

Inclusion, Resilience, Change

ADB's Strategy 2020 at Mid-Term



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Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term

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Abbreviations

ADB	–	Asian Development Bank
CO ₂	–	carbon dioxide
CoP	–	Communities of Practice
CPS	–	country partnership strategy
DRM	–	disaster risk management
FCAS	–	fragile and conflict-affected situations
IED	–	Independent Evaluation Department
KPS	–	knowledge products and services
MDG	–	millennium development goal
MIC	–	middle income country
MTR	–	mid-term review
PCR	–	project completion report
PPP	–	public–private partnerships
PSD	–	private sector development
PSM	–	public sector management
PSO	–	private sector operations
PSOD	–	Private Sector Operations Department
QAE	–	quality-at-entry
SME	–	small and medium enterprise
TA	–	technical assistance

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Foreword

The midterm review of Strategy 2020 provides the Asian Development Bank (ADB) a precious opportunity to draw on its vast experience over the first 5 years of the strategy's implementation. This evaluation report views the three strategic agendas of inclusive growth, environmental sustainability, and regional integration set out in 2008 as being highly relevant for the second half of Strategy 2020. In fact, rising inequalities in the region makes inclusion more pressing, runaway climate change adds fresh urgency for environmental action, while regional integration can be a unique contribution from this premier regional institution.

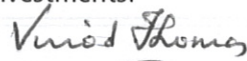
Amidst the organization's strengths, the crucial gap, however, lies not so much in the naming or articulation of the strategic agenda, but rather in its connection to business priorities and operational approaches. The key message of this report, therefore, is to go beyond a statement of these goals to making them an operational reality on the ground. The recommendations so derived are about ways and means for addressing a *triple bottom line* of fostering simultaneously economic growth, social inclusion and environmental sustainability.

Valuable consultations with governments, development partners, communities of practice, and external peer reviewers, coupled with the lessons of experience provide Independent Evaluation the basis for this report. Perhaps different from traditional independent evaluations, this work has moved in tandem with the work of Management during this review. As a result, many of the evaluative implications are also reflected in Management's report on the subject.

The thrust of this evaluation is to press on actions and results on the ground—with determination and a reinvigorated sense of urgency—that will make the pursuit of the threefold agenda much more effective going forward. Evaluative evidence leads up to actions to raise the impact further in seven vital areas: Inclusion, Resilience, Integration, Governance, Synergies, Outcomes, and Teamwork.

The seven point recommendation represents a substantial change rather than just a fine-tuning. Building on ADB's great strength in having a results framework, the needed shift obliges the leadership to call for and get results on the three-fold goals. It also hinges on operational reforms to generate outcomes (rather than only outputs), supported by a shift to financing results (rather than primarily financing construction). That in turn relies on tapping synergies across sectors and connecting the dots among interventions. Vital would be support for teamwork across organizational boundaries, enabling the mobilization of all resources at hand.

The seven steps aim not only for greater cost efficiency at the institution, but equally, greater value addition for clients. Discussions of strategy and budget are often confined to issues of cost cutting, but that addresses only one side of the ledger. Achieving greater impact depends crucially on the gains to clients from ADB's interventions. In that spirit, much of the evaluative evidence in this report speaks to the development effectiveness associated with policies and investments.



Vinod Thomas
Director General
Independent Evaluation

Seven Steps to Raise ADB's Impact

The Asia and Pacific region has made striking progress in reducing income poverty over recent decades. At the same time, income disparities have widened, and environmental degradation has worsened markedly in many respects. The challenges of social inclusion, environmental care and regional integration—Strategy 2020's three-fold strategic agenda—are even more urgent today than they were in 2008, when the strategy was initiated. Meanwhile, as regional consultations have confirmed, expectations of countries regarding ADB support for their development have never been higher.

As a premier regional public institution, ADB can and must rise to the challenge of meeting these expectations. This review by Independent Evaluation finds that to do so, ADB must adapt its business model—and most importantly, harness its financial and human resources as well as its partnerships—to reorient operations to better deliver on its 2020 agenda. In moving from stated goals to actual results, country partnership strategies ought to support operationally a blend of activities that drive inclusive growth, environmental sustainability, and regional integration. Portfolio performance in infrastructure and other areas needs to help reach the institution's target of 80% success, which has long remained elusive.

1. Inclusion and Poverty

The region has experienced one of the fastest economic growth rates in the world, but income and non-income inequality have been on the rise, while poverty, malnutrition, and gender disparity remain widespread. Gini coefficients have risen in 12 out of 28 Asian economies, affecting 80% of Asia's population, and the region remains far from achieving gender equality. Areas where progress is particularly lacking include access to productive resources and economic opportunity; there are also wide deficits in education and health. These trends hurt social cohesion, limit participation, and threaten to block sustained growth.

Both infrastructure and non-infrastructure projects can promote inclusive growth, but such an outcome is not automatic, as is often assumed. Projects geared toward promoting high growth will make an optimal contribution to inclusive growth only if designed with the objective of benefiting lower-income groups relatively more. Hence, the choice of projects should be determined by their likely impact on areas such as job creation, poverty reduction, and improving access to social services.

In relation to ADB's primary emphasis on infrastructure projects, the institution ought to rebalance the thrust of its portfolio both by seeking greater economic and social inclusion in infrastructure operations, and increasing support for projects that broaden access to opportunities and support social protection. The portfolio would need to apply a filter to ensure that its benefits accrue to lower income groups (say, the

bottom 40%) relatively more. There are examples to build on in the areas of rural development, social protection, access to energy, and transport infrastructure. ADB's private sector operations can contribute more to inclusive growth through initiatives for inclusive businesses and projects in frontier markets.

2. Climate Change, Environment, and Resilience

Runaway climate change and continuing environmental degradation are proving to be game changers. Air and water pollution are pervasive threats to health and wellbeing in the region, while deforestation, land degradation and soil erosion worsen the impacts of climate change. Industrial countries have much greater emissions per capita, but developing Asia now contributes over one-third of global carbon dioxide emissions (twice its share of global gross domestic product).

There is a growing divergence between worsening environmental and disaster trends and ADB's actions in this respect. Disasters are proving to be costly, affecting the economic growth rates of countries. They also exacerbate inequality, as the most vulnerable people are the worst affected, and have the hardest time recovering. The double hammer of growing inequality and the increasing frequency of intense disasters make it more difficult to address vulnerability.

Investments in disaster resilience, generated through the approach of building-back-better and integrated disaster risk management, ought to be a major priority for ADB, and not a niche-product. The institution has made sizable disaster response investments in rehabilitation and reconstruction following disasters. It now needs to scale up its contribution to prevention by investing much more in climate change adaptation, climate change mitigation, and disaster risk management. While energy has made progress through investments in efficiency and renewables, transport needs to go much further in shifting from constructing roads to alternatives such as rails and waterways.

3. Regional Cooperation and Integration

ADB has provided considerable support for regional integration, primarily by focusing on infrastructure that supports regional physical connectivity. ADB is uniquely positioned to play a significant role in regional public goods in which countries individually tend to underinvest.

To raise its impact on regional cooperation and integration, ADB needs to move beyond support for cross-border roads and transmission lines, and increase support for regional public goods through lending, knowledge exchange, and policy dialogue. Priority areas include food security, trade facilitation, and natural resource management, including disaster mitigation.

4. Governance and Private Sector Development

Results-oriented public sector management is a prerequisite to simultaneously fostering economic growth while ensuring social inclusion and environmental sustainability. Good governance is also essential for a policy and regulatory environment that enables the private sector to flourish, including through public-

private partnerships. Expanding private sector development and private sector operations to 50% of the annual portfolio by 2020 is appropriate. However, ADB's support for strengthening the enabling environment for private sector development has not been growing much, which will likely limit the impact of private sector operations, and support for public–private partnerships.

ADB needs to sustain its operational support for governance, and be responsive to growing demand for such support, including from middle-income countries. ADB also needs to do more to help address other critical constraints to private sector investment and activity, including business impediments faced by small businesses, and female and rural entrepreneurs, through support for education, finance sector development, infrastructure reforms, and reforms that improve competition and strengthen property rights.

5. Operational Focus and Synergy

Operational selectivity must be a means to achieving better development outcomes, rather than a mechanical goal. By setting a target for core areas, ADB has consistently exceeded its intended focus on infrastructure, to the detriment of other areas. In this regard, Independent Evaluation supports the proposed targeted increases in health and education operations as a step in the right direction. A more important objective would be to capitalize on synergies across areas—for example, transport and market development; sanitation and health; education and agriculture.

In rebalancing the portfolio, ADB ought to move away from a 80%–20% target, and phase out the core/non-core distinction. Such rebalancing entails dropping the infrastructure share from over 70% of recent years. Engagement at the country level would be driven by a country's desired development outcomes rather than by uniform corporate targets. This requires programs that seek links and synergy across sectors, collaboration with development partners, and support for governance and the private sector.

6. Achieving Outcomes

Alongside a number of improvements in portfolio performance, the result of projects has consistently fallen short of the 80% target success rate. This report calls for efforts to raise project performance, especially on the evaluation criteria of effectiveness and sustainability. Both criteria are heavily influenced by the level of effort made on project supervision, including disbursement and procurement, which has been a weakness of ADB operations. The needed actions are likely to vary across areas, as evaluations have shown. Moreover, delivering outcomes on complex challenges calls for innovation and risk taking, and both operations and Independent Evaluation must encourage this.

To improve the achievement of development outcomes, ADB will need to strengthen implementation supervision and ensure the sustainability of its operations, particularly in infrastructure. Increasing the use of results-based lending to finance transport, for example, would facilitate moving beyond repeater construction projects to wider support for operations and maintenance.

7. Teamwork

While staff represent a great strength of the organization, the fragmentation of their skills and knowledge across ADB calls for a review of the effectiveness of the organization's structure in delivering results. The lack of a critical mass of expertise, the dispersion of available talent, and the difficulty of harnessing talent when and where it is needed most, are often identified issues in observations of organizational performance. Project teams need improved access to the best of ADB knowledge and global good practices, while the teams need to strengthen their contributions to organizational learning. As more countries move into middle-income status, new knowledge sources become available that can be of broad benefit, including to lower-income countries.

Furthermore, the increase in the staff size of ADB resident missions has not been accompanied by a corresponding transfer of decision-making authority. While the direction should be seamless team delivery across ADB, the proportion of operations administered by resident missions (measured by the number of loans, grants and technical assistance projects administered) fell to 30% in 2012, from 34% in 2009.

Stronger incentives can promote work across boundaries and help address skill shortages in certain areas. Rewards could promote team-based project delivery, with teams held accountable for outcomes. Regional departments could take differentiated approach in decentralizing operations to meet the diverse demands and priorities of low-income countries, fragile and conflict-affected situations, and middle-income countries. The changing development landscape calls for a stronger role for ADB as a broker of knowledge.

Seven Principal Areas for Change

Key Issue	Proposed Change
How to foster Strategy 2020's agenda of Inclusive Growth, Sustainability, and Regional Integration	Endorse the strategic agenda, but translate it into three operational priorities—the <i>triple bottom line</i> —of growth, inclusion, and environmental sustainability.
1. Inclusion and Poverty: Inequality has increased for more than 80% of the region's population, and vast poverty remains.	Seek relatively greater gain for lower income strata, not only in social sectors but also for infrastructure. Rather than assuming inclusion to be automatic, pursue the goal more directly.
2. Climate Change, Environment, and Resilience: Runaway climate change and worsening environmental and disaster trends outpace the response.	Expand climate change mitigation and adaptation work, make disaster risk management a priority in country partnership strategies, and provide cutting-edge leadership.
3. Regional Cooperation and Integration: ADB's considerable support for regional integration and cooperation has been concentrated on physical connectivity.	Complement support for cross-border roads and transmission lines with greater support for food security, trade facilitation and cross-border natural resource management, including disaster mitigation.
4. Governance and Private Sector Development: The quality of governance, including control of corruption, has stagnated, while insufficient support has been given to inclusive growth by private sector operations.	Deepen support for good governance through sector operations in countries. Continue to respond to demand for public sector management operations. Strengthen support for inclusive business.
5. Operational Focus and Synergy: Targets lead to an unintentional overshooting of infrastructure at the expense of other vital areas.	Pursuing goals at the country level calls for complementary multisector interventions. Rebalance the portfolio by phasing out the 80:20 target and the distinction between core and non-core operations.
6. Achieving Outcomes: There is a need to improve operational performance, in particular with respect to effectiveness and sustainability.	Strengthen implementation supervision, and give more attention to the sustainability of infrastructure and its outcomes. Increase the use of results-based lending.
7. Teamwork: Fragmentation of staff skills and knowledge across ADB compromises the institution's effectiveness in delivering results.	Give stronger incentives and place more accountability on staff for achieving good outcomes. Differentiate the approach to decentralization according to the country contexts. Play a stronger role as a knowledge broker for clients.

ADB = Asian Development Bank.

Views from External Experts

The Independent Evaluation Department (IED) invited an external panel of recognized experts to reflect on the evolving development landscape and implications for the Asian Development Bank (ADB). Their views are synthesized here. The panel members were:

1. Honorable Kristalina Georgieva, Commissioner for International Cooperation, Humanitarian Aid and Crisis Response, European Union
2. Dr. Noeleen Heyzer, Under-Secretary General of the United Nations and Executive Secretary, United Nations Economic and Social Commission for Asia and the Pacific
3. Honorable Mari Pangestu, Minister of Tourism and Creative Economy, Republic of Indonesia
4. Honorable Emilia Pires, Minister of Finance, Timor-Leste

An Evolving Landscape

The panel highlighted critical factors affecting development in the region. On the positive side, Asia has succeeded in eliminating half the world's absolute poverty and expanding its middle class, and despite recurring crises is poised to become the center of the global economy. Moreover, there is growing public interest and political support for improving governance and tackling the most serious threats, most notably inequality, climate change, and environmental degradation. A new sense of urgency for raising development outcomes has emerged and the potential for continued growth and development remains generally strong.

A new sense of urgency for raising development outcomes has emerged

As one panelist stated, "Asia has the resources, technological prowess and collective will to eliminate both poverty and hunger... Given this rate of progress, eliminating extreme poverty by 2030 is well within reach."

But sustaining progress and achieving the full potential of the region will not be easy. There are many challenges, and some—like runaway climate change—are already impacting the region. Following the same development path, with its negative environmental and social externalities, would be incrementally costly.

Many people continue to suffer various forms of deprivation. As a panelist argued, "The continuation of poverty and hunger in the region, which continues to experience one of the fastest economic growth rates in the world, is unacceptable."

The pattern of growth has not been optimal, with inadequate employment generation and inclusion of women, youth, and marginalized segments of society. The share of women in non-agriculture employment remains low in many countries. Even where growth has created jobs, many are in less-productive areas with poor working conditions. A panelist noted that, "With a lack of decent jobs in the organized sectors, large numbers of youth are migrating from traditional occupations to cities looking for work, but end up in low-paid informal sector work."

Inequality is a real and growing concern. In addition to income inequality, disparities in education, health care, food security, housing, and access to safe water demand greater attention. These multiple forms of deprivation reinforce each other,

complicate poverty reduction efforts, and can only be addressed through more integrated, multisector approaches, and better collaboration.

***Natural disasters
are hitting the
poor hardest***

Climate change and environmental degradation continue to intensify, demanding urgent action. Many areas have seen major environmental damage and Asia is a growing global polluter with a rising share of emissions, contributing to the runaway climate change crisis. More frequent and intense natural disasters are hitting the poor hardest. One panelist noted, “a clear trend of increased vulnerability of the poorest part of society. The double hammer of growing inequalities and more frequent and devastating disasters makes the task of reducing extreme poverty harder.”

Persistent health and education challenges hamper human development. Reducing maternal and child mortality, halting non-communicable diseases, and improving health infrastructure are key concerns. While enrolment rates have improved, the quality of education remains weak in many countries and many students are still unable to complete primary schooling.

***Shocks have
exposed the
inadequacy of
social
protection
systems***

Recurrent economic and environmental shocks have exposed the inadequacy of social protection systems in the region. Governments and their development partners must do more to safeguard their most vulnerable through stronger safety nets and other measures. During crises, as one panelist noted, “Countries did better in minimizing damage if they had a safety net system which can be quickly implemented. More work needs to be done in advance of a crisis.”

Debt sustainability is a growing concern in some countries. One panelist stressed that this “is particularly important for fragile states and small island states in the Pacific.” For several countries, capacity to service public debt, including debt to ADB, is a challenge, particularly with fiscal volatility.

Improving infrastructure remains a priority, but complementary non-infrastructure investments are required to maximize returns. Sustainability and maintenance of infrastructure remain weak, especially in fragile and island states where resources and capacities are limited. Improving the inclusiveness impacts of infrastructure is equally important.

These challenges are complex, interlinked, and in some cases intensifying, outpacing efforts by countries and their development partners to address them. At the same time, there is growing momentum for greater participation by people in addressing these challenges. This brings the region and its development institutions to a critical juncture. As one panelist described it: “Asia stands at the cusp of its next big transformation as it continues to rethink and reinvest in itself.”

Implications for ADB

***Resilience is now
an overwhelming
priority***

Some directional and organizational shifts are essential to improving ADB’s responsiveness and effectiveness. With the ever-growing threat of climate change, the panel strongly encouraged ADB to enhance support for disaster risk management and building resilience. As one argued, “Investment in resilience must become a core business of ADB.” This includes suggestions to strengthen infrastructure disaster-proofing and expand risk insurance programs. The need to help countries build resilience is now “an overwhelming priority.”

Building resilience among the most vulnerable requires scaling up support for social protection and safety nets. As one panelist put it, “Given the increasing levels of poverty in parts of Asia and its disaster risk exposure, investment in social protection needs to grow.” Doing so would also strengthen ADB’s achievement of its inclusive growth agenda.

The panel called for greater support for gender equality and empowerment in the region. This is “a fundamental end in its own right” argued one panelist, and a prerequisite for inclusive and sustainable development.

*Gender equality
is a fundamental
end in its own
right*

Governance is a key determinant of development (and development assistance) success. To achieve better results, the panel pointed to the imperative of improving governance and government (at all levels) and the need for greater alignment of assistance with national priorities and systems. “Research shows that good governance and development go hand in hand,” stated one panelist.

The panel endorsed ADB’s continued role in infrastructure, but with greater efforts to increase its inclusiveness and sustainability. One panelist suggested that infrastructure decisions should be based on, “where impact will be highest in terms of job creation, poverty reduction, and increasing livelihoods,” and that complementary investments should be made, “so that the impact of the connectivity is felt.” Consideration can also be given to pooling of regional funds for infrastructure.

Complex, interlinked, and intensifying challenges require more integrated, cross-sector, and complementary interventions. While this is inherently difficult, especially in limited-capacity environments, it is increasingly necessary. High-level outcomes such as inclusive growth result from complementary lower-level outcomes and achievements. This requires ADB to improve its collaboration and coordination with partners, including non-traditional ones.

*Complex
challenges
require more
integrated
interventions*

To improve organizational effectiveness the panel made several specific suggestions: (i) strengthen overall staff competency, (ii) improve incentives and encouragement for the most qualified staff to work in the most difficult environments, (iii) devolve more decision-making authority to country offices, and (iv) strengthen the evaluation function for better organizational learning.

In the words of one panelist, “Given the intensity and vastness of challenges faced by developing Asia, business as usual is not going to be an option, and all development partners, including ADB, face the imperative to fulfill their commitments, take decisive action and accord high priority to the poorest and the most vulnerable countries.” Another concluded that, “ADB as a regional public institution can and should do more.”

Chair's Summary: Development Effectiveness Committee

1. The DEC welcomed the Independent Evaluation Department's Special Evaluation Report: Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term (IN.27-14) and appreciated the opportunity to discuss it with both IED and Management prior to the Board discussion on the Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and the Pacific (Working Paper 1-14). DEC also appreciated the constructive and collaborative approach taken by IED and Management in the preparation of these papers, and noted that inputs provided by the DEC in its discussions on other strategic issues such as private sector development, decentralization, environmental sustainability and disaster risk management, inclusive growth, and knowledge solutions, had been taken into account.

2. The DEC observed that the landscape of the Asia region has changed considerably over the past few years. Lower-income countries were becoming middle-income countries and were evolving in their priorities and demands, thus requiring ADB to adapt. ADB was seen as facing challenges in its lending capacity to match the scale of the development agenda in Asia and the Pacific, an issue that cannot be ignored in a strategic discussion as it has implications for ADB's institutional efficiency and effectiveness.

3. DEC members were interested how the Midterm Review (MTR) process can lead to tangible changes in the way ADB does business going forward. The DEC praised IED for focusing on the right set of challenges which need to be addressed in order to strengthen the impact of Strategy 2020, although the report's discussion of governance and regional integration were somewhat lacking due to absence of recent evaluative base. While recognizing that the discussion focused on strategy, some DEC members mentioned that ADB will also need a time bound action plan that elaborates on how and when the changes will happen, while others saw a need for some additional narrative to support any recalibration of ADB's strategic direction.

4. The DEC noted that a key issue for ADB is the fact that its project success rate has remained stagnant at 67% (lower in challenging regions such as the Pacific). DEC supported IED's view that ADB needs to re-orient its staff, teams, and organizational culture towards achieving excellence, which can be brought about by introducing stronger incentives, recognition and rewards for the delivery of successful projects with a focus on disbursements and project implementation rather than project approvals.

5. DEC supported plans to (i) streamline business processes to reduce delays in project implementation, (ii) promote efficient and cost-efficient procurement, (iii) develop career streams for technical and managerial staff, (iv) share resources across departments by mobilizing interdepartmental and interdisciplinary teams, and (v) empower resident missions (RM) and create incentives for staff to work in RMs. DEC

members agreed with most of the IED recommendations, while some of the diverging views are covered in the next paragraphs.

