *World Development Indicators Online* (available: <http://devdata.worldbank.org>).

- ^e Economies are divided among income groups according to 2004 gross national income (GNI) per capita, calculated using the World Bank Atlas method. The groups are: low income, \$825 or less; lower middle-income, \$826–3,255; upper middle-income, \$3,256–\$10,065; and high income, \$10,066 or more. Available: <http://siteresources.worldbank.org/DATASTATISTICS/Resources/CLASS.XLS>
- ^f ADB. 2005. *Key Indicators 2005: Labor Markets in Asia: Promoting Full, Productive, and Decent Employment*. Manila.
- ^g Institutions data are based on the Public Institutions Index (Scale of 1 to 7, 7 being the highest) of the World Economic Forum's Growth Competitiveness Index (low <4; 4<=medium<=5; high >5). Public institutions index for selected Asian MICs: AZB-4.09; BAN-2.55; IND-4.52; INO-3.58; KAZ-3.89; MAL-5.36; PAK- 3.31; PHI-3.30; PRC-4.41; SRI-3.34; THA-4.88; and VIE-3.43. Source: World Economic Forum 2005. *The Global Competitiveness Report 2005-2006*. Geneva.
- ^h Market access data: A-investment grade market access and/or strong balance of payments position; B-volatile market access; C-insignificant market access; and D-loss of creditworthiness. Source: World Bank. 2005. *Towards a New Development Partnership in Middle Income Countries*. Draft under Preparation. 27 January. Washington.
- ⁱ World Economic Forum 2005. *The Global Competitiveness Report 2005–2006*. Geneva.
- ^j UNDP 2005. *Human Development Report 2005*. New York.
- ^k Standard World Bank definitions are used. Severely indebted means either of two key ratios is above critical levels: present value of debt service to GNI (80%) and present value of debt service to exports (220%). Moderately indebted means either of two ratios exceeds 60% of, but does not reach critical levels. For economies that do not report detailed debt statistics to World Bank Debtor Reporting System, severely indebted means three of four ratios (averaged over 2002–2002) are above critical levels: debt to GNI (50%); debt to exports (275%); debt service to exports (30%); and interest to exports (20%). Moderately indebted means three of four key ratios exceed 60% but not reach critical levels. All others are classified as less indebted. Source: World Bank. 2005. *Towards a New Development Partnership in Middle Income Countries*. Draft under Preparation. 27 January. Washington.
- ^l ADB 2006. *Operations Manual*. Section A1/OP: Classification and Graduation of Developing Member Countries. Manila (28 March).
- ^m See Transparency International. 2005. *Corruption Perceptions Index 2005*. Available: <http://www.transparency.org>. CPI score relates to perceptions of the degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt). Corruption is defined as using public funds for private gain.

Synopsis of OCR Countries

Grouping	Main characteristics
<p>More Developed Economies Malaysia Thailand</p>	<ul style="list-style-type: none"> • Malaysia and Thailand have made impressive strides in economic development which have resulted in rapid reductions in poverty and robust social development. • They quickly recovered from the Asian financial crisis through a set of successful economic, monetary and fiscal policies. • They have achieved considerable internal equity and made progress on non-income MDGs, supported by higher allocations of government expenditures on social services. • Thailand has not borrowed from ADB's public sector window since 2000. ADB is trying to re-engage with Thailand. A new partnership strategy is being prepared in 2006 focusing on three strategic areas: infrastructure, capital markets, and institutional capacity building. Thailand has strongly supported and participated in the GMS program. • Malaysia stopped borrowing from the ADB after the crisis. ADB has not prepared an operation strategy for Malaysia since 1997. Malaysia may be involved in regional projects in the context of the new RSCP (but not necessarily as a borrower).
<p>Emerging Economies (B2 Countries) People's Republic of China India</p>	<ul style="list-style-type: none"> • India and the PRC are major OCR borrowers. Although both countries are classified as B2, their operations have been funded exclusively by OCR. • The economic rise of these two countries has been impressive in the last 10 years, and forecasters see continued rapid growth in the years ahead. Nonetheless, more than half of the world's poor live in the two countries and equity and environmental issues remain. • Growth has been supported by strong reform agendas, which have attracted a considerable inflow of foreign direct investment. • OCR operations in the PRC have traditionally focused on infrastructure, particularly in the transport sector. The Government's recent focus on a more balanced development path provides opportunities for ADB to strengthen partnership with the PRC in new areas such as public health and education as well as rural and agriculture development. • India's OCR operations have focused primarily on growth-oriented infrastructure investments, while relying on IDA to support non-revenue generating operations. In line with the Government's renewed focus on rural development, in 2005 ADB began operations in agriculture and water resource management.
<p>Emerging Economies (B1 Countries) Pakistan Viet Nam</p>	<ul style="list-style-type: none"> • Both countries have access to concessional windows (e.g., ADF and IDA). Viet Nam is classified as an IDA-only country by the World Bank. • Economic growth has resumed in recent years in Pakistan after a period of slowdown. Poverty and inequity remain significant, along with slow progress on non-income MDGs. • In recent years Pakistan has become a major OCR borrower. Even though the country is classified as B1, over two thirds of ADB lending to Pakistan over the past 5 years has been funded by OCR (mostly for infrastructure projects, and resource management programs). • Viet Nam has witnessed rapid growth during its transition to a market economy. Improving business competitiveness is a new challenge. Poverty and inequity remain key issues. Viet Nam has borrowed from OCR during the last 2 years for projects in the power sector.

Grouping	Main characteristics
Debt-burdened countries Indonesia Philippines Papua New Guinea	<ul style="list-style-type: none"> • OCR operations have declined sharply in these countries over the period 2000–2005. • Indonesia and the Philippines have recovered from the crisis but face persisting challenges over economic, public and fiscal management. Because of fiscal constraints, a large share of support in recent years has been in the form of program loans. • The Philippines and Indonesia have made progress on the human development front although regional disparities remain. The countries have yet to identify effective measures to address this through their decentralized administrative structures. • ADB private sector operations have been active in both countries. • Although the context is different, Papua New Guinea is also facing serious fiscal difficulties, including debt and fiscal management issues. Recent reductions in borrowing reflect the Government's efforts to reduce public debt to more sustainable levels.
Transitional economies Azerbaijan Kazakhstan Uzbekistan Turkmenistan	<ul style="list-style-type: none"> • The Central Asian republics joined ADB in the 1990s/early 2000s. • Most countries experienced severe economic decline and a dramatic rise in poverty after the breakup of the former Soviet Union. This trend has been recently reversed, with robust growth rates after 2000. • Countries are undergoing a transition from planned to market economy, although the pace of reforms varies substantially across countries. • In Uzbekistan and Turkmenistan, the pace of reform has been very slow which has limited the scope of ADB operations. OCR operations in Uzbekistan have been active but limited. OCR operations in Turkmenistan have not started. • Kazakhstan, with substantial revenues from natural resources, has shown little interest in standard OCR public sector lending. The government views private sector operations as the main vehicle for future ADB operations. • OCR operations in Azerbaijan are limited (ADB operations are mostly funded through ADF).
Small-island states Cook Islands Fiji Marshall Islands Micronesia Nauru Palau Tonga	<ul style="list-style-type: none"> • Pacific DMCs face significant challenges in generating broad-based and sustained economic growth. In many countries, poverty incidence has increased in recent years. • ADB's operations in these countries are mostly in the form of TA grants rather than loans, except for Fiji where OCR lending is mostly concentrated in physical infrastructure.
Other Countries Bangladesh Sri Lanka	<ul style="list-style-type: none"> • Bangladesh and Sri Lanka both have access to concessional windows (e.g., ADF and IDA). • Bangladesh faces formidable challenges in law and order, infrastructure, financial markets, social services and private sector development. In recent years OCR has financed major infrastructure projects (mostly in the power sector) and will continue to do so. • Of immediate concern for Sri Lanka are the fragile political situation, the country's weak fiscal position, and the possible impact of tsunami reconstruction on large infrastructure projects. Although OCR operations have been steadily increasing during the last 5 years, the size of OCR lending to the country in the medium term is uncertain and will depend on progress in economic growth and fiscal consolidation.

ADB = Asian Development Bank, ADF = Asian Development Fund, DMC = developing member country, GMS = Greater Mekong Subregion, IDA = International Development Association, MDG = Millennium Development Goal, OCR = ordinary capital resources, PRC = People's Republic of China, RCSP = Regional Cooperation Strategy & Program, TA = technical assistance.