A. Inclusive growth

6. DEC noted that in terms of inclusive growth, IED argues that targeted interventions comprised 21% of total operations over 2000-2012 and that the poverty focus under the inclusive growth agenda may have fallen rather than increased after the adoption of Strategy 2020. DEC agreed with IED's recommendation that in its infrastructure projects, ADB should seek greater economic and social inclusion and increase support for projects that broaden access to opportunities. But some DEC members cautioned against overcomplicating project designs in this effort to address inclusion.

7. While some DEC members supported the proposal that ADB's portfolio should increasingly focus on low-income groups, others expressed concern about IED's suggestion that ADB applies a filter – which could be included in the Country Partnership Strategy – to its infrastructure projects to ensure that benefits accrue to lower income groups (i.e. the bottom 40%) relatively more, as this would require obtaining sufficient reliable data on household incomes in project areas, and from a monitoring and evaluation this would raise the cost of projects to survey.

8. Recognizing that there is room for ADB to do more on inclusiveness, Management indicated that inclusiveness should be considered at the country level rather than at the project level, and that the CPS should consider areas of inequality where ADB could get involved, taking into consideration also what other development partners are doing. While DEC agreed with IED's view that all projects can be made to contribute to inclusive growth to some extent, a DEC member indicated that indirect benefits to the lower income groups also contribute to poverty alleviation and that projects should not be constrained by a need to have only direct benefit to the bottom 40%.

B. Review of 80% target for core areas versus 20% for noncore areas.

9. DEC noted that IED recommends that ADB ought to move away from the 80%-20% target and phase out the core/non-core distinction. A DEC member disagreed and indicated ADB should keep the 80%-20% target at the corporate level until 2020, in line with Management's view, while respecting that some countries may not want to achieve this target due to different demands. Some DEC members opined that selectivity and focus in operations continue to be essential because of ADB's limited resources, and ADB's need to become a specialized resource rather than an all-round player.

10. DEC supported IED's recommendations calling for efforts to raise effectiveness and sustainability and improving the link between outputs and outcomes. DEC agreed that in order for ADB to remain relevant in the region, ADB needs to show sustainable results on the ground. DEC agreed with the need to continue to improve project design and emphasized that the quality of the implementation support and monitoring is essential in obtaining sustainable results. A DEC member was particularly supportive of IED's proposal to rely more on results based lending (RBL), and move away from a

focus on generating outputs to generating meaningful outcomes. Management provided information on upcoming RBL projects planned for 2014 and 2015.

11. Some DEC members expressed concern that ADB and IED reports may lead to commitments for ADB to do more work in many additional areas such as education, health, social protection, disaster risk management, micro-finance, good governance, urban transport, railways, etc. DEC urged Management to consider the existing challenges of maintaining a critical mass of staff with technical skills in transport, energy etc. While some DEC members considered that ADB will remain essentially an infrastructure bank, they were of the view that Management also needs to decide in what areas ADB will do less. Given the level of poverty and inequality in the region, a DEC member supported more interventions on social protection, but questioned the need to build up ADB's health portfolio given the existing lack of technical skills in our core areas. The member recommended that Management looks at how to address problems in some of ADB's key sectors such as finance and sanitation, in line with the needs of the region.

C. Regional Cooperation and Integration

12. DEC noted IED's recommendation for ADB to move beyond support for cross-border roads and transmission lines and increase support for food security, trade facilitation, natural resource management and disaster mitigation. A DEC member noted however that there is still a large demand for roads and transmission lines by DMCs to enhance regional connectivity and this demand is likely to continue for the next five years.

13. A DEC member considered that developing regional capital and bond markets is also very important for regional cooperation and integration and crucial for meeting the region's financial needs, but noted this had been dropped from IED's priority areas. The member indicated that finance is one of five core areas but noted that IED's report discusses little about finance, mostly only on SME finance, and that priority should be given to financial sector reform and policy dialogue. IED noted that the report selectively focused on areas of interest to ADB's strategic agenda drawing on evaluative evidence.

D. Knowledge

14. DEC noted IED's recommendation that ADB should not limit its knowledge work to areas in which it provides financing and that ADB should enhance knowledge activities to become a knowledge bank, for example in areas such as social protection. The DEC Chair noted that innovation and value addition are critical differentiating factors necessary for ADB's success in the future, since funding is not the only most important element for Upper Middle-Income Countries. He supported sharing of relevant knowledge and experiences among DMCs in the form of South-South cooperation, where ADB may innovatively play the role of broker in a cost-effective way. A DEC member agreed that ADB should become a knowledge bank, but should not become a knowledge institution like the OECD.

E. Climate Change, Environment and Resilience

15. DEC was pleased to note that ADB has increased its investments in environmental sustainability and climate change since the launch of Strategy 2020. A

DEC member indicated that efforts must continue on sustainable transport since transport is not only a major cause of CO2 emissions but also constitutes a large share of ADB's infrastructure investments. A DEC member supported mainstreaming disaster risk reduction in operations, but sought clarification as to what exactly this would entail in operational terms. Another member suggested that in addition to climate change adaptation and mitigation considerations in projects, ADB could provide cutting edge leadership to ADB's clients and consider working in areas where it has not ventured before. DEC members agreed with IED's recommendation that investments in disaster resilience ought to be a major priority, depending on the DMCs' needs and priorities, rather than a niche area in ADB's work.

F. Private Sector Development

16. A DEC member supported the proposal made by IED for strengthening inclusive business operations but noted that if ADB is to reach its target of 50% of private sector operations by 2020, there must be a tighter collaboration between PSOD and regional departments regarding how to reach that target.

G. Review of organizational structure

17. Some DEC members did not agree with IED's view that ADB needs to review its organizational structure, which IED perceived to be an underlying factor in the fragmentation of skills and the perceived "silos" in the organization. A DEC member considered that the regional set up had served ADB well and did not require a major reorganization. Another member suggested that it may be better to focus on making the current system work by sharing staff across departments and strengthening Communities of Practice (COPs). Another member supported further decentralization done in a differentiated manner, based on the situation of the respective developing member country (DMC) and of the RM.

A Changing Asia and Pacific Region

1. The Asian Development Bank (ADB) has undertaken a midterm review (MTR) of Strategy 2020 to take stock of progress and determine whether the institution is on course to achieving the strategy's goals and objectives.¹ The MTR assesses implementation progress since 2008 and considers key issues and challenges for 2014–2020.²

2. At the request of the Board of Directors, Independent Evaluation committed to preparing a report on the implementation performance and continued relevance of Strategy 2020. The report has been prepared in coordination with ADB's Strategy and Policy Department and takes into account the findings of the MTR, which itself draws extensively on evidence from evaluations.

3. The report focuses mainly on issues for which evidence from evaluations is available. Regional cooperation and integration, for example, are not discussed in depth as evaluation on this topic is pending. The other two strategic agendas of inclusive growth and environmentally sustainable growth are addressed, as are two drivers of change—private sector development (PSD) and knowledge solutions. The available evaluation results on gender are out of date, and an evaluation of partnerships is scheduled for 2015, so these drivers of change are not discussed in depth. Governance, another driver of change, is highlighted throughout the report both as (i) a prerequisite to successfully addressing the triple bottom line policy challenge of simultaneously fostering economic growth, while ensuring social inclusion and environmental sustainability; and (ii) a critical component of strengthening the enabling environment for PSD. The report concludes with a discussion of how ADB can harness its financial and human resources to deliver better development outcomes.

A. Strategy 2020

4. With the adoption of Strategy 2020, ADB reaffirmed its vision of an Asia and Pacific region free of poverty, and its mission to help developing member countries reduce poverty and improve living conditions and quality of life. ADB's vision and mission are to be achieved through a multidimensional framework comprising three strategic agendas; five drivers of change; differentiated approaches to ADB's four main types of developing member countries; and five core (and three non-core) operational areas (plus three other areas of operations). Moreover, Strategy 2020 pledges to

With Strategy 2020, ADB reaffirmed its vision of an Asia and Pacific region free of poverty

¹ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

² For more details on the MTR, refer to: <http://www.adb.org/strategy-2020-mid-term-review>

transform the institution through a set of operational and institutional goals and targets. Under Strategy 2020, ADB committed to having 80% of its operations in core operational areas by 2012, scaling up PSD and private sector operations (PSO) to 50% of operations by 2020, complementing every dollar lent with a dollar provided in cofinancing, and have 30% of operations promote regional integration. A comparison of Strategy 2020's framework with those in previous ADB corporate strategies is provided in Appendix 1. This comparison shows that while ADB's strategic goals have largely remained similar, there has been a narrowing of the means to achieve them, in particular through the identification of priority sectors in the Medium-Term Strategy II in 2006,³ and Strategy 2020.

5. To improve the institution's effectiveness in achieving development outcomes, Strategy 2020 adopted a results framework with four levels to track progress in long-term development outcomes.⁴ The main features of Strategy 2020, in terms of challenges to the region and ADB's response, are summarized in Figure 1.

³ ADB. 2006. *Medium-Term Strategy II, 2006–2008*. Manila.

⁴ The initial results framework was revised to reflect lessons from the first 5 years of implementation.



B. A Changing Asia and Pacific Region

1. Income and Social Inequality

6. Although poverty reduction has progressed at an unprecedented rate in Asia and the Pacific, the region remains home to 1.64 billion people (40% of the population) who live on less than \$2.00 a day. This group includes 730 million people who live in extreme poverty, on less than \$1.25 a day. Income disparities have grown in the 12 economies that account for 80% of the region’s population. From the mid-1990s to the late 2000s, the average Gini coefficient for the region as a whole worsened from 39 to 46, or by 1.4% per year. Growth has not generated enough decent, productive employment. As a consequence, about 60% of the workers in Asia and the Pacific are

Although poverty reduction has progressed, the region remains home to 1.64 billion people who live on less than \$2.00 a day

⁵ A comprehensive discussion of development changes in Asia and the Pacific is also included in the MTR.
⁶ ADB. 2012. *Asian Development Outlook 2012: Confronting Rising Inequality in Asia*. Manila.

currently engaged in highly vulnerable employment, which they are forced to accept because of the absence of adequate social protection systems.⁷

The region also faces growing non-income inequality, notably in education and health

7. The region also faces growing non-income inequality, notably in education and health. Although access to basic education has improved markedly, three nations in the region have out-of-school populations that remain among the highest in the world. Across the region, women still face wide deficits in education and, especially, health. Insufficient antenatal care, and deliveries that are overseen by unqualified medical personnel, and contribute to high maternal mortality. This is the leading cause of death among adolescent girls across the region, and the major reason for low female life expectancy, particularly in South Asia. Income and non-income inequality, moreover, are mutually reinforcing, leaving the 900 million people living on between \$1.25 and \$2.00 a day increasingly vulnerable to falling back into extreme poverty.

2. Environmental Sustainability

8. Expanding demand for natural resources, accompanied by unsustainable and inefficient resource use patterns, has led to converging economic, resource, and environmental challenges. Many countries are increasingly concerned about the environmental impacts of growth as it has been pursued to date. These include rising urban air and water pollution; and growing soil erosion, desertification, and water scarcity. The rate of growth in greenhouse gas emissions has also accelerated, mirroring the trends in overall material and energy use, with Asian countries expected to generate 45% of global energy-related emissions by 2030. These trends, coupled with rapid urbanization, climate change, and deforestation, pose a threat to future development outcomes.

9. Cities in Asia are growing at an unprecedented pace; the resulting congestion, waste, pollution, and associated health impacts remain key challenges in sustaining urban development. One important manifestation of this urbanization trend is a decline in investments in agriculture and rural development. This has resulted in a corresponding lack of opportunities in the region's rural areas, where the majority of the poor live (footnote 7).

With a fourfold rise in floods and storms, climate change has become an imminent and existential danger

10. Climate change is a serious threat to the economic prosperity of the region.⁸ With a fourfold rise in floods and storms, climate change has, in fact, become an imminent and existential danger in a growing number of countries. And while the effects of environmental degradation and climate change affect everyone, the poor are the least able to either mitigate or adapt, adding another layer to their vulnerability.

11. Climate change threatens forests on an alarming scale, yet deforestation is not highlighted as such in the MTR, although it accounts for one-fifth of all greenhouse gas emissions. The majority of countries in Southeast Asia have been exposed to a net loss of their natural forests during 2000–2012, in turn leading to reduced biodiversity.⁹ The globally significant biodiversity and natural resources of Asia and the Pacific provide

⁷ United Nations Economic and Social Commission for Asia and the Pacific, United Nations Development Programme, and ADB. *Asia Pacific Aspirations: Perspectives for a Post-2015 Development Agenda* (Asia-Pacific Regional Millennium Development Goals Report 2012/2013).

⁸ V. Thomas, J.R. Albert, and R. Perez. 2013. Climate-Related Disasters in Asia and the Pacific. *Economics Working Paper Series 358*. Manila: ADB.

⁹ Hansen, et al. 2013. High-Resolution Global Maps of 21st-Century Forest Cover Change. *Science*. 342 (6160). Pp. 850-853. <http://earthenginepartners.appspot.com/science-2013-global-forest>

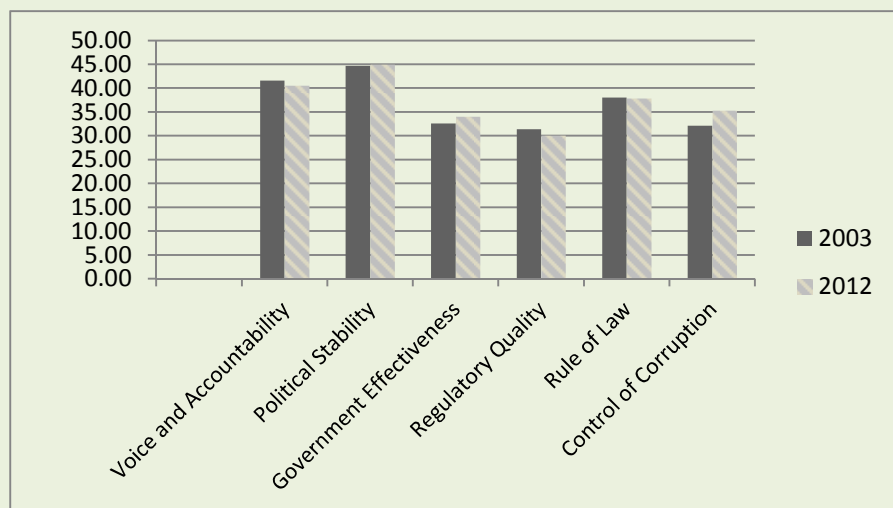
sustenance for millions of the region's residents—including through seafood and agricultural products, fodder, fuel wood, timber, and medicine—in addition to serving a vital role in assimilating wastes, recycling nutrients, regulating the climate, and recharging aquifers.¹⁰

12. The socioeconomic and environmental trends outlined above indicate that there are risks associated with a traditional development path of pursuing growth first, and mitigating externalities later. Unfortunately, the Kuznets curve provides little hope that, in the absence of deliberate actions, these negative trends will be reversed in time to address the immediate challenges that the Asia and the Pacific region faces; indeed, a reversal could come too late, after an environmental tipping point has been reached.¹¹

3. Governance

13. High-quality, results-focused public sector management (PSM) is a prerequisite to addressing the triple bottom line, which is a fundamental policy challenge for Asia and the Pacific: simultaneously sustaining economic growth while ensuring social inclusion and environmental sustainability. In addition, governance is a key component of the enabling environment for PSD. Governance indicators suggest that the overall quality of governance in the region has stagnated during 2003–2012 (Figure 2). Limited progress on the control of corruption and government effectiveness is offset by slight deteriorations in voice and accountability, regulatory quality and the rule of law. As a consequence, the region still has a limited ability to effectively respond to complex policy challenges, provide public services and achieve development results and outcomes.

Figure 2: Average Percentile Ranking of ADB Developing Member Countries 2003–2012



ADB = Asian Development Bank.

Source: Worldwide Governance Indicators. <http://info.worldbank.org/governance/wgi/index.aspx#home>

¹⁰ ADB.2013. *Environment Operational Directions 2013–2010—Promoting Transitions to Green Growth in Asia and the Pacific*. Manila.

¹¹ P. Petri, and V. Thomas. 2013. *Development Imperatives for the Asian Century*. *ADB Economics Working Paper Series 360*. Manila: ADB.

14. A single approach to governance improvements does not exist. Low-income countries need to improve government effectiveness, the quality of regulations, and the rule of law, and expand corruption controls to support growth. Middle-income countries (MICs) face the challenge of responding to the aspirations of a growing middle class, and demands for a greater say in the development process. Inflows of low-interest foreign capital into Asia may have allowed some countries to reduce the pace of governance reforms, but recent financial market volatility and a slowing of economic activity have added fresh urgency to long-term structural actions to ensure development gains are preserved, and future growth benefits all.¹²

C. Implications for ADB

While Strategy 2020's agendas remain relevant, they need to be updated operationally

15. While Strategy 2020's three strategic agendas remain relevant to Asia and the Pacific, they need to be updated operationally to deliver stronger outcomes in the face of heightened challenges. In this respect, ADB's decision to carry out a MTR of Strategy 2020 is commendable. The review is a valuable opportunity to draw on lessons from the first 5 years of the strategy's implementation, including those from evaluation. ADB must seize this opportunity to review experience and make the changes necessary to deliver better results.

1. The Three Strategic Agendas

A more balanced portfolio to deliver inclusive outcomes is needed

16. **Inclusive growth.** Successive guidelines have stressed the contribution of the portfolio to inclusive growth—the first strategic agenda of Strategy 2020—through three pillars of interventions: high growth mainly (pillar 1), access to opportunities (while sometimes also addressing growth) (pillar 2), and social protection (pillar 3). Given the observed trend of rising inequality in Asia, ADB should aim for greater inclusion across its sovereign and non-sovereign operations in all sectors. A clear and monitored focus needs to be given to including the poor (i.e., the lower half of the income distribution) in all ADB operations. To this end, a more balanced portfolio of infrastructure and social and environmental operations to deliver inclusive outcomes is needed, along with greater balance across pillars 1, 2, and 3. Chapter 2 provides more discussion of the inclusive growth agenda.

17. **Environmentally sustainable growth.** The urgency for the second strategic agenda—environmentally sustainable growth—is heightened by severe environmental degradation and more frequent climate-related disasters. Both public and private sector energy portfolios have seen an appropriate increase in climate-friendly investments, but a similar increase has not yet occurred in the transport portfolio; overall, the problems far outpace the response, from ADB and the region. Given the focus of ADB on infrastructure, and the region's extreme vulnerability to climate disasters, Independent Evaluation looks to ADB to make a far-reaching operational contribution in confronting climate change adaptation, climate mitigation, and disaster risk management—by tapping the vast climate funds and leveraging its own resources. There are positive examples in the private sector and renewable energy, but they need to be vastly expanded. The recent evaluation of ADB's support for the Millennium Development

¹² ADB. 2013. *Asian Development Outlook 2013 Update: Governance and Public Service Delivery*. Manila.

Goals (MDGs)—particularly MDG7 (Ensure Environmental Sustainability)—also pointed in this direction.¹³

18. Together with the continued focus on growth, the renewed stress on inclusiveness and the environmental imperative imply that ADB must support a triple bottom line policy response. This approach will help align ADB's commitment to the post-2015 development agenda and emerging sustainable development goals.

19. Following a series of devastating natural disasters—in the People's Republic of China (PRC), India, Pakistan, the Philippines, Thailand, and elsewhere—the need for ADB to help build disaster risk management capacity is especially urgent. ADB has a track record in this area: its disaster recovery projects often have a higher success rate than ADB-supported projects overall. A shift from the limited objective of restoring particular types of infrastructure in the affected areas to rehabilitating livelihoods, or increasing disaster resilience by *building-back-better* is timely in view of the frequency of the calamities the affected countries have experienced.¹⁴ The second strategic agenda is discussed in detail in Chapter 3.

The need to build disaster risk management capacity is especially urgent

20. **Regional Integration.** Strategy 2020 has helped to promote the third strategic agenda relating to regional integration. Based on an ongoing evaluation,¹⁵ most of the lending support was provided for transport and energy connectivity projects in the areas of road, rail, hydropower generation, and electricity transmission and distribution. More limited support, much of it non-lending, has been provided for trade facilitation, tourism, natural resources management, health and capital markets development projects. ADB is well positioned to support regional public goods, for which enhanced policy dialogue with stakeholders is a key factor. A recent IED paper suggests, for example, that ADB can play a unique role in facilitating regional dialogue and cooperation on food security.¹⁶ There is also a need to balance better the infrastructure and institutional aspects of regional physical connectivity, as suggested in an evaluation focusing on the Greater Mekong Subregion.¹⁷ Evaluations done in the Pacific also provide good examples of regional cooperation on which ADB can build.

There is a need to balance better the infrastructure and institutional aspects of regional connectivity

2. Thematic Drivers of Change

21. **Governance.** All three agendas require good governance, but government effectiveness remains a major concern in the region, as evidenced by various country assistance program evaluations. It is essential that ADB maintain support to enhance governance in the public sector through its sector operations, PSM operations, and technical assistance (TA) projects. An ongoing evaluation of ADB's support for good governance finds continued demand for ADB support in this area.¹⁸

It is essential that ADB maintain support to enhance governance

¹³ IED. 2013. *Thematic Evaluation Study: ADB Support for Achieving the Millennium Development Goals*. Manila: ADB.

¹⁴ The concept of "building back differently and elsewhere" has recently been introduced by policy makers in the disaster risk management community.

¹⁵ IED. Forthcoming. *Thematic Evaluation Study: Regional Cooperation and Integration*. Manila: ADB.

¹⁶ IED. 2013. *Working Paper: Food Security Challenges in Asia*. Manila: ADB.

¹⁷ IED. 2008. *Regional Cooperation and Assistance Program Evaluation: Greater Mekong Subregion, Maturing and Moving Forward*. Manila: ADB.

¹⁸ IED. Forthcoming. *Thematic Evaluation Study on ADB Support for Enhancing Governance in its Public Sector Operations*. Manila: ADB.