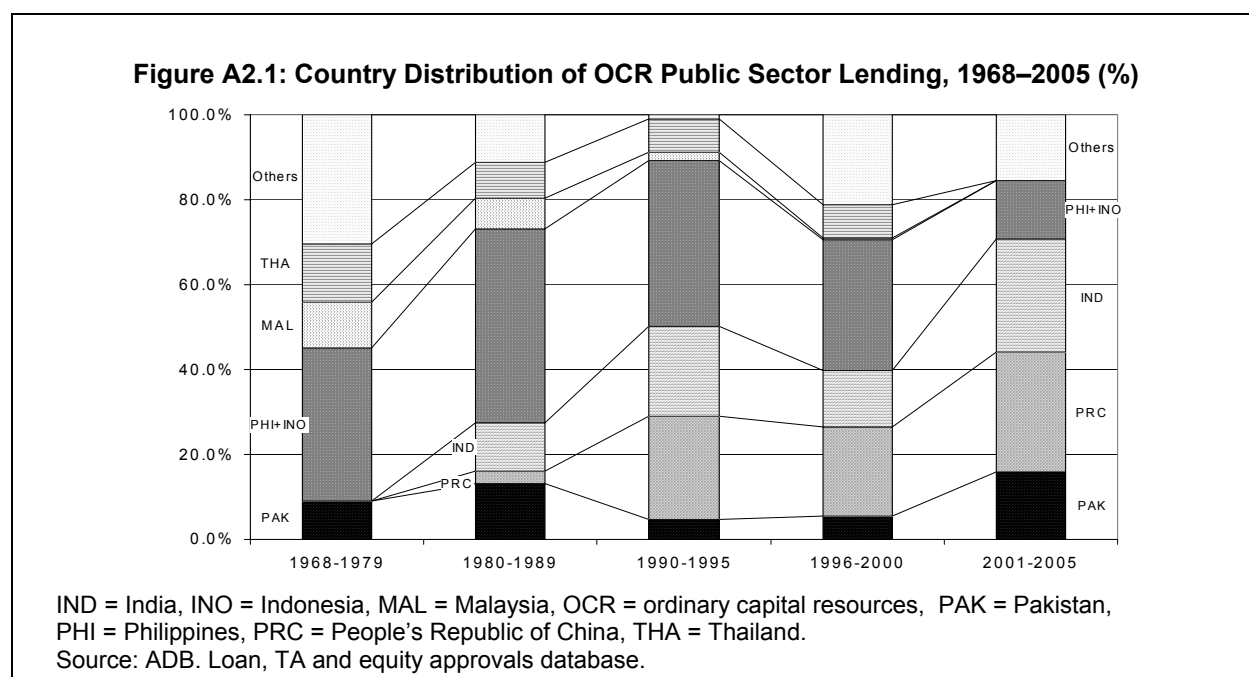
TRENDS IN NON-CONCESSIONAL LENDING OPERATIONS

1. This appendix discusses trends in the public sector, private sector and technical assistance (TA) operations of the Asian Development Bank (ADB) in countries that borrow from ADB's ordinary capital resources (OCR countries). The trends in public and private sector operations are compared with those of other multilateral development banks (MDBs), including other regional development banks.

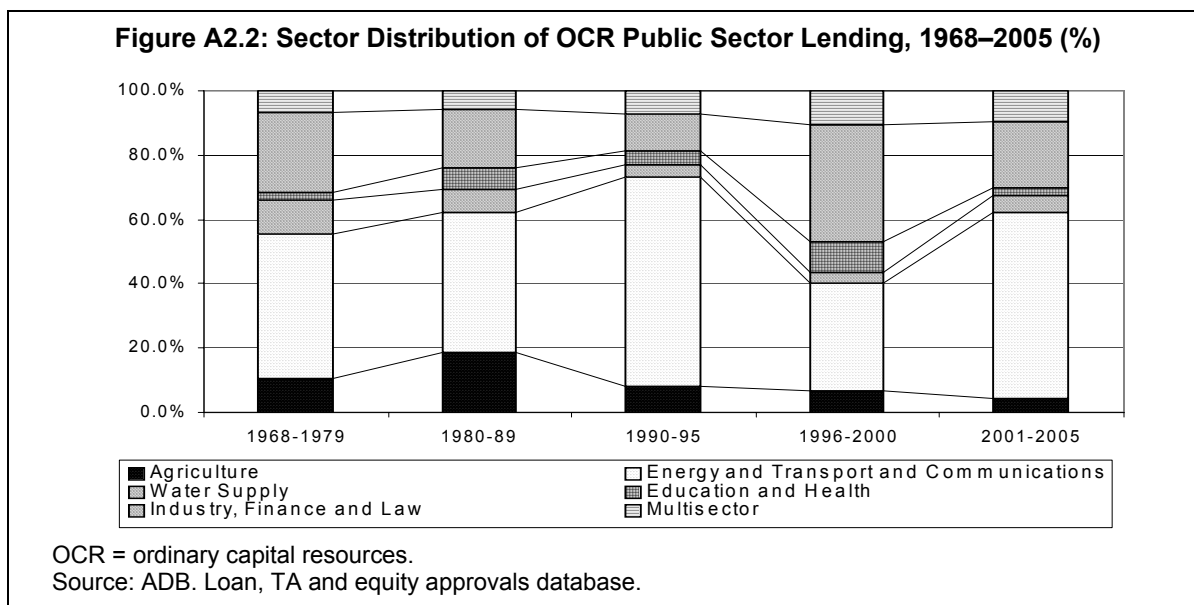
A. Public Sector, Private Sector and Technical Assistance Operations in OCR Countries

1. Public Sector Operations

2. **Patterns.** Approvals of new OCR loans for the public sector remained relatively constant from 1990 to 2005 (except during the 1997 Asian financial crisis). As illustrated in Figure 2 in the main text, the volume of program loans and their percentage of the total have increased since the late 1990s. While the percentage averaged about 7% during 1990–1996, it increased to about 31% after the crisis. However, there are significant differences across countries.¹ In contrast, the volume of investment loans gradually declined from \$3.7 billion in 1993 to its lowest level in 1999 (\$2.2 billion), although the trend reversed slightly thereafter. Investment loans stood at \$2.9 billion in 2005. Overall, as depicted in Figures A2.1 and A2.2 below, recent new approvals have been concentrated in three countries (India, Pakistan, and the People's Republic of China [PRC] accounting for about 80% of the total portfolio) and in a few sectors (energy and transport accounting for 60%).



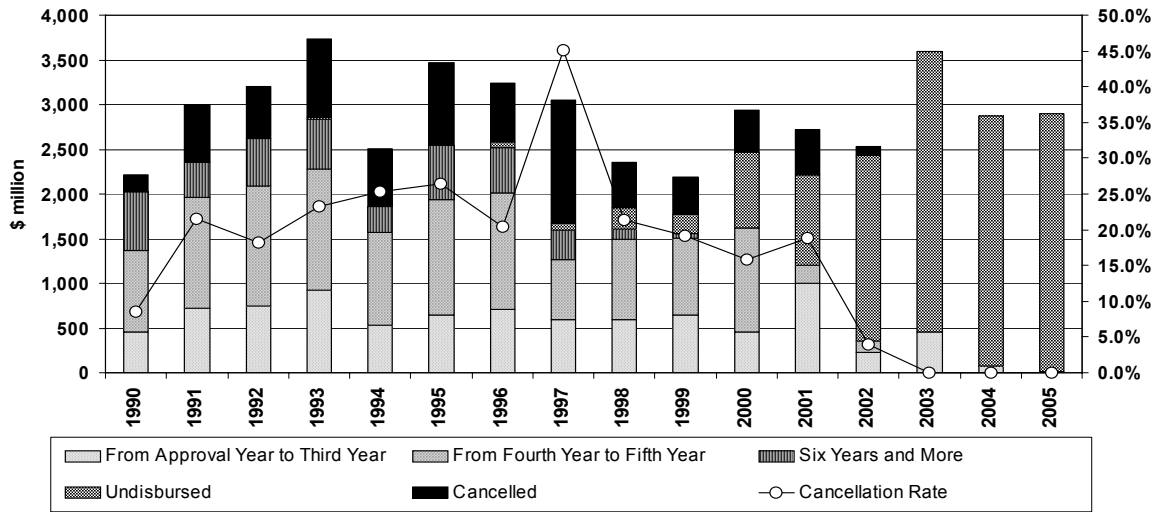
¹ Over the period 2000–2005, program loans accounted for about 54% of total OCR approvals in B1 countries (the bulk of these were in Pakistan). In B2 countries, this share was much lower at around 15% (most of the program loans were in India and Indonesia—there has been no program loan in the PRC). Finally, for C countries, the share of program loans was 57% (all program loans for group C countries were in the Philippines).



3. **Start-up Delays.** Loan approval by the Board of Directors means that loan processing has been completed and the project or program is essentially ready for implementation from ADB's perspective. However, before implementation can actually begin, the loan must still be signed by ADB and the borrower and declared effective by ADB once conditions have been met. During the 1990s, loan signing for investment loans was an average 106 days after approval, and loan effectiveness averaged 214 days after approval. By 2002, the average lead time to signing had doubled to 216 days and the time to effectiveness was over 1 year (393 days). Program loans averaged 26 days for signing and 102 days for effectiveness. The overall averages slightly improved in 2003 to 210 days for loan signing and 310 days for loan effectiveness. The reasons for the long lead time are unique to each project and program. However, the most common reasons cited include difficulties in (i) fulfilling loan conditions (particularly for program loans), (ii) ensuring "project readiness" and preparation for procurement, and (iii) making necessary fiduciary and safeguard arrangements. This may imply that projects are brought to the Board for consideration too early. However, even prior to approval, loans are taking longer to design. Since the mid-1990s, and in particular since 2000, the lead time to project approval has increased significantly. This is more pronounced for the lead time for infrastructure operations, which increased from an estimated 54 staff weeks for loan processing in 1995 to 75 staff weeks in 2004, primarily because of safeguard assessments.