ADB can pay more systematic attention to increasing inclusiveness of PSO

22. **Private sector operations.** As indicated in Chapter 4, operations in the private sector are envisaged to grow rapidly.¹⁹ The target of increasing PSD and PSO (combined) to 50% of ADB's annual operations by 2020 is a good goal, particularly in light of the private sector's increasing importance as a source of growth, particularly in MICs, and the decreasing importance of official development assistance (ODA) relative to non-ODA inflows. Recent evaluation findings suggest that adequate support for an enabling environment will be required to enhance entrepreneurship and private investment, including under public-private partnership (PPP) models. In addition, more effort is needed to support inclusive growth through PSO. ADB can pay more systematic attention to increasing inclusiveness of PSO, given evidence that such a focus need not undermine profitability.

23. **Knowledge.** As stressed in a 2012 evaluation, what could set ADB apart in achieving outcomes would be its delivery of knowledge, from both operations and research.²⁰ Despite efforts to improve, and a number of successes, some critical constraints keep ADB from becoming a more effective knowledge institution. Strengthening knowledge services for clients requires, above all, pulling together all of ADB's currently fragmented knowledge, and making it available when needed. Improvements are needed to identify knowledge needs, capture and share tacit knowledge, and integrate knowledge in operations to support development outcomes; these are discussed in Chapter 5.

3. Operational and Institutional Implications

The target of 80% of operations in core areas has led to an overemphasis on infrastructure

24. ADB's selective engagement at the country level should be driven by a country's desired development outcomes, including knowledge needs, and by opportunities for partnerships, rather than by uniform operational targets, set by ADB on a regional basis. The top-down target of 80% of operations in five core areas has in practice led to a consistent overemphasis on infrastructure to the detriment of non-core areas, which can be essential for development outcomes. A large number of country partners, moreover, have asked for increased support in the non-core areas of health, agriculture and integrated disaster risk management. ADB should move away from this target and the core or non-core distinction.

25. In addition, the current climate of constrained fiscal space in traditional donor countries has given new urgency to the quest for innovative partnerships and financing approaches, notably including the leveraging of private funds (Box 1).

¹⁹ IED. Forthcoming. *Thematic Evaluation Study: ADB Support for Strengthening the Enabling Environment for Private Sector Development*. Manila: ADB.

²⁰ IED. 2012. *Special Evaluation Study on Knowledge Products and Services: Building a Stronger Knowledge Institution*. Manila: ADB.

Box 1: Asia's Evolving Development Finance Landscape

The development financing landscape has drastically changed over the past 10 years. Since the 2002 Monterey Consensus on Development Financing, the importance of non-ODA flows has significantly increased. Non-ODA flows now account for more than 80% of resources flowing into developing countries, with two-thirds of those resources coming from the private sector, and the remaining one-third from other sources such as personal remittances and charitable foundations.

In the majority of middle-income countries, more than 50% of flows are non-ODA; in lower-income countries this is less than 20%. Moreover, new donors—such as Brazil, the People's Republic of China, India, Mexico, and South Africa—are emerging; these act on a more discretionary basis rather than through the pledged commitments typical of traditional donor countries. The importance of IFIs as development financiers is now decreasing, so their continued relevance must be manifested in different ways, notably by leveraging non-ODA funds and providing expert advisory and knowledge services.

IFI = international financial institution, ODA = official development assistance.

Source: Organisation for Economic Co-operation and Development. Resource Flows Beyond ODA in DAC Statistics. <http://www.oecd.org/dac/stats/beyond-oda.htm>

26. It is imperative to maintain skills in key operational areas, and deploy them effectively, yet the current organizational setup has led to a fragmentation of skills and knowledge, unclear mandates, and coordination challenges. A review of the organizational structure, including of the potential gains of decentralization, would be timely to address these issues and ensure that the appropriate talent is assigned in the right positions, at the right time.

27. Building on recent improvements, every effort is now needed to achieve (and surpass) the goal of 80% successful projects. The greatest effort should be directed to outcomes and sustainability, which are the criteria most relevant to impact. In sum, to deliver better results with limited resources, ADB needs to harness all its resources—including at headquarters and in countries, in public and private sectors, and whether focused on country or thematic work. The drive of ADB leadership to pursue greater development outcomes remains key; accountability for outcomes (rather than outputs) would be a far reaching change. An emphasis on knowledge building and sharing is a natural way to maximize development returns. These approaches can be underpinned by performance evaluation, recognition, and reward systems. A more detailed discussion on this is included in Chapter 6.

Building on recent improvements, every effort is now needed to achieve the goal of 80% successful projects

CHAPTER 2

Inclusive Growth

Economic growth in developing countries in Asia has been remarkable, but not inclusive

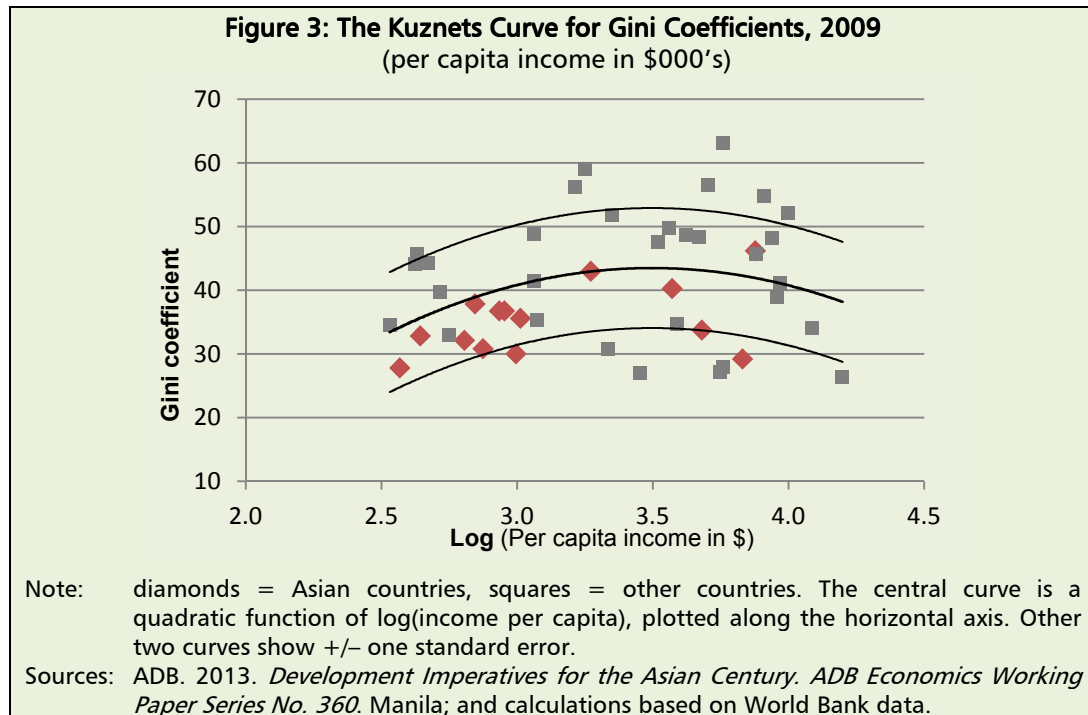
28. Economic growth in developing countries in Asia since the early 1990s has been remarkable, but not inclusive.²¹ Poverty, disparities, and other challenges remain pervasive. The region is still home to three-fifths of the world's undernourished and has the largest number of poor and deprived people. Inequality has grown across most parts of the region and is now more pronounced in Asia than in most other developing regions.²²

29. Persistent inequality can impede growth prospects and sustainability. Historical experience, as illustrated by Kuznets curve (Figure 3), suggests that income growth has correlated so far with lower inequality over time. However, this process may not necessarily continue; even if it does, it may come too late for many Asian countries, making the traditional sequencing of growing first then addressing negative externalities later highly risky.²³

²¹ This chapter draws heavily on findings from the ongoing IED study, IED. Forthcoming. *Thematic Evaluation Study: ADB's Support for Inclusive Growth*. Manila: ADB. Broadly defined, inclusive growth is growth with social equity, or a growth process in which all segments of the population can participate, especially the poor, and it concerns the impact of economic growth in reducing poverty and inequality, and broadening economic opportunity. This differs from pro-poor growth, which deals only with the effectiveness of growth in reducing poverty.

²² International Monetary Fund. 2013. *The Elusive Quest for Inclusive Growth: Growth, Poverty, and Inequality in Asia*. IMF Working Paper WP/13/152. Washington, DC.

²³ ADB. 2013. *Development Imperatives for the Asian Century*. ADB Economics Working Paper Series, No. 360. Manila.



30. Disparities in income distribution coexist with inequality in opportunities, in particular access to basic social services. Recent assessments of Asia's progress in achieving the MDGs find that while access to basic education has generally improved, access to health care, water and sanitation, safety nets, and employment opportunities still lags. These areas require greater attention and resources from countries and their development partners (footnote 13).

31. Recurrent economic shocks and natural disasters, threats to food security, a lack of jobs in the face of a rapidly growing labor force, and rapid urbanization are factors that will affect the region's ability to both grow and achieve greater inclusion. Furthermore, the region is also far from achieving gender equality, with women in many countries in Asia and the Pacific still facing wide deficits in education and health. In combination these challenges point to an even greater need to focus on inclusiveness—and for more effective support for this strategic agenda.

A. ADB's Response

32. Recognizing that poverty reduction is impacted by both the pace and pattern of growth, Strategy 2020 made inclusive growth an institutional priority, and provided a basic framework built on three mutually-reinforcing pillars: high, sustainable growth (pillar 1); broader access to opportunities (pillar 2); and social protection and safety nets (pillar 3). But implementing this agenda has been challenging. There has been confusion whether Strategy 2020 committed to supporting any of the pillars, or all of them. The framework provided no clear indicators or targets, making it difficult to incorporate inclusive growth elements into the project classification system and reflect these in the corporate results framework. Moreover, Strategy 2020's prioritization of five core operational areas²⁴—in the absence of clear targets for other areas—

*Strategy 2020
made inclusive
growth an
institutional
priority*

²⁴ Strategy 2020's five priority areas, which are to account for 80% of operations, are infrastructure, environment, regional cooperation and integration, finance sector development, and education.

effectively removed any priority for other areas, including health and social protection; this occurred despite the fact these areas are of critical importance, according to ADB's own inclusive growth framework. Within the five core operational areas, infrastructure, environment and regional operations are very broad in scope, and this has led to their crowding out the relatively limited and more defined areas of such as education and finance.

More attention to inequality is required 33. More attention to inequality within the inclusive growth agenda is required, given that inequality has risen in many countries. The original inclusive growth framework characterized a growth process as inclusive even where poverty is declining but inequality is rising, as in the PRC and India.

34. Recent efforts aim to address some of these challenges. In 2012, ADB added an indicator on inclusive growth (with three sub-indicators) to the results framework, enabling better monitoring of projects supporting inclusive growth. In 2013—5 years after adopting the inclusive growth agenda—ADB issued inclusive growth operational guidelines that present a more refined framework and give better guidance for staff. These guidelines do not suggest how much emphasis is to be given to each of the three indicators and the operations to which they refer, but state that progress on all three pillars is required for growth to be classified as inclusive, even while support will have to be selective, in line with its established priorities and resource base.²⁵

35. Nonetheless, the guidelines do clarify that ADB cannot exclusively support just any of the pillars in a particular context. Determining the emphasis among the three pillars should be driven mostly by the country context, which in turn requires sound inclusive growth diagnostics as part of program and country partnership strategy (CPS) design.

36. ADB has adopted numerous policies, plans, and guidelines since 2008, some of which clearly reflect—and try to support—the agenda. For example, the 2011 Financial Sector Operational Plan emphasizes financial inclusion through microfinance, rural financial institutions, and support to small and medium-sized enterprises (SMEs).²⁶ Appendix 2 lists major policies, plans and guidelines adopted since 2008.

37. More effort is needed to deepen and broaden inclusive growth analytics in country strategies. A review of recent CPS found their analyses of country progress and constraints placed more focus on growth (pillar 1), with limited analysis of broadening access to economic opportunities and providing adequate safety nets.²⁷ With the exception of the PRC, and to a lesser extent Mongolia and Tajikistan, articulations of inclusive growth in the seven countries covered by the ongoing evaluation primarily address growth and income poverty, but generally omit discussion of access to opportunities or safety nets.

38. The 2012 quality-at-entry (QAE) exercise found similar results in its sample of CPS adopted in 2010–2011. While it found most CPS *satisfactory* in their promotion of inclusion, this was based on more general commitments to sustainable growth and employment generation. The QAE found that most CPS: (i) did not clearly address social protection, direct health care services, safety nets, or access to assets; and (ii) did not

²⁵ ADB. 2013. *Guidelines on Inclusive Economic Growth in the Country Partnership Strategy*. Manila.

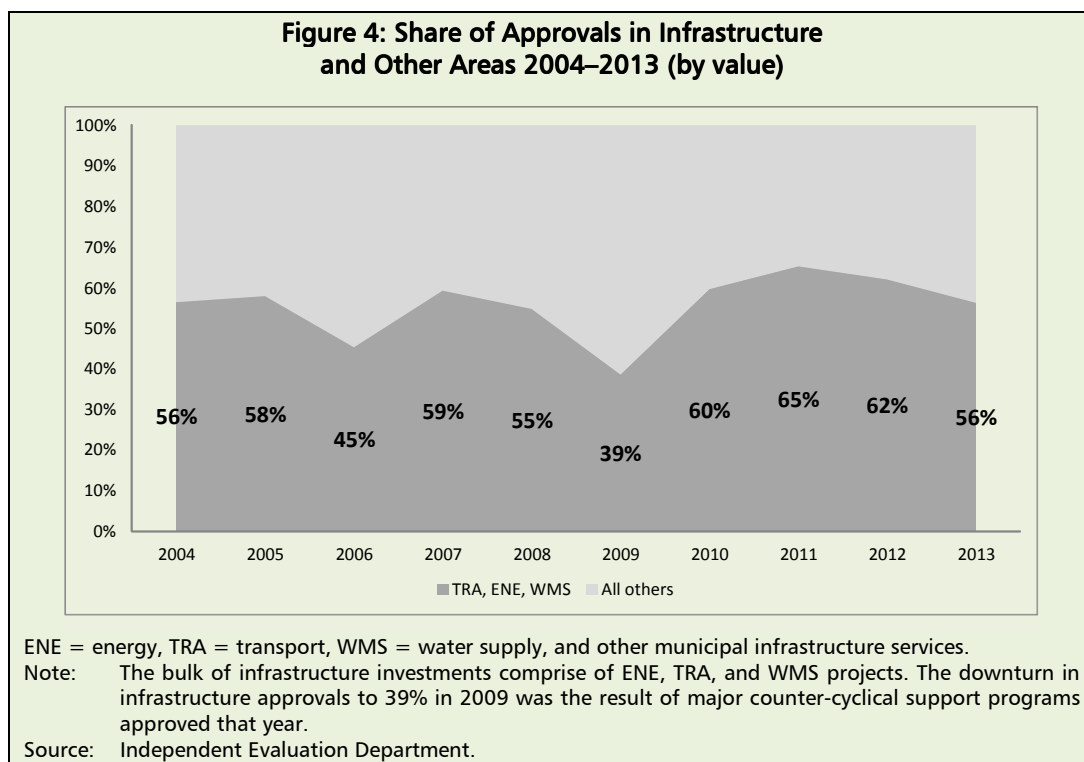
²⁶ ADB. 2011. *Financial Sector Operational Plan*. Manila.

²⁷ Conducted in connection with IED's ongoing inclusive growth evaluation

always indicate whether these areas were adequately supported by other development partners.

39. Operationally, the adoption of the inclusive growth agenda in 2008 made virtually no difference in project approvals and the portfolio. ADB was to support inclusive growth primarily through operations in infrastructure, education, and other essential services such as water and sanitation. But a review of loan approvals shows no major distributional change going back over a decade. Approvals have remained concentrated in infrastructure—primarily transport, energy, and water supply and other municipal infrastructure services—which together accounted for an average of 55% of the portfolio during 2004–2008, and 56% during 2009–2013 (Figure 4). ADB estimates that infrastructure alone (across all sectors) made up some 67% of approvals in 2003–2007, and increased to 72% during 2008–2012.²⁸ While infrastructure can promote inclusive growth, this cannot automatically be presumed (Box 2).

While infrastructure can promote inclusive growth, this cannot automatically be presumed



40. For infrastructure, given limited resources, the choice of projects should be based on maximizing impacts in terms of job creation, poverty reduction, and increasing people’s livelihoods. There should also be a concentration of other projects and/or programs focused in the same area so that the impact of the connectivity is felt.

²⁸ ADB. 2013. *Strategy 2020: Implementation Progress 2008–2012*. Manila.

Box 2: Inclusive Impacts of Infrastructure

Infrastructure is essential for development; during 2008-2012 ADB committed \$47 billion, or nearly three-fourths of the total loan resources of \$65 billion, to infrastructure projects. Transport, energy, water, sanitation, and other basic services and facilities enable social and economic progress, and it is fairly well established that physical investments in these areas can promote inclusive growth. This occurs through the creation of jobs, expansion of economic activity, improvements in connectivity, and other means.

But infrastructure investment cannot automatically be presumed to promote inclusive growth. Different types of infrastructure have varying effects on growth and poverty reduction, as borne out by many years of evidence from evaluations. Some infrastructure projects can expand access but have little impact on income or vulnerabilities. Railways and toll roads, for instance, can help connect major urban areas and spur overall economic growth, but they may not directly improve education and health opportunities or support livelihoods for the poor.

On the other hand, some infrastructure has generally stronger, more direct inclusiveness impacts. For example, rural roads often have direct effects on the poor. Highways with labor-intensive construction and inclusion of complementary rural access roads also show greater inclusion impacts. In island countries, inter-island shipping (the equivalent of rural roads) is also considered more inclusive.

Empirical evidence suggests that infrastructure has its greatest inclusion impacts when combined with complementary investments and activities, including those to support capacity building, policies, and institutions. Maximizing the inclusiveness of infrastructure investments, therefore, requires careful attention to project design and complementary investments, based on sound sector and country diagnostics.

ADB = Asian Development Bank.

Sources: ADB. 2012. *Infrastructure for Supporting Inclusive Growth and Poverty Reduction in Asia*. Manila; ADB. 2010. *ADB's Contribution to Inclusive Growth in Transport and Energy Projects*. Manila; and IED. Forthcoming. *Thematic Evaluation Study: ADB's Support for Inclusive Growth*. Manila: ADB.

41. Across the three pillars, ADB estimates that about 62% of resources have supported the growth pillar during 2008–2012. Meanwhile, support for pillar 2 (access to opportunities) through sectors that more directly promote social inclusion remained limited, and declined in some cases. Support to education, health, and agriculture now each represent only 2%–3% of approvals, with education (a core operational area) and health allocations falling slightly over the 2003-2007 to 2008-2012 periods. Support to the finance sector (which includes support for financial inclusion) declined from 13% of approvals during 2003–2007 to 8% during 2008–2012.

Support to social protection represented just 1% of loan approvals

42. Support to social protection and safety nets (pillar 3) represented just 1% of loan approvals over 2008–2012, based on ADB estimates. An evaluation of ADB's implementation of the 2001 Social Protection Strategy found support during 2002-2011 limited (except in crisis periods), with stand-alone social protection projects making up just 2.5% of approvals over the decade.²⁹ ADB adopted the strategy in the

²⁹ IED. 2012. *Special Evaluation Study: ADB Social Protection Strategy 2001*. Manila: ADB. The evaluation classified interventions as stand-alone if they had a clear, principal focus on one or more of the five major

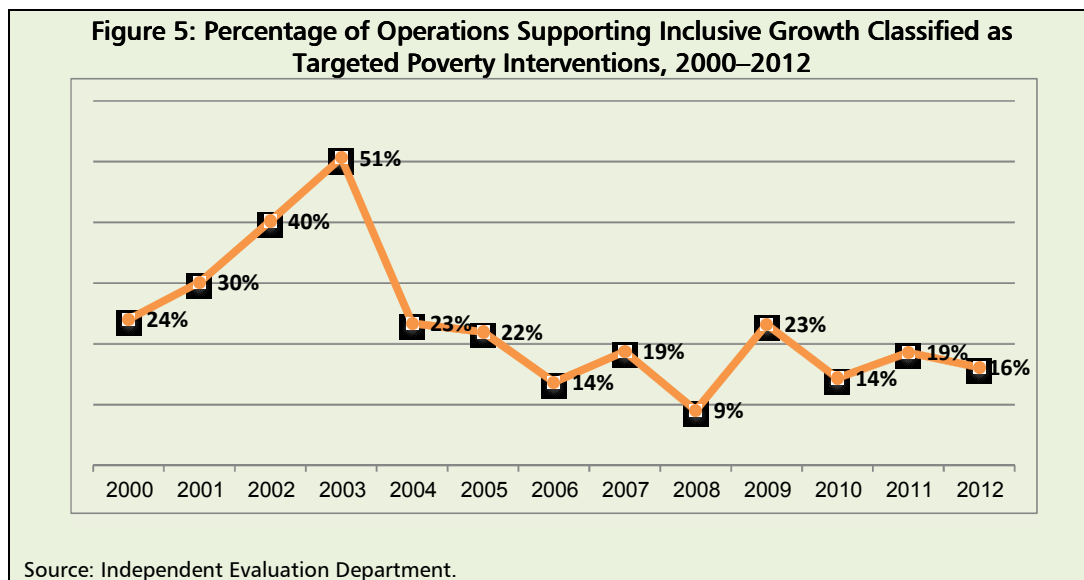
aftermath of the Asian Financial Crisis, which exposed weaknesses in social protection programs across Asia. With the strategy, ADB pledged to strengthen social protection programs during non-crisis years to better prepare countries for future shocks. While the evaluation found evidence of this happening in some cases, overall follow-through on this commitment was weak. The recent round of crises in 2008–2010 delivered a hard lesson, re-exposing weaknesses in social protection systems and again highlighting the need for greater ADB attention to this area.