4. **Disbursements.** Figure A2.3 shows approvals for new investment loans since 1990 (the height of each bar represents the total volume of new approvals each year), and the status of disbursement from the portfolio approved in a given year. Of the OCR investment loans worth about \$17.6 billion approved in 2000–2005, \$12.7 billion remains undisbursed (the checkered area within each bar). Two key reasons for slow disbursement are the selection of challenging project sites and the low capacity of executing and implementing agencies, coupled with complex designs and/or implementation arrangements. There are considerable cross-country variations in disbursement patterns. The good performance of the portfolio in the PRC masks trends in other countries. From the PRC portfolio, more than 80% of project loans approved before 2000 were disbursed within 6 years from approval, in contrast to other countries, where less than 60% of project loans approved before 2000 were disbursed within 6 years from approval.

Figure A2.3: OCR (Public Sector) Disbursement and Cancellation (1990–2005, Project Loans)

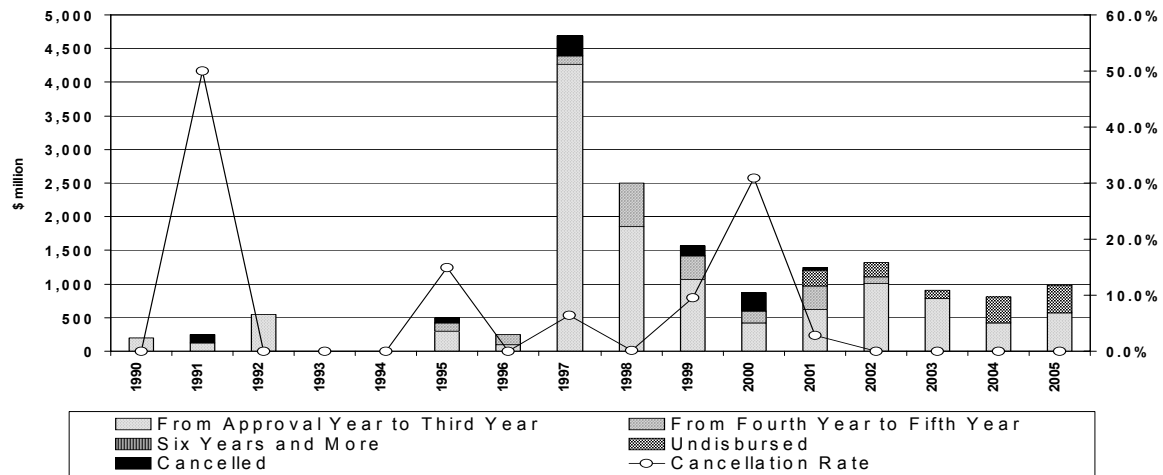


OCR = ordinary capital resources.

Source: ADB. Loan financial information system as of 8 March 2006.

5. **Difficulty in Meeting Program Loan Conditions.** As of March 2006, outstanding tranche releases remain from program loans provided in 2001 (\$234 million), 2002 (\$217 million), 2003 (\$124 million), 2004 (\$379 million) and 2005 (\$405 million)—see the checkered portion of the bar in Figure A2.4. In particular, conditions requiring legislative actions have led to substantial delays. This implies that one or more of the following factors may be at work: (i) OCR countries may lack ownership of and commitment to the reform agenda; (ii) the reform agenda may be overly complex and ambitious; and (iii) the time and effort required to implement the reform program may have been underestimated.

Figure A2.4: OCR (Public Sector) Disbursement and Cancellation (1990–2005, Program Loans)



OCR = ordinary capital resources.

Source: ADB. Loan financial information system as of 8 March 2006.

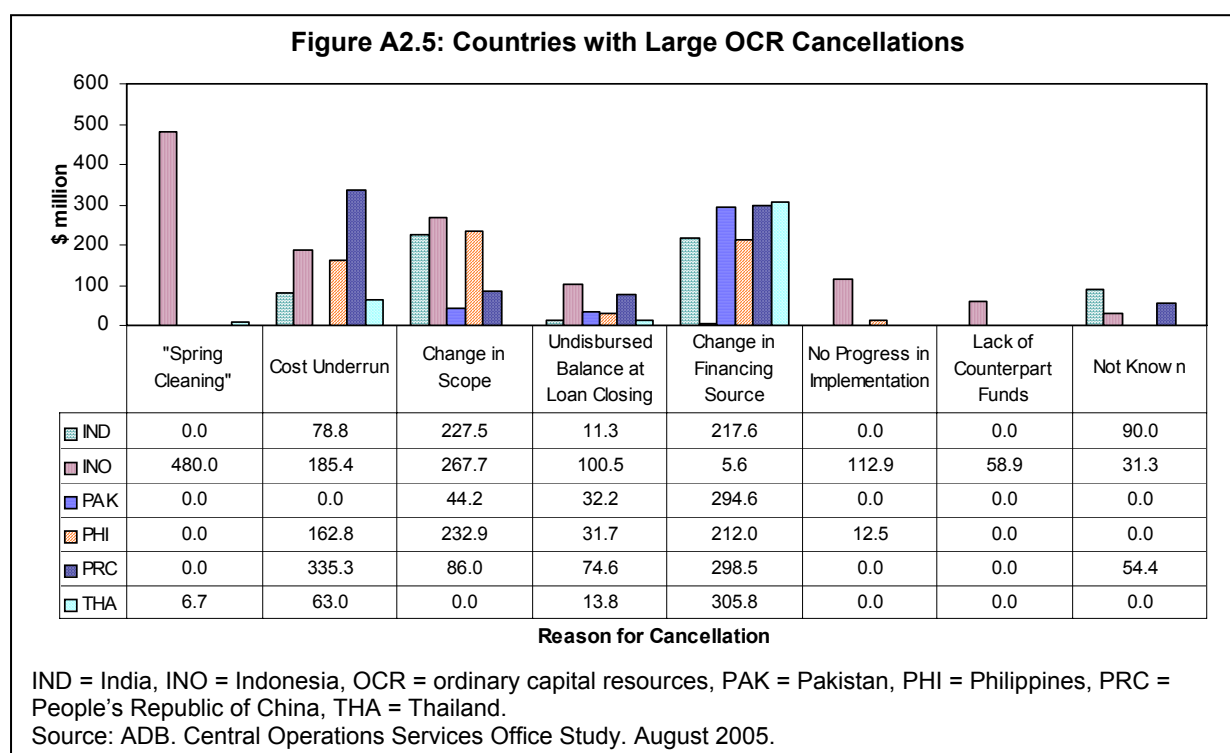
6. **Cancellation.** Cancellation rates are also very high. A recent study by the ADB Central Operations Services Office compared trends in annual new OCR approvals and cancellations. The study noted that, on average, \$800 million of OCR loans are cancelled each year from the active portfolio (Table A2.1).

Table A2.1: Annual OCR (Public Sector) Loan Approvals and Cancellation of Surplus Loan Proceeds, 1995-2004
(\$ million)

Item	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Total
Loan Approvals	3,963.0	3,490.4	7,749.4	4,859.3	3,761.6	3,863.1	3,939.9	3,897.8	4,538.7	3,704.5	43,767.7
Annual Cancellations	236.9	699.1	491.1	1,330.0	858.2	1,051.4	891.6	1,011.7	924.4	794.4	8,288.8

Source: ADB. COSO study. August 2005.

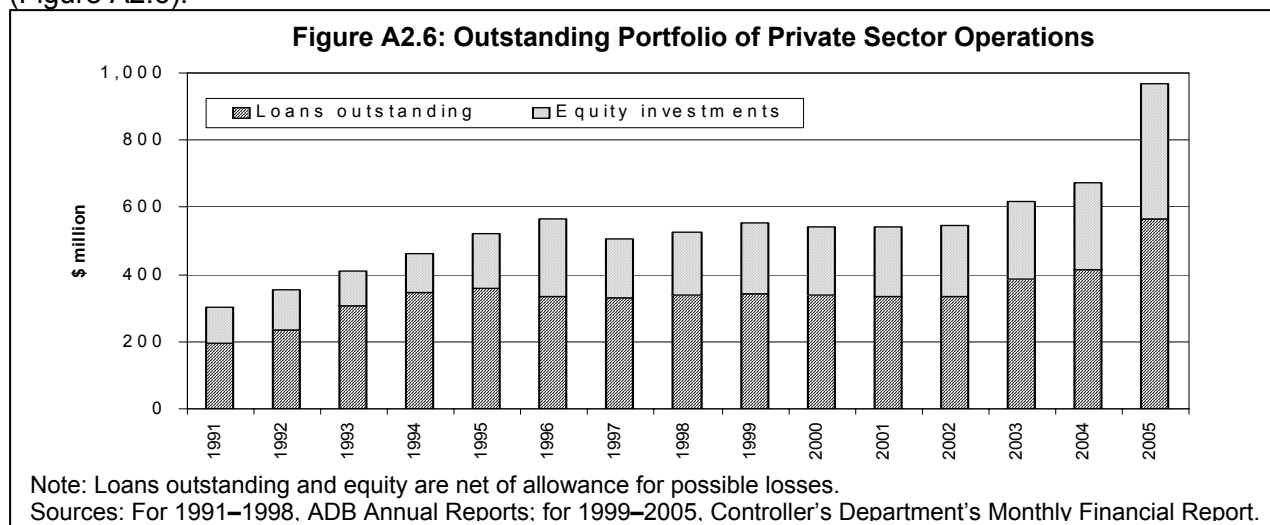
7. The reasons for cancellations vary. As shown in Figure A2.5, the PRC India, Pakistan, and Thailand cancelled a large amount of OCR loans because of changes in financing sources. The PRC had large cost underruns due to competitive bidding and/or larger than required funding allocations. India, Indonesia and the Philippines experienced large cancellations because of reductions or changes in project scope and/or cancellation of project components. Over the past 10 years, the year with the largest volume of cancellations was in 1998, when the Asian financial crisis brought about portfolio restructuring, mainly in Indonesia. In crisis-hit economies, exchange rate adjustment also had an impact and surplus funds were cancelled.



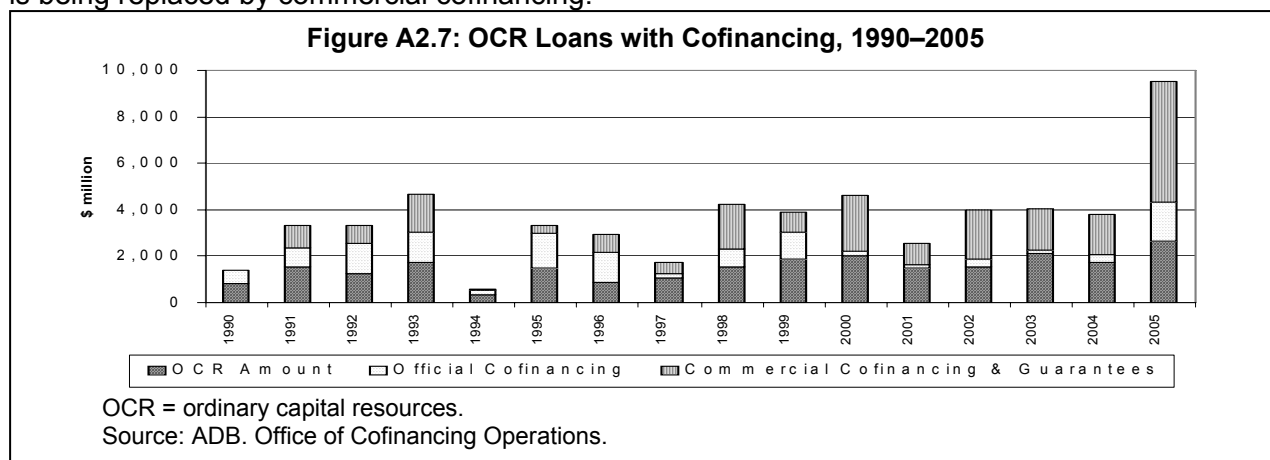
2. Private Sector Operations and Commercial Cofinancing

8. **Approvals and Asset Size.** Since the mid-1990s, new approvals for private sector operations have been increasing substantially, despite substantial fluctuations across years (see Figure 3 in the main text). In the case of private sector operations (which, in contrast to public sector operations, often depend on a wider range of factors that are often beyond the

control of ADB), new approvals do not always represent an accurate picture of the situation, as not all approved loans become operational. In such cases, the asset size (often referred to as the exposure level) provides a more accurate picture of the growth in private sector operations. The asset size is calculated as cumulative disbursements of equity investments, loans and guarantees minus repayments. Despite fluctuations in approval levels, the outstanding portfolio net of allowance for possible losses increased from \$301 million in 1991 to \$970 million in 2005 (Figure A2.6).



9. **Cofinancing.** OCR operations have been increasingly engaged with private entities, not only as borrowers, but also as cofinanciers. Over the years, the profile of cofinanciers has been changing (Figure A2.7), with commercial cofinanciers playing a much greater role. On average, over the period 1990–2005, more than \$2.0 billion (over 50%) of the new annual OCR approvals catalyzed additional resources from other financiers.² While governments were ADB’s primary cofinancing partners until the mid-1990s, their role has decreased considerably since then and is being replaced by commercial cofinancing.

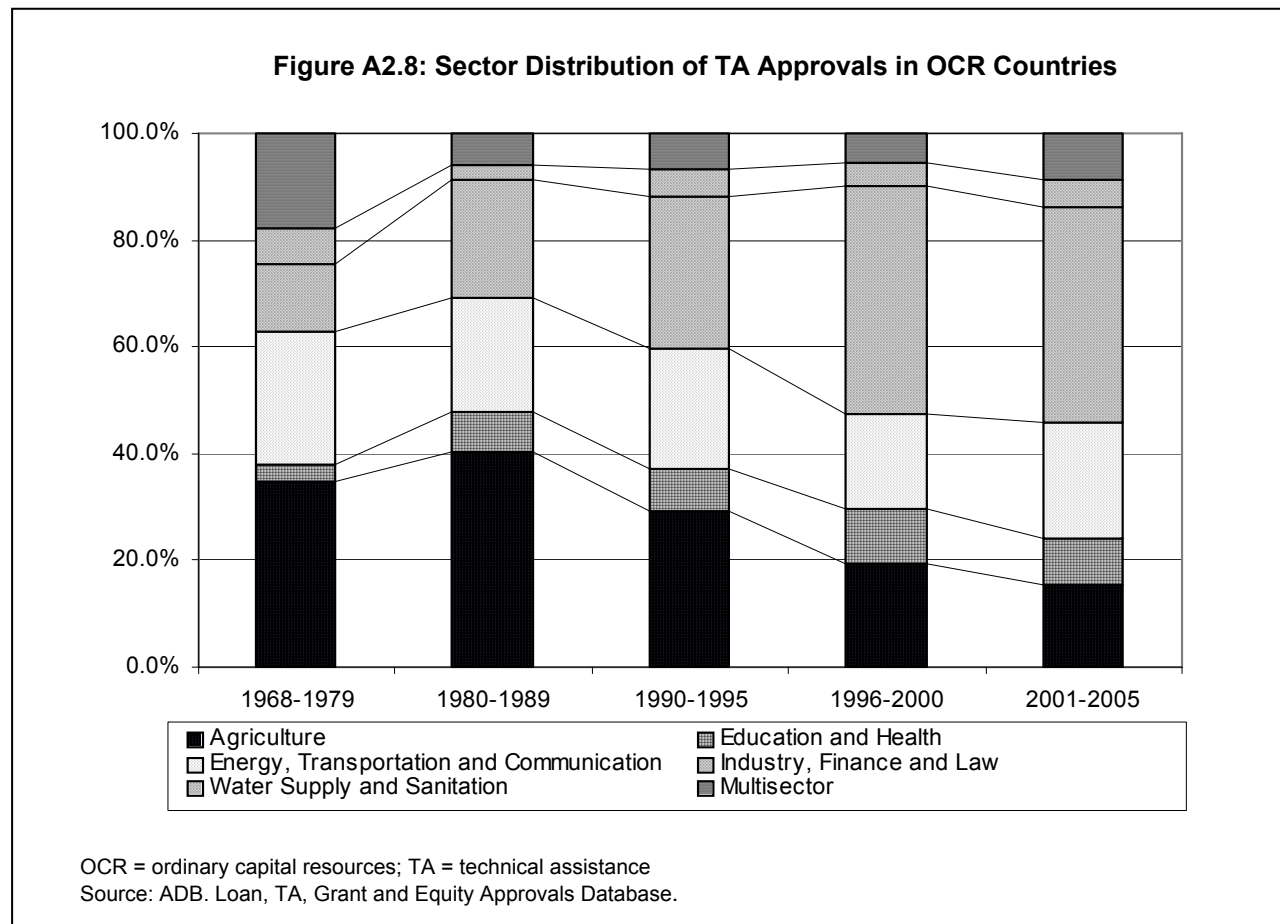


² The unusually high level of cofinancing in 2005 can be attributed to three very large projects (costing more than \$1 billion each). These are Loan 2181-PRC: Central Sichuan Roads Development Project (\$544.9 million of cofinancing); Loan 2182-PRC: Zhengzhou-Xian Railway Development Project (\$1.667 billion of cofinancing); and Loan 2214-INO: Tangguh Liquefied Natural Gas Project (\$2.954 billion of cofinancing).