43. While the overall composition of the portfolio has remained largely unchanged, the proportion of operations classified by ADB as targeted (versus general) poverty interventions has declined steadily during 2003–2013, based on IED analysis of ADB project classifications.³⁰ The ongoing evaluation of inclusive growth finds that by amount, targeted interventions comprised only 21% of total operations supporting inclusive growth during 2000–2012. From 2000 to 2003, the share of targeted interventions in inclusive growth operations rose sharply, peaking in 2003 when more than half of projects supporting inclusive growth fell into this category (Figure 5). This was triggered by the introduction of the Poverty Reduction Strategy and its 40% target of lending for poverty interventions. The introduction of the Enhanced Poverty Reduction Strategy in 2004 appeared to reverse this trend, with targeted interventions declining sharply to 23% in 2004 and remaining low since then.

The overall composition of the portfolio has remained largely unchanged

44. This steady decline in targeted interventions is cause for some concern, in that it suggests a diminishing pro-poor focus of investments over time. Thus, the poverty focus of the inclusive growth agenda may have fallen rather than increased after adoption of Strategy 2020. While ADB is not focused on eradicating extreme poverty, it can make an effort to ensure that those just below and above the poverty line can capture the benefits of its interventions. ADB’s stated focus under Strategy 2020 shifted from pro-poor growth to inclusive growth, but a crucial question is whether the shift was to inclusive growth, or in practice to just growth.

The poverty focus of the inclusive growth agenda may have fallen rather than increased



social protection categories: social assistance; social insurance; labor market; child protection; and micro/area-based schemes, focused mostly on one of more areas of social protection.

³⁰ Targeted interventions: (i) support poverty reduction (under the category poverty interventions in the Poverty Reduction Strategy), (ii) are located in areas with high concentrations of the poor, or (iii) support achievement of the non-income MDGs.

45. The response of the Private Sector Operations Department (PSOD) to the inclusive growth agenda can be strengthened, as found in a recently completed evaluation.³¹ ADB can pay more systematic attention to increasing the inclusiveness of PSO, given evidence that such a focus need not undermine profitability (see Chapter 4 for more details). The share of PSOD transactions that seek to directly benefit the poor, rural populations, or women has remained at 13% of total approvals since approval of Strategy 2020, despite growth in the non-sovereign portfolio.

46. Few projects sought to increase access to infrastructure, health, and education services for poor or rural populations. Compared with some other multilateral development banks, PSOD has yet to make concerted efforts to promote inclusive businesses, i.e., companies and projects that offer goods, services, and livelihoods to income groups at the bottom of the pyramid (including the poor, the vulnerable, and low-income groups) in ways that can be expanded in scale. Moreover, PSOD had limited operations in poor and economically disadvantaged regions of non-frontier markets and countries.

The penetration of microfinance among the poor remains low

47. IED's 2012 microfinance evaluation found operations *less than effective* in achieving results.³² Support concentrated on developing the policy environment and addressing supply side constraints to sector growth, with less focus on demand-side issues, such as developing the capacity of the poor to access and use financial services, in order to make microfinance more inclusive and effective for the poor. Support for pro-poor innovative products and delivery models was limited, with little attention to the social performance of microfinance operations. As a result, the penetration of microfinance among the poor remains low (para. 99). Meanwhile, PSOD's dedicated microfinance operations were mostly effective in increasing access to finance for the poor, rural areas, and women.

B. Recommendations

48. Changes that have taken place during 2009–2013, in combination with the outlook for Asia, suggest that a focus on inclusion will remain vitally important for the region. As the region's premier development bank, and in seeking to deliver better on the *triple bottom line*, ADB should support this agenda with increased vigor and effort. Importantly, ADB could aim to increase inclusion across its sovereign and non-sovereign operations in all sectors. A clear and monitored focus needs to be given to including the poor (say, the lower 40% of the income distribution) in the results of operations. This requires ADB to strive for a more balanced portfolio of infrastructure and social and environmental sector projects to deliver inclusive outcomes, with better balance across the three pillars. It also requires more attention in project design. All projects, regardless of their sector, can contribute (more or less) to inclusive growth. This requires careful ex ante assessment to determine how the project design can maximize poverty and inclusiveness impacts, as well as identification of complementary interventions to help achieve these outcomes.

49. Moreover, inclusive growth is a means for achieving the overarching objective of poverty reduction. Inclusive growth involves all segments of the population, including the poor. A shift to inclusive growth also requires a concern for inequality,

³¹ IED. 2013. *Thematic Evaluation Study: ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth*. Manila: ADB.

³² IED. 2012. *Special Evaluation Study: Microfinance Development Strategy 2000. Sector Performance and Client Welfare*. Manila: ADB.

and consideration of income and non-income dimensions of poverty. To strengthen ADB's delivery on the inclusive growth agenda, the ongoing evaluation makes the following recommendations.

50. A simultaneous focus on poverty and inequality in ADB's inclusive growth framework has become more necessary given Asia's changing socioeconomic landscape. Strategy 2020 was formulated amid optimism regarding the region's progress in reducing poverty. However, gains (in terms of rapid growth and poverty reduction) are now at risk, as a result of the impact of the food and financial crises that began in 2008, and other shocks. More importantly, inequality is rising in many countries, increasing the vulnerability of the poor and other marginalized groups. ADB should tailor its support to particular country needs, but rising inequality across Asia and the lag in social protection system development requires an increase in ADB support for pillars 2 and 3.

Rising inequality and the lag in social protection requires an increase in support for pillars 2 and 3

51. Constraints to and opportunities for inclusive growth vary among economies. Strategy 2020's 80:20 allocation of support for core and noncore operations may in some cases undermine efforts to address inclusive growth, because of the observed crowding-out effect. Infrastructure, which makes up the bulk of the core areas of ADB operations, can contribute to inclusive growth, but other areas of operations are more directly linked to inclusive growth and the reduction of inequality. Accordingly, ADB should base its allocation of support for inclusive growth in significant part on specific country contexts, instead of distributing support between core and noncore areas according to a fixed formula.

52. Projects geared to promoting high growth can contribute to inclusive growth if they are designed with a clear objective of directly benefiting lower-income groups. For example, infrastructure projects that connect poor and better-off areas, or roads that connect rural areas to markets and urban hubs can promote inclusiveness. A stronger connection between strategic objectives and project design and implementation in this respect is needed.

53. Country teams need to play a much bigger role in synergizing ADB's country programs with government programs and the programs of development partners. Selectivity in areas of operations, while valuable in some respects, weakens their impact if the complementary programs not undertaken by ADB are also not supported by others. For example, an ADB-supported road project could promote inclusiveness if it is part of a plan that also addresses schools and healthcare centers in the same area, and receives special support from the government and other development partners. Further strengthening ADB's capacity for developing, facilitating, and monitoring synergies with complementary programs and projects of other donors is imperative.

54. There is a pressing need for ADB to improve the quality of inclusive growth analysis in CPS, as this will guide country operations. Although the staff guidelines incorporate a set of indicators to monitor inclusive growth, these do not include targets at the country level. Country teams must be encouraged to adopt country-level targets for inclusive growth indicators to help improve outcomes.

Box 3: Inclusive Pillar 1 Projects

Independent Evaluation Department evaluations and validations provide good examples of projects, focused primarily on infrastructure that had notable inclusive impacts, specifically in terms of directly benefitting poor, vulnerable, and marginalized communities. These examples are diverse in terms of size, sector, and focus, but they share at least two common features: (i) they were purposely designed with the objective of improving the welfare of certain poor and/or vulnerable groups; and (ii) they were generally well executed, including through collaboration with partners.

Transport infrastructure. The Bangladesh Jamuna Bridge Project provides a good example of a pillar 1 intervention that promoted inclusiveness. The bridge connected the eastern and western halves of the country, improving the flow of goods and people and spurring economic growth. The bridge brought access to the poorer western side of the country, integrating it into the larger economy, and generating new economic opportunities for the poor.

Energy infrastructure. The Lao People's Democratic Republic Northern Area Rural Power Distribution Project achieved its electrification targets, improving access to and reducing the cost of basic electricity for poor households. The project connected 32,830 new households in 570 northern area villages.

Telecommunications infrastructure. Several ADB investments in Afghanistan, Bangladesh, and Papua New Guinea have demonstrated both strong commercial viability and social impacts by making mobile communication more accessible and affordable for rural and low-income populations. Box 5 in Chapter 4 provides details on the project in Bangladesh.

Rural community development. Several infrastructure-related projects that focus on rural community development stand out as highly inclusive, including the Indonesia Rural Infrastructure Support Project. The project improved access to basic infrastructure and services for some 2 million people in 1,840 villages. The project improved road access to markets, water supply and irrigation facilities, supply of basic goods, and access to education and public services, with project activities generating 2,700 person-days of employment per village.

ADB = Asian Development Bank, Lao PDR = Lao People's Democratic Republic.

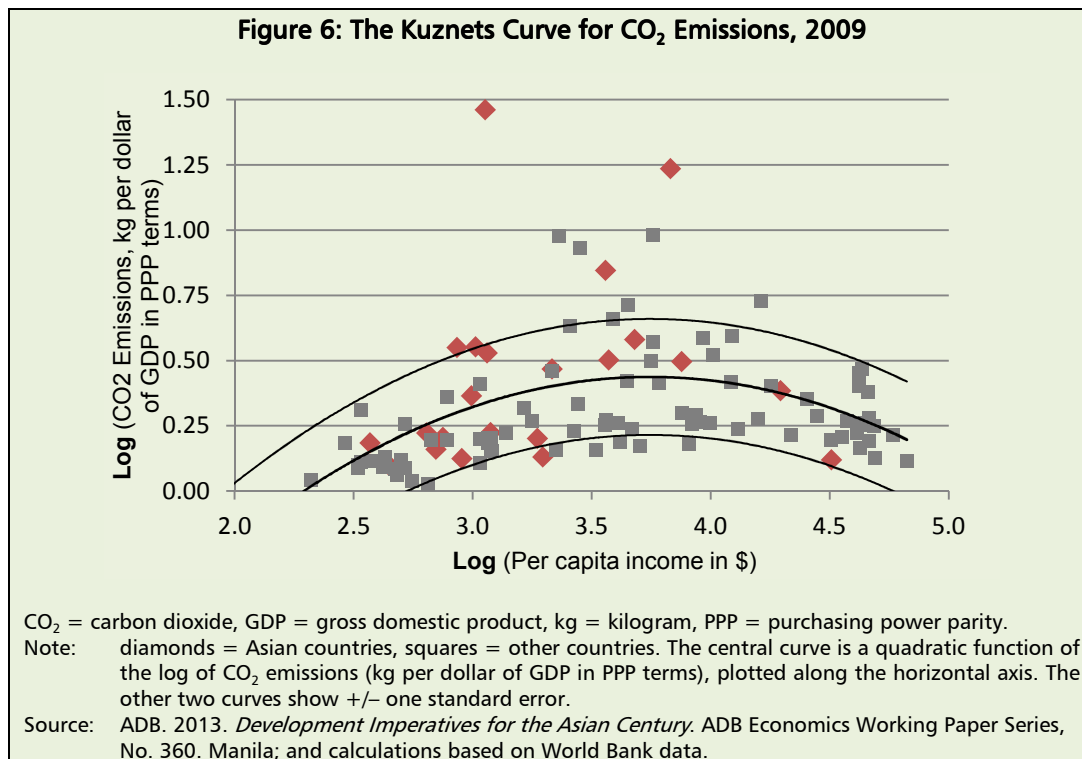
Sources: IED. Forthcoming. *Thematic Evaluation Study: ADB's Support for Inclusive Growth*. Manila: ADB; IED. 2012. *Validation Report: Rural Infrastructure Support Project in Indonesia*. Manila: ADB; IED.

2012. *Validation Report: Northern Area Rural Power Distribution Project in Lao People's Democratic Republic*. Manila: ADB.

Environmentally Sustainable Growth

55. Asia has witnessed exceptional economic growth, but key environmental conditions have deteriorated. Climate change has become an immediate threat for the region. Historical data indicate that negative environmental externalities associated with earlier stages of (rapid) economic growth tend to be smoothed out in the long term, as suggested by the Kuznets curve (Figure 6). Unfortunately, the Kuznets relationship provides little hope that, in the absence of deliberate actions, these negative trends will be reversed before the region confronts unforgiving environmental constraints. For Asia and the Pacific region, this situation makes a policy response that prioritizes growth while delaying consideration of mitigating environmental externalities perilous.³³

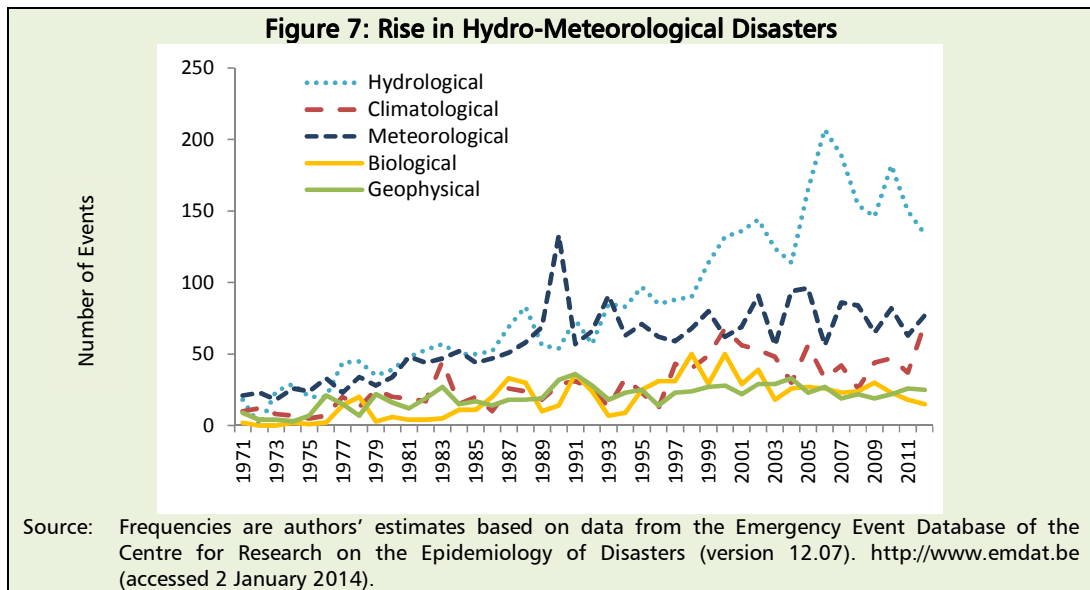
Environmental conditions have deteriorated



³³ The Environmentally Sustainable Growth agenda covers the mitigation of negative environmental externalities, climate change mitigation and adaptation, and disaster risk management.

Investing in sustainable growth and adapting to climate change must be viewed as benefits to growth

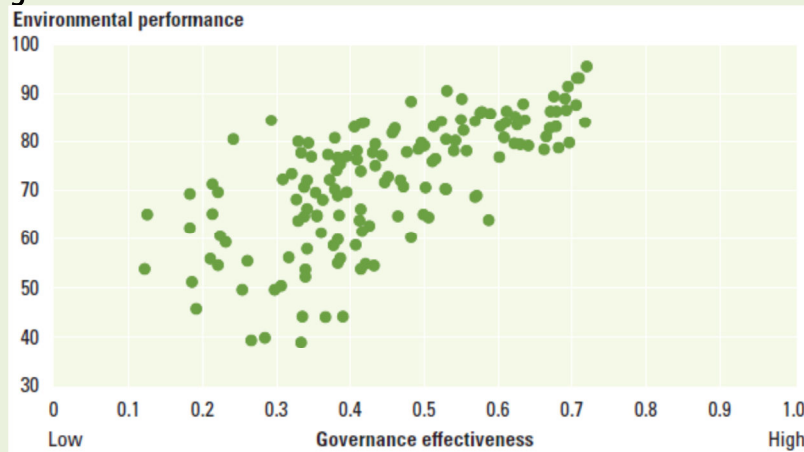
56. In recent years, countries in Asia and the Pacific have shown the highest vulnerability worldwide to climate-related disasters; hydro-meteorological disasters in Asia and the Pacific quadrupled over the last 4 decades (Figure 7). ADB estimates that the economic cost for Southeast Asia of not mitigating and adapting to climate change could be equivalent to a loss of 6.7% of gross domestic product per year by 2100—twice the world average.³⁴ Climate change is, indeed, a game changer, and addressing the causes and managing the risks associated with climate change are central to sustained economic growth. Investing in sustainable growth and mitigating and adapting to climate change must be viewed as benefits of or contributors to growth, rather than as costs of, or detractors from growth.



57. The heavy burden of environmental destruction in Asia and the Pacific is understood and even appreciated to a considerable extent. Nevertheless, just as in many other parts of the world, there is little action. The most likely reason may be governance, which is a key driver of change in boosting environmental performance (Figure 8). Many governments across Asia and the Pacific have established policy, legal, and institutional frameworks to promote sustainable development. Most countries are parties to major multilateral environmental agreements. However, as noted in the recently issued environment operational directions,³⁵ even in cases where policy frameworks are adequate, actual reforms and implementation often do not materialize as a result of limited institutional capacity, lack of technical expertise, insufficient funding, and fragmented institutional arrangements, in addition to vested interests and the lack of true motivation to act.

³⁴ ADB. 2009. *The Economics of Climate Change in Southeast Asia: A Regional Review*. Manila.

³⁵ ADB. 2013. *Environment Operational Directions 2013–2020: Promoting Transitions to Green Growth in Asia and the Pacific*. Manila.

Figure 8: Government Effectiveness versus Environmental Performance

Note: Environmental performance is measured by the environmental performance index. The Environmental Performance Index (EPI) ranks how well countries perform on high-priority environmental issues in two broad policy areas: protection of human health from environmental harm and protection of ecosystems. Government effectiveness is an indicator of the capacity of governments to effectively formulate and implement sound policies.

Source: World Bank. 2010. *World Development Report 2010*. Washington, DC.

A. ADB's Response

58. Strategy 2020, in its written presentations, recognizes that environmental degradation and the disastrous effects of climate change are key challenges for the region. Unless approaches to economic growth are altered to address the destruction of natural resources and pollution, the region's prospects for strong and sustained growth are in jeopardy. Strategy 2020 also states that only environmentally sustainable growth can effectively contribute to poverty reduction, because many of the poor depend on natural resources for their livelihood. What is crucial, however, is how ADB's stated commitment to environmentally sustainable growth is translated into operations.

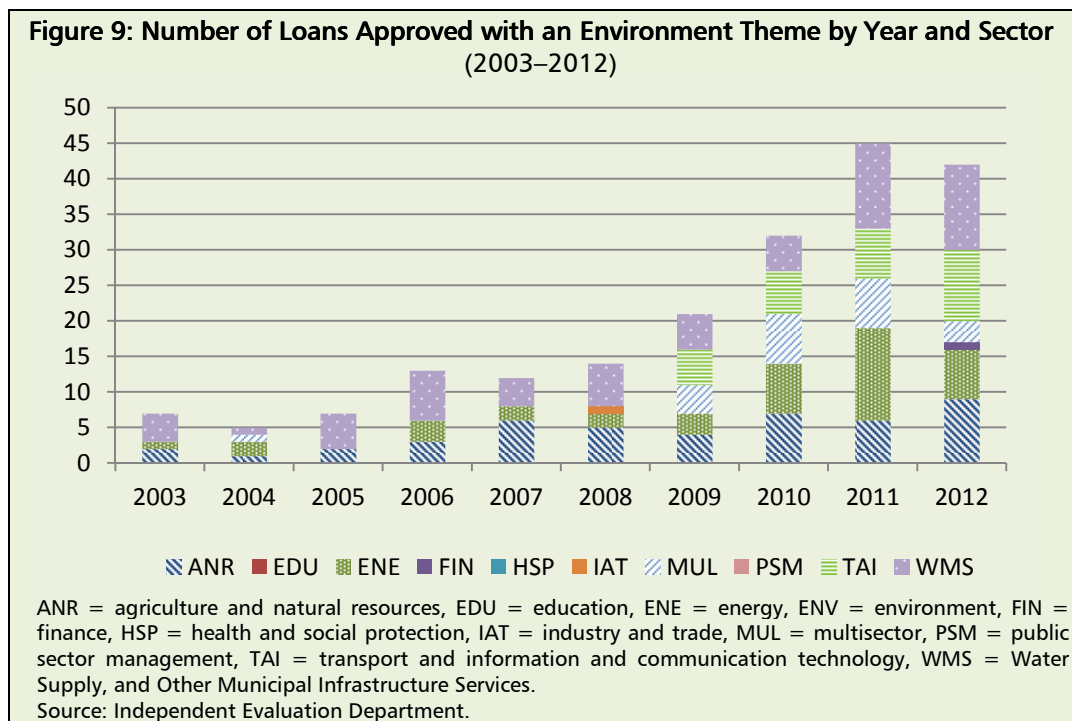
59. Evaluations refer to three areas where the commitment can be assessed in terms of actions (if not impact): (i) support for climate change mitigation and adaptation; (ii) reducing the carbon footprint of Asia's cities; and (iii) strengthening environmental regulation and management, including through knowledge transfer. Discernible progress has been made in terms of increasing operational focus in these areas.

60. A review undertaken for this report examined selected CPS approved during 2001–2011; it reveals an increasing emphasis on addressing environmental concerns.³⁶ At the country level, the focus reflects varying country needs or conditions (e.g., coastal zone management, fisheries, urban air quality, and urban transport). From 2005 onwards, there has been an increased attention to renewable energy sources, energy conservation, and energy efficiency, as shown by an increase in projects tagged for environmental sustainability in the Results Framework.³⁷ As illustrated in Figure 9,

³⁶ The PRC, India, Nepal, the Pacific region, Pakistan, and Viet Nam

³⁷ ADB. 2013. *Development Effectiveness Review 2012 Report*. Manila.

the number of projects with environmental sustainability as a theme tripled during 2003–2012. The distribution across sectors has also become more balanced.