3. Technical Assistance Operations

10. TA approvals for OCR countries show a gradually increasing trend from 1970 to 1995. This has since leveled off at \$100 million–\$120 million for 200–250 TA projects annually (see Figure 4 in the main text). The fastest growth was in advisory TA projects, which now comprise over 50% of annual TA approvals in OCR countries. This trend reflects the increased importance accorded to policy and institutional reforms, capacity building, and knowledge transfer in ADB’s operations with OCR countries.

11. **Sector Distribution.** Since 1996, TA approvals in OCR countries focused on law, industry and finance, energy, and transportation sectors consistent with the sector concentration of the OCR lending operations (Figure A2.8). The increased share of the industry, finance and law sectors since 1996 also reflects the response to the Asian financial crisis. During the 1970s and 1980s, many TA operations were in agriculture, natural resources, and water supply, a trend also noted in lending operations. Across TA types, project preparatory and advisory TA projects are more closely linked to lending operations as compared with regional TAs.



12. **Country Distribution.** From 1996 to 2005, the PRC, Indonesia and Pakistan were the top three TA recipients. About 35% of TA approvals for OCR countries during the decade were for these three countries. In 2005, however, Indonesia dropped to fourth position, which was consistent with the slow down in lending operations for this country.

Table A2.2. Top TA Recipients in OCR Countries

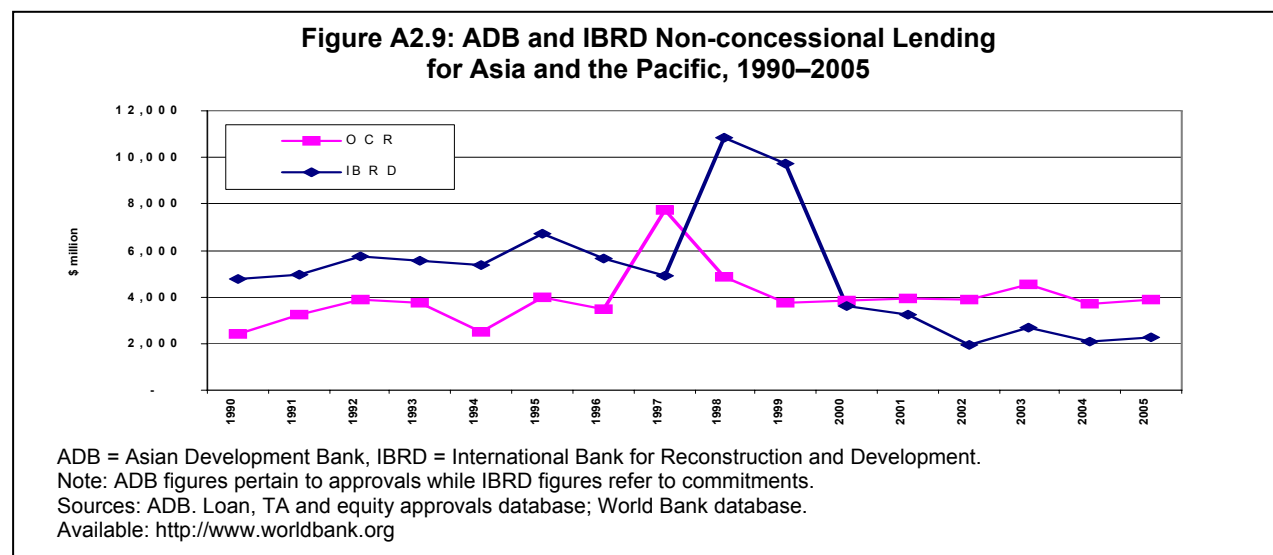
1996–2005				2005			
Rank	DMC	Amount (\$ million)	% of Total	Rank	DMC	Amount (\$ million)	% of Total
1	PRC	166.4	14.7	1	PRC	18.4	15.3
2	Indonesia	134.5	11.9	2	Pakistan	15.3	12.7
3	Pakistan	93.1	8.2	3	Viet Nam	12.3	10.2
4	Viet Nam	91.2	8.1	4	Indonesia	10.3	8.6
5	India	87.5	7.7	5	Bangladesh	7.5	6.2
6	Philippines	63.6	5.6	6	India	6.3	5.3
7	Bangladesh	62.9	5.6	7	Philippines	4.6	3.8
8	Sri Lanka	52.4	4.6	8	Thailand	3.3	2.8
9	Uzbekistan	32.0	2.8	9	Sri Lanka	3.1	2.6
10	Thailand	25.3	2.2	10	Azerbaijan	2.9	2.4
Total		1,131.3	100.0	Total		120.5	100.0

DMC = developing member country, OCR = ordinary capital resources, PRC = People's Republic of China, TA = technical assistance.

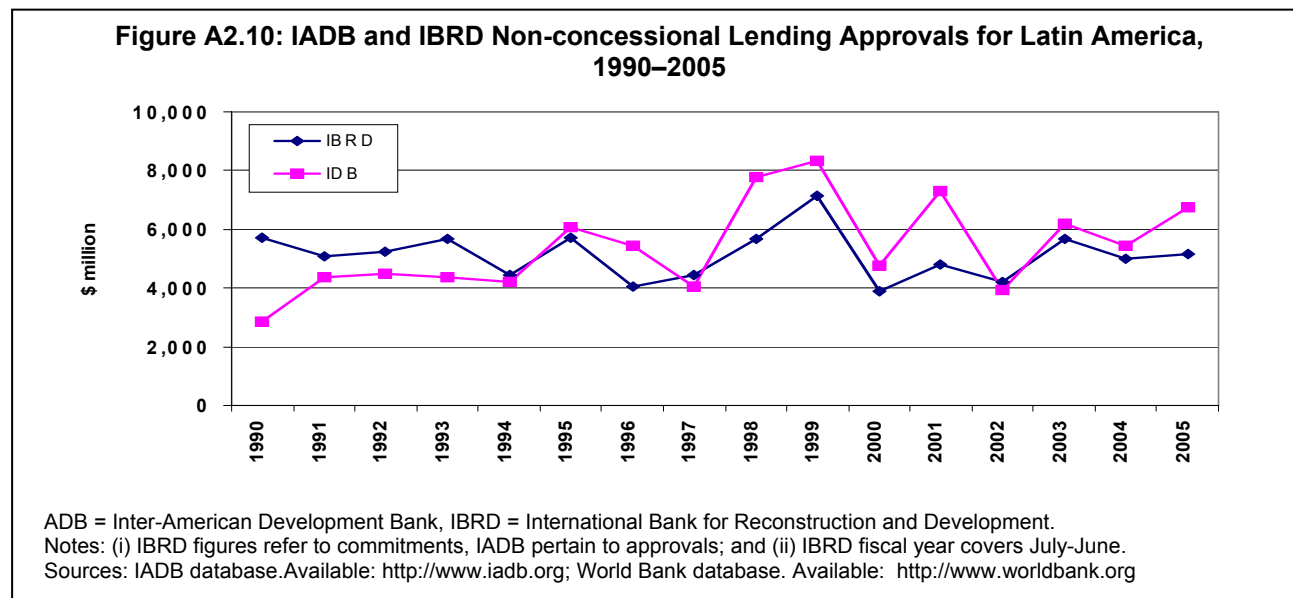
Source: ADB. Loan, TA, Grant and Equity Approvals Database.

B. Trends Across Other Multilateral Development Banks

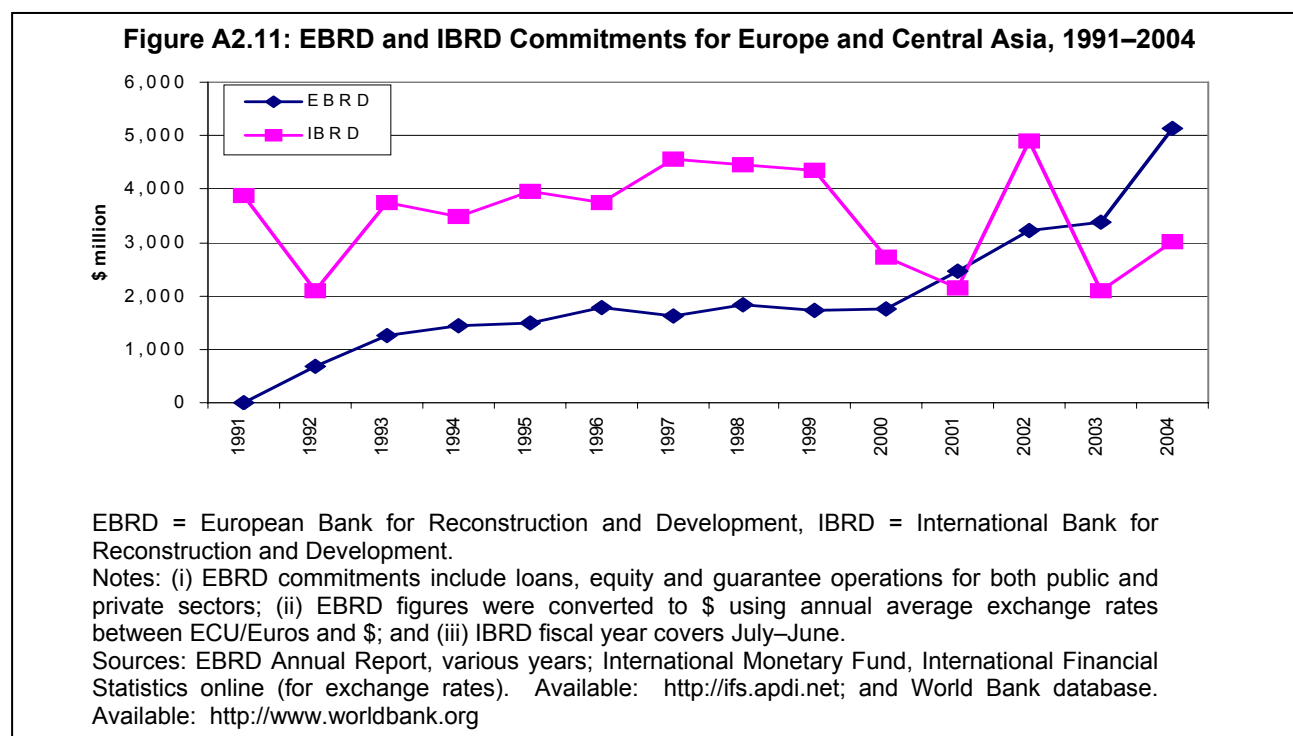
13. **New Loan Approvals.** The trends and challenges related to non-concessional loans are common across several MDBs. In Asia, following the 1997 financial crisis, the World Bank also experienced a major decline in new approvals of the International Bank for Reconstruction and Development (IBRD) loans (Figure A2.9).



14. While these patterns are more pronounced in Asia, they have also been observed in Latin America (Figure A2.10) where a significant number of countries are categorized as MICs. Operations at both the Inter-American Development Bank (IADB) and the IBRD have remained relatively stagnant, with occasional increases for emergency operations (e.g., in Argentina, Brazil, and Mexico).



15. In Eastern Europe and Central Asia, IBRD lending followed a more erratic pattern (being relatively stable during the 1990s but declining significantly after 1999),³ while the approval levels at the European Bank for Reconstruction and Development steadily increased over the same period (Figure A2.11).⁴

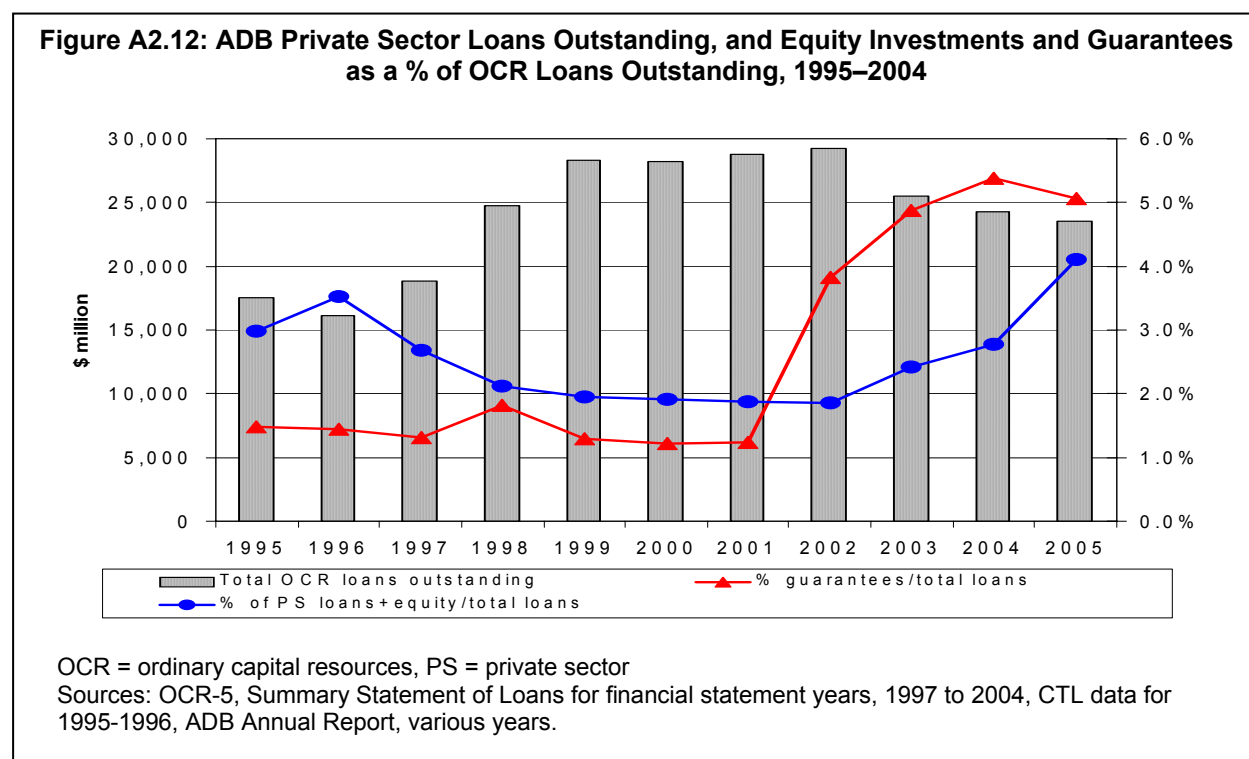


³ Except in 2002, when Turkey engaged in substantial special adjustment loans.

⁴ The EBRD was established in 1991 and caters to a different client base (i.e., it invests mostly in private enterprises, usually with other commercial partners).

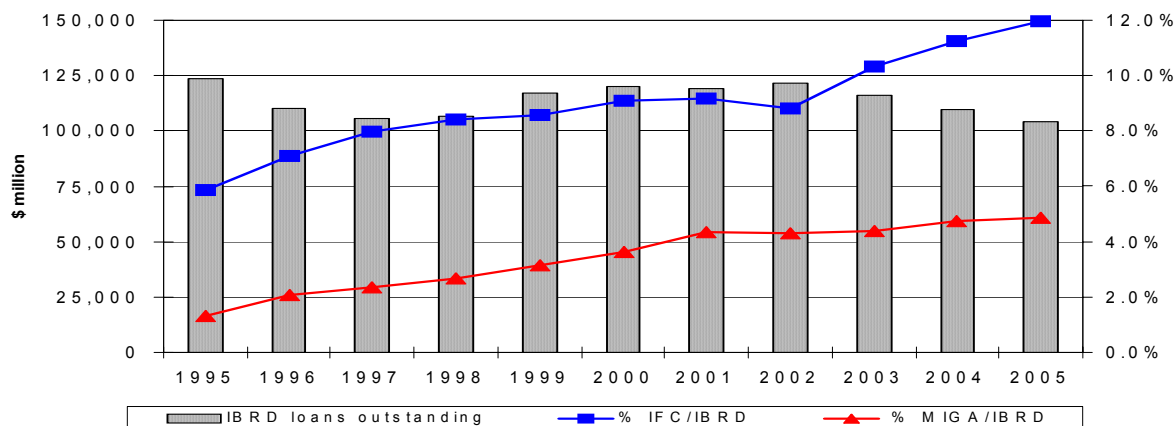
16. **Asset Sizes Across MDBs.** The asset size at ADB and IBRD⁵ has declined since 2002, while the asset size of IADB has increased steadily (Figures A2.12 to A2.14, the total asset size or loan outstanding is represented by the height of the bars for each year). The recent trends at ADB and IBRD may be attributed to several factors (including stagnation in approvals, poor disbursement performance, repayments, prepayments, and cancellations). In contrast, the increasing asset size of IADB in recent years may be attributable to large disbursements of program loans during the Latin American financial crisis in 1994–1995 and 1999, the early adoption of a new lending framework in 2000 and updated operational policies and procedures.

17. **Private Sector Operations.** There are significant differences in private sector operations trends across MDBs. In ADB, the level of private sector loans outstanding and equity investments and their share to total OCR loans outstanding grew in the early 1990s but declined after the Asian financial crisis to about 2% of total OCR loans outstanding during 1998–2002 (the lines in Figure A2.12). With post-crisis recovery, this share increased to 4.1% in 2005, which exceeds the level of IADB but is much lower than that in the World Bank group. The level of outstanding guarantees as a percentage of OCR loans has increased sharply from an average of 1.4% during 1995–2001 to 4.7% from 2002–2004, much higher than IADB but comparable to the World Bank group. For the World Bank group, loans outstanding and equity investments of the International Finance Corporation as a percentage of IBRD loans outstanding grew significantly from around 6% in 1995 to more than 12% in 2005 (the lines in Figure A2.13).