61. ADB supported 234 climate change investment projects during 2009–2012.³⁸ More than 80% of ADB's climate change mitigation efforts are focused on clean energy; support to mitigation in agriculture, forestry, and land-use sectors has been limited. The Energy Efficiency Initiative, launched in 2005, set a target of increasing ADB support to clean energy projects to \$1 billion per year during 2008–2012. This target was achieved and subsequently raised to \$2 billion for 2013; this target has also been achieved. Despite the difficulties in tracking the climate change portfolio, a significant part is now seen to support climate change mitigation or adaptation.

62. Two crucial issues emerge, however: (i) whether the attention—even taking into account the increase in projects that support environmental sustainability—is commensurate with the need and what is called for in Strategy 2020; and (ii) whether project results are adequate, or simply label projects as supportive of environmental sustainability.³⁹ A 2011 evaluation suggested that further progress could be made by providing insights from energy efficiency improvements in major energy-using sectors, such as industry and buildings, and through enhanced awareness within ADB of innovative modalities (e.g., energy service companies and guarantee funds).⁴⁰ The evaluation of ADB support for the MDGs pointed out that while ADB has increasingly supported MDG7, action remained minimal in comparison with the size of the problem, and follow up was limited (footnote 13).

³⁸ IED. Forthcoming. *Thematic Evaluation Study: ADB Support for Climate Change Adaptation and Mitigation*. Manila: ADB.

³⁹ Assessment of this issue is hampered by weaknesses in the systematic monitoring on environmental sustainability, and the resulting lack of data.

⁴⁰ IED. 2011. *Review of Energy Efficiency Interventions*. Manila: ADB.

63. For example, while ADB has sharply increased efforts to reduce carbon dioxide (CO₂) emissions through cleaner, more efficient energy operations, CO₂ emissions in Asia continue to rise, and progress in meeting the target relating to CO₂ emissions lags behind that for any other MDG target. East Asia alone accounts for 30% of global energy-related CO₂ emissions. A 2009 evaluation showed ADB how to monitor and eventually reduce the greenhouse gas emission intensity of its energy operations by preparing a consistent framework to identify projects with significant greenhouse gas impacts or savings.⁴¹ ADB has also given attention to clean water production and distribution, but as of 2011, 17 countries have not met their safe water targets; in 9 countries more than a third of the rural population has no access to safe water; while in 17 countries (including the PRC, India, and Indonesia) more than a third of the population has no access to improved sanitation.⁴²

64. There is a need both for greater effort, and for obtaining results from the focus on sustainability. ADB (and other organizations) have weak records in tracking results on the environment, and evaluation is handicapped in assessing the degree to which results accrue from increased effort, inadequate though it may be. Project evaluations suggest areas that can be singled out, and that could contribute to better results.

65. First, it must be recognized that the environment is a cross-cutting theme, and that environmentally sustainable growth requires that attention be given to operations in various sectors, and by various actors. Environmental sustainability has been integral to ADB operations beginning in the early 1970s. Four sectors stand out in the context of MDG7, both in terms of the number of projects and volume of approval: (i) water and other municipal infrastructure services, (ii) agriculture and natural resources, (iii) energy, and (iv) multisector operations. Evaluations point to the need for stronger linkages among these areas in terms of identifying opportunities for obtaining environmental results. Benefits will be realized through far greater collaboration across these areas, and integration of their expected impacts within CPS.

66. Second, crucial gaps must be addressed. Energy operations have been increasingly directed towards energy efficiency and clean energy, and a similar transition is required in transport, with far more emphasis on climate proofing, urban transport investment, and railways. The Transport Emissions Evaluation Model for Projects was developed as part of a 2010 evaluation.⁴³ The model measures carbon emissions during project construction and implementation stages. While several other financial institutions have begun using the model, ADB has yet to fully embrace it. Box 4 highlights a sustainable transport model that mitigates against climate change by providing a high-quality public service alternative to private motorization.

Energy operations have been directed towards energy efficiency and clean energy, and a similar transition is required in transport

⁴¹ IED. 2009. *Evaluation Knowledge Brief on Greenhouse Gas Implications of ADB's Energy Sector Operations*. Manila: ADB.

⁴² ADB. 2013. *ADB Key Indicators 2013*. Manila.

⁴³ IED. 2010. *Evaluation Knowledge Brief on Reducing Carbon Emissions from Transport Projects*. Manila: ADB.

Box 4: Sustainable Transport

ADB's Sustainable Transport Initiative, with an operational plan approved in 2010 (Appendix 2), recognizes the importance of maintenance as part of developing a transport system that is accessible, safe, environment-friendly, and affordable. While preparing a shift toward rail and urban transport, the initiative intends to provide more support for asset management and road maintenance through programs that help improve the systems for selecting, implementing, and financing road maintenance. The plan needs diligent implementation across operations departments, with policy dialogue on the increasing cost of roads in view of climate change.

An effective and efficient public transport system is the cornerstone of creating a viable alternative to increasing private motorization. BRT represents a new mass transit option that provides high-level service at a fraction of the cost of other traditional options. BRT is proving to be a means for cities to join the ranks of quality public transport.

In 2013, the ADB-financed BRT system in Lanzhou (PRC) was inaugurated with passenger services.^a The system represents a milestone for ADB, as its first operational urban public transport system that featured application of the Clean Development Mechanism. The initial investment supported a 12.5 kilometer BRT corridor with 19 stations. A complementary investment in bicycle lanes further enhanced accessibility and enabled an integrated approach.

The system has also supported integration with land use and urban development, as the corridor connects Lanzhou to the community of Anning, which is being developed as a second city center. Already commercial development, both along and underneath the stations, has been catalyzed by the project. Lanzhou's success is now being replicated elsewhere with new BRT systems being financed by ADB in Davao (Philippines), Dhaka (Bangladesh), Hubei Yichang (PRC), Jiangxi Fuzhou (PRC), Jiangxi Ji'an (PRC), and Ulaanbaatar (Mongolia).

ADB = Asian Development Bank, BRT = bus rapid transit, PRC = People's Republic of China.

Note: ^a Case study provided by the Transport Community of Practice.

Sources: Independent Evaluation Department. 2013. *Annual Evaluation Report 2013*. Manila: ADB; and inputs from the Transport Community of Practice.

67. Of the seven MDG targets, the biggest challenges to ADB and the region are related to CO₂ emissions reductions, access to improved sanitation, and forest cover. Only 51% of ADB's programmed sanitation outputs for 2009–2012 were expected to be delivered by the end of 2012, the lowest among Level 2 targeted outputs included in ADB's results framework. Also, ADB largely withdrew from operating in forestry in the early 2000s. Renewed country interest in the sector, resulting from climate change among other things, is a reminder of its crucial importance for the region and ADB.

**Support for
climate change
adaptation
remains modest**

68. Furthermore, an ongoing evaluation (footnote 38) finds that support for climate change adaptation, which began in 2009, remains modest—estimated at about \$764 million in 2011, and \$895 million in 2012. In line with ADB's overall investment portfolio (72% of which is for infrastructure components), climate change adaptation interventions are concentrated in climate proofing of infrastructure projects. Of the 100 approved investment projects that were classified as climate change adaptation projects during 2009–2012, at least 49 included some infrastructure climate proofing measures, and in 81 the majority of the investment was for infrastructure. This is in line

with a previous IED finding of an unmistakable shift towards infrastructure, with over 80% of total project financing going to energy.⁴⁴ At least 54 of the 100 investment projects mentioned above included some form of non-infrastructure climate resilience-building measures. Climate resilience-building is addressed through one or more of measures that:

- (i) address drivers of vulnerability (8 projects);
- (ii) increase resilience to climate extremes (floods, droughts, storm surges) and erosion (12 projects);
- (iii) strengthen agricultural support services (5 projects); and,
- (iv) support capacity development (25 projects).

69. Five projects also included a response to damage from natural hazards through rehabilitation of infrastructure to reconnect to markets and re-establish water supplies.

70. The recent devastating natural disasters in the PRC, India, Pakistan, the Philippines, Thailand, and elsewhere underscore the urgent need for ADB to help build disaster risk management (DRM) capacity. ADB has a record in this area, and its disaster recovery projects have often been more successful than projects overall. But many disaster recovery projects to date were mainly concerned with the limited objective of restoring particular types of infrastructure in the affected areas, rather than rehabilitating livelihoods, or increasing disaster resilience by *building-back-better*.⁴⁵ The needed shift in focus to prevention and preparedness will have increasing appeal to countries in view of the frequency of the disasters they have faced.

71. A recent evaluation of ADB's response to natural disasters found that, with the exception of Bangladesh, Nepal and the Pacific countries, most country programs have not treated the growing frequency of natural disasters as a systemic risk to sustained economic growth, and do not systematically include disaster risk reduction measures.⁴⁶ ADB is more reactive than pro-active in focusing on creating awareness through policy dialogue with country clients and technical advisory services.

Most country programs have not treated natural disasters as a systemic risk to sustained growth

72. Independent evaluation, therefore, stressed the: (i) preparation of a natural disaster vulnerability assessment for vulnerable countries, (ii) adoption of an integrated approach to DRM, beyond infrastructure rehabilitation, (iii) strengthening of partnerships with other development partners in this area, (iv) integration of climate change and natural disaster activities, and (v) further development of risk finance insurance options for the region. Follow-up on these recommendations is beginning, including through the revised draft DRM Action Plan.

73. The Climate Change Fund, financed from ADB's internal resources and managed by ADB, leveraged no external financing. The Clean Energy Financing Partnership Facility and the Climate Change Fund enabled a large number of applicants to avail of these funds, but provided little experience to ADB staff in seeking climate financing from externally managed climate funds.⁴⁷

⁴⁴ IED. 2012. *Annual Evaluation Review*. Manila: ADB.

⁴⁵ Notable exceptions include the post-tsunami support in Aceh, Indonesia, and the post-earthquake support in Gujarat, India (both financed by the Japanese Fund for Poverty Reduction).

⁴⁶ IED. 2012. *Special Evaluation Study: ADB's Response to Natural Disasters and Disaster Risk*. Manila: ADB.

⁴⁷ The Climate Change Fund is reported to have leveraged: (i) nearly 8 times the funds it allocated for carbon emission savings, (ii) 49 times the funds it allocated for reduced emissions from deforestation and forest degradation (REDD+) and land use, and (iii) over 90 times the amount it allocated for climate change

B. Recommendations

The urgency of sustainable growth is heightened by environmental degradation and climate-related disasters

74. The urgency of environmentally sustainable growth is heightened by environmental degradation and the frequency of climate-related disasters, which have worsened since the adoption of Strategy 2020. Overall, the problems far outpace the response from the region and ADB. There has been an appropriate increase in climate investments in the ADB energy portfolio, but a similar increase has not taken place in the transport portfolio. The recent evaluation of ADB's support for the MDGs—particularly MDG7—showed much room for further action.

75. Pursuing environmentally sustainable growth represents a benefit to growth, rather than a cost to development. This imperative must be much better integrated into ADB operations. As a regional public institution, ADB has a key responsibility to contribute to a cleaner development path, and in doing so, can contribute significant added value. The renewed stress on inclusive growth and the imperative of ensuring environmental sustainability is best met by ADB adoption of a *triple bottom line*, which will help align ADB's commitment to the post-2015 development agenda and emerging sustainable development goals.

ADB must make a far-reaching contribution to environmental sustainability and climate change mitigation and adaptation

76. Given the institution's focus on infrastructure and the region's extreme vulnerability to climate disasters, ADB must make a far-reaching operational contribution to promotion of environmental sustainability, and climate change adaptation and mitigation, in part by tapping the vast climate funds. Specifically, we flag the following areas for action.

77. Implementing a *triple bottom line* requires strong environmental governance, which is lacking in many countries; ADB support for environmental governance is vital, and in keeping with its overall commitment to supporting strengthened governance in the region. In providing such support ADB should recognize: (i) the need to seek and exploit opportunities for incremental progress; (ii) that sector governance enhancement is a continuing, long-term process; and (iii) the need for a solid understanding of the local governance context as the basis for support.

78. Climate change mitigation and adaptation are an essential part of the paradigm shift to a *triple bottom line* policy response. Addressing environmental degradation and disasters can reduce the impact of shocks. An ongoing evaluation (footnote 38) indicates that ADB is well-positioned to increase its role as a knowledge broker on climate change. Critical issues where state of the art knowledge is required include carbon sequestration, tradeoffs and linkages between climate change mitigation and adaptation; overlaps and connections between adaptation and DRM; sustainable food, energy and water security; and urban development. There also needs to be far greater motivation to leverage non-ADB funds to finance climate change needs.

79. The evaluation of ADB's response to natural disasters and disaster risk concluded that natural disasters are in part a consequence of increased population, poverty, and climate change, and that support for natural disaster management is

adaptation. These figures, however, refer to ADB's normal sources of financing TA and investment projects only (i.e., ordinary capital resources, Asian Development Fund, other TA resources, and other ADB-administered climate funds). The Climate Change Fund was not used to leverage any externally managed climate funds.

insufficient and needs to be increased. The ongoing study on climate change-related operations is strengthening this conclusion with respect to climate change adaptation—going beyond energy efficiency gains and renewable energy sources to include governance, regulatory changes, and community development. Disaster risk prevention and management need to be especially increased in fragile situations.

80. The draft integrated DRM operational plan (Appendix 2) still contemplates treating disaster risk reduction through various other thematic operation plans (such as gender, water, urban, and PPPs). It is important to establish disaster risk reduction as a mainstream theme. While risk assessments vary according to the type of disaster and the agency preparing the assessment, ADB—as the premier regional development financing institution—should serve as a conduit for regional skills, knowledge, and experts and bring together countries to act on disaster risk mitigation. ADB needs to establish a more permanent institutional setup (e.g., community of practice, or a formal network of disaster risk reduction experts).

It is important to establish disaster risk reduction as a mainstream theme

81. Finally, as signaled in the recently approved Environment Operational Directions, the region would benefit if ADB increases its presence in forestry, particularly in the area of sustainable forestry management (footnote 10). The deforestation challenge involves regional and global public goods, and ADB is well positioned to take a leading role in this area, particularly in presenting evidence, and engaging in knowledge-based advocacy and awareness building.

CHAPTER 4

Private Sector Development

ADB pledged to help countries attract investments that support inclusive growth and improve the environment

82. Strategy 2020 identified PSD and PSO as its first driver of change.⁴⁸ The strategy commits ADB to expanding its work with the private sector to generate greater economic growth, to assuming greater—but thoroughly assessed—risks, and acting as a catalyst for investments that the private sector might not otherwise make. Moreover, it pledges that ADB will: (i) do more to help countries attract direct private sector investments that support inclusive growth and improve the environment, (ii) invest in infrastructure, and (iii) advise governments on the basics of a business-friendly environment to spur market-led growth.

83. Strategy 2020 calls for expanding PSD and PSO, to reach 50% of annual operations by 2020. Key tasks to accomplish this include: (i) adapting ADB's organizational structure, (ii) adding new or substantially enhancing permanent staff skills, and (iii) optimizing the deployment of resources to support PSD through ADB's various regional departments and the PSOD. Tools to catalyze change and greater private investment in countries include direct financing, credit enhancements, risk mitigation guarantees, and innovative new financial instruments. Moreover, ADB is to promote PPPs in all core operational areas, gaining experience first in MICs, and then expanding to all countries.

A. ADB's Response

Staff resources for PSD and PSO almost doubled

84. Significant progress has been made in aligning PSD and PSO with Strategy 2020 since 2008. Staff resources for PSD and PSO almost doubled during 2010–2012, and a fifth vice-presidency was created to support PSO and cofinancing operations in 2010. The share of PSD-themed operations grew from an average of 29% during 2003–2007 to 38% during 2008–2012. Most of this growth has resulted from increases in PSO and PPP-related support, while there was little change in enabling environment support.

85. Amounts approved for non-sovereign operations (including PSO and lending to public agencies without government guarantees) accelerated to an average of \$2 billion during 2008–2012 from \$777 million during 2003–2007, but this stands at an average of 15% of overall approved amounts. ADB projects have been successful in catalyzing private financing, mainly through ADB's direct financial support; the use of new financial instruments or guarantees has increased in nominal terms, but not as a share of total ADB support. At the end of 2012, infrastructure PSO of \$4 billion leveraged projects with a total estimated value of over \$33 billion, or over 8 times

⁴⁸ This section draws mostly on the following two evaluations: (i) IED. 2013. *Thematic Evaluation Study: ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth*. Manila: ADB; and (ii) IED. 2013. *Thematic Evaluation Study: ADB Support for Strengthening the Enabling Environment for Private Sector Development*. Manila: ADB.

ADB's investment. ADB's \$767 million investment in private equity funds was matched by \$4.4 billion from other financiers, 6 times ADB's investment.

86. Since the approval of Strategy 2020, the share of PSOD transactions that seek to directly promote inclusion of the poor, rural populations, or women has remained at 13% of total approvals, against a growing non-sovereign portfolio. There is no specific target for PSO that promote inclusive business. PSOD had limited operations in poor and economically disadvantaged regions of non-frontier countries. Additionally, few projects sought to increase access to infrastructure, health, and education services for poor or rural populations. There is evidence that a focus on inclusion need not undermine profitability. Of the 171 PSOD projects approved during 2000–2012, 62 have been evaluated. The 12 inclusive projects had better development impact and investment profitability ratings than the other projects (see table below).

**Evaluation Ratings for Projects with Direct Inclusion Effects
and other Private Sector Operations Department Projects**

Item	Inclusive Projects	Other Projects
Positive development impact rating	100%	68%
Positive ADB investment profitability rating	100%	76%
Positive overall success rating	100%	68%

ADB = Asian Development Bank

Note: Ratings are based on Independent Evaluation Department evaluation reports, where available as of 31 December 2013, and otherwise on Private Sector Operations Department evaluations.

Source: Independent Evaluation Department.

87. By comparison, PSOD scaled up its attention to mitigating climate change risk through its focus on clean energy in 2009, with increased investments in combined-cycle gas plants, solar power, and wind power. The number and value of projects seeking to contribute directly to environmentally sustainable growth have increased substantially, although from a low base, since the approval of Strategy 2020. The share (in terms of number) of PSO promoting renewable and clean energy, energy efficiency, and solid waste management increased from 8% of total PSO approvals during 2000–2008 to 49% during 2009–2012. PSO have been the main channel to promote renewable energy sources, accounting for 69% of related ADB investment volumes.

Projects seeking to contribute directly to environmentally sustainable growth have increased substantially

88. PSO also supported regional integration focusing on trade cooperation and climate change financing through the Trade Finance Program, Supply Chain Finance, and the Climate Public-Private Partnership Fund.

89. Infrastructure accounted for about 60% of PSO commitments. Ranging from telecommunications to energy generation projects, these transactions made substantial contributions to economic growth and development; the 19 infrastructure transactions approved after 2000 with independent evaluation ratings passed the 10% hurdle rate for economic viability, with many having rates of economic return exceeding 20%. Some projects also directly promoted inclusion, particularly in telecommunications (Box 5) and water, while energy projects indirectly facilitated rural electrification. About half of PSOD-supported infrastructure projects helped catalyze additional private investment in the respective sectors and countries by demonstrating commercial feasibility of private sector participation, and introducing new technologies or financial structures and risk-sharing arrangements.

Box 5: Telecommunications Project in Bangladesh

Bangladesh had very poor telephone service in the mid-1990s, with one of the lowest telephone-densities in the world (less than one telephone per 100 inhabitants). The situation was worse in rural Bangladesh, with less than one telephone per 1,000 inhabitants. The sector participants were the government-owned Bangladesh Telegraph and Telephone Board, two rural service providers primarily offering pay telephone services in district centers, and a mobile telephone operator. In 1996, the government granted three additional cellular service licenses.

In 1998, the Asian Development Bank approved an equity investment of \$1.6 million and a senior loan of up to \$30.0 million for one of the companies to construct and operate a nationwide cellular telephone system that would provide common cellular services in the main cities, and village pay telephone services in rural areas. In 2004, the Asian Development Bank approved another loan of up to \$20.0 million for an expansion of the network. The project surpassed all operating and financial objectives, with an economic internal rate of return of 30%. The project made a substantial contribution to the growing telecommunication industry, and increased private participation in the sector.

The project promoted inclusiveness through its village phone program, by which the company provides the cellular service while an affiliate leases phones to village entrepreneurs, who in turn sell telephone services to fellow villagers. The benefits have been two-fold, providing earning opportunities for the rural poor who serve as village phone operators while expanding telephone access to people in rural areas. Today, about 700,000 village phone operators are active in approximately 83,000 of the roughly 87,000 villages (95%). The number of village phone operators continues to increase, but their incomes have been decreasing as a result of lower call rates and margins, competition, and an increase in the number of people that own phones.

A survey of village phone users found that the program was perceived to have greatly improved their livelihoods, earning opportunities, and well-being by allowing them to (i) get better prices for their produce and supplies;^a (ii) save time and money by not having to travel; (iii) get remittance details from family members abroad; and (iv) inquire about health-related issues.^b Most respondents also stated that phone services greatly improved their safety and security, contributed to poverty reduction, and empowered women. Another initiative is its growing network of community information centers, which offer high-speed voice, data, and other communication services at low rates to previously unconnected people.

Note: ^a One of the supported company's value-added services is the CellBazaar, a user-generated market where buyers and sellers are able to trade basic goods (e.g., rice, fish, motorcycles, used goods) using their mobile phones.

^b In 2006, the company launched its HealthLine service, a medical call center staffed by licensed physicians that gives the company's mobile phone subscribers an opportunity to seek health-related advice or consultation through an interactive teleconference.

Source: Independent Evaluation Department.

90. Financial sector transactions made up about one-third of PSOD transactions. Many of these transactions did not contribute to sustainable growth or inclusion, and 13 of the 25 post-2000 transactions with independent evaluation ratings rated *less than satisfactory* or *unsatisfactory* for development impact. The actual investment strategies of some PSOD-supported private equity funds differed from the development objectives stated at investment approval, and employment effects were not optimized. Many other financial sector transactions with SME development objectives were largely

ineffective in improving the availability of SME finance, with total credit to small businesses not growing or expanding more slowly than credit to other business segments.

91. Importantly, some of the financial intermediaries supported by PSOD with the objective of facilitating access to finance for SMEs or rural areas lacked strategies, products, or systems conducive to lending to these business segments, and set no specific targets for such lending. By comparison, most direct investments in financial institutions contributed to market development by furthering competition or improving market infrastructure.

92. PPPs have become an institutional priority, as reflected in the 2012 PPP operational plan.⁴⁹ ADB has adopted its first targets for PPP projects and created upstream activities to promote PPPs, which are expanding in all regional departments (although limited by TA resource constraints). Some success has been seen with the adoption of PPP policies and laws and with strengthening of PPP units in countries, mainly in MICs, and similar approaches are being introduced in less developed member countries. However, this has not translated into expected levels of actual PPP transactions, mainly as a result of a lack of progress on underlying sector reforms (particularly those related to sector unbundling and tariffs), regulatory capacity constraints, financial sector issues, and overall investment climate concerns. Although there has been a high level of support for infrastructure PPPs, there have been few comparable efforts with non-infrastructure PPPs.

PPPs have become an institutional priority, however, this has not translated into expected levels of transactions

93. Strategy 2020 set no specific targets for support to improve the enabling environment for PSD. The 2000 Private Sector Development Strategy and the 2006 revised strategic framework did not provide substantial guidance on conceptual or operational approaches to strengthening the enabling environment. Partly because of this lack of direction, ADB policy and institutional support for strengthening the enabling environment for private enterprises has been smaller (and has grown less) than did support for investment. Also, unlike in the PPP area, ADB lacks a corporate support structure to provide operational guidance, promote internal coordination with other relevant communities of practice and between the various operational and knowledge departments working on PSD topics, and develop staff skills to a level commensurate with PSD mainstreaming objectives.

94. Some elements of the investment climate that are critical to fostering PSD have not received adequate attention. For example, support for education to prepare a qualified workforce has been limited at less than 3% of total lending. While support for infrastructure has been high, more could be done to address gaps in electricity supply, which together with governance-related issues are key concerns of private entrepreneurs. Support for transport infrastructure did not fully recognize its relevance for PSD, as rural income generation, construction industry or logistics issues, and constraints to private sector participation were insufficiently addressed.

Some elements of the investment climate have not received adequate attention

95. Support for reforms to reduce unnecessary regulatory transaction costs, enhance competition, improve the rule of law and property rights, and reduce corruption is small but increasing. Success in these areas has been mixed, with reforms related to business registration, tax administration, procurement systems, customs administration, and other trade facilitation measures showing promise, although their ultimate impact on business transaction costs and new enterprise formation will depend on adequate implementation.

⁴⁹ ADB. 2012. *Public-Private Partnership Operational Plan 2012-2020*. Manila.

A sound financial system is important for PSD and economic development

96. A sound financial system is important for PSD and economic development in general. Given its role in inclusive and private sector-led growth, Strategy 2020 identified financial sector development as a core area, but set no specific quantitative targets for sector operations. Since approval of Strategy 2020, financial sector operations have declined from 11% of total ADB financing (for sovereign and non-sovereign operations) during 2003–2007 to 8% during 2008–2012, with the share of PSO in total sector operations increasing from 34% to 60%.⁵⁰ Reasons for the absolute and relative decline of financial sector operations under ADB's public sector window need to be further investigated, but are likely to include the increase in PSM-related operations during the 2008-2010 crises periods, reduced client needs and demand, and a more restricted focus for country strategies and programs on fewer sectors.

97. At the same time, project success ratings for sovereign and non-sovereign financial sector projects have been notably below the ADB average. Support for financial sector reforms had highly uneven results. In most countries, support for capital market reforms did not significantly improve enterprise access to external equity or debt financing, despite improvements in the legal and regulatory frameworks for securities markets. More effort is required to address enforcement problems and improve frameworks for corporate governance, financial disclosure, and debt recovery.

Banking sector reforms contributed to improved sector soundness

98. ADB-supported banking sector reforms contributed to improved sector soundness and facilitated increases in private sector credit. However, in some countries, interest rate margins, and thus financing costs for entrepreneurs, remain high due to macroeconomic uncertainty, lack of competition, lack of reliable credit and financial information on borrowers, inadequate risk management skills of banks, and, to a lesser extent, continuing interest rate distortions.

99. A 2012 evaluation on ADB's microfinance operations (footnote 32) found operations *less than effective* in achieving results. ADB support concentrated on developing the policy environment and addressing supply side constraints, with less focus on demand-side issues such as developing the capacity of the poor to access and use financial services, and to make microfinance more inclusive and effective for the poor. ADB support for pro-poor innovative products and delivery models was limited, with little attention to the social performance of microfinance operations. As a result, the penetration of microfinance among the poor remains low. As of end 2010, the average penetration in the 21 countries with ADB microfinance support was 20% for those living below \$1.25 per day. Country case study surveys showed that fewer than 9% of microfinance clients lived on less than \$1.25 per day, and fewer than 22% lived on less than \$2 per day.

B. Recommendations

100. ADB's private sector work can and should make greater contributions to the strategic agendas of Strategy 2020, in particular inclusive growth. Based on independent evaluations, actions in the following areas are critical, and ADB might consider updating its PSD strategy to reflect these priorities.

101. Efforts to improve the enabling environment for private sector development are critical. Support for business regulatory, competition and governance reforms needs to be increased and enhanced through a greater focus on outcomes during project

⁵⁰ Calculated sector shares do not include financial sector components in multisector operations.

design, and adequate support for reform implementation. Additionally, support needs to also focus on alleviating business constraints for small, rural and female entrepreneurs. PPPs can be further facilitated through more support for building the required regulatory capacity and implementing underlying sector reforms, particularly with regard to sector unbundling and tariff (and subsidy) systems that enhance access by the poor while reflecting true costs, and thereby minimizing economic distortions and the use of natural resources.

102. Financial sector operations need strengthening, including those seeking to enhance SME development by focusing on addressing underlying issues that affect private sector financing access and costs, rather than financial intermediation-type projects. This requires (i) continued ADB engagement in policy dialogue on financial sector reform, including rectifying causes of interest rate distortions, strengthening financial market competition and regulation, strengthening financial market supervision and regulatory enforcement, improving frameworks for financial and corporate governance, and developing functioning secured transaction and bankruptcy regimes; and (ii) more support for improving credit information and credit risk management systems, and financial literacy programs.

Financial sector operations need strengthening

103. ADB's private sector work needs to do more to support inclusive growth. PSOD needs to explore how it can best support companies with inclusive business models, including through TA and appropriate financing mechanisms. In addition, PSOD should explore how the outreach of supported investments can be improved through complementary measures by ADB or other development partners. Policy dialogue by regional departments with client governments on reforms to remove barriers to private investment in social infrastructure and services would help increase viable project opportunities.

ADB's private sector work needs to do more to support inclusive growth

104. PSOD can also provide more support in underdeveloped regions of MICs, where most of Asia's poor live. In addition to recent improvements in monitoring the direct employment effects of PSO, supported private equity funds need specific strategies to optimize their contributions to employment generation, if this is among their stated development impacts.

105. ADB needs to strengthen the coordination of its PSD support. While there has been some improvement in collaboration between regional departments and PSOD, there is still little synergy between ADB's PSOs and other operations. Regional departments need to focus enabling environment support on key areas of PSO, and to become more involved in project development activities; while PSOD needs to become more actively engaged in PSD and enabling environment work. There is a need to determine how such cooperation can be implemented, for example, through organizational changes and staff incentives. Investment support needs to be carefully sequenced with enabling environment support, particularly for SME development and PPPs.

106. There is substantial room to improve the scope, quality, and use of private sector assessments, which could also improve mainstreaming of the PSD agenda across ADB operations; systematic consideration and monitoring of potential private sector contributions and impacts in country and sector strategies and operations can also help in this regard.

There is substantial room to improve private sector assessments

107. To improve the impacts of microfinance operations, ADB needs to refine the microfinance development strategy to adopt new practices, business models, and products, to support financial inclusion. Efforts are needed to reduce demand-side

constraints (e.g., financial literacy of borrowers, consumer protection). A greater focus on clients (e.g., by combining access to finance with livelihood programs) and use of financial innovation and technologies will enhance effectiveness. When the policy environment is in place, there is a need to focus on market infrastructure development to ensure a strong and sustainable expansion of microfinance operations.

Knowledge Solutions

108. The demand for and supply of knowledge are both evolving rapidly, while the means of applying it through new technologies and networks are expanding. The expanding knowledge base within countries complements regional and global expertise, and requires much greater appreciation and better coordination of these multiple knowledge sources.

The demand for and supply of knowledge are both evolving rapidly

109. Strategy 2020 was the first ADB strategy to pay special attention to the knowledge agenda and to recognize knowledge as a catalyst for development. The strategy committed ADB to a larger role in leveraging knowledge solutions for the region, and called for actions that included: (i) supporting a more robust body of empirical knowledge to resolve critical obstacles to development, (ii) identifying and passing on best practices, (iii) supporting pilot projects, (iv) enriching internal learning from communities of practice (CoPs) and long-term strategic partnerships, and (v) distributing knowledge in ways that have both an immediate impact and catalytic force.

A. ADB's Response

110. ADB has taken some strategic and organizational steps to addressing the growing demand from countries for assistance that extends beyond financial and project support. A 2012 evaluation of ADB knowledge products and services (KPS) found that progress has been made on the knowledge agenda in various areas, leading to an overall positive assessment of responsiveness. The evaluation found good knowledge practices among some CoPs (e.g., transportation and water), regional departments (e.g., Southeast Asia and East Asia), and resident missions (e.g., the PRC and India). Efforts have also been made to improve some aspects of the enabling environment for knowledge management, including improvements in information technology systems and websites.⁵¹

ADB has taken some steps to addressing growing demand

111. The evaluation found examples of success stories and exceptional, high-quality KPS (Box 6). Knowledge dissemination has expanded, with steady growth in KPS downloads, website traffic, and publication sales. Since 2005, ADB has conducted periodic internal and external surveys to gather feedback on its knowledge work.

Knowledge dissemination has expanded

112. The evaluation found the implementation of ADB's 2009–2011 Knowledge Management Action Plan to be satisfactory, but with some gaps. The recent adoption of the Knowledge Management Directions and Action Plan (2013–2015) provides

⁵¹ This chapter draws heavily on findings and recommendations from the 2012 evaluation: IED. 2012. *Special Evaluation Study on Knowledge Products and Services: Building a Stronger Knowledge Institution*. Manila: ADB.

guidance on some (but not all) issues and areas, including a clearer definition of what constitutes a knowledge solution and how to prioritize and implement such solutions.

Publication output has expanded significantly and grown more diverse

113. ADB's publication output has expanded significantly and grown more diverse since 2008, in terms of formats and coverage. The number of flagship and knowledge and/or research publications produced by knowledge and regional departments doubled during 2007–2011 (Figure 10). ADB's Department of External Relations estimates that the total publication output (including all publication categories) has grown five-fold since 2007.

Box 6: Examples of Useful Knowledge Products and Services

The 2012 evaluation on KPS identified a number of studies, projects, and initiatives with high relevance, use and influence. In Central and West Asia, an example was the CAREC Transport and Trade Facilitation: Partnership for Prosperity study^a which guided the region's strategy for transport, trade, and integration more broadly. ADB's work on SOE reforms through the Private Sector Development Initiative in the Pacific was recognized as influential, supporting high-level dialogue and learning alongside ongoing SOE reforms across a number of countries. As an information technology example, the ARIC website has proven to be an effective portal for sharing knowledge and facilitating policy dialogue. In PRC, support for the eco-compensation agenda played a major role in creating and sharing good practices and stimulating policy dialogue. ADB's long-term regional cooperation work in the Greater Mekong Subregion also provides examples of useful knowledge work. ADB's Social Protection Index is a unique knowledge product with high relevance to development policy in the region.

The evaluation encouraged ADB to make these special examples the norm rather than the exception, offering suggestions on how this might be done, including through greater focus on client knowledge needs, continued improvements in enabling technologies, and stronger control of publication quality.

ADB = Asian Development Bank, ARIC = Asia Regional Information Center, CAREC = Central Asia Regional Economic Cooperation, GMS = Greater Mekong Subregion, KPS = knowledge products and services, PRC = the People's Republic of China, SOE = state-owned enterprise.

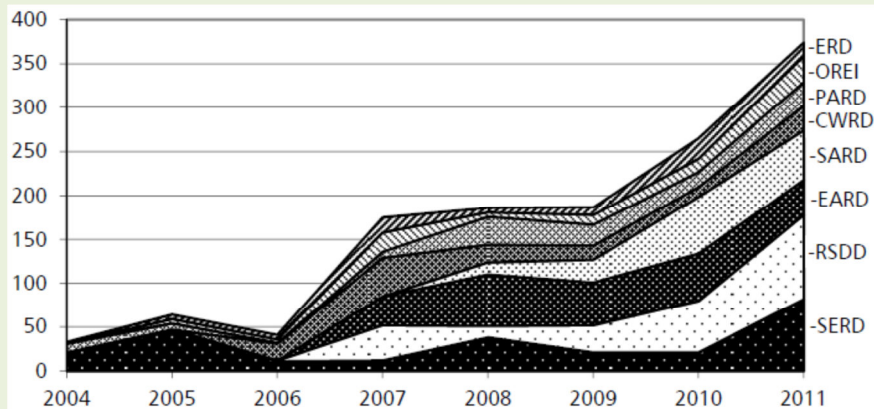
^a ADB. 2009. *CAREC Transport and Trade Facilitation: Partnership for Prosperity*. Manila.

Source: IED. 2012. *Special Evaluation Study on Knowledge Products and Services: Building a Stronger Knowledge Institution*. Manila: ADB.

A number of concerns and constraints need attention

114. A number of concerns and constraints need attention. While ADB's KPS output has grown substantially, a wide range of knowledge management approaches prevail within the organization without sufficient coherence, coordination, and consideration of whether they fulfill priority needs. This has created a risk to quality, a sense of confusion, and lack of clarity on the direction of knowledge management.

Figure 10: ADB Flagship and Knowledge and Research Publications by Department 2004–2011



ADB = Asian Development Bank, CWRD = Central and West Asia Department, DER = Department of External Relations, EARD = East Asia Department, ERD = Economics and Research Department, OREI = Office of Regional Economic Integration, PARD = Pacific Department, RSDD = Regional and Sustainable Development Department, SARD = South Asia Department, SERD = Southeast Asia Department.
 Note: Flagship and knowledge and/or research publications are categories A and B in ADB’s publication classification system, including books, briefs, flagship series (e.g. annual flagship publications), journals, reports, stand-alone flagships (i.e. one-off flagship publications, working papers).
 Source: IED. 2012. *Special Evaluation Study on Knowledge Products and Services: Building a Stronger Knowledge Institution*. Manila: ADB.

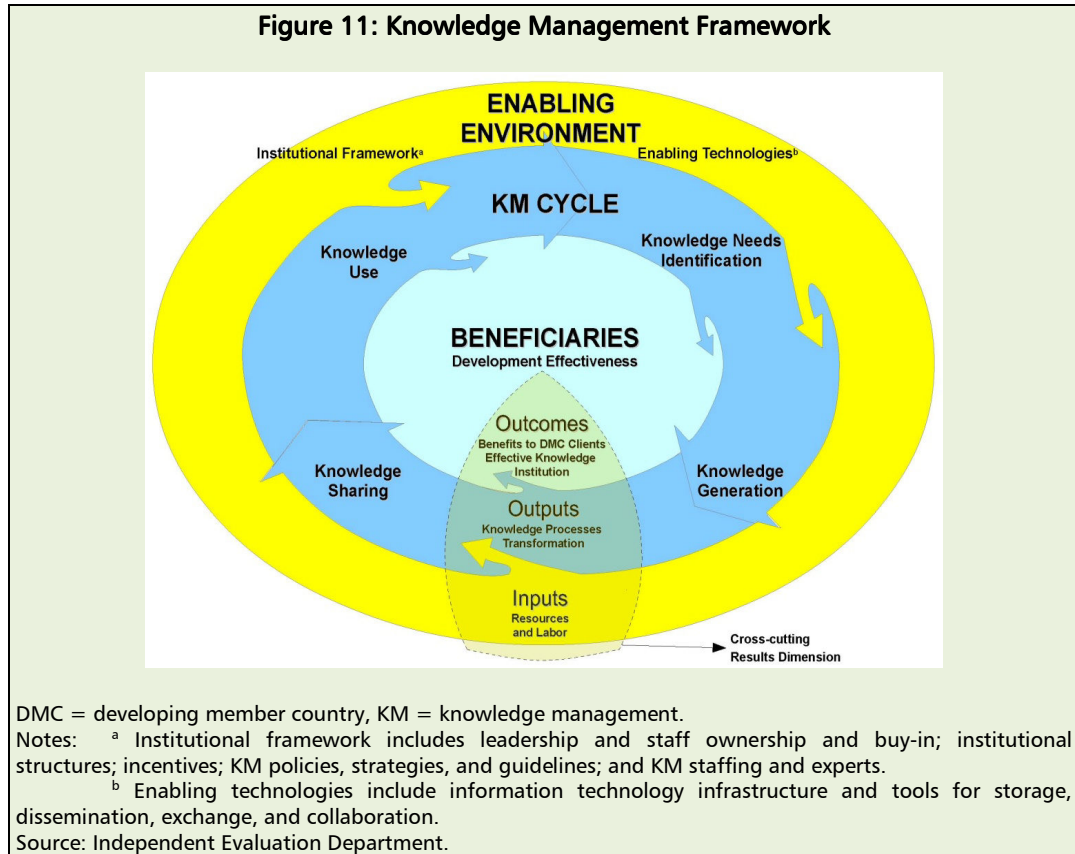
115. The inadequate harnessing and dissemination of tacit knowledge impedes ADB efforts to create a competitive advantage for its KPS at the country level. The role of CoPs is undoubtedly important, but their performance varies highly. Identification of country-level knowledge needs is a gap. Moreover, the work program and budget framework does not show direct resource allocations toward specific knowledge activities (beyond departmental budget allocations), and the project classification system does not capture knowledge work.⁵² In the regional departments, knowledge work is often given lower priority relative to lending work.

Knowledge work is often given lower priority relative to lending work

116. While ADB is becoming more knowledge oriented, there remains a poor understanding of knowledge management, stemming largely from a lack of clarity and common agreement on key concepts and terms and the respective knowledge management roles of different organizational units. Weak guidance as well as ineffective coordination across departments and across knowledge channels (between headquarters and resident missions) are other key constraints. The proliferation of publications reflects greater effort to generate and disseminate knowledge, but the poor quality of some publications poses risks to ADB’s reputation. To help visualize and clarify ADB’s knowledge management system and where reforms and improvements may be targeted, the 2012 evaluation proposed the knowledge management framework depicted in Figure 11. The framework illustrates that ADB’s knowledge management system comprises many distinct but dependent functions and processes. Raising the overall effectiveness of the system therefore requires coordinated reforms and improvements across all these areas, versus piecemeal and otherwise uncoordinated reforms.

ADB’s knowledge management system comprises many distinct but dependent functions

⁵² A revised project classification system proposes to add a new knowledge marker for projects



A major concern relates to how ADB harnesses and leverages tacit knowledge

117. A major concern relates to how ADB harnesses and leverages tacit knowledge and how well staff embed knowledge in project designs and impart it in the course of implementation. While some staff have developed deep expertise in some core business areas, there is concern that this rich experience is not being adequately codified and shared across different parts of the organization. One of the goals of the Knowledge Management Action Plan that was largely not achieved is the capturing of tacit knowledge from departing staff. The knowledge that is or could be unique to ADB—which would give it a strong comparative advantage—is knowledge of what works and what doesn't; staff gain such knowledge each day in the field, as they design and monitor the implementation of projects.

118. Technical assistance is an important tool for ADB, but it is not given attention commensurate with its potential. Evaluations have raised concerns on the use of TA for knowledge.⁵³ The relevance of TA is increasing as ADB's knowledge role continues to expand and as client demand for knowledge and capacity development support continues to diversify. While case studies show examples of successful TA use, in instances where ADB has provided continued, long-term support, evaluations also find lingering challenges. For example, regional TA is an important public good provided by ADB, but it is not well coordinated and integrated with other ADB programs. The same applies to many TA outputs originating from ADB's knowledge departments. Countries are often insufficiently involved in TA design and implementation, which reduces

⁵³ IED. 2007. *Special Evaluation Study: Performance of Technical Assistance*. Manila: ADB. IED. Forthcoming. *Thematic Evaluation Study: Role of Technical Assistance in ADB*. Manila: ADB.

ownership and sustainability. TA completion reports vary in quality and are not used effectively to capture and share knowledge.

119. ADB's current model for processing and administering projects gives little support to implementation (discussed further in Chapter 6), lacks continuity, and is not well integrated with ADB goals regarding knowledge. Teams rely increasingly on consultants, who often cannot impart institutional knowledge when designing and supporting project implementation. Consultants also lack the incentive to extract relevant lessons and incorporate them into ADB's knowledge base. While the resources and staffing for knowledge management have more than doubled (from \$30 million in 2009 to \$69 million in 2012, based on budget allocations to the knowledge departments), operational staff appear to lack resources to devote to such operations-linked knowledge work.

Teams rely increasingly on consultants, who often cannot impart institutional knowledge

B. Recommendations

120. Leading knowledge institutions around the world are moving away from a hub-and-spoke, one-way dissemination model towards a more interactive, open source, knowledge co-creation model, including more emphasis on coordination, using local knowledge and South–South learning. This evolution brings a significant opportunity to better leverage knowledge to raise development outcomes.

121. ADB recognizes that its relevance and responsiveness to clients, and its ability to support a *triple bottom line* agenda, will depend increasingly on its effectiveness as a knowledge institution. Increasing the development impact of ADB's knowledge work requires a better coordinated and integrated approach that addresses weakness in the entire knowledge management system (Figure 11).