⁵ IBRD total loans outstanding, IFC loans outstanding and equity investments, and MIGA outstanding guarantees in Fig. A1.15 show global coverage of World Bank Group operations.

Figure A2.13: IFC Loans and Equity Investments, MIGA Guarantees as % of IBRD Loans Outstanding, 1995–2005

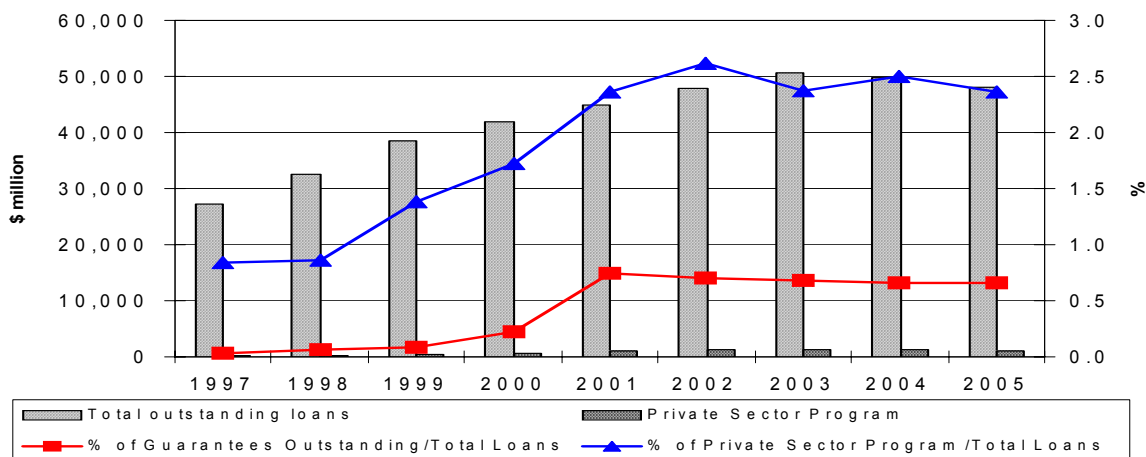


IBRD = International Bank for Reconstruction and Development, IFC = International Finance Corporation, MIGA = Multilateral Investment Guarantee Agency.

Notes: (i) IBRD, IFC and MIGA fiscal years cover July–June. Provisions for losses have not been subtracted from outstanding loan, equity and guarantees data; (ii) IBRD loans outstanding are net of undisbursed balance; (iii) IFC data refer to loans outstanding and equity investments; and (iv) MIGA refer to guarantees outstanding. Sources: IFC Annual Report, various years; MIGA Annual Report, various years; and World Bank Annual Report, various years.

The level of guarantees outstanding by the Multilateral Investment Guarantee Agency as a percentage of IBRD loans outstanding also increased from 1.3% in 1995 to 4.9% in 2005. At IADB, private sector loans as a percentage of total loans outstanding rose steadily from less than 1% in 1997 to 2.5% in 2004 (the lines in Figure A2.14). The level of guarantees outstanding as a percentage of total loans outstanding by IADB is relatively modest at less than 1% compared with ADB (about 2.5%).

Figure A2.14: IADB Loans and Guarantees Outstanding, 1997–2005



IADB = Inter-American Development Bank.

Notes: (i) IADB data refer to loans outstanding of ordinary capital resources; (ii) Private sector data refer to loans outstanding under the Private Sector Program; and (iii) Guarantees data refer to outstanding guarantees and subject to call.

Sources: IADB. Annual Reports, various years.

OVERVIEW AND TENTATIVE TIMETABLE OF PROPOSED ACTIVITIES

Key Result Area/Measures	Proposed Activities	Department Responsible	Timetable
1. Reducing the Costs of Doing Business with ADB			
A. Ensuring that ADB financial costs remain competitive	a. Comprehensive review of LIBOR-based loan product - Enhancement of ADB's Loan and Debt Management Products	TD	<ul style="list-style-type: none"> Board discussion of W-paper planned for end August 2006, and R-Paper in October 2006.
B. Exploring means to soften terms for regional public goods and social services	a. Common approach to blending mechanisms	MDB working group/SPD	<ul style="list-style-type: none"> A paper is currently being drafted (with World Bank taking the lead) which will serve as basis for discussion with interested donors. Expected date of completion: third or fourth quarter of 2006.
	b. Public goods and social sector facility	SPD	<ul style="list-style-type: none"> For further discussions.
	c. OCRg Facility in the water sector	RSDD	<ul style="list-style-type: none"> For further discussions.
	d. APFEE (part of broader energy efficiency I)	RSDD	<ul style="list-style-type: none"> Draft proposed to be finalized in July 2006. Consultations with donors will follow.
	e. CMI	RSDD	<ul style="list-style-type: none"> Expected date of approval: third or fourth quarter of 2006.
C. Introducing greater flexibility in ADB programming cycle	a. Reforming of CSP process	SPD	<ul style="list-style-type: none"> To be completed in the third quarter 2006.
	b. Pilot-testing of new CPS in Thailand	SERD	<ul style="list-style-type: none"> Board discussion tentatively planned for fourth quarter of 2006.
D. Delegating operational services and decisions	a. Review of RM operations	SPD/BPMSD	<ul style="list-style-type: none"> Review to start in second quarter of 2006; to be completed in 2007.

Key Result Area/Measures	Proposed Activities	Department Responsible	Timetable
E. Streamlining operational policies, strategies and business processes	a. New approach for cost sharing and eligibility of expenditures	RSDD	<ul style="list-style-type: none"> Approved in August 2005.
	b. Review of safeguard policies	RSDD	<ul style="list-style-type: none"> All three policies (environment, indigenous peoples and resettlement) simultaneously under review. Consolidated safeguard policy update expected to be submitted for Board approval in fourth quarter of 2007.
	c. Reforming business processes	SPD	<ul style="list-style-type: none"> To be completed in the third quarter 2006.
	d. Updating of financial management guidelines	RSDD	<ul style="list-style-type: none"> Revised Guidelines for the Financial Management and Analysis of Projects issued in December 2005.
	e. Updating of procurement guidelines	COSO	<ul style="list-style-type: none"> Approved in February 2006. The new guidelines became effective 1 April 2006
	f. Updating of guidelines on use of consulting services	COSO	<ul style="list-style-type: none"> Approved in February 2006. The new guidelines became effective 1 April 2006.
	g. Updating of disbursement guidelines	CTL	<ul style="list-style-type: none"> Revised Handbook to be issued in the third quarter of 2006.
	h. Review and updating of policy on supplementary financing	SPD	<ul style="list-style-type: none"> Revised policy approved in November 2005.
2. Expanding and Enhancing Operational Instruments			
A. Introducing new instruments and financing modalities on a pilot basis under the IEI	a. MFF	RSDD	<ul style="list-style-type: none"> Approved in August 2005. To be implemented on a pilot-basis for an initial period of 3 years.
	b. State owned enterprises and local government subsovereign lending	RSDD	
	c. Refinancing and Restructuring Modality	RSDD	

Key Result Area/Measures	Proposed Activities	Department Responsible	Timetable
	d. Local currency financing	TD	
B. Improving existing instruments	a. Review of TA Program	SPD	<ul style="list-style-type: none"> • Expected date of completion: first quarter of 2007.
	b. Program lending and use of conditionality	SPD	<ul style="list-style-type: none"> • Background study completed during the first half of 2006. Informal Board Seminar planned in the third quarter 2006. Further work will depend on the outcome of the seminar.
	c. Credit enhancement and risk management products	OCO	<ul style="list-style-type: none"> • Review of Credit Enhancement Operations ongoing. Discussion of R-paper is planned for August 2006. • ADB's New Financing Partnership Strategy to be discussed by the Board in July 2006.
3. Enhancing Service Quality			
A. Enhancing knowledge management within the organization	a. ADB-wide knowledge management framework established	BPMSD	<ul style="list-style-type: none"> • New knowledge management. Framework approved in June 2004 • First 3-year KPS work plan approved in October 2005. • Quality-at-entry criteria for KPS to be developed in 2006. • New CoP paper approved in August 2005. • Establishment of two knowledge hubs by end 2006.
B. Improving human resources management	a. Adoption of a new human resources strategy	BPMSD	<ul style="list-style-type: none"> • New human resources strategy approved in October 2004. Progress report on implementation to be completed by December 2006.
	b. Complete skills inventory of ADB staff	BPMSD	<ul style="list-style-type: none"> • To be completed in the third quarter of 2006.