ADB recognizes that its relevance will depend increasingly on its effectiveness as a knowledge institution

122. Evaluation findings suggest that ADB should strengthen: (i) identification of knowledge needs, among both internal and external clients; (ii) generation of high-quality, cutting-edge, and in-demand knowledge products (e.g. through stronger quality control mechanisms); (iii) capturing and sharing of embedded and tacit knowledge across ADB departments and countries; (iv) integration of knowledge work into country strategies and project cycles, as some regional departments have begun to undertake with good success (e.g., through country knowledge plans); (v) the role of resident missions in the knowledge cycle; (vi) internal coordination, with clearer delineation among knowledge departments; and (vii) incentive systems, with better recognition and rewards for stand-out knowledge work. Continued improvements in enabling technologies are also critical, as are efforts to better monitor the use of (and client satisfaction with) ADB KPS.

123. Greater attention to the knowledge needs of the growing MIC clientele is necessary. The value of two-way knowledge transfer has been highlighted by MICs. A justification for ADB's continued presence in MICs is the potential knowledge and influence they have on regional and public goods, which ADB can help channel to lower-income countries.

Greater attention to the knowledge needs of MIC clientele is necessary

124. ADB needs to develop signature knowledge areas and strengthen generation, coordination and collaboration on these. ADB can strive to be at the forefront in areas of critical importance to clients and the region. Importantly, to remain relevant ADB should not limit its signature areas to the sectors in which it provides financing. ADB can be an intellectual leader in other areas; for example, in advocating for regional public goods, as it relates to deforestation (para.11). As other organizations (e.g., development partners, think tanks, universities, and nongovernment organizations)

expand their knowledge work, ADB needs to improve its coordination and collaboration with them.

***More attention
should be given
to the use and
effectiveness of
ADB TA***

125. More attention should be given to the use and effectiveness of ADB TA, including the introduction of reimbursable TA arrangements, and dedicated trust funds for undertaking and deepening competence in signature knowledge areas with high potential for solving the region's most difficult development challenges. Greater effort is needed to ensure higher-quality TA designs and completion reports. TA can respond much more to demand, and thereby focus more sharply on the most critical problems faced by countries.

Harnessing Resources for Better Outcomes

126. Under Strategy 2020, ADB committed to:
- (i) improving the coherence of strategies and policies in support of Strategy 2020;
 - (ii) enhancing the human resources and skills mix in a range of fields, including infrastructure, environment and private sector operations;
 - (iii) improving the organizational structure, including to: foster professional excellence and promote synergies among operations, and decentralize decision-making to resident missions; and
 - (iv) increasing corporate responsiveness to countries by lowering transaction costs for project preparation and implementation and reducing documentation requirements.

127. In addition, a corporate results framework was introduced to monitor progress against the goals set out in Strategy 2020, and a mechanism was put in place through the Development Effectiveness Review to monitor performance annually and draw up action plans where required.

128. With these reforms Strategy 2020 intended to transform ADB and lift its performance, thereby enabling it to more effectively respond to the region's major development challenges. While ADB has taken some steps to implement these changes, the full effects—and the intended institutional transformation—have yet to be realized. The institutional transformation will not occur without stronger demand for results from ADB leadership.

Strategy 2020 intended to transform ADB and lift its performance

A. ADB's Response

129. **Strategy and policy coherence.** In line with Strategy 2020's call for improved strategic and policy coherence, ADB adopted some 50 new directional documents (policies, plans, guidelines, etc.) from 2008–2013 to support and operationalize Strategy 2020 (Appendix 2). The documents give direction on various elements of Strategy 2020: strategic agendas, drivers of change, the five core and other operational areas, as well as institutional and organizational transformation. However, in some important areas, the formulation of clear operational guidance was substantially delayed (such as in the case of inclusive growth), or not undertaken at all. For example, although a 2007 evaluation highlighted the need for a decentralization strategy,⁵⁴ no clear guidance has been issued. Likewise, MIC and PSD strategies have not been

ADB adopted new directional documents to support and operationalize Strategy 2020

⁵⁴ IED. 2007. *Special Evaluation Study: Resident Mission Policy and Related Operations: Delivering Services to Clients*. Manila: ADB.

updated after Strategy 2020, despite the emphasis Strategy 2020 placed on these topics.

ADB has achieved staffing expansion, but concerns on the overall skills mix remain

130. **Staffing.** ADB has achieved staffing expansion, and staff represent a great strength, but concerns on the overall skills mix remain. Following the adoption of Strategy 2020 in 2008, ADB underwent a general capital increase in 2009, leading to a significantly increased lending program.⁵⁵ The general capital increase was accompanied by a Board decision to add 500 new staff members between 2010 and 2012, which ADB achieved. The addition was spread across categories (180 international staff members, 170 national staff members, and 150 administrative staff members); locations (360 in headquarters and 140 in resident missions); and sectors. Much of the staff increase came at lower staff grades due to internal promotions at higher grades.

131. A review of the workforce expansion indicated that nearly half (48%) of the additional staff members (this tally includes both technical and non-technical support staff) went into “priority sectors and themes” in the operations departments and resident missions, to support staff capacity in project administration and portfolio management, safeguards compliance, gender and development, and social development.⁵⁶ However, during consultations with ADB CoPs for this report (Appendix 4), CoP members identified skill shortages and gaps across a number of critical areas, including in core areas of Strategy 2020. Further, several CoPs expressed frustration over what they perceive as a de-prioritization and steady de-skilling of expertise in their areas in recent years.

132. The allocation of staff within the organization is a related concern. While the staff increase responds to consistent evaluation messages that ADB pay more attention to project implementation and supervision, both in technical terms and in assuring due diligence and good governance, the additional staff members were scattered across various departments and divisions. Figure 12 provides a basic illustration of how international staff (by job title; see note under Figure 12) are scattered across organizational units and core operational areas. Only five core area specializations have 10 international staff members or more in one department (an indicator of a good critical mass of expertise). A critical concentration of technical expertise in areas of operation is essential to ensure quality projects that deliver outcomes and sustainability.

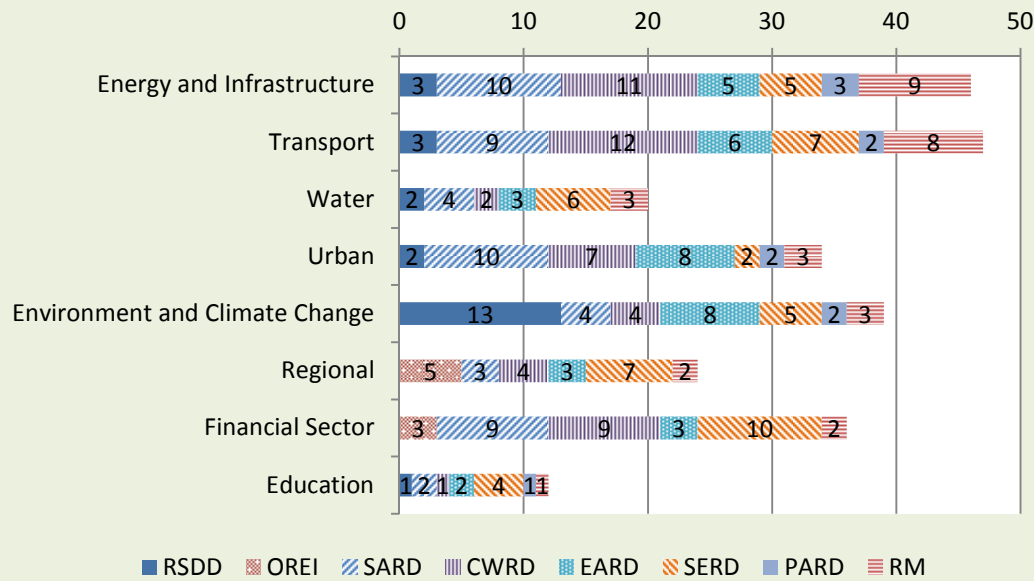
ADB's organizational structure fragments skills

133. The CoPs constitute an informal approach to knowledge sharing, but their use to ensure sharing and coherence of approaches and knowledge is a challenge. This issue was highlighted in the 2012 knowledge evaluation (footnote 20), which stated that ADB's current organizational structure fragments sector and thematic skills in multiple units and teams across regional departments, and presents a formidable challenge to effective and efficient knowledge management and sharing across the institution. This concern was also voiced during consultations with CoPs (Appendix 4).

⁵⁵ Operations during 2008–2012 represented a 75% increase over 2003–2007.

⁵⁶ ADB. 2013. *Review of Implementation of 3-Year Workforce Plan 2010–2012*. Manila.

Figure 12: International Staff With a Job Title Indicating Core Area Specialization



BPMSD = Budget, Personnel, and Management Systems Department; CWRD = Central and West Asia Department; EARD = East Asia Department; OREI= Office of Regional Economic Integration; PARD = Pacific Department; RM = resident mission; RSDD = Regional and Sustainable Development Department; SARD = South Asia Department; SERD = Southeast Asia Department.

Note: The chart is provided for illustrative purposes only. The chart shows distribution of 258 international staff members, strictly by job title, using a roster provided by BPMSD for staffing composition as of 31 October 2013. Staff members were separated into 19 categories by job title, including categories reflecting ADB’s five core operational areas. Advisors and heads, directors and deputy directors were placed in their own categories. In cases where a position had a further specialty, such as a transport economist or an urban development specialist (water supply and sanitation), it was placed in the more specific category. Operational staff that have a sector specialization but whose job title does not indicate this are excluded from this illustration.

Source: IED analysis based on BPMSD staff roster as of 31 October 2013.

134. **Organizational structure.** ADB’s current structure with five regional departments is intended to improve the country focus, but has led to a dispersal of knowledge and skills. This may explain why project managers rely increasingly on consultants for project work. This growing reliance on consultants has costs, including for institutional knowledge and staff learning, as highlighted in the 2012 knowledge evaluation.⁵⁷

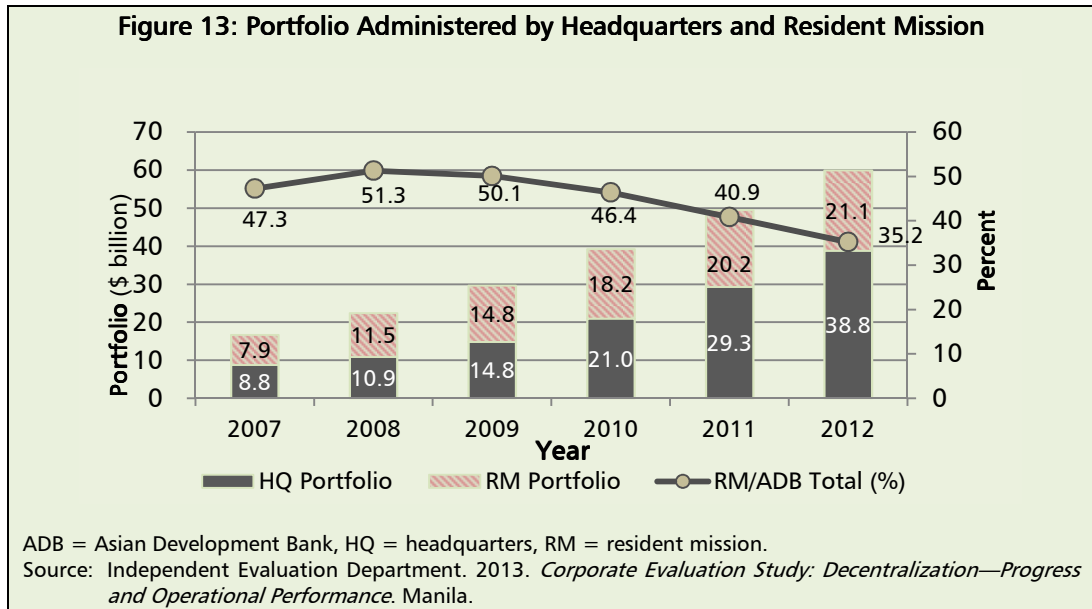
135. The organizational structure has been expanded with the addition of two vice presidents. The position of vice president for private sector operations and co-financing is intended to increase attention to PSO, but how and whether this will improve coordination between sovereign and non-sovereign operations remains unclear. The knowledge management and sustainable development vice presidency as significantly expanded, but building, delivering and sharing knowledge across the many locations in ADB where knowledge is and can be delivered and shared remains a challenge, as does coordination between knowledge and operations departments.

136. **Decentralization.** There has been significant progress in locating staff members (and funding) within resident missions. Half of the staff members in ADB regional

⁵⁷ A background analysis of ADB consultant utilization data, conducted by IED as part of the 2012 knowledge evaluation, showed that ADB’s annual procurement of consultants (by person-month, for all categories of consultant) increased by 64% during 2002–2011.

The increase in staff at the resident missions has not been accompanied by a corresponding transfer of responsibilities and authority

departments are now based within resident missions, with benefits that include increased client contact and country knowledge. This is all progress. At the same time, problems remain with the type of decentralization and devolution pursued. The increase in staff numbers at the resident missions has not been accompanied by a corresponding transfer of responsibilities and decision-making authority. The proportion of the portfolio administered by resident missions has in fact declined since 2008, dropping steadily from 51.3% in 2008 to 35.2% in 2012 (Figure 13).⁵⁸ The proportion of loans, grants and TA projects administered by resident missions rose to 34% in 2009, and subsequently dropped to 30% in 2012.⁵⁹ In the same period, the expenses at resident missions have increased by 69%.



Empowering resident missions with greater technical capacity and authority would move ADB to the next phase of decentralization

137. The objective of increasing responsiveness by locating country directors—and more recently deputy country directors—in resident missions is undermined by the limited delegation of operational responsibility and decision-making authority from regional department heads to country directors. Empowering resident missions with greater technical capacity to undertake core business activities, operational responsibilities, and decision-making authority would move ADB to the next phase of decentralization. Increasing TA budget under the discretion of Country Directors would help. An important area where the role of resident missions can be enhanced is in knowledge management, in particular the identification of country knowledge needs and potential knowledge sources (local think tanks, nongovernment organizations), and in knowledge transfer and sharing within and across countries. A differentiated approach to delegation of responsibilities is needed, based on the specific development contexts, demands, and priorities of low-income countries, fragile and conflict-affected

⁵⁸ From June 2009 when Central and West Regional Department (CWRD) introduced the joint-venture approach, its portfolio data are reported as headquarters-administered. Corrected for this change, there would be a small increase in the resident mission portfolio of CWRD. However this would be small and the overall trend of the graph would not change because the increase in CWRD portfolio constituted a small part (less than 5%) of the total ADB portfolio.

⁵⁹ IED. 2013. *Corporate Evaluation Study: Decentralization: Progress and Operational Performance*. Manila: ADB.

situations (FCAS), and MICs. This would be helped by increased TA budgets that can be allocated at the discretion of the country directors.

138. Finally, for decentralization to be effective, the costs and benefits need to be better quantified and monitored. An expanding resident mission network has added significantly to the budget. Resident missions now account for 17.6% of the organization's total budget (footnote 59), and over half of the operational budget devoted to portfolio management, project processing, and country and regional strategy and programming.⁶⁰ But the cost-effectiveness and net benefits of decentralization have yet to be assessed, in part because of the lack of a time recording system. It is time to systematically track costs and benefits of resource allocation to and empowerment of resident missions.

The cost-effectiveness and net benefits of decentralization have yet to be assessed

B. Country Programs and Selectivity

139. Selectivity was a driving principle in the design of Strategy 2020, and the resulting prioritization of core operational areas was largely based on the argument that ADB should focus on what it does best. This was captured in the operational goal that five core operational areas would comprise 80% of total approvals by 2012. The actual distribution over 2009–2012 amounted to a crowding out of most areas of operations other than infrastructure. Independent Evaluation has maintained that country programs ought to be country-driven (i.e., they could opt to mainly pursue other interventions, complementing corporate core areas of operations). The 80% target is a corporate target that does not need to be applied rigidly across all countries. While infrastructure has always been a main target of ADB operations, Independent Evaluation has argued that the concentration of operations in this area may need to be complemented by other operations to achieve broader development outcomes.⁶¹ For example, the pursuit of additional measures or operations to reach the poor through cross-sector outcomes may increase inclusiveness and help human development.

140. Further, selectivity needs to favor areas where private markets and the private sector will not focus. Also, as recognized in Strategy 2020, partnerships are a key complement to selectivity in operations. Areas that receive less operational focus, but which are nonetheless critical for development outcomes, must receive additional efforts from ADB to crowd-in other partners. Counter to the expectations set forth in Strategy 2020, the recent MDG evaluation found that partnerships in health, education, and gender have not blossomed as anticipated (footnote 13). This issue is also highlighted in IED's 2012 Annual Evaluation Review (AER), which states that the degree to which strategic alliances and partnerships have been built has been mixed.⁶² ADB's selective engagement at the country level, as captured in CPS, ought to be driven by a country's desired development outcomes, including knowledge needs, and by partnership opportunities.

Partnerships in health, education, and gender have not blossomed as anticipated

⁶⁰ Based on analysis of budget data for 2012.

⁶¹ IED. 2013. *Annual Evaluation Review*. Manila: ADB.

⁶² IED. 2012. *Annual Evaluation Review*. Manila: ADB.

Box 7: Reorienting Team and Organizational Culture

ADB's development effectiveness results from its ability to deliver value and solutions through its country and regional programs—and its constituent lending and knowledge activities. ADB teams that work directly with clients and partners lie at the core of this model of value delivery. Thus, team composition, leadership, incentives and the overall organizational culture fundamentally influence ADB's performance and development effectiveness. To improve its performance, ADB needs to re-orient its staff, teams, and organizational culture towards achieving excellence. Three ways to do this can be considered.

First, stronger incentives, recognition, and rewards can be placed on the delivery of *successful* (and *highly successful*) projects and the achievement of development outcomes. This contrasts with what is widely perceived to be an organizational culture that incentivizes staff to focus on project approvals and delivery of outputs, with weak accountability for results. It is essential that ADB more intensely focus its energy, attention, and incentive systems on achieving outcomes in projects and country programs. Staff, teams, and managers need to be held more accountable for results—positive or negative.

Second, far more attention should be given to strengthening project management. Stronger support and supervision during project implementation is critical in shaping project outcomes. The lack of continuity in project leadership, with the average tenure of a project manager as low as 1.8 years, warrants greater scrutiny from management. Allocation and the use of sufficient funds and time for supervision during implementation is the second-most important reason (after weak local capacity) that explains why projects are rated *less than successful*. The 2012 Annual Evaluation Review^a noted that over one-third of PCRs completed in 2011 and 2010 cited supervision problems. This is a longstanding problem, and ADB Management is well overdue in taking tangible steps to address it.

Finally, further strengthening ADB's knowledge orientation and embedding good knowledge management practices into operations are crucial for the future relevance of ADB. For this, tacit knowledge embedded in projects needs to be better disseminated to staff and clients. ADB teams need improved access to the best of ADB knowledge, and the best practices of development partners and the global community; project teams also need to strengthen their contributions to ADB knowledge and organizational learning.

ADB = Asian Development Bank, PCR = project completion report.

^a IED. 2012. Annual Evaluation Review. Manila: ADB.

Source: Independent Evaluation Department

While there have been operational improvements, performance in delivering outcomes remained stagnant

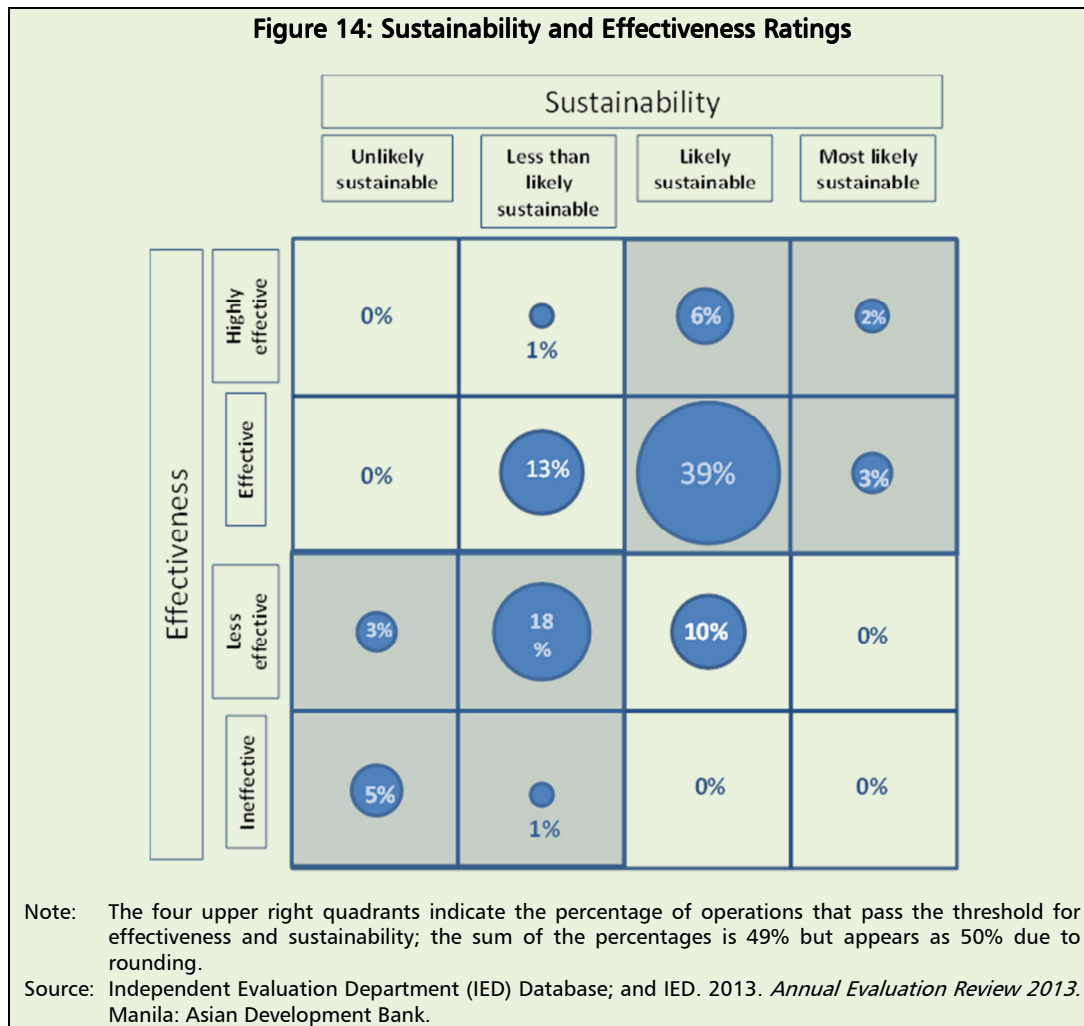
C. Program, Project, and ADB Performance

141. While there have been a number of operational improvements, performance in delivering project outcomes remained stagnant during 1998–2012, with 65% of projects rated *effective* or *highly effective*. Performance has been most disparate in lower MICs, with some countries performing far below average. Projects in FCAS (several are MICs) have fared worse on aggregate, with only 41% rated *successful* in the 2000s, a small improvement from 38% in the 1990s. Importantly, across all borrowing countries, the criteria most relevant to impact—development outcomes and

sustainability—are consistently rated the lowest in most evaluations. The 2011 evaluation on Managing for Development Results also identified a disconnect between the delivery of outputs and the achievement of outcomes.⁶³ This finding was later supplemented by evaluations that called for more complementarity between outputs of different types to arrive at a positive development outcome.

142. The 2013 AER found that the success rate of sovereign operations has remained stagnant over the years, standing at 67% in the 2000s (footnote 61), similar to what was recorded in the 1990s. Even in sectors and countries where overall success ratings are relatively good, there can be particular sustainability issues. In the operations evaluated by IED in project performance evaluation reports and project completion report (PCR) validation, only 49% of operations are both *effective* and *sustainable*, while 27% are likely to be neither sustainable nor effective (Figure 14).

Even in sectors and countries where overall success ratings are good, there can be particular sustainability issues



143. Program and project performance is largely dependent on good project design by ADB and clients, good project implementation by clients, and good supervision by ADB. Operations departments have a long way to go in this regard. The 2010 Development Effectiveness Review reported that 29% of PCRs completed in 2008–2010 indicated project implementation problems; 24% indicated project supervision issues

Performance is dependent on project design, implementation, and supervision

⁶³ IED. 2011. *Special Evaluation Study: Managing for Development Results*. Manila: ADB.

ADB business processes may have been compressed too much after streamlining in 2010

(staff turnover, insufficient field missions and so on); and 21% indicated project design issues.⁶⁴ The 2012 AER found that 37% of 2011 and 2010 PCRs had noted project supervision issues (footnote 62). Problems also persist in project design. ADB's 2012 QAE assessment rated QAE lower than in the 2010 exercise, with a mean score of 2.9 (on a scale of 1 to 4), compared to the threshold of 2.7. As in other assessments, the ratings were lowest for development outcomes and impacts, as well as achievability and sustainability. At the country level, ADB performance was found to *be less than successful* in 5 of the 10 country assistance program evaluations and CPS validations completed between 2010 and 2013.⁶⁵ IED also receives a worrying number of concerns raised by staff in operations regarding the shortness of the expected 1-year duration project processing phase, suggesting that ADB business processes may have been compressed too much after their streamlining in 2010.

144. The complexity of the challenges facing the region will place a premium on innovation and risk taking. A crucial question for ADB is how it can encourage innovation and new solutions rather than reward the continuation of previous practices and projects, even if those had good project ratings. In all of this, Independent Evaluation has a key role to play, both in ensuring rigor and encouraging improved outcomes. It would be worthwhile for evaluative approaches to be continually updated and improved to enable Independent Evaluation to better support the strategic agenda. Project ratings must reflect dynamic conditions and encourage the initiation of new and promising approaches.

D. Recommendations

145. Strategy 2020 called for institutional transformation to raise ADB's performance, effectiveness, and impacts. While some organizational reforms have been undertaken since 2008, this remains an unfinished, and in some respects unclear, agenda. Nevertheless, the region and its development challenges are rapidly changing. To keep up with this change and to make a more consequential contribution, ADB itself must continue to change. Business as usual is not an option. Significantly increasing the proportion of successful projects and programs, and improving delivery on outcomes, requires further institutional and business process reforms.

ADB's selective engagement at the country level needs to be driven by a country's desired outcomes, rather than uniform corporate targets

146. To improve the relevance, responsiveness, and results of ADB's operations its selective engagement at the country level needs to be driven by a country's desired development outcomes, including knowledge needs, and by opportunities for partnerships, rather than uniform corporate targets that are set by ADB on a regional basis. An important step would be to move beyond focusing on individual projects designed and implemented by a single division, and move toward coherent country programs that take advantage of linkages and synergy across sector and thematic interventions, with greater emphasis on the desired outcomes envisaged under the three Strategy 2020 agendas. In light of the above, Independent Evaluation recommends that ADB reconsider the need for an 80% corporate target for core areas of operations.

147. Staffing and structure need more careful attention. It is imperative that ADB maintain a critical mass of skills in key operational areas and departments, and address

⁶⁴ ADB. 2010. *Development Effectiveness Review*. Manila.

⁶⁵ IED. 2013. *Annual Evaluation Review*. Manila: ADB; and subsequent country assistance program evaluations.

the current fragmentation of skills. While infrastructure remains a clear priority, it would help ADB's effectiveness to develop new competencies in other relevant areas. ADB needs to adopt a more dynamic perspective to human resource management, ensure that it employs appropriate talent, and matches positions and people in a way that delivers better results. A review of the institution's structure and staff distribution would be timely to address these issues and ensure that the organization functions such that the whole exceeds the sum of its parts.

148. Projects are the essential instruments by which ADB contributes to development. The institution must make every effort to achieve the long-standing goal of 80% successful projects. The greatest effort needed is on the criteria that are most relevant to impact: outcomes and sustainability. Evaluations at country and sector levels suggest a number of actions to improve the link between outputs and outcomes: realistic assessment of institutional capacity, rigorous analysis of the linkages at design stage, active management of the necessary complementary activities during implementation, better monitoring of outputs, and better monitoring and measurement of emerging outcomes.⁶⁶

Evaluations at country and sector levels suggest a number of actions to improve the link between outputs and outcomes

149. ADB's own performance in ensuring better QAE and improved implementation support is key. Improving its performance will require ADB to deploy its skills and knowledge in strong teams that work with clients throughout the project cycle, from project processing to project supervision. Teams must remain with projects, share and build knowledge along the way, and be accountable for outcomes.

150. The institution can do more to capture the potential gains of decentralization. First, the decentralization model needs to be driven and differentiated by the specifics of the country program. IED recommends that regional departments take a differentiated approach to decentralizing operations to meet the diverse regional development contexts, demands, and priorities of low-income countries, FCAS, and MICs. Second, empowering country directors by delegating greater operational authority—and accountability for results—should be a priority, particularly in countries with large programs. Third, effective use of the technical and local knowledge possessed by national staff is critical. Fourth, resident missions are well placed to assess the demand for knowledge services, to identify local sources of knowledge, and to play a more active role in knowledge sharing and interaction. Finally, the net benefits of decentralization need to be better quantified; one way to facilitate this is through a time recording system.

151. To deliver on its great promise, ADB needs to harness all its resources—across headquarters and resident missions, public and private sectors, country work and thematic work, and international and national staff. ADB leadership must drive and serve as role models in embedding changes in the organization's culture, including: (i) accountability for outcomes rather than outputs; (ii) team delivery; (iii) collaboration across boundaries; (iv) active partnerships that build synergies; (v) understanding knowledge demand, generating high quality knowledge, and sharing it for effective use; and (vi) balancing innovation with risk. Much of this would need to be reflected in performance evaluation, recognition and reward systems. Independent Evaluation should contribute by improving its contribution to organizational learning, and encouraging innovation and initiation of new and promising approaches.

To deliver on its great promise, ADB needs to harness all its resources

⁶⁶ IED. 2011. *Special Evaluation Study: Asian Development Fund Operations*. Manila: ADB.

Appendixes

APPENDIX 1: ADB'S EVOLVING STRATEGIC LANDSCAPE

Strategic, thematic, and operational priorities as articulated in high-level ADB corporate strategies from 1999 to present

Priorities	PRS (1999)	LTSF and MTS I (2001)	Enhanced PRS (2004)	MTS II (2006)	Strategy 2020 (2008)
Strategic Pillars, Priorities, Agendas	3 Elements/Pillars <ul style="list-style-type: none"> Pro-poor Sustainable Economic Growth Social Development Good Governance 	3 Core Strategic Areas <ul style="list-style-type: none"> Sustainable Economic Growth Inclusive Social Development Governance for Effective Policies and Institutions 	3 Strategic Pillars <ul style="list-style-type: none"> Pro-poor Sustainable Economic Growth Inclusive Social Development Good Governance 	5 Strategic Priorities <ul style="list-style-type: none"> Catalyzing Investment Strengthening Inclusiveness Promoting Regional Cooperation and Integration Managing the Environment Improving Governance and Preventing Corruption 	3 Strategic Agendas <ul style="list-style-type: none"> Inclusive Growth Environmentally Sustainable Growth Regional Integration
Cross-Cutting Themes, Priorities, Drivers	4 Priorities <ul style="list-style-type: none"> Good Governance Private Sector Gender (women) Environmental Sustainability 	3 Strategic Themes <ul style="list-style-type: none"> Private Sector Development Regional Cooperation and Integration Environmental Sustainability 	5 Thematic Priorities <ul style="list-style-type: none"> Gender Equality Environmental Sustainability Private Sector Development Regional Cooperation Development Capacity 	(none specified)	5 Drivers of Change <ul style="list-style-type: none"> Private Sector Development Good Governance Gender Equity Knowledge Solutions Partnerships
Sector, Operational Priorities	3 Sector Priorities <ul style="list-style-type: none"> Agriculture and Rural Development Social Sectors Infrastructure and Finance 	(none specified)	(none specified)	6 Priority Sectors (Group 1) <ul style="list-style-type: none"> Road Transport Energy Urban Infrastructure Rural Infrastructure Education Finance Sector 	5 Core Operational Areas <ul style="list-style-type: none"> Infrastructure Environment Regional Cooperation and Integration Finance Sector Education Other areas <ul style="list-style-type: none"> Health Agriculture Disaster and Emergency Assistance

ADB = Asian Development Bank, LTSF = Long-Term Strategic Framework, MTS = medium-term strategies, PRS = Poverty Reduction Strategy.
Source: ADB strategy documents.

APPENDIX 2: MAJOR ADB POLICIES, PLANS, AND GUIDELINES ADOPTED BEGINNING IN 2008

Strategy 2020 Sector/Theme/Area	Year: Title
3 Strategic Agendas	
Inclusive Growth	2013: Guidelines on Inclusive Economic Growth in the CPS
Environmentally Sustainable Growth	(see Environment below)
Regional Integration	(see RCI below)
5 Drivers of Change	
PSD and PSO	2012: Public–Private Partnership Operational Plan 2012–2020
Good Governance and Capacity Development	2012: Results-Based Public Sector Management: A Rapid Assessment Guide 2012: Integrity Principles and Guidelines 2011: Practical Guide to Capacity Development in a Sector Context 2011: Revised Guidelines for Implementing GACAP II 2010: Revised Capacity Development Action Plan 2008: Guidelines for Implementing GACAP II
Gender Equity	2013: Gender Equality and Women's Empowerment. Operational Plan (2013–2020) 2012: Guidelines for Gender Mainstreaming Categories of ADB Projects
Knowledge Solutions	2013: Knowledge Management Directions and Action Plan (2013–2015): Supporting Finance ++ 2009: Knowledge Management Action Plan (2009–2011)
Partnerships ^a	2009: Cooperation Arrangements for Development Partnerships
5 Core Operational Areas (plus 3 others)	
Infrastructure (transport, energy, urban, water and sanitation, others)	2013: Guidelines for Climate Proofing Investment in the Energy Sector 2013: Urban Operational Plan 2012–2020 2012: Implementation of Sustainable Transport Initiative: Mainstreaming Road Safety in ADB Operations Action Plan 2011: Water Operational Plan 2011–2020 2011: Guidelines for Climate Proofing Investment in Transport Sector: Road Infrastructure 2010: Sustainable Transport Initiative 2009: Energy Policy
Environment	2013: Environment Operational Directions 2013–2020 2010: Addressing Climate Change in Asia/Pacific: Priorities for Action 2009: Safeguard Policy Statement
Regional Cooperation and Integration ^b	2012: A Strategic Framework for the CAREC Program 2011–2020 2012: GMS Regional Investment Framework 2013–2017 ^c 2011: GMS Economic Cooperation Program Strategic Framework (2012–2022) 2011: Regional Cooperation Strategy: South Asia 2011–2015 2009: ADB's Pacific Approach 2010–2014
Finance Sector Develop	2011: Financial Sector Operational Plan
Education	2010: Education by 2020—A Sector Operations Plan 2008: Education and Skills: Strategies for Accelerated Development
Others (health, agriculture, disaster and emergency assistance)	2014: Integrated Disaster Risk Management Operational Plan (in preparation) 2013: Operational Plan for ANR Sector: Promoting Food Security in Asia and the Pacific 2014–2020 (in preparation) 2013: Social Protection Operational Plan 2013–2020 (Draft)

Strategy 2020 Sector/Theme/Area	Year: Title
	2012: Guidelines for Climate Proofing Investment in Agriculture, Rural Development, Food Security 2011: Strategic Directions Paper on HIV/AIDS 2011–2015 2009: Operational Plan for Sustainable Food Security 2008: Action Plan for Implementing ADB Disaster and Emergency Assist. Policy 2008: Positioning ADB Disaster/Emergency Assistance Policy in Changing Regional Environment 2008: Operational Plan for Improving Health Access and Outcomes under S2020
Member Country Groupings	
Graduated DMCs, MICs, LICs, FCAS	2013: Operational Plan for Enhancing ADB's Effectiveness in FCAS
Institutional/Organizational Transformation	
	2013: ADB Revised Results Framework 2013–2016 2013: Information Systems and Technology Strategy III 2012: Accountability Mechanism Policy 2011: Public Communications Policy 2011: Our People Strategy 2010: Streamlined Business Processes 2009: Revised Project Classification System 2009: ADB Action Plan on Managing for Development Results 2009–2011 2008: ADF Results Framework

ADB = Asian Development Bank, ADF = Asian Development Fund, ANR = agriculture and natural resources, CAREC = Central Asia Regional Economic Cooperation, CPS = country partnership strategy, DMC = developing member countries, GACAP II = Second Governance and Anticorruption Action Plan, GMS = Greater Mekong Subregion, FCAS = fragile and conflict-affected situations, LIC = low income country, MIC = middle income country, PSD = private sector development, PSO = private sector operation, RCI = regional cooperation and integration.

Note: This table excludes studies, most guides/guidance notes, policy papers, staff instructions, and Operations Manual revisions/additions.

^a The ADB Strategy and Policy Department lists a total of 33 partnership agreements of various forms (letters of intent, memoranda of understanding, partnership frameworks, etc.) dated January 2008 to October 2012.

^b Excludes numerous regional and subregional cooperation strategies, programs and operations business plans.

^c The framework covers labor migration, urban development, energy, and transport and related services.

Source: Independent Evaluation Department.

APPENDIX 3: SUMMARY OF MESSAGES FROM EXTERNAL STAKEHOLDERS

Independent Evaluation Department observations from regional Mid-Term Review consultations held in Cambodia, Fiji, India, Kyrgyz Republic, and the Philippines, organized by Strategy 2020 agendas, operational focus, and institutional effectiveness.

A. Three Strategic Agendas

- (i) Strengthen pursuit of the three strategic agendas through a more balanced operational focus, improved institutional effectiveness, and a much stronger focus on outcomes; poverty reduction and inclusiveness should remain at the center of the strategic and operational focus of the Asian Development Bank (ADB);
- (ii) promote inclusiveness more effectively by broadening the portfolio and refocusing on the poor and vulnerable and marginalized regions;
- (iii) increase support for environmental sustainability and help developing member countries address and adapt to the growing climate challenge; and
- (iv) continue to emphasize regional cooperation and integration and expand this work into more areas.

B. Operational Focus

- (i) Maintain an emphasis on infrastructure but improve its strategic impacts through greater inclusiveness and sustainability;
- (ii) respond better to unique challenges facing middle-income countries and fragile and conflict-affected states through better diagnostics, knowledge work, and coordination;
- (iii) refocus on enhancing governance through long-term support for public sector management and capacity development, in particular at the sector level;
- (iv) improve the inclusiveness and sustainability impacts of private sector operations through stronger engagement, better knowledge work, and greater efforts in frontier countries and regions; and
- (v) adopt a more country-centric approach to selectivity and a more versatile portfolio to improve responsiveness.

C. Institutional Effectiveness

- (i) Empower resident missions through a greater delegation of portfolio authority that will allow resident missions to better serve client governments and more effectively engage with development partners;
- (ii) increase the impact of the ADB knowledge work through a sharper focus on country knowledge needs, better coordination, and greater focus on innovation and sharing;
- (iii) ensure ADB's resource base remains adequate through better leveraging and innovation;
- (iv) improve the leveraging of partnerships through more upstream dialogue, planning, and coordination, and through stronger engagement with civil society;
- (v) place greater focus on high-impact community-driven projects, sector-based approaches, and achieving sector outcomes;
- (vi) make doing business with ADB easier through continued business process reforms; and
- (vii) instill a stronger focus on results and outcomes across the institution to raise ADB's contribution to development effectiveness.

APPENDIX 4: SUMMARY OF MESSAGES FROM INTERNAL STAKEHOLDERS

Observations from internal consultations with members of 10 (out of 14) Asian Development Bank (ADB) Communities of Practice (CoPs).

1. **Focus and selectivity.** A prominent concern expressed by members focused on the degree of selectivity under Strategy 2020, with several members stating that ADB has taken selectivity too far—sometimes at the expense of country responsiveness. A common observation was that the implementation of Strategy 2020 had been much more restrictive than called for by the strategy. A related point raised was that allocating a portion of the portfolio to select sectors may not always produce approvals; this can result from various factors, including that some developing member countries prefer not to borrow for certain sectors (e.g., education), or because ADB may not be engaging in dialogue with countries regarding their needs in certain sectors. Several groups felt that desired country outcomes should have greater weight in determining selectivity.

2. **Environmental sustainability and climate change.** Numerous members from various CoPs (e.g., water, transport, environment, and energy) tied their respective areas of work directly to the challenge of environmental sustainability. Members voiced strong concerns regarding the growing threat of climate change and the need for a more concerted response by countries and ADB. Members pointed to several areas where ADB has done well in incorporating environmental sustainability (e.g., clean energy), and highlighted other areas where more can be done (e.g., sustainable transport). Members stated that country demand for cleaner and “greener” energy, transport, and urbanization was on the rise, warranting an adequate response from ADB, including in the form of its strategic focus, staffing and expertise, and resources. Several members suggested that supporting the environmental sustainability agenda more effectively calls for a broader focus and reconsideration of some non-core areas, such as forestry and fisheries.

3. **Inclusiveness.** Much like environmental sustainability, the issue of inclusiveness cut across many of the discussions with CoPs. Members felt that Strategy 2020’s prioritization of inclusive growth was highly appropriate, and would become even more relevant. Members suggested that ADB can support inclusiveness more effectively through multiple avenues, including support for gender equity, a greater focus on non-income inequality, and a stronger push for rural development and agriculture. At the same time, some members were unclear about how the inclusive growth agenda was to be implemented.

4. **Infrastructure operations.** There was general agreement that infrastructure should remain a core business of ADB and that keeping a focus on infrastructure has served ADB well. Several members felt that ADB’s infrastructure investments pay inadequate attention to inclusiveness. Some expressed that even within infrastructure there may be too narrow a focus, pointing to the need for greater focus on maritime and air transport, multi-modal infrastructure, and transport corridors (with a major unmet need for regional infrastructure). Members also emphasized the need to complement investment in infrastructure with capacity and institution building.

5. **Staff skills and organizational design.** Despite the staff expansion under Strategy 2020, members expressed strong concern over skill shortages and gaps across a number of critical areas, including in core areas of Strategy 2020. Several CoPs voiced concern over what they perceive as a de-prioritization and steady de-skilling of expertise in their respective areas. Members expressed fear that this is resulting in ADB no longer having a critical mass of experts in some important areas, even those areas where ADB has had a longstanding operational focus (e.g., energy generation/distribution). Members listed a number of new skill areas where they also felt ADB needs to expand, such as in

cutting-edge transport and energy, trade facilitation, and regulatory and institutional expertise. A related concern is how skills are spread out across ADB, with some members describing the current situation as fragmented, both across and even within departments. One group discussed the need for strong anchors for core skill areas. Several members indicated that ADB's pool of hard, technical skills seemed to be diluted over time by more general expertise.

6. **Teamwork, innovation, and incentives.** Members felt that silos within ADB compromise teamwork and affect efforts to build inclusion into projects. Members expressed a need for greater recognition and rewards for teamwork, but with the assurance that not only team leaders but also team members are given due recognition and reward. On knowledge and technical assistance, members voiced concern that knowledge work remains a low priority for operational staff, in large part due to weak incentives. Furthermore, members commented that Strategy 2020 provides disincentives for innovation. Several members stated that the organizational culture discourages risk taking (the term risk aversion was commonly used).

7. **Governance, public management, and capacity development.** Members felt that governance and capacity development remain fundamental to achieving better sector outcomes and contributing to inclusive growth. Sector assessments and risk assessment and management plans need to be better integrated at the diagnostic and/or design stage. Members also suggested that governance be captured as a driver of change at the outcome level, with possible indicators including cost-effective service delivery, increased accountability, and enhanced citizen participation. Members of several CoPs pointed to country governance and capacity (e.g., in environmental management) as fundamental to achieving better outcomes, including better results from ADB-supported operations.