Key Result Area/Measures	Proposed Activities	Department Responsible	Timetable
	c. Performance management system	BPMSD	<ul style="list-style-type: none"> First cycle of the PDP has been concluded. Further refinements made to the 2006 cycle, which is ongoing.
	d. Enhanced separation package	BPMSD	<ul style="list-style-type: none"> Approved by the Board on 19 May 2005. Implementation ongoing.
	e. Establishment of Learning and Development Unit	BPMSD	<ul style="list-style-type: none"> Created in 2005. Full review of current programs undertaken in 2005. ADB-wide training needs assessment implemented in 2005. Revamp of ADB training programs in 2006.
C. Increased emphasis on quality-at-entry, Development effectiveness and results	a. CSP and Business Process Reform	SPD, BPMSD	<ul style="list-style-type: none"> To be completed in the third quarter of 2006.
	b. Enhancement to PPMS	OED/COSO	<ul style="list-style-type: none"> New PPMS guidelines issued in December 2005. Implementation ongoing.
	c. Quality-at-entry assessment of CSPs and projects	ADB-wide activity	<ul style="list-style-type: none"> Panel formed in January 2006. Review ongoing. Report expected to be completed by the third quarter of 2006. Assessment to be repeated every 2 years.
	d. Global perception survey	DER	<ul style="list-style-type: none"> Survey to poll 700 stakeholders and opinion leaders in 24 countries launched in first quarter of 2006; results are expected by third quarter of 2006. Survey to be repeated every 3 years.

APFEE = Asia-Pacific Fund for Energy Efficiency, BPMSD = Budget, Personnel and Management Systems Department, CMI = carbon market initiative, CoP = communities of practices, COSO = Central Operations Services Office, CPS = country partnership strategy, CTL = Controller's Department, CSP = country strategy and program, DER = Department of External Relations, EEI = energy efficiency initiative, KPS = knowledge products and services, LIBOR = London interbank offered rate, MDB = multilateral development bank, MFF = multitranches financing facility, OAS = Office of Administrative Services, OCRg = ordinary capital resources grant, OED = Operations Evaluation Department, PDP = performance development plan, PPMS = project performance management system, RD = regional department, RSDD = Regional and Sustainable Development Department, SERD = Southeast Asia Department, SPD = Strategy and Policy Department, TRM = Thailand Resident Mission, TD = Treasury Department, WPBF = work program and budget framework.

PROVISIONAL RESULTS FRAMEWORK^a

Objectives	Result Areas	Key Indicators	Data Sources/Reporting Mechanisms	Remarks
1. Reducing the costs of doing business with ADB	1. Competitiveness of financial products ensured	<ul style="list-style-type: none"> • Actual terms of OCR products compared to those similar institutions • Client satisfaction 	TD's annual review of loan charges RDs; SPD; DER; client feedback (surveys, country consultations)	
	2. Support for regional public goods and social services enhanced	<ul style="list-style-type: none"> • Number of new mechanisms and facilities introduced • Number of projects using such mechanisms or facilities • Client satisfaction 	SPD; RSDD; IEI monitoring report RSDD; IEI monitoring report; Board documents RDs; SPD; DER; client feedback (surveys, country consultations)	
	3. Greater flexibility in ADB programming cycle introduced	<ul style="list-style-type: none"> • Number of months from CSP or CPS initiation to finalization • Client satisfaction 	RMT/SPD; RDs' CSP processing schedule RDs; SPD; DER; client feedback (surveys, country consultations)	Targets to be established with each client country at the outset of programming exercise
	4. Operational policies, and decisions delegated	<ul style="list-style-type: none"> • Number of tasks (programming, processing, and administration) delegated to RMs • Various indicators of portfolio performance (start-up times, time from approval to effectiveness, country 	RDs' yearly accomplishment report; SPD and BPMsD's review of RM operations OED's Annual Report on Loan and Technical Assistance Portfolio Performance; RSDD's annual sector reports;	Indicators to be further refined during review exercise

Objectives	Result Areas	Key Indicators	Data Sources/Reporting Mechanisms	Remarks
		contract award ratio, disbursement, cancellation, etc.) <ul style="list-style-type: none"> • Client satisfaction 	CTL's LFIS and GFIS; COSO's PMIS RDs; SPD; DER; client feedback (surveys, country consultations)	
	5. Operational policies, strategies and business processes streamlined	<ul style="list-style-type: none"> • Number of policies and strategies reviewed and consolidated • Number of policies and strategies retired • Number of months from concept clearance to effectivity • Disbursement ratios • Loans signed per number of staff per year • Client satisfaction 	SPD's quarterly updates of policy and strategy work SPD; PPIS CTL's LFIS COSO; Loan, TA, Grant, Equity Approval; RSDD's annual sector reports Board document RDs; SPD; DER; client feedback (surveys, country consultations)	
2. Expanding and enhancing operational instruments	1. New instruments and financing modalities introduced on a pilot basis	<ul style="list-style-type: none"> • Number of new or enhanced instruments offered • Number of projects using new modalities offered • Assessment of pilot tests completed with 	RSDD; Board documents IEI monitoring report; Board documents RSDD	

Objectives	Result Areas	Key Indicators	Data Sources/Reporting Mechanisms	Remarks
		<p>clear recommendation regarding the mainstreaming of new instruments or modalities</p> <ul style="list-style-type: none"> • Client satisfaction 	<p>RDs; SPD; DER; client feedback (surveys, country consultations)</p>	
	<p>2. Existing instruments improved</p>	<ul style="list-style-type: none"> • Successful completion of TA reform agenda • Review of conditionality and use of program instrument completed with clear ADB position on the issue articulated • TA completion and audit performance reports rating improved • Program loan disbursement ratios improved • Private sector and PPP operations expanded • Number of guarantee products introduced or enhanced • Number of guarantee products used 	<p>SPD; Board documents</p> <p>SPD; Board documents</p> <p>RDs; OED's TA Completion Report, TA Performance Audit/ Evaluation Report; RSDD's annual sector reports ; TAIS</p> <p>OED's Program Performance Audit/ Evaluation Report</p> <p>PSOD; RDs; Board documents</p> <p>OCO; TD; RDs; Board documents</p>	

Objectives	Result Areas	Key Indicators	Data Sources/Reporting Mechanisms	Remarks
		<ul style="list-style-type: none"> • Clients satisfaction 	RDs; SPD; DER; client feedback (surveys, country consultations)	
3. Enhancing service quality	1. Enhancing knowledge management within the organization	<ul style="list-style-type: none"> • Improved ratings of KPS at entry, completion, and post-completion evaluation • Increased accessibility of information 	Client satisfaction (survey every 3 years as part of MfDR) Staff survey (every 3 years as part of ADB-Wide staff engagement survey) KPS quality-at-entry and post evaluation reports (knowledge management framework progress reports, OED reports)	
	2. Improvement of human resources management	<ul style="list-style-type: none"> • Staff profile and skills aligned with departments work program • Improved project performance • Client satisfaction 	BPHR information system RDs; OED's Project/ Program Performance Audit/ Evaluation Report RDs; SPD; DER; client feedback (surveys, country consultations)	
	3. Increased emphasis on quality-at-entry, development effectiveness and results	<ul style="list-style-type: none"> • Number of results-based CSPs conducted • Improved quality at entry of program/project • Improved project performance 	SPRU; RDs Retrospective reviews of CSP and sample projects RDs OED's Annual Report on Loan and Technical	Baseline and refined quality at entry criteria to be established during first retrospective review (initiated in February 2006) Systematic analysis will require updated data processing/reporting

Objectives	Result Areas	Key Indicators	Data Sources/Reporting Mechanisms	Remarks
		<ul style="list-style-type: none"> • Percentage of staff time spent on implementation • Client satisfaction 	<p>Assistance Portfolio Performance; COSO's PMIS</p> <p>BPHR</p> <p>RDs; SPD; DER; client feedback (surveys, country consultations)</p>	<p>system to consolidate data across various data systems within ADB.</p>

ADB = Asian Development Bank, BPMSD = Budget, Personnel and Management Systems Department, BPHR = Human Resources Division, COSO = Central Operations Services Office, CPS = country partnership strategy, CSP = country strategy and program, CTL = Controller's Department, DER = Department of External Relations, GFIS = grant financial information services, IEI = Innovation and Efficiency Initiative; KPS = knowledge products and services, LFIS = Loan Financial Information Services, MfDR = managing for development results, OCO = Office of Cofinancing Operations, OCR = ordinary capital resources, OED = Operations Evaluation Department, PMIS = portfolio management information system, PPIS = project processing information system, PPP = public private partnership, RD = regional department, RM = resident mission, RMT = regional management team, RSDD = Regional and Sustainable Development Department, SPD = Strategy and Policy Department, SPRU = Results Management Unit, TA = technical assistance, TAIS = technical assistance information services, TD= Treasury Department, WPBF = work program and budget framework.

^a The appendix presents a provisional results framework, reflecting the broad nature of the paper (i.e., the paper presents a broad overview of the various initiatives planned and/or ongoing but does not provide details on individual initiatives which are or will be addressed in separate papers). More detailed results frameworks will have to be developed in parallel for each of the proposed initiatives and will have to be monitored separately. To the extent possible, these should include specific benchmarks and targets for monitoring purposes